Palestine Economic Policy Research Institute

Report: Financing Palestinian SMEs

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Introduction

This document was prepared by the Palestine Economic Policy Research Institute (MAS) at the request of The Portland Trust. It examines the needs and supply of Small and Medium-sized Enterprises (SMEs) for credit, and how they would be affected by a loan guarantee scheme which reduced the onerous collateral requirements currently restricting their growth. The analysis examines both the demand for, and expected supply of, credit over the short and medium term.

The demand analysis is based on the most in-depth and up-to-date information on Palestinian SMEs' financing needs. During August 2005, MAS and the Palestinian Central Bureau of Statistics (PCBS) conducted an extensive survey consisting of structured interviews with 450 Palestinian SMEs from across the West Bank and Gaza Strip. The survey was specially commissioned for this report, which presents its results.

On the supply side, interviews were conducted with the major banks in the Palestinian Territories to examine historical credit decisions as well as future projections of the supply of credit. The authors used existing published and unpublished secondary data from the PCBS and the Palestinian Monetary Authority (PMA) to supplement and verify the survey data.

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Executive Summary

- The financing needs of Palestinian SMEs over the short and medium term are substantial: **SMEs estimate that their immediate financing needs amount to $647.2 million over the next year**. $571m of the immediate financing needs would be in the form of individual credit extensions worth $10,000-$500,000.

- Based on current economic conditions, **SMEs estimate their credit needs over the next five years to be $996m**. 95% of the amount required would be in the form of loans over $10,000, amounting to $950m.

- If closures are eased and the political and economic prospects improve, demand could be substantially higher.

- Collateral requirements severely restrict demand. Postulating **a loan guarantee scheme which covered even 60% of collateral requirements (and under current economic conditions), SMEs estimate demand for loans over 5 years to reach $909 million.** This would cover over 90% of their estimated credit needs.

- Credit officers note that a third of loan applications are rejected for insufficient collateral. SMEs indicate that over 70% of all rejected applications are for this reason. Furthermore, 100% of SMEs who applied for credit and then withdrew cited prohibitive collateral requirements. Of those SMEs which succeeded in obtaining a loan, almost three quarters stated that it was not enough to cover more than 75% of their capital requirements.

- $335 million of credit was disbursed for private-sector economic activities in 2004. Even under a pessimistic scenario, where the credit/deposit ratio falls to *Intifada*-levels, the total credit supply 2005 – 2009 for economic activities is estimated to reach almost $2 billion. **A positive projection**, where the ratio reaches Jordan's in 2003 (57%), **sees this credit supply rise to over $3 billion in the next 5 years.**

- Only 13% of SMEs have applied for credit since 2000, but 63% state they have plans for expansion in the next five years. 66% of SMEs state they are currently in need of financing. These figures could be even higher if economic circumstances continue to improve.

1 - Demand for Credit [1]

Financing characteristics

Expansion plans

The Palestinian financing sector is facing a major dilemma: a relatively big market with good potential demand and available resources for funding (even over-liquidity) on one side is faced with very low actual demand and supply for credit. 66% of SMEs state they are currently in need of financing. These needs will increase in the medium term, as 63% state they have plans for expansion in the next five years.

Table 1: Distribution of SMEs according to whether they have expansion plans in the next five years

Economic Activity	Yes (%)	No (%)
Industry	59.8	40.2
Construction	85.7	14.3
Internal trade	69.8	30.2
Transportation and telecom.	81.8	18.2
Services	58.8	41.2
Water and Electricity Supplies	54.5	45.5
Real Estate	68.3	31.7
Total	**62.9**	**37.1**

(Source MAS and PCBS SME Survey, 21/08/05)

Loan Applications

Economic growth brought about by a peace dividend would likely see these figures growing substantially. However, owing in large part to the dire macroeconomic conditions and conservative banking practices since 2000 a very small percentage of SMEs have actually applied for credit from a bank in the past 5 years.

Table 2: Distribution of SMEs according to whether SME had applied for a loan 2000- 21/8/2005 by economic activity (%)

Economic Activity	Applied loan	Did not apply
Industry	15	85
Construction	29	71
Internal trade	9	91
Transport and tel.	27	73
Services	12	88
Water and Electric.	17	83
Real Estate	5	95
Total	**13**	**87**

(Source MAS and PCBS SME Survey, 21/08/05)

[1] This chapter examines SMEs' estimates of their demand for credit. It draws heavily on the MAS / PCBS survey of SMEs, August 2005. For more information on the methodology, please see Annexe B.

Those who had not applied were asked in the survey their reasons for not doing so. A relatively high percentage (33%) cited religious reasons, but a growing Islamic Banking sector in Palestine is likely to reduce this figure.

Those which had applied for credit had mainly done so through overdrafts, the average size of which was $82,095.

Table 3: Distribution of SME Applications for Credit Facilities by type of Credit (2000-21/8/2005)

Form of Credit Facility	Average ($)	Frequency (%)
Overdraft	82,095	44.4
Letters of Credit	10,000	0.4
Loans (1 year)	7,939	14.0
Loans (1-3 years)	16,007	29.2
Loans (3-5 years)	28,428	9.3
Loans (5 years +)	19,506	2.7
Total	**21,553**	**100%**

(Source MAS and PCBS SME Survey, 21/08/05)

Collateral

The main need has clearly been for short- and medium-term credit; 88% is in terms of overdraft or loans under 3 years. However, even when approved, the size of these loans is often insufficient to meet the needs of the enterprise. Only around a quarter of credit arrangements financed more than 75% of SMEs needs.

Table 4: Distribution of SMEs by economic activity according to fraction of capital requirements met by credit (2000 - 21/8/2005)

Economic Activity	Percentage Financed			
	Under 25%	25%-50%	50%-75%	Over 75%
Industry	13.3	13.3	40	33.3
Construction	20	40	0	40
Internal trade	33.3	66.7	0	0
Transport and telecom.	0	66.7	33.3	0
Services	13.8	42.8	14.2	29.1
Water and Electricity	0	100	0	0
Real Estate	0	0	100	0
Total	**15.1**	**35.9**	**23.3**	**25.7**

(Source MAS and PCBS SME Survey, 21/08/05)

The collateral required by the banking system is the main constraint for demand expanding. Of the SMEs which applied for credit and were rejected, most (72.3%) stated that the refusal was due to inadequacy of collateral. Meanwhile, of those which applied and subsequently withdrew their applications, 100% did so citing the prohibitive collateral prerequisites. None said they reconsidered because of steep interest rates or bank charges, although these probably play a part in preventing some applications in the first place.

The main share of collateral provided by those who received loans is personal guarantees, credit notes and postponed checks, which contribute about 44% of the total. The following table summarises the distribution of collateral type within the collateral structure:

Table 5: Type of collateral provided by SMEs

Collateral type	
Cash	15
Lands & buildings	
Moveable assets & goods	
Personal & financial papers	

(Source MAS and PCBS SME Survey, 21/08/05)

SMEs' financing needs

A- Short term needs (one year)

Those SMEs who need immediate financing estimate their needs to amount to $647.2 million. 44.5% ($288 million) of this amount is to purchase fixed assets (investment capital), the remainder to cover the needs of working capital in terms of repaying debt (including rents, salaries etc.), purchasing raw materials and spare parts, or financing marketing campaigns. The average credit size needed for working capital is about $5,900, and $12,300 is desired for the purchase of assets. The overall average size of short term credit is about $18,200.

A-1 Short term working capital needs

Table 6 shows the urgent (within the coming year) needs for credit to cover working capital (loan repayment, purchase of raw materials and spare parts, financing promotional campaigns). The main needs are within the internal trade sector (37%), industry (27%) and services (21%).

Table 6: Structure of short term credit needed to finance working capital

Sector	Average credit size $	Total amount / $m	of total
Industry	4,563	97.0	27.1
Construction	36,045	36.8	10.3
Internal trade	10,612	131.6	36.7
Transport & Tel.	635	0.6	0.2
Services	3,829	74.4	20.7
Water & electricity	1,783	0.4	0.1
Real estate activities	3,696	17.7	4.9
Total	5,974	358.5	100

(Source MAS and PCBS SME Survey, 21/08/05)

A-2 Credit needed to finance purchase of assets

The industrial sector's needs for credit to finance the purchase of assets is the greatest ($110.8 million), representing 38.5% of the total credit needs for this purpose. Not unexpectedly, the real estate sector comes in second place with a need of $63.3 million (Table 7).

Table 7: Structure of credit needs to finance purchase of assets

Sector	Average loan size / $	Total amount / $m	
Industry	13,549	110.8	38.5
Construction	26,563	9.8	3.4
Internal trade	11,023	35.0	12.2
Transport & Tel.	48,517	18.1	6.3
Services	5,075	50.0	17.4
Water & electricity	25,960	0.8	0.2
Real estate activities	5,765	63.3	22.0
Total	12,321	287.9	100

(Source MAS and PCBS SME Survey, 21/08/05)

A-3 Size of short term loans needed

Most SMEs across all economic sectors require $10,000 or less in loans. About 73% of credit needs – by volume of loans – fall into this category (see Table 8 for more details). This is mainly due to the fact that the SMEs which dominate the general composition of the Palestinian economy display modest needs for funds in terms of credit size, and many of those surveyed declared no demand for credit at all.

Table 8: Structure of short term credit needs in terms of size of loan (%)

Loan size Category -$	Industry	Construction	Internal trade	Transport & telecom.	Services	Water & elect.	Real Estate	All Sectors
0-10,000	62.1	57.1	67.9	63.6	84.7	100	71.4	72.7
10,001-20,000	11.4	0	9.4	9.1	8.6	0	4.8	9.0
20,001-30,000	8.3	0	7.5	9.1	1.9	0	2.4	5.1
30,001-40,000	7.6	0	0	9.1	1.0	0	2.4	3.0
40,001-50,000	4.5	0	3.8	0	1.1	0	4.8	3.0
50,001-75,000	3.8	7.1	3.8	0	0.5	0	4.8	2.6
75,001-100,000	0.8	7.1	5.7	0	0	0	4.8	1.9
Over 100,000	1.5	28.6	1.9	9.1	2.2	0	4.8	2.7

(Source MAS and PCBS SME Survey, 21/08/05)

However, the vast majority of the *value* of the short-term credit needed by SMEs is in the form of loans over $10,000. **Indeed, 88% ($571m of the total $646m) would be in the form of individual credit extensions worth over $10,000**, a figure which rises to 98% in the construction sector. The following table represents the amount of short-term credit that would be required in loans of over $10,000.

Table 9: Size distribution of short term credit needs by SMEs

	Size of credit needed $						
	0 - 5000		5001 - 10000		10000 +		
Economic activity	Sum (Million US $)	%	Sum (Million US $)	%	Sum (Million US $)	%	Total
Industry	11.8	*5.7*	11.34	*5.5*	184.7	*88.9*	207.8
Construction	0.4	*0.9*	0.74	*1.6*	45.4	*97.5*	46.6
Internal trade	7.6	*4.6*	7.94	*4.8*	151.1	*90.7*	166.7
Transport. & tel.	0.5	*2.8*	0.46	*2.5*	17.7	*94.7*	18.7
Services	18.2	*14.7*	6.45	*5.2*	99.6	*80.1*	124.3
Water & electric	0.4	*35.5*	0.81	*64.5*	-	-	1.3
Real estate	2.1	*2.6*	6.36	*7.8*	72.5	*89.5*	81.0
Total	**41.1**	***6.4***	**34.10**	***5.3***	**571.1**	***88.4***	**646.3**

(Source: PCBS and MAS SMEs survey 2005)

B- Medium term needs (five years)

The SMEs based their projections on current conditions: a considerable easing of internal movement restrictions but the economy still operating well below its potential. Continued high transaction costs, particularly for external trade and the movement of goods and services between the West Bank, Jerusalem and the Gaza Strip, are an important factor. Once these are reduced, and a permanent peace is seen as at least feasible, medium-term credit needs are likely to increase significantly.

B-1 Credit needs to finance fixed assets

For the purpose of the report, we divided credit needed to finance investment plans into two categories: purchase of fixed assets and working capital. Investment in fixed assets is broken down into four areas: adding new production lines, opening new branches, entry into new business areas, and expansion of existing facilities in terms of land and buildings.

The SMEs estimated their needs of credit to purchase fixed assets to be $856 million over the next five years. This amount of credit will be requested by SMEs in addition to the own contribution (equity). Table 10 shows the credit needed to finance each investment area. Opening new branches captures 31% of credit needed ($269 million) followed by entry into new businesses (29%), and expansion of existing facilities (land and buildings) 22.8%. The yearly distribution of the credit needed cannot be accurately estimated, although the yearly average is around $171 million over the next five years.

SMEs working in the industrial sector are taking the leading role in terms of credit needed to finance their capital investment plans, with $290 million needed (33.9% of capital needed), followed by internal trade (29.5%), and then services (17.5%).

Table 10: Structure of medium-term credit needs to finance fixed assets in terms of investment area – million US$

Sector	New production lines	New branches	Entry into new businesses	Expansion of existing facilities	Total - $	%
Industry	80.7	54.1	61.8	93.9	290.4	33.9
Construction	4.2	10.4	33.4	7.2	55.2	6.4
Internal trade	23.8	100.5	95.6	33.1	252.9	29.5
Transport $ Tel.	4.0	11.5	15.6	2.3	33.4	3.9
Services	11.0	61.4	24.0	53.4	149.8	17.5
Water & electricity	0		0.1	1.2	1.3	0.2
Real estate	12.8	31.2	25.2	4.5	73.7	8.6
Total	136.5	269.1	255.6	195.5	**856.6**	
%	15.9	31.4	29.8	22.8		100

(Source MAS and PCBS SME Survey, 21/08/05)

B-2 Credit needs to finance working capital

The need to finance working capital for the coming five years includes expansion of existing capacity acquiring new assets. SMEs were asked to estimate their credit needs to finance working capital associated with the planned increase in utilised capacity, and a ratio of 15% is used to estimate working capital needs associated with the new assets.[2]

Table 11 shows that the estimated SMEs' working capital needs equals $267 million. This figure differs from the estimated working capital needs in the short term which was about $358 million. The reason for this difference is that the short term working capital needs include credit to pay due loans (to suppliers, unpaid wages and bills, loan repayments). 52% of credit needed will be used to finance working capital associated with the expansion of utilised capacity.

The internal trade sector's working capital needs captures the highest share out of working capital needs with 30.0% ($80.4m) followed by the industrial sector with 27.7% ($74.2m).

It is worth noting that credit to finance working capital needs is not recurrent in the sense that once it is available, SMEs will not ask for credit every year. They will ask for credit to finance positive net working capital.[3] The amount of net working capital needs varies according to the level of economic activities of SMEs. Under an optimistic scenario, based on average growth rates in non-*Intifada* years (1994 – 1999), this averages 4%.

[2] The 15% is the ratio commonly used in feasibility studies in the Palestinian Territories to estimate working capital needs associated with new investments.
[3] Net working capital is the change in working capital.

Table 11: Structure of medium-term credit needs to finance working capital – million US$

Sector	Increasing utilised capacity	Working capital associated with purchase of fixed assets (15%)	Total - $m	%
Industry	30.6	43.6	74.2	27.7
Construction	24.7	8.3	33.0	12.3
Internal trade	42.5	37.9	80.4	30.0
Transport & Tel.	4.0	5.0	9.0	3.4
Services	12.7	22.5	35.2	13.1
Water & electricity	4.4	0.2	4.6	1.7
Real estate	20.3	11.1	31.4	11.7
Total	139.1	128.5	**267.6**	
%	52	48		100

(Source MAS and PCBS SME Survey, 21/08/05)

Medium-term credit needs to finance investment plans

When SMEs consider their investment plans for the next five years, fewer put their credit needs at less that $10,000. In the construction and transportation sectors, for example, almost two thirds of SMEs (64.3% and 63.6%) now say they require loans of more than $10,000. However, overall only 33.5% of the enterprises surveyed put their credit needs above this level.

Table 12: Structure of medium-term credit needed to finance investment plans (Five year horizon) (%)

Loan size Category	Industry	Construction	Internal trade	Transport & tel.	Services	Water & elect.	Real Estate	All sectors
0-10,000	57.6	35.7	60.4	36.4	80.4	91.7	61.9	66.5
10,001-20,000	11.4	0	13.2	0	8.2	0	4.8	9.5
20,001-30,000	9.8	0	5.7	18.2	3.3	0	4.8	6
30,001-40,000	4.5	0	1.9	9.1	1.1	0	9.5	3.2
40,001-50,000	7.6	7.1	1.9	0	2.2	0	4.8	4
50,001-75,000	2.3	0	1.9	18.2	1.1	0	4.8	2.2
75,001-100,000	1.5	14.3	7.5	0	2.0	8.3	2.4	3.2
Over 100,000	5.3	42.9	7.5	18.2	1.7	0	7.1	5.4

(Source MAS and PCBS SME Survey, 21/08/05)

Once again, the majority of SMEs require little or no credit to finance their medium term needs. However, the vast majority of the value of this credit required is in terms of loans of over $10,000. Indeed, of the total required to finance new production lines, new branches, entry into new businesses, expansion of existing facilities and increasing utilised capacity - a total of $995.8m over 5 years - over 95% will be in the form of loans larger than $10,000**. Credit needs for loans over $10,000 therefore total $948 million over the next five years.** Again, industry and internal trade require the lion's share, while more construction SMEs require this size of loan than any other. (See Table 13)

Table 13: Size distribution of me dium-term credit needs[4] by SMEs

Economic activity	Size of credit needed $						Total
	0 - 5000		5001 - 10000		10000+		
	Sum (Million US $)	%	Sum (Million US $)	%	Sum (Million US $)	%	
Industry	5.08	*1.6*	4.8	*1.5*	311.09	*96.9*	321.0
Construction	0.23	*0.3*	0.8	*1.0*	78.81	*98.7*	79.9
Internal trade	6.09	*2.1*	4.4	*1.5*	284.86	*96.5*	295.3
Transportation & telecom	0.31	*0.8*	-	-	37.02	*99.2*	37.3
Services	11.96	*7.4*	7.5	*4.6*	143.02	*88.0*	162.5
Water & electricity	0.21	*3.7*	1.5	*26.0*	4.03	*70.3*	5.7
Real estate	3.72	*4.0*	0.7	*0.7*	89.57	*95.3*	94.0
Total	**27.60**	***2.8***	**19.7**	***2.0***	**948.41**	***95.2***	**995.8**

(Source: PCBS and MAS SMEs survey 2005)

The effects of collateral guarantee schemes on demand for credit

Lack of guarantees (both in terms of quality and quantity) is the major reason rejecting credit applications by SMEs. 72% of rejected credit application were related to guarantees. Financing institutions (banks and NGOs) require guarantees well beyond the credit applied for. The issue of guarantees is more prominent for SMEs than large firms due to their legal structure. Most SMEs are family businesses with complicated structures of ownership (many are inherited and split between heirs), a lack of isolation of personal accounts from business accounts, and a lack of registered property.

Three scenarios were postulated to estimate the contribution of new financing schemes to SMEs' demand for credit. SMEs were asked to assess the impact of each scenario on their demand for credit in the medium term (five years). The scenarios were built on the premise that SMEs would be requested to provide partial coverage of guarantees: 80% of the credit demanded, 60% and 40% (i.e. a financing institution will cover the remaining 20%, 40% and 60%).

Table 14 shows the SMEs' response to the three scenarios. For scenario one, the total credit demand will be $563 million, which increases to $669 million under the second scenario and $909 million under the third. The latter figure represents more than 90% of SMEs stated needs over 5 years.

The largest credit demands will come from the industry sector ($326m), followed by services and internal trade.

[4]Excluding projected needs for working capital associated with the purchase of fixed assets.

Table 14: Effect of alternative guarantees on SMEs credit demand by sector - $million

Sector	First Scenario: 20% guaranteed	Second scenario: 40% guaranteed	Third scenario: 60% guaranteed
Industry	218.9	225.6	326.0
Construction	79.3	104.0	124.0
Internal trade	78.0	101.6	155.0
Transport & Tel.	16.6	21.0	38.0
Services	128.0	166.7	187.0
Water & electricity	5.2	5.7	6.8
Real estate	37.0	44.6	72.0
Total	563.0	669.2	908.8

(Source MAS and PCBS SME Survey, 21/08/05)

It seems that a 60% guarantee scheme has a huge effect on SMEs' demand for credit. SMEs are willing to significantly expand their businesses, leading to a major increase in their economic role in terms of output and job creation.

2 - Supply of Credit

The Palestinian Banking System

The Oslo agreement between the Palestinian Liberation Organization (PLO) and Israel signed in 1993 opened the door for creating a banking sector in Palestine for the first time in more than 30 years. The new sector witnessed dramatic growth, with 22 banks by 2004 (one for every 136,000 people) with 133 branches (one branch for 23,000 people). The banks' approach is to expand their branch network to small towns outside big cities, and the Palestinian Monetary Authority (PMA) recently approved more than 15 new branches. Ten banks are Jordanian and 1 Egyptian, and their credit policies are determined by their mother HQ in Amman or Cairo with respect to the PMA's regulations. The remainder are one international bank (HSBC, headquartered in London) and 10 Palestinian banks.

By the end of 2004 the total assets of the banking sector reached $5,113.58 million[5], a 132% increase from 1996. Total deposits (public & private) constituted 76% of total assets, while credit facilities did not exceed 28% of assets. The credit to deposit ratio rose to 37% in the fourth quarter of 2004, but this was still below the 40% minimum set by the PMA, and significantly below other countries in the region[6].

The private sector, retail and corporate has the biggest portion of the credit facilities provided (71%), with the remaining for the public sector. However, private sector credit facilities were only about 30% of the private sector deposits. 43% of outstanding credit is in term of loans including personal consumption loans, 56% is in term of overdraft. There is a very high level of liquidity in the system and a high potential increase in the supply of credit.

The sector is dominated by five leading banks (two Palestinian and three Jordanian), which have 62% of total outstanding credit in 2004[7] (Table 15) and 42% of credit facilities provided in the year 2004[8].

Table 15: Outstanding Credit Facilities of five leading Banks 31-12-04

Bank	Outstanding Credit / $m	Percentage of Total
The Arab Bank	513	35.9
Bank of Palestine	158	11.1
Bank of Jordan	84	5.9
Cairo – Amman Bank	95	6.7
Palestine Investment Bank	37	2.6
Total	887	62.2

[5] Consolidated balance sheet-PMA
[6] Credit to deposit ratio in Egypt was 64% (2004); Israel 77% (March 2005); and Lebanon 79% (May 2005). Source: Websites of respective Central Banks.
[7] The banks' published balance sheets and income statements
[8] PMA Unpublished figures

The products provided by banks vary, but the majority are for small loans up to 6 years, with average nominal interest rate of 7- 9% plus 2.5% fees, the cost of which is usually deducted in advance. Interest charged on overdrafts range from 15-17% for Israeli Shekel accounts to 9-12% for those in Jordanian Dinars[9]. Figures for 2004 indicate that 41% of disbursed facilities for the private sector are in term of overdraft and 50% in term of loans, including personal consumption loans[10].

The banks have adopted a very conservative lending policy, largely due to the unstable political environment and the weak legal system which makes it hard to claim on collateral. In addition, the fact that many are based abroad has meant their focus has not been on activities in the Palestinian Territories. This has helped the banking system to weather one of the worst recessions in recent history, but has stifled private-sector growth. Collateral requirements often reach 130 – 150% of the loan value, and businesses are further constrained by the fact that most land outside the cities is un-registered, and therefore cannot be accepted as a guarantee.

For personal loans the salaries of employees are commonly used as guarantee, and the bank is authorised to deduct payment from the monthly salary or the compensation fund in case of leaving work. The risk with this type of guarantee is very low, and there is therefore high competition among banks over this market. However, with many employees already indebted, this market is shrinking. Most of the outstanding credit is for loans under $10,000.

The non-banking sector

There is an experienced micro-finance industry in the West Bank and Gaza Strip, which has been in operation for more than 18 years. There are currently eight specialised micro-credit organisations with consolidated donated capital between $35-38 million[11]. The active outstanding loan portfolio is $29.3 million. In 2004 the eight organisations provided loans of $30 million for 26,000 clients (an average of $1,150 per loan), with only $2 million disbursed for loans of more than $10,000. The main target groups being low income or disadvantaged people, and the organisations being non-profit, the collateral required is lower and far more flexible than in the banking sector.

The Banking Sector's Credit Supply

Methodology

A- The banks lend to the public and private sectors, and the private sector includes both corporate and individual loans. Individual credit is divided according to the banks' classification into loans for personal consumption and loans for economic activities, with corporations asking for loans under individual credit in many cases. Thus this analysis will focus on **credit for economic activities**, which means both **corporate loans and individual credit designated for economic use.**

[9] Interviews with credit officers
[10] Unpublished PMA figures
[11] The Palestinian micro-finance network

B- The following credit supply analysis was based on information provided by five leading banks about credit with a ceiling of $500,000, excluding individual loans for personal use. The latter are usually below $10,000, so the resulting figures are believed to be a close approximation to the supply of credit facilities for private investment between $10,000 - $500,000. These 5 banks contributed 41.8% of credit facilities provided by all banks in 2004[12], so the data were multiplied by 2.39 (1 / 0.418) to estimate the total credit supply.

C- Previous years' credit supply (1996-2003) was estimated based on the outstanding balance of economic activities' credit facilities in the consolidated balance sheet published by the Palestinian Monetary Authority using the following formula:

D = P1-(P-R) where:

D = Disbursed amount
P1= Outstanding portfolio at the end of the year
P = Outstanding portfolio at the beginning of the year
R = Repayment (which was estimated as 1/3 of P because the average period for credit facilities for small and medium enterprises including overdraft is 3 years.)

To check the accuracy of the formula it was applied for year 2004. The outcome is $329.4 million credit disbursed. The actual figure from records is $334.4 million, a margin of error of 1.5%. This was deemed acceptable, and the same method was applied to predict the supply for the coming five years.

D- The consultants interviewed regional credit officers from the leading banks, but in order to get comprehensive picture credit officers from smaller banks were also interviewed.

Credit supply in 2004 for economic activities

The total credit supply in 2004 as shown in the following table is $540.3 million, 82.65% for the private sector and 17.35% for the public.

Table 16: Credit of $10,000 - $500,000 Disbursed in 2004

By Beneficiaries	Amount / $m	Percentage
Public Sector	93.75	17.35
Private Sector	446.55	82.65
TOTAL	**540.30**	**100**

(Source: Unpublished PMA data)

About 75% of the credit for the private sector was for investment, and most was in the form of loans. (Table 17)

Table 17: Structure of private-sector credit extension 2004

[12] PMA

Private Sector by Use	Amount / $m	Percentage
Personal	111.79	25.03
Investment	334.76	74.97
TOTAL	**446.55**	**100**
Private Sector by Product		
Loans	221.85	49.68
Overdraft	184.90	41.41
Other	39.80	8.91
TOTAL	**446.55**	**100**

(Source: Unpublished PMA data)

Economic activities: credit by sector

The Palestinian economy is dominated by micro and small enterprises, which is reflected by the fact that 72% of total credit under $500,000 is also for less than $100,000. Credit for more than half a million dollars is very rare, according to the credit officers interviewed. The main share of credit is for trade and services, followed by construction and industry.

Table 18: Credit for investment, 2004, by sector and size of loan

	Value of Credit /$m			
Sector	**10,000-100,000**	**100,001-500,000**	**Total**	**%**
Agriculture	4.04	1.54	5.59	1.67
Industry	24.11	9.75	33.87	10.13
Construction	49.30	17.53	66.84	19.99
Trade	88.45	33.26	121.71	36.40
Transportation	8.35	3.99	12.34	3.69
Tourism	6.41	2.46	8.87	2.65
Services	50.45	17.21	67.67	20.24
Finance	10.59	6.93	17.51	5.24
Total	**241.72**	**92.67**	**334.39**	**100**
	72.29%	**27.71%**	**100%**	

(Source: Unpublished PMA data)

Historic trends and average annual growth rate

The annual disbursement growth rate analysis clearly demonstrates the effect of the political environment. The periods with high political tension (2001-2002 and 1998) saw violent clashes and economically-stifling closures and curfews, while the periods 1996-1997 and 2003-2004 saw relative calm and economic growth. (Table 19)

Table 19: Credit Disbursed for Economic Activities 1996 – 2004 / $m

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Outstanding at beginning of year		305.14	444.58	504.23	683.61	870.89	789.14	735.36	753.82
Repayment		101.71	148.19	168.08	227.87	290.30	263.05	245.12	251.27
Outstanding at end of year	305.14	444.58	504.23	683.61	870.89	789.14	735.36	753.82	832.04
Disbursement		**241.15**	**207.84**	**347.46**	**415.15**	**208.55**	**209.27**	**263.58**	**329.49**
Disbursement growth rate (%)			**- 13.81**	**67.17**	**19.48**	**- 49.77**	**0.35**	**25.95**	**25.01**

(Source: Calculated by consultant based on published PMA data)

The effect of collateral requirements on credit supply

The five leading banks were asked to provide information from their records about applications for credit below $500,000 for all product types that were denied owing to lack of collateral. An average of 34% were turned down for this reason.

Table 20: Applications for credit rejected for collateral reasons (January 2000 – August 2005)

	Arab Bank	Bank of Palestine	Bank of Jordan	Cairo Amman Bank	Palestinian Inv. Bank	Total
No. of applicants	60,700	19,580	15,800	14,200	7,500	**117,780**
No. applicants denied for lack of collateral	21,200	8,200	4,500	3,800	2,500	**40,200**
Denied (%)	**35**	**42**	**28**	**27**	**33**	**34**

(Source: Credit officers of 5 leading banks)

To spot-check the accuracy of the result, two regional credit officers from other banks and one credit officer from an NGO providing loans of more than $10,000 were asked for their estimation of what percentage of applications for credit were denied for lack of collateral. The rough calculation supports the results.

Palestinian Banking Corporation (PBC)	40%
The Jordanian National Bank (JNB)	33%
The Arab Centre for Agricultural Development (ACAD)	45%
Average	**39%**

As is mentioned in Chapter 1 above, SMEs surveyed suggested that loans rejected for reasons of collateral could represent over 70% of all loan rejections[13]. This implies an overall rejection rate of around 50%, which correlates with informal estimates from banks.

Selected regional credit officers were also asked how much they would be likely and willing to increase the supply of credit if 60% of the loan were guaranteed by a reputable financial institution.

Increase in credit estimated by loan officers:

Arab bank	300%
Palestinian Banking Corporation	200%
National Jordanian Bank	150%
Cairo Amman Bank	300%
Housing Bank for Trade and Finance (Jordanian)	160%
Average	**222%**

Future supply projection

Assumptions

The estimation of the credit supply for the coming five years was based on the projection of deposit growth, credit to deposit ratio, and the ratio of credit for economic activities (i.e. private sector corporate loans and loans to individuals for economic purposes) to total credit facilities. Therefore it was assumed:

A- The average annual deposit growth rate prevailing for 2004 in the banking sector in Palestine (8.72%) will hold for the coming five years.
B- The proportion of credit facilities for economic activities to total facilities for 2004 (58%) will stay the same for the coming five years.

Projection

Based on the above assumptions there are three scenarios related to the political environment and the banks' behaviour and policies:

1: Progressive Scenario

After a transitional period the Palestinian and Israeli sides make significant progress towards agreement for permanent final solution. Within this environment the banks adopt progressive policies that would approach those in other close regional countries like Jordan, which means an increase in credit-to-deposit ratio to 57% (as in Jordan in 2003). It is assumed that rather than jumping to the new level, banks will gradually increase their exposure by 4% per year over the period.

[13] Other reasons include poor credit history, high political risk, unconvincing feasibility studies or business plans.

2: Moderate Scenario
A calm, stable political environment prevails in a transitional period, but with continued uncertainty over the final status. In this scenario the banks are most likely increase the credit supply at least to meet the PMA's minimum requirement (credit-to-deposit ratio not less than 40%). They are assumed to meet it in year 2 and continue to lend at that rate.

3: Conservative Scenario
The same political environment which prevailed in period 1996-2004 will apply to the coming five years (stability with economic growth in some years, very high tension and confrontation with economic contraction in other years). The average annual credit/deposit rate of 33% will be applied during the coming period – i.e. banks resume an ultra-cautious approach – an outcome consistent with a worsening of closures and movement restrictions occurs.

By using the same methodology and formula to analyse the credit supplied for private sector economic activities (corporate loans plus individual loans for economic activities) for the years before 2004, the outcome is presented in the following table:

Table 21: Credit Supply over 5 years / $m

	2005	2006	2007	2008	2009	5-year total
Scenario 1	**451**	**530**	**621**	**723**	**840**	**3164**
Scenario 2	**377**	**445**	**449**	**488**	**530**	**2289**
Scenario 3	**252**	**339**	**369**	**401**	**436**	**1798**

(Source: Calculated by consultant)

Conclusion: Financing needs and credit supply

More than enough liquidity exists in the Palestinian banking system to finance the realistic medium-term demand for credit of Palestinian SMEs. It is clear that even in the most pessimistic projection of credit supply growth (where the credit to deposit ratio falls back to 33% and banks resume their ultra-cautious lending policies), that demand for credit by Small and Medium-sized Enterprises would be covered by existing supply. However, the banking system is still not using its resources effectively. While almost two thirds of SMEs state they require financing, little more than one in eight have applied for credit in the past 5 years. Of those that received it, less than half state it covered more than 50% of their capital requirements.

Collateral requirements of 130% - 150% both deter SMEs from applying for loans and prevent them from receiving enough credit to meet their needs. One purpose of a loan guarantee scheme is to give banks confidence to unlock finance. A risk-averse banking system survived the severe recession that accompanied the Al-Aqsa *Intifada*; it now needs an incentive to drive the private sector forward. Under a guarantee scheme banks could be envisaged to at least double the amount they are currently prepared to lend. With this should come more competitive and experienced banking practices that should last into the future.

Most important, however, is the effect on the demand by SMEs for credit. Even under existing conditions, three fifths of SMEs say they plan to expand in the next five years. Banking credit officers reject more than a third of applications for collateral guarantee reasons, and SMEs attribute over 70% of rejections to this restriction. **SMEs estimate their medium-term needs for credit to approach one billion dollars,** and under even a 60% collateral guarantee scheme demand would increase to meet more than 90% of these needs. In such circumstances SMEs could fulfil their role as the engine for growth in the Palestinian economy (See Annexe A).

Annexe A: General Features of Palestinian SMEs

Overview of the Palestinian Economy

For almost 38 years, the Israeli occupation of the West Bank and Gaza Strip has put the Palestinian economy under the pressure of various constraints. Despite serious efforts to promote Palestinian economic growth and development, supported by substantial international aid flows during the past decade, the last five years has witnessed a severe economic downturn. A number of economic indicators showed encouraging signs of recovery during 2004, including the GDP and the stock market. Nevertheless, economic indicators generally remain below their levels in 1999.

The economic recovery that took place during 1997-1999, with annual growth rates of around 10%, has been reversed as a result of the last four years of intensified Israeli restrictions. Palestinian GDP reached US$4,512 million in 1999 but dropped by 15% to US$3,839 million in 2002. Because of the extremely high population growth rates GDP per capita was 26% lower in 2002 (US$1,191). In 2003 GDP recovered to US$4,011 million, but GDP per capita declined by another 0.5% to US$1,185.

The economic crisis has also resulted in increasing rates of unemployment and poverty. Unemployment rocketed from 10% before the *Intifada* in 2000 to over 35% in 2002. Since then unemployment rates have decreased (to equal 21% in the second quarter of 2005[14]) but poverty rates have continued to increase. Data for the first quarter of 2005 show 67% of Palestinian families live below the World Bank's poverty line, according to statements by the families themselves concerning their income[15].

Regarding the economic structure of the Palestinian economy, services contribute some 45% of the Palestinian GDP, traditional industries 14% and agriculture and fishing 9%[16]. The Palestinian economy remains heavily dependent on Israel and suffocated by the occupation. Palestinian trade is dominated by the Israeli market, which in 2002 was the source of 75% of Palestinian commodity imports[17]. It is also estimated that more than 90% of commodity exports are destined for the Israeli market[18]. Between 1999 and 2002, exports and imports of Palestinian goods and services declined by 60% and 47% respectively and recovered only marginally in 2003.

In general, Israeli control and unpredictable closures of Palestinian borders have impeded the regular flow of Palestinian exports and imports and led to higher transaction costs. The Palestinian private sector is struggling to cope with the severe pressure that political instability has added to the already difficult challenge of

[14] PCBS, Labor Force Indicators in the Palestinian Territory, 1995-2005. This is the ILO definition, however, and excludes 'discouraged' workers.
[15] Palestinian Central Bureau of Statistics, 2005, Survey of Israeli measures' effect on economic conditions of Palestinian families, 12th Round (January-March 2005)
[16] MAS, Quarterly Economic and Social Monitor, April 2005.
[17] PNA Ministry of Finance, unpublished data, 2004.
[18] PCBS, unpublished data, 2004.

developing the competitiveness of its production processes. Small and medium-sized enterprises carry a large part of this burden as they constitute the bulk of Palestinian economic establishments and their structure has been severely distorted by the protracted conflict. At the same time, economists and development experts stress the vital role of Palestinian SMEs in rehabilitating the economy and as an engine for long-term and sustainable growth.

The international community has provided large amounts of assistance to the Palestinian people, especially after the establishment of the Palestinian National Authority. Moreover, the already-high levels of aid directed to the Palestinians have almost doubled over the last four years of political crisis. Donors provided an annual average of $960 million during 2001-2003 and disbursements per capita equalled $250 in 2004. However, aid disbursements have naturally shifted towards emergency humanitarian support in an attempt to mitigate the effects of the recent political crisis. In 2003, over 60% of aid flows were directed to emergency and relief assistance, reducing the scope for development activities. While it is essential at such times to channel assistance to sustain basic services and meet people's vital needs, the sustainable future of Palestine relies on fostering internally-driven economic growth.

Definition of SMEs

For the purpose of this study, Small and Medium Enterprises (SMEs) were defined as all operating enterprises in the Palestinian economy that employ fewer than 50 people and have an operating surplus of at least $5,000. The definition was built based on the final results of the economic surveys series disseminated by the Palestinian Central Bureau of Statistics (PCBS) for the years 1999 – 2003, and is designed to exclude those firms who would probably be ineligible for a bank loan of over $10,000.

Methodology

Acknowledging the significant role that SMEs play in the Palestinian economy in terms of their share in employment in the local labour market, their share of the total number of operating establishments, and their contribution to the GDP, this section gives in detail a statistical view of the SMEs' profile.

The analysis in this Annexe is based on data published by the Palestinian Central Bureau of Statistics (PCBS) in the annual economic surveys series 1999 – 2004, and the results from the SME survey implemented by the PCBS for the benefit of UNCTAD 2003; these data sources cover all economic activities undertaken in the Palestinian Territory. The analysis takes a descriptive approach to cover the most important indicators that reveal the situation of SMEs in the Palestinian economy, beside a comparison of these indicators over the period covered by the study.

This section includes a projection of the future expansion of SMEs during 2005 -2009 in terms of the number of SMEs and their estimated value added. These figures are projected according to two different scenarios – one assuming an improvement of economic and political conditions and the other simulating a continued severely-depressed situation.

The economic role of Palestinian SMEs

The most recent data published by the PCBS indicate that the number of SMEs operating in the Remaining West Bank (excluding Jerusalem) and Gaza Strip reached 65,454 in 2003 (PCBS, Economic Survey Database 2003, see Table 1 in Annexe). In fact, the Palestinian private sector is dominated by small and medium-sized businesses, which comprise a consistent 90% of the total number of registered economic establishments operating in the Palestinian Territories in the years 1994, 1997 and end of 2004 (PCBS, Database of General Census of Economic Establishments, 2004).

Table 22 shows the distribution of SMEs and some important SME-related indicators according to economic sector.

Table 22: Distribution of SMEs and their Employees, Output and Value Added According to Economic Activity in the Remaining West Bank and Gaza Strip, 2003

Activity	Firms %	Employees %	Employees' Compensation %	Output %	Value added %
Industry	20.8	31.5	40.5	44.6	35.4
Construction	0.5	1.8	4.4	7.7	4.7
Internal trade	59.9	46.2	26.8	34.1	43.7
Services	18.1	19.2	25.7	12.0	14.1
Transportation, storage and telecommunication	0.7	1.3	2.5	1.6	2.1
Total	**100**	**100**	**100**	**100**	**100**

Employment

The SMEs employed 167,558 workers, of whom 86% are men and only 14% are women. The PCBS economic survey also revealed that more than half of SME employees are unpaid workers (usually business owners and family members) as only 49% are paid for their services (77.8% males and 22.2% females). In total, employees' compensation amounted to $248.4 million.

The internal trade sector employed 46.2% of the total number of workers employed by Palestinian SMEs. The industrial sector ranked second in terms of its contribution to employment, providing jobs for 31.5% of SME workers, but the sector was placed first (40.5%) in terms of employee compensation. Second rank in this category belonged to the internal trade sector, whose share in employee compensation did not exceed 26.8%, despite its large contribution to employment.

Output and Value Added

A closer look at the data shows that SMEs achieved a total output of $1,739.2 million in 2003. The total value added by SMEs reached $957.2 million in the same year, representing 55% of total output. Moreover, total assets used in SME production amounted to $1,431.9 million. The industrial sector contributed 44.6% of output, followed by internal trade (34.1%) and services (12.0%). In terms of value added, however, internal trade contributed the largest share at 43.7%, while the industrial sector and services were the sources of 35.4% and 14.1% respectively.

Table 23: Performance of SMEs in 1999, 2000 and 2003. ($1,000)

Activity	Year	# of firms	# of employees	Employees' Compensation	Output	Value added	Average book value
Industry	1999	14,772	64,196	177.8	1252.4	551.1	373.9
	2000	14,420	67,725	185.0	1308.2	518.2	494.2
	2003	13,624	52,864	100.6	775.5	339.4	284.7
Internal trade	1999	38,175	71,839	83.6	643.9	470.4	183.2
	2000	41,126	75,536	93.5	639.3	491.0	308.6
	2003	39,186	77,363	66.6	592.5	418.5	239.5
Transport + Tel.	1999	574	2,565	9.0	42.7	18.2	26.3
	2000	525	2,396	8.5	37.1	22.8	21.4
	2003	439	2,165	6.3	28.1	19.9	15.9
Services	1999	12,242	34,288	79.5	275.1	173.6	214.6
	2000	13,509	38,156	87.1	317.5	205.2	205.3
	2003	11,867	32,191	63.8	209.0	134.9	874.7
Construction	1999	332	3,671	22.4	167.5	82.5	30.9
	2000	423	5,183	26.7	150.3	56.6	40.4
	2003	338	2,975	11.0	134.2	44.5	17.1

Source: PCBS. Establishment Surveys, various years.

Problems facing SMEs

SMEs are often begun as a mechanism for personal financing and self-employment projects as a coping mechanism during volatile economic conditions. Such SMEs are characterised by small start-up capital and low investment size due to the fact that most SMEs are self-financed (savings, informal borrowings, etc.). The ability to obtain and benefit from available and latent resources requires a handful of assurances which for the most part are not readily accessible for this category of establishments. SMEs suffers from their weak ability to furnish collateral and other conditions to access credit.

The PCBS Small and Medium Establishments survey of 2003 asked SMEs about the obstacles that hindered their participation in international trade. More than one third (35.5%) of the respondents reported that obtaining credit was a major problem. High transportation costs and the lack of government support (especially in terms of lower taxes and provision of market information) also figured prominently.

Table 24: Obstacles hindering the participation of SMEs in international trade

Obstacles	The most important	Important	Less important	Unimportant
Weakness in structure and preparation of the product	8.1	17.1	21.1	53.7
Lack of skilled employees	6.7	13.4	22.4	57.5
High costs associated with imports and exports	20.1	32.5	15.0	32.4
Ineffective trade promotion institutions	14.9	23.4	18.3	43.4
High transportation cost	27.1	30.3	10.1	32.5
Complex export and import laws	20.9	29.3	20.0	29.8
High taxes imposed on establishments	26.7	31.0	15.2	27.1
Lack of professional experience in international trade	23.3	22.0	20.9	33.8
Lack of information related to international markets and export opportunities	27.1	22.6	15.3	35.0
Obstacles to obtaining loans to finance import and export activities	17.8	17.7	24.1	40.4
The decline of transportation and shipment service quality	13.5	22.7	17.5	46.3
Low telecommunication service quality	5.4	14.9	17.4	62.3
High customs duties and taxes	25.8	33.0	12.8	28.4
The absence of government strategies to develop SMEs	38.3	27.1	3.9	30.6

Projections

The following tables project the number and value added of small and medium-sized establishments over the next 5 years under two scenarios. The first scenario was made under the assumption that with progress towards a peaceful settlement with Israel that economic conditions will improve. The projections were based on the annual growth rate for the period 1994 – 2000 at constant prices, which amounts to around 4% per year. The second scenario is pessimistic. It assumes that conflict conditions will continue, and the attendant problems arising for SMEs will persist. This rate is based the average real GDP growth rate for the period 2001-2004, which is less than one percent.

The results of the projections under the optimistic scenario indicate that the number of newcomers to the sector may reach 17,244 enterprises by the year 2009, an increase of 16.5% compared with their number in 2003. Projections for value added under the same scenario indicate that the SME sector will grow by 24% by 2009 compared with its level by the end of 2003. Internal trade contributes 43% of this growth and industry contributes by approximately 35%.

Under the pessimistic scenario SMEs enterprises will barely grow at all; the total increase in the number of enterprises may not exceed 3,339 enterprises by 2009 compared with their number by the end of 2003. Internal trade activities will represent the majority of this increase, growing by 1,999 enterprises. Industrial activities are projected to increase by 695 and services by 650. In terms of value added, the results under the pessimistic scenario show an increase of only 5.1% by the end of 2009. Internal trade is still the largest contributor, with industrial activities and services again coming in second and third.

Table 25: Optimistic Scenario: Number of SME establishments 2005 – 2009

Economic activity	Operating surplus $	Number of SMEs in	2005	2006	2007	2008	2009
Industry	0 -5000	8208	8865	9220	9588	9972	10371
	5000 - 10000	2461	2658	2764	2875	2990	3109
	10000 - 20000	1388	1500	1560	1622	1687	1754
	20000 - 30000	541	585	608	632	658	684
	30000 - 50000	380	410	427	444	461	480
	50000 +	645	697	724	753	784	815
	Total	13624	14714	15302	15915	16551	17213
Construction	0 -5000	117	126	131	137	142	148
	5000 - 10000	46	50	52	54	56	58
	10000 - 20000	54	59	61	63	66	68
	20000 - 30000	25	27	28	29	30	32
	30000 - 50000	38	41	42	44	46	47
	50000 +	58	63	65	68	70	73
	Total	338	365	379	395	410	427
Internal trade	0 -5000	27508	29709	30897	32133	33418	34755
	5000 - 10000	6289	6792	7064	7346	7640	7946
	10000 - 20000	3226	3484	3623	3768	3919	4076
	20000 - 30000	950	1026	1067	1110	1154	1200
	30000 - 50000	478	516	537	558	581	604
	50000 +	735	794	826	859	893	929
	Total	39186	42321	44014	45774	47605	49509
Transport	0 -5000	240	259	270	280	292	303
	5000 - 10000	89	96	100	104	108	112
	10000 - 20000	44	48	49	51	53	56
	20000 - 30000	12	13	13	14	15	15
	30000 - 50000	18	19	20	21	22	23
	50000 +	36	39	40	42	44	45
	Total	439	474	493	513	533	555
services	0 -5000	9702	10478	10897	11333	11787	12258
	5000 - 10000	1374	1484	1543	1605	1669	1736
	10000 - 20000	480	518	539	561	583	606
	20000 - 30000	78	84	87	91	94	98
	30000 - 50000	104	112	117	121	126	131
	50000 +	130	140	146	152	158	164
	Total	11868	12817	13330	13863	14417	14994
Total		65454	70691	73518	76459	79517	82698

Source: calculated by consultant based on PCBS data

Table 26: Optimistic Scenario: Value Added 2005 – 2009 (/ $1,000)

Economic activity	Operating surplus $	Value added in	2005	2006	2007	2008	2009
Industry	0 -5000	46069	49755	51745	53814	55967	58206
	5000 - 10000	36185	39080	40643	42269	43959	45718
	10000 - 20000	33952	36668	38134	39660	41246	42896
	20000 - 30000	27422	29616	30801	32033	33314	34647
	30000 - 50000	28131	30382	31597	32861	34176	35543
	50000 +	167601	181009	188249	195779	203611	211755
	Total	339360	366509	381169	396416	412273	428764
Construction	0 -5000	1131	1221	1270	1321	1374	1429
	5000 - 10000	1297	1401	1457	1515	1575	1638
	10000 - 20000	2865	3095	3218	3347	3481	3620
	20000 - 30000	1181	1275	1326	1379	1434	1492
	30000 - 50000	3560	3845	3998	4158	4325	4498
	50000 +	34505	37265	38756	40306	41919	43595
	Total	44539	48102	50026	52027	54108	56272
Internal trade	0 -5000	69280	74822	77815	80927	84165	87531
	5000 - 10000	55212	59628	62014	64494	67074	69757
	10000 - 20000	63167	68220	70949	73787	76738	79808
	20000 - 30000	30993	33472	34811	36203	37651	39158
	30000 - 50000	22971	24808	25800	26832	27906	29022
	50000 +	176911	191063	198706	206654	214920	223517
	Total	418532	452014	470095	488898	508454	528793
Transport	0 -5000	2952	3188	3316	3449	3586	3730
	5000 - 10000	1137	1228	1277	1328	1381	1436
	10000 - 20000	1225	1323	1376	1431	1489	1548
	20000 - 30000	713	770	801	833	866	901
	30000 - 50000	1333	1439	1497	1557	1619	1684
	50000 +	12491	13490	14030	14591	15175	15782
	Total	19851	21439	22297	23189	24116	25081
services	0 -5000	60361	65190	67798	70509	73330	76263
	5000 - 10000	15731	16990	17669	18376	19111	19875
	10000 - 20000	15132	16342	16996	17676	18383	19118
	20000 - 30000	5882	6352	6606	6871	7146	7431
	30000 - 50000	8625	9315	9688	10075	10478	10897
	50000 +	29137	31468	32727	34036	35398	36813
	Total	134868	145657	151484	157543	163845	170399
Total		957149	1033721	1075070	1118073	1162796	1209308

Source: calculated by consultant based on PCBS data

Table 27: Pessimistic Scenario: Number of SME establishments 2005 - 2009

Economic activity	Operating surplus $	Number of SMEs in	2005	2006	2007	2008	2009
Industry	0 -5000	8208	8290	8373	8457	8542	8627
	5000-10000	2461	2486	2510	2536	2561	2587
	10000 - 20000	1388	1402	1416	1431	1445	1459
	20000 - 30000	541	547	552	558	563	569
	30000 - 50000	380	384	387	391	395	399
	50000 +	645	651	658	665	671	678
	Total	13624	13760	13898	14037	14177	14319
Construction	0 -5000	117	118	119	121	122	123
	5000 - 10000	46	46	47	47	48	48
	10000 - 20000	54	55	55	56	56	57
	20000 - 30000	25	25	26	26	26	26
	30000 - 50000	38	38	38	39	39	39
	50000 +	58	59	59	60	60	61
	Total	338	341	345	348	351	355
Internal trade	0 -5000	27508	27783	28061	28342	28625	28911
	5000 - 10000	6289	6352	6415	6480	6544	6610
	10000 - 20000	3226	3258	3291	3324	3357	3391
	20000 - 30000	950	960	969	979	989	998
	30000 - 50000	478	483	488	492	497	502
	50000 +	735	742	750	757	765	772
	Total	39186	39578	39974	40373	40777	41185
Transport	0 -5000	240	242	245	247	250	252
	5000 - 10000	89	90	91	92	93	94
	10000 - 20000	44	44	45	45	46	46
	20000 - 30000	12	12	12	12	12	13
	30000 - 50000	18	18	18	19	19	19
	50000 +	36	36	37	37	37	38
	Total	439	443	448	452	457	461
services	0 -5000	9702	9799	9897	9996	10096	10197
	5000 - 10000	1374	1388	1402	1416	1430	1444
	10000 - 20000	480	485	490	495	499	504
	20000 - 30000	78	78	79	80	81	81
	30000 - 50000	104	105	106	107	108	109
	50000 +	130	131	133	134	135	137
	Total	11868	11986	12106	12227	12349	12473
Total		65454	66109	66770	67438	68112	68793

Source: calculated by consultant based on PCBS data

Table 28: Pessimistic Scenario: Value Added 2005 – 2009 (/ $1,000)

Economic activity	Operating surplus	Value added in	2005	2006	2007	2008	2009
Industry	0 -5000	46069	46530	46995	47465	47940	48419
	5000 - 10000	36185	36547	36912	37281	37654	38031
	10000 - 20000	33952	34291	34634	34980	35330	35683
	20000 - 30000	27422	27696	27973	28253	28536	28821
	30000 - 50000	28131	28413	28697	28984	29274	29566
	50000 +	167601	169277	170970	172679	174406	176150
	Total industry	339360	342754	346181	349643	353139	356671
Construction	0 -5000	1131	1142	1154	1165	1177	1189
	5000 - 10000	1297	1310	1323	1336	1350	1363
	10000 - 20000	2865	2894	2923	2952	2982	3012
	20000 - 30000	1181	1192	1204	1216	1228	1241
	30000 - 50000	3560	3595	3631	3668	3704	3741
	50000 +	34505	34850	35199	35551	35906	36265
	Total	44539	44984	45434	45888	46347	46810
Internal trade	0 -5000	69280	69972	70672	71379	72093	72814
	5000 - 10000	55212	55764	56321	56884	57453	58028
	10000 - 20000	63167	63798	64436	65081	65732	66389
	20000 - 30000	30993	31303	31616	31932	32251	32574
	30000 - 50000	22971	23200	23432	23667	23903	24142
	50000 +	176911	178680	180467	182271	184094	185935
	Total	418532	422717	426944	431214	435526	439881
Transport	0 -5000	2952	2982	3012	3042	3072	3103
	5000 - 10000	1137	1148	1160	1171	1183	1195
	10000 - 20000	1225	1238	1250	1262	1275	1288
	20000 - 30000	713	720	727	735	742	749
	30000 - 50000	1333	1346	1359	1373	1387	1401
	50000 +	12491	12616	12742	12869	12998	13128
	Total	19851	20050	20250	20453	20657	20864
services	0 -5000	60361	60965	61574	62190	62812	63440
	5000 - 10000	15731	15888	16047	16208	16370	16534
	10000 - 20000	15132	15283	15436	15590	15746	15903
	20000 - 30000	5882	5941	6000	6060	6121	6182
	30000 - 50000	8625	8711	8799	8887	8975	9065
	50000 +	29137	29429	29723	30020	30320	30624
	Total	134868	136217	137579	138955	140344	141748
Total.	less than 50 employees	957149	966721	976388	986152	996013	1005973

(Source: calculated by consultant based on PCBS data)

Annexe B: Demand Analysis Methodology

A) Sample Size and Selection

The 2004 establishments census was the starting point in the sampling process. The census was conducted by the Palestinian Central Bureau of Statistics. It included information about all establishments in the Palestinian Territories including number of workers, activity, location, ownership (private, public, and NGOS), and legal status.

For the purpose of this study the sample frame was adjusted. The adjustments included:

1. Private firms only were included.
2. Firms employing less than 50 workers.
3. Firms in the West Bank and Gaza excluding East Jerusalem (due to inability to collect data in this area).
4. Internal trade firms employing more that two workers. This was justified on the grounds that 64% of SMEs are in the internal trade sector, of which 96% employ less than 5 workers. To avoid the very small ones who might not need credit, we dropped all firms employing fewer than three workers in this sector.

A stratified sample of 450 SMEs was then chosen from ten economic activities. The activities are defined according to the International Standard Industrial Classification-ISIC at the first and second digit. The activities are: mining and manufacturing industries; internal trade; transportation, telecommunications and storage; construction; real estate; and services, which included hotels and restaurants, education, health, and personal services.

The sample was stratified according to the share of each activity in the adjusted sample frame (i.e. the sample share of each activity equals its share in the sample frame). The table shows the distribution of the sample.

Table 29: Distribution of the study sample according to the number of employees by economic activity

Economic Activity	Number of Employees					
	1-5	**6-10**	**11-15**	**16-20**	**Over 21**	**Total**
Industry	117	8	2	1	3	131
Construction	6	5	3	0	0	14
Internal trade	50	3	0	0	0	53
Transportation & telecom.	7	3	1	0	0	11
Services	168	11	2	2	1	184
Water and Electricity	12	0	0	0	0	12
Real Estate	40	2	0	0	0	42
Total	**400**	**32**	**8**	**3**	**4**	**447**

Data was collected on the 16th, 17th, and 18th of August 2005 by PCBS field workers.

B) Questionnaire design

A three-page questionnaire was designed according to the TOR of the study. The first part of the questionnaire included demographic questions to define the business characteristics of the respondent like his activity, number of workers, capital structure, etc. The second part included questions about credit practices in terms of need for credit, applications for credit, rejection and approvals, amount of credit requested, collateral provided etc. Short (one year) and medium (up to five years) credit needs were investigated in the third part of the questionnaire including areas of credit usage based on their investment and expansion plans. The fourth part investigated the potential impact of alternative credit schemes provided by a financing institution. Three schemes were investigated: 20%, 40% and 60% collateral guarantees.

C) Survey Administration

PCBS and MAS conducted a two-hour training session for 52 field workers, explaining to them the questionnaire, key concepts and relevant methodological issues (like how to handle non-respondents, incomplete answers, etc.). A survey coordinator was assigned from PCBS to oversee the field work. An ACESS file was developed to enter data then transferred into SPSS file for data analysis. The ISD (information System Directorate) in the PCBS handled the computer work. MAS research coordinator was in contact with PCBS to ensure timely delivery of the survey results.

Annexe C: Questionnaire

Survey of the Risks Related to Financing Activities and the Financing Needs of Palestinian SMEs, 2004 (Translated and summarised)

General profile of the Firm

EQ1. Serial Number…..

EQ2. Establishment Number…..

EQ3. Class…..

EQ4. Population Cluster…..

EQ5. Outcome of the interview:
1. Complete.
2. Incomplete.

EQ6a. Commercial Name:………….

EQ6b. Main Economic Activity:…………

EQ7. Legal Ownership………

EQ8. Capital Size (Book Value in US$)………

EQ9. Capital Size (Market Value in US$)…….

EQ10. Number of permanently employed workers (in 2004)…….

EQ11. Value of Production (throughout 2004 in US$)……

EQ12. Source of Financing (Percent):
1. Self Financed.
2. Loans.
3. Donations.

Credit Profile and Risk Attitudes of the Firm

EQ13. Have you ever applied for a loan?
1. Yes.
2. No.

13a. If not, why?
1. No need
2. Religious reasons
3. Complex procedures
4. Poor terms

EQ14. Total dollar amount of credit facility applied for ……

1. Overdraft…..
2. LCs & bank guarantees….
3. Loans (one year or less)…..
4. Loans (1-3 years)…..
5. Loans (3-5 years)……
6. Loans (Over 5 years)…….

EQ15**.** ***1. Loan amount fully approved.***
2. Loan amount partially approved.
3. Application under consideration.
4. Application rejected.

Please write the appropriate number from the list above next to credit facility type:

1. Overdraft.
2. LCs & bank guarantees.
3. Loans (One year or less).
4. Loans (1-3 years).
5. Loans (3-5 years).
6. Loans (Over 5 years).

EQ16. In the case where the loan was partially approved, what percent of the loan amount was approved?

1. Overdraft……
2. LCs & bank guarantees……
3. Loans (One year or less)……
4. Loans (1-3 years)………
5. Loans (3-5 years)……..
6. Loans (Over 5 years)……..

EQ17. Amount of **cash collateral** provided for any of the following credit facility types :

1. Overdraft……
2. LCs & bank guarantees…..
3. Loans (One year or less)…..
4. Loans (1-3 years)…….
5. Loans (3-5 years)…….
6. Loans (Over 5 years)…….

EQ18. Dollar value of **land and buildings** used as collateral for any of the following credit facility types:

1. Overdraft…..
2. LCs & bank guarantees……
3. Loans (One year or less)……
4. Loans (1-3 years)……

5. Loans (3-5 years)……
6. Loans (Over 5 years)……

EQ19. Dollar value of **transferable assets/ inventory** used as collateral for any of the credit facility

1. Overdraft…..
2. LCs & bank guarantees……
3. Loans (One year or less)……
4. Loans (1-3 years)……
5. Loans (3-5 years)……
6. Loans (Over 5 years)……

EQ20. Dollar value of **guarantees/ financial securities** used as collateral for any of the following credit facility types:

1. Overdraft…..
2. LCs & bank guarantees……
3. Loans (One year or less)……
4. Loans (1-3 years)……
5. Loans (3-5 years)……
6. Loans (Over 5 years)……

EQ21. ***1. Credit facilities meet Less than 25% of my company's needs.***
2. Credit facilities meet 25%-50% of my company's needs.
3. Credit facilities meet 50%-75% of my company's needs
4. Credit facilities meet more than 75% of my company's needs.

Please use the appropriate number from the above list to place next to credit facility type.

1. Overdraft…..
2. LCs & bank guarantees……
3. Loans (One year or less)……
4. Loans (1-3 years)……
5. Loans (3-5 years)……
6. Loans (Over 5 years)……

EQ22. What was the underlying purpose of the loan (%)?

1. The purchasing of equipment, land & buildings.
2. Financing working capital.

EQ23. Why was your credit application rejected?

1. "I refused the conditions and stipulations set forth by creditors".
2. "The bank refused my application".
3. Other. Please identify…………

EQ24. Please rank (according to your personal priorities) the reasons for your refusal to accept credit terms set by creditors:

1. Relatively high interest rates.
2. Relatively high bank fees and commissions.
3. Loan repayment period is short.
4. Complex procedures associated with collateral and co-signers.

5. Other. Please state…..

EQ25. Please rank (according to your own priorities) reasons for the bank's rejection of your application:

1. The inadequacy of collateral provided.
2. The bank rejected the feasibility study and business plan.
3. High risk (from the bank's point of view).
4. Other. Please state….
5. I do not know.

Pending business activities for financing (up until mid 2006)

EQ26. What are your immediate financial needs (US$) in any or all of the following cases:

1. Repay the loans of a third party. $....
2. Purchase raw materials and spare parts. $....
3. Finance sales campaigns. $....
4. Purchase Assets. $...

EQ27. Are you planning to expand your business within the next five years?

1. Yes.
2. No.

EQ28. If you are planning to expand, what are the areas of your business expansion plan and how much is required for each?

1. Expand production line.
2. Opening new branches.
3. Expansion into new areas.
4. Expanding on the land or building.
5. Increasing production capabilities.

EQ29. Local financial institutions require borrowers to provide collateral which reaches as high as 100% of the value of loan sought. What would be the amount of loan you would apply for if collateral was reduced as follows?

1. Collateral to loan amount ratio is 80%. Value of loan would be (in US$)……
2. Collateral to loan amount ratio is 60%. Value of loan would be (in US$)……
3. Collateral to loan amount ratio is 40%. Value of loan would be (in US$)…….

Annexe D: References

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