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TIJARA PROVINCIAL ECONOMIC GROWTH PROGRAM

THE MICROFINANCE INDUSTRY PROFILE OF IRAQ

An Overview of the Emerging Iraqi Microfinance Industry



June 2009

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The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

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Acronyms

ACDI/VOCA	A US-based private non-profit development organization formed in 1997 from the merger of two companies, Agricultural Cooperative Development International (ACDI) and Volunteers in Overseas Cooperative Assistance (VOCA).
ACSI	Access to Credit in Southern Iraq
CERP	Commander's Emergency Relief Program, Iraq
CHF	Cooperative Housing Foundation; a US-based private non-profit development organization
CMOC/RTI	Civil Military Operations Center/Research Triangle Institute
MENA	Middle East and North Africa region
MFI	Microfinance Institution
MF	Microfinance
NGO	Non-Governmental Organization
OSS	Operational Self-Sufficiency – a ratio measuring level of operational cost-coverage
PaR	Portfolio at Risk – a ratio measuring level of loan repayment
PEG	Provincial Economic Growth
PRT	Provincial Reconstruction Team(s)
QRF	Quick Response Fund
RI	Relief International – a US-based private non-profit development organization
USAID	United States Agency for International Development

The Microfinance Industry in Iraq at a Glance

Iraq boasts a long history of informal finance. Microfinance, however, based on standards of best practice, only began emerging as an industry after the regime change in May 2003, when CHF International established the ACSI program (Access to Credit in Southern Iraq) in July 2003. ACDI/VOCA began microfinance operations in January 2004. It was soon followed by another Iraqi microfinance NGO, Al-Thiqa, in February 2004 to carry out the same kind of program.

In 2006, the first two indigenous microfinance NGOs, Al Bashaer in Baghdad, and Al Aman in Kirkuk were founded by Iraqi governing boards of directors through cooperation and funding from the USAID - *Izdihar* program and the U.S. military. Since then, nine more indigenous microfinance institutions (MFIs) have been established. The Iraqi microfinance industry thus comprises 13 organizations that are serving all of the 18 Governorates of Iraq as illustrated in the outreach map below.

Through June 2009, the modern industry has disbursed nearly 138,000 loans of U.S. \$ 316 million¹, and the MFIs are currently reaching over 46,000 customers. All of the MFIs were supported by the U.S. Government with funding and technical assistance through the USAID - *Izdihar* Project until the end of March 2008. From April 2009, USAID – *Tijara* has served the industry.

With the very limited lending from commercial banks to micro- and small businesses in Iraq, MFIs have demonstrated considerable comparative advantages in their financial service provision. The MFIs are, however, challenged not only by the volatile security situation but also by an immature policy and regulatory system, donor pressure for quick disbursement and detailed reporting, and difficulties in recruiting, training, and retaining qualified personnel. As all MFIs are registered as NGOs, they are not yet integrated with the formal financial sector and remain outside the purview of the central bank.

In addition, the MF industry in Iraq faces problems typical of the sector at this stage of its development, e.g. lack of capital and capacity at the MFI level, and very limited industry support structures such as enabling policies and licensing systems, credit reference services, performance monitoring systems etc. In spite of the challenges, the young industry demonstrates promising trends towards increased sustainability.

In February 2007, the Iraq Microfinance Strategy was published, designed with a three to five year time frame, and driven by the MFIs and practitioners, through their business plans and operations. The volatile Iraqi environment and the changing programs, policies, and priorities of donors and policymakers in Iraq continue to effect its implementation. The ultimate goals of the strategy are to:

- **Increase access to sustainable financial services by poor and low-income households, micro enterprises, and larger, more established small enterprises;**
- **Build the capacity of microfinance institutions to ensure operational and financial sustainability;**
- **Encourage the development of businesses and services that support the microfinance industry (such as banks and business development services); and**
- **Support change of the legal framework for MFIs as part of modernizing and broadening of the financial sector.**

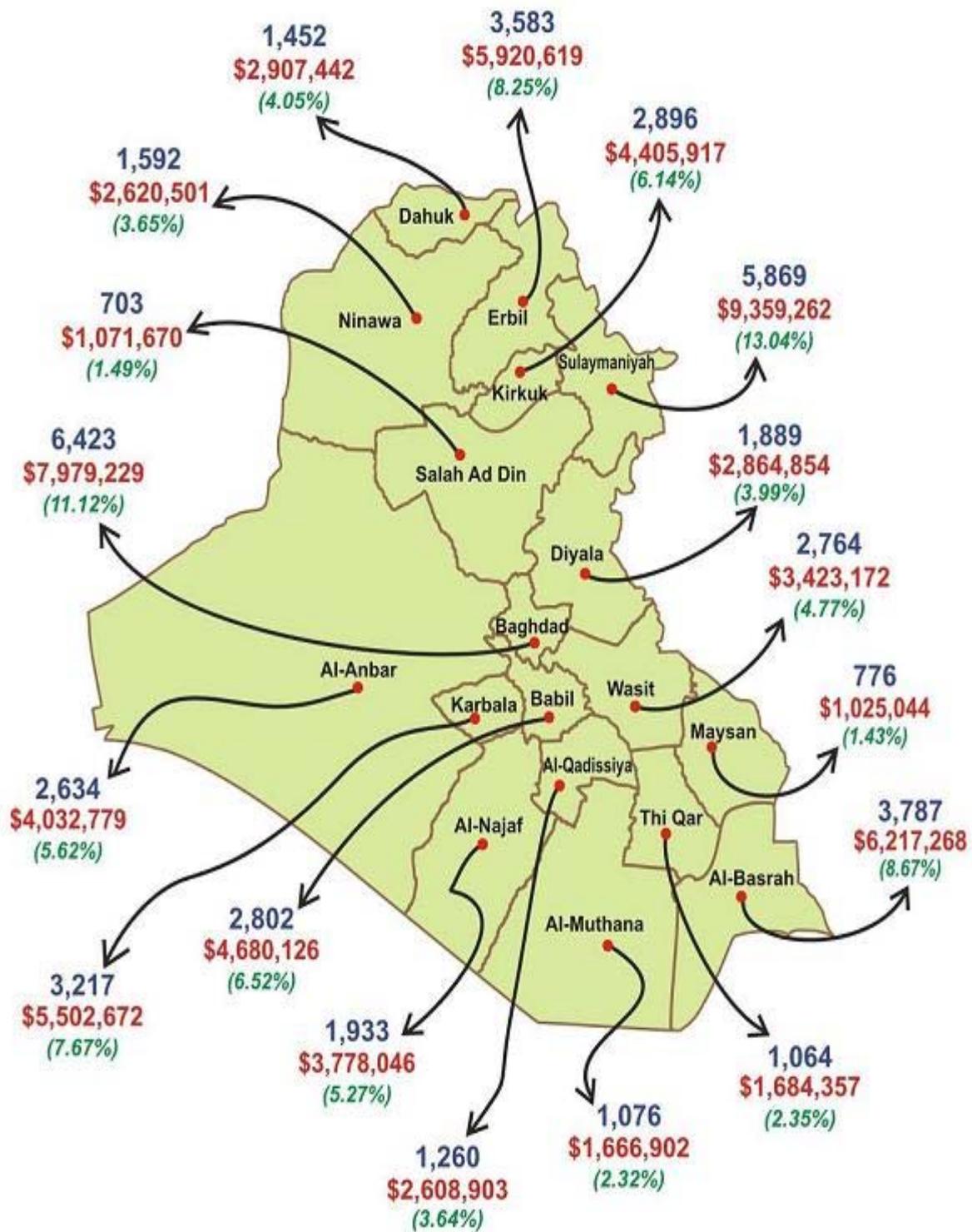
¹ All monetary amounts herein out expressed in U.S. dollars (\$).

To achieve these goals, MFIs, practitioners, and other stakeholders have identified the following seven strategic areas of focus in the medium term (three-five years):

1. Clearly defining what “microfinance” means in the context of Iraq;
2. Promoting awareness of microfinance and its benefits among its client base, donors, government officials, and the banking industry, including awareness among the Iraqi and global microfinance industries of how Iraqi microfinance differs or maintains similarity with other microfinance industries globally;
3. Seeking a legal and regulatory environment that supports and enables establishing new MFIs and integrating them into the overall financial sector;
4. Building institutional and human resource capacity through training, technical assistance and systems support;
5. Emphasizing transparent operations by adopting internationally accepted standards of reporting and encouraging computer-based recordkeeping for administrative, managerial, and evaluation purposes;
6. Supporting industry development through informal networking opportunities, while ensuring that donors and practitioners maintain appropriate levels of information security; and
7. Increasing bank linkages to: (i) provide MFIs and their clients with needed banking services; and (ii) promote partnering arrangements between MFIs and banks.

For the articulated vision to be achieved there is a need to build the capacity of the microfinance institutions; as well as to enhance the effectiveness of service providers. A suitable enabling environment for the microfinance industry is also needed in terms of practical laws, regulations and, most importantly, positive, appropriate attitudes on the part of all stakeholders, official and public, to the value of building inclusive financial systems. Strategies have therefore been drafted, which focus on:

- **Building the capacity and developing demand-driven financial service products for MFIs**
- **Promoting capable private sector capacity building providers**
- **Ensuring an appropriate enabling policy and regulatory environment such that microfinance is mainstreamed into the Iraqi financial sector**



The Microfinance Institutions

There are 13 Microfinance Institutions (MFIs) are currently operating in Iraq, reaching customers in all 18 provinces (Governorates) of the country from a total of 61 branches and outlets.



CHF International/Amalkom established its Access to Credit in Iraq (ACSI) program in July 2003, operating from its head office in Hilla, Babel. The organization has 12 outlets covering the South and Baghdad.



Al-Thiqa was founded in January 2004 and operates 12 outlets from its head office in Kirkuk, covering the Northern Governorates as well as returning to Baghdad. Al-Thiqa is supported by ACDI-VOCA.



Relief International/Izdiharouna started operations in July 2006 from its head office in Sulaimaniya. It has eight outlets in the areas of Sulaimaniya, Wasset, Missan and Karbala. RI is supporting the locally registered MFI Izdiharouna, operating in the towns of Kut, Iskandariya and Sadda.



Al-Bashaer started lending in August 2006 from its head office in Al Mansour, Baghdad. It now reaches customers throughout the city, using 15 branch offices, as well as serving the adjacent town of Madain.



Al-Aman began lending in July 2006 from its head office in Kirkuk. It has expanded its operations to serve outlying areas through three satellite offices.



Rabiayn Economic Development Center (REDC) started in December 2007 from its head office in Mosul in Ninewah Governorate and reaches clients in town of Hamdaniya from one additional outlet.



Al-Mosanid, an existing NGO providing development services in the Salah ad Din Governorate, resurrected an existing microfinance program in November 2008, operating from its head office in Tikrit and six outlets in the province.



Tala'far Economic Development Center (TEDC) was established in November 2007 and operates from one office in Tala'far in Ninewah Governorate.



Al-Takadum in the Al Anbar Governorate was established in 2007. Three independent branch organizations are so far operating in Al-Qaim, Fallujah and Ramadi respectively.



Bright Future Foundation (BFF) began operations in December 2007 with technical support from CHF International. With its head office in Erbil, it reaches clients from 2 additional outlets in Erbil and Sulaimaniya.

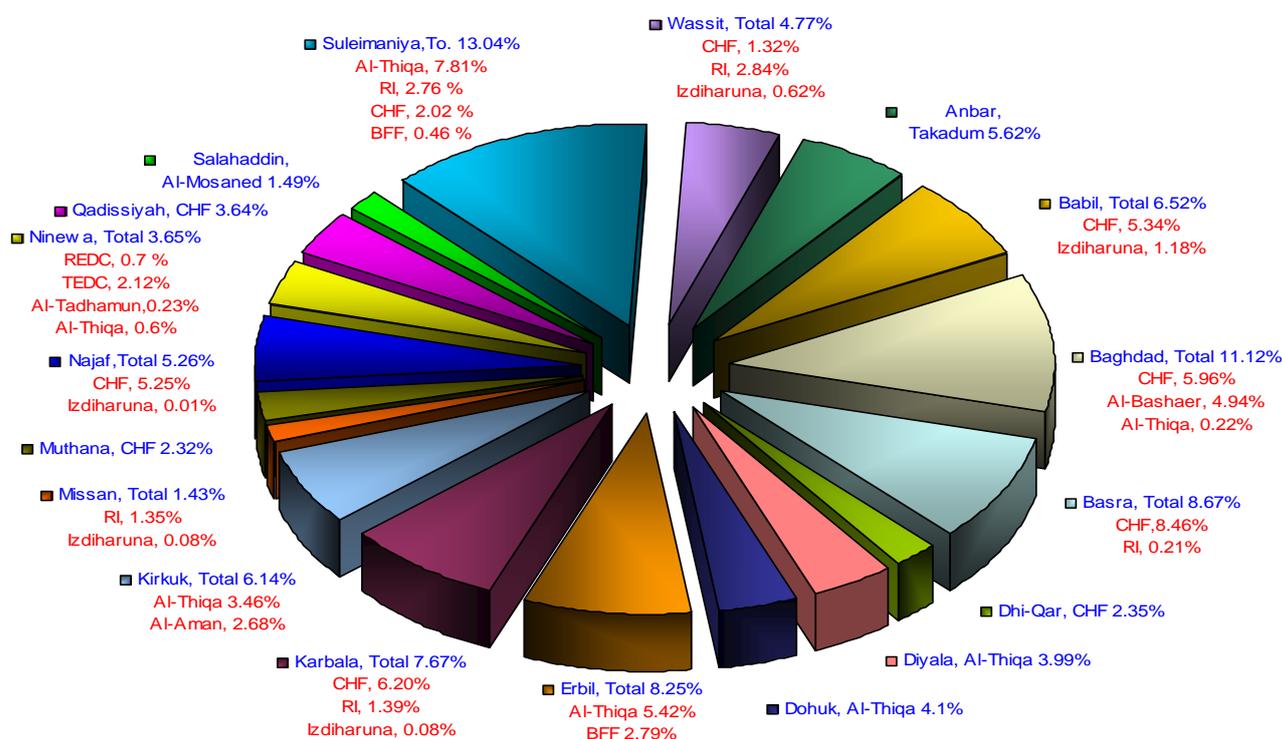


Al-Tadhamun was established in January 2009 in Mosul, Ninewah. The organization has one office in Mosul and one satellite office in Telkeyf.

While portfolio growth remains high – at 60% over the past year - and loan repayment is good – with portfolio at risk (PAR) levels on average for loans whose payments are 30 days or more late 1.1% in most cases – operating efficiency is low. This is due to the high costs of security and the low productivity of new loan officers with limited access to clients’ businesses.

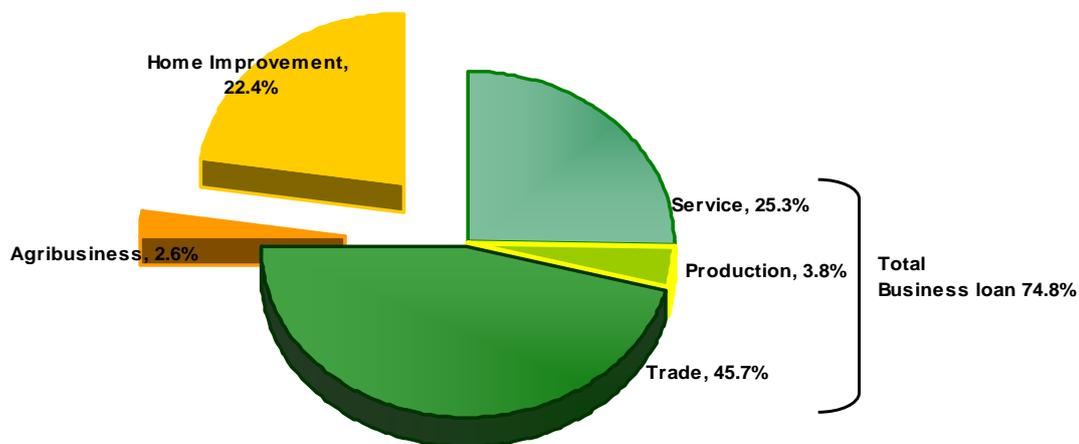
Since inception through to the end of June 2009, the MFIs have disbursed a total of 137,892 loans at a total value of \$316 million. The outstanding portfolio is 45,720 clients with a balance of \$72 million,

Figure 2: Loans Outstanding by Province, June 2009



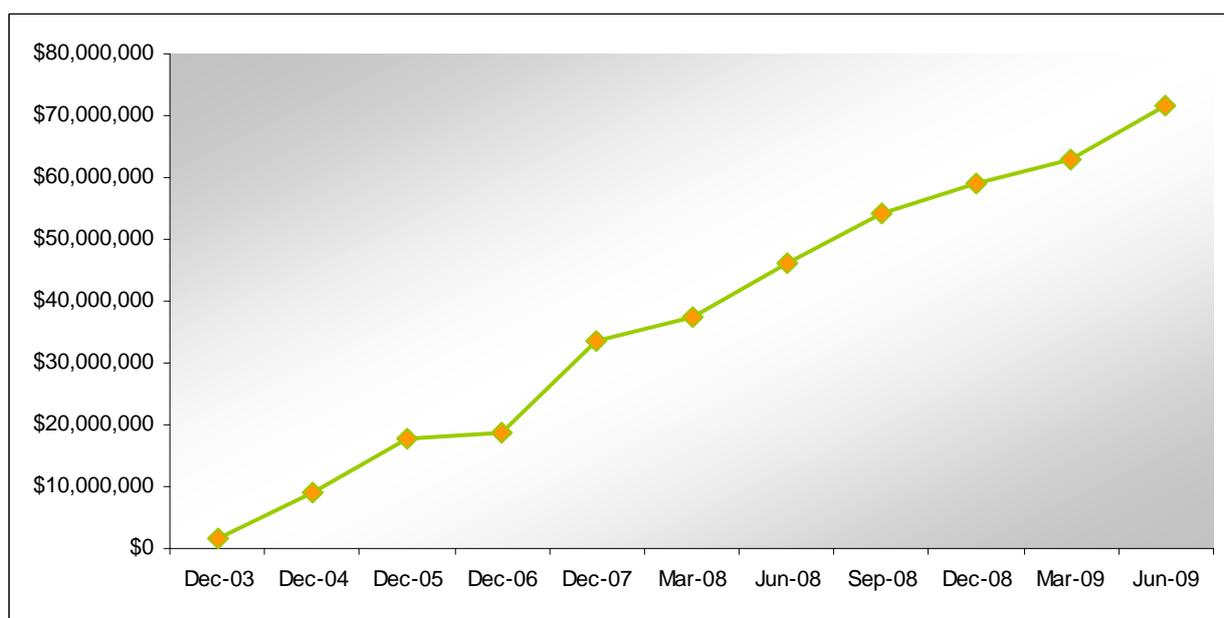
Iraqi MFIs have not targeted the poorest nor women. However, they do target those who would have no access to other sources of finance such as banks. They are becoming more proactive in targeting women by using strategies that should increase the proportion of this group served. Most loans (74.8%) have been disbursed to micro- and small businesses, while consumption-based personal loans mostly for home improvement are 22.4 % of the total loans disbursed. Since inception, women are 15% of MFI clients while holding 13% of the loan value, and outstanding loans is \$10 million (14%) and 8,207 women (18%).

Figure 3: Sectoral Distribution of Loans Disbursed



In the [six](#) years since the beginning of the first microfinance institutions in Iraq, growth has been impressive as illustrated in Figure 4. With limited formal employment opportunities in the private sector, the demand for microfinance in Iraq is expected to remain high.

Figure 4: Microfinance Portfolio Growth in Iraq (in US\$)



The Product Range

The range of products available to clients remains limited. Most MFIs offer one standard loan product – a collateralized working capital loan with repayment terms from 10 to 12 months. Several MFIs offer an Islamic lending product called al Murabaha. Larger MFIs also offer loans for home improvement, consumption and other personal purposes. Personal guarantors, mostly with government salaries, remain the primary source of collateral. Solidarity group lending is progressively being introduced starting in 2009.

Several of the MFIs are currently exploring opportunities for new client targeting and product development, including:

- **Solidarity group lending for women**
- **Agricultural loans**
- **Business loans to women**

Loan sizes range from \$500 - \$ 3,000 with a few MFIs providing larger loans to small businesses. For secular lending, interest rates are from 12 to 18% flat per year in 2008, up from 7 - 9% in 2007.

None of the MFIs offer savings services, voluntary or compulsory.



The services offered by micro enterprises meet the daily needs of people. In this picture, a tailor in Erbil welcomes a customer.

MFI Performance

As at end June 2009, performance in the industry is summarized below:

Table 5: Key Performance Indicators

Performance Indicators through June 2009	Total Industry
Average MFI Age	2 Years, 7 Months
Number of MFI Employees of MFIs	783
Number of Loans Outstanding	45,720
Amount (\$) Outstanding	\$71,748,763
Percentage (%) Loans to Women	14%
Number of Loans Disbursed to Date	137,892
Amount (\$) Disbursed to Date	\$316,275,832
Average Outstanding Loan Size	\$1,569
Portfolio at Risk (Balance of Loans w/ Repayments Overdue > 30 Days)	1.1%
Operational Cost Ratio (Average; Annualized)	19%
Portfolio Yield (Average; Annualized)	30%
Operational Self-Sufficiency (OSS) (Average; Annualized)	160%

The young industry still comprises MFIs that are primarily in the "start-up" stage of maturity where grant capital remains needed from either shareholders or donors. Iraqi MFIs have received significant grant funding since start-up. The industry is now focused on increasing productivity; enhancing efficiency; and attaining viable levels of managerial, technical and financial self-sufficiency. Already, however, the majority of MFIs are able to cover their direct operational expenses (e.g. salaries, rent, and transportation, among others) with internally generated revenues such as from loan interest and fees.

As another step forward in the development and strengthening of the Iraqi microfinance industry is that Iraqi MFIs are increasingly able to develop and implement their own strategic business plans. These guide them by focusing and inspiring governing board members, management and staff to attain their goals and contribute to their mission – which for most Iraqi MFIs is the provision of high-quality financial services to small businesses and poor households across the country.

Trends

Trend	Status in Iraq, June 2009	Reference MENA 2007 Benchmark
Portfolio Growth:	<i>Very high, average of 60% over past 12 months</i>	44%
Cost of Capital:	<i>Low (0%) as all MFIs are currently grant-funded.</i>	4.8%
Operating Costs:	<i>High at average of 19% due to security costs in the conflict-affected environment.</i>	19.1%
Portfolio Yield:	<i>Increasing, 31% on average for larger MFIs, and 29% on average for smaller ones, overall average of 30%.</i>	22.2%
Sustainability:	<i>Increasing, - 160 % OSS on average for 11 MFIs; - Three large MFI and four small MFIs are financially self-sufficient - Four small MFIs operationally self-sufficient</i>	96%

After only six years of operation in a challenging security environment, the overall results attained must be commended as very promising.

It is encouraging that the vast majority of clients (74%) are served by the strongest MFIs that also manage the majority of the outstanding portfolio (77%). The average loan size, even of the strongest MFIs is relatively low, indicating depth of outreach. As from 2009, the introduction of solidarity group lending will bring average loan sizes down and women's participation up.

It is of concern in the industry that the smallest MFIs have the largest average loan sizes – as weak organizations run a higher risk of failure to collect effectively on loans, and with the larger loans, more capital could be at risk. This trend is already evident in PARs, which are of significance among the smallest MFIs.

The productivity of the loan officers is low for Iraqi MFIs. This can be partially explained by the current funding structure that encourages MFIs to recruit more Loan Officers than needed at the beginning before the portfolio has grown sufficiently to cover staffing costs. Newer staff are also less productive than experienced ones. Additionally, the poor security environment makes it difficult and time consuming for Loan Officers to reach and meet with clients. Therefore, the overall client caseload is lower than in less conflict-affected countries. The average Loan Officer caseload for small MFIs in the MENA region is 265 whereas for Iraqi MFIs of similar size, the caseload is only 61% of the MENA average at 162.

Progress towards sustainability continues, with five MFIs now covering their operational costs, while two have attained financial self-sufficiency. In other words, they are generating revenue to cover all operational costs as well as loss to inflation and financing expense which would be incurred were the MFIs to borrow capital for lending at commercial rates. When strategic business plans are developed and financial projections underpin the expected development, the MFIs will be well prepared for growth of scale.

² See benchmarks in the Global Microfinance Information Exchange database, <http://www.themix.org>

Funding of Microfinance

To date, the Iraqi microfinance industry has been financed largely by grants from the U.S. Government. The 13 MFIs combined have received US\$ 82.4 million since inception in 2004. Of this amount, the large MFIs have received 82%, while the balance of 18% has been allocated to the smaller, indigenous MFIs.

Of all funding received, \$60 million, or 73%, has been for loan capital. Loan capital funding has been recycled by MFIs more than three times (total loan balance disbursed since inception less an average of 15% interest divided by loan capital input = 3.7). The current reflow ratio is positive at 1.2 of loan capital funds to outstanding loan portfolio.

Of the total funding of the industry, \$31 million, or 37%, has been provided from USAID, while other funders include the military emergency fund called CERP, quick response funds (QRF) and others³.

Despite the significant funding available, the strong demand for microfinance and loans to smaller businesses results in funding constraints for the MFIs. With increased financial solidity and professionalization among Iraqi MFIs, there will be increasing need for financing from costed capital for growing loan portfolios. Currently, the national Iraqi banking industry is reluctant to meet such a demand. In the future, Iraqi MFIs would like to diversify their funding sources towards costed capital, assuming that the enabling environment is suitable. Suitability would come in the form of MFIs becoming officially recognized and registered as financial intermediaries needing to be financially self-sufficient and eventually profitable.

Medium-term Perspective

- **MFIs would benefit from migration from their current required registration as NGOs under the Ministry of Planning and Development Cooperation to registering with the Central Bank of Iraq as non-bank financial intermediaries (NBFIs) under appropriate legislation and regulation.**
- **A gradual reduction in grant funds for loan capital should be replaced by access to costed capital sources.**
- **Technical assistance, training and institutional strengthening will be crucial to solidify managerial and technical sustainability, especially in the younger MFIs. Governance and management training will be needed, along with systems development and strengthening of policies, procedures and planning skills.**

For more information on the Iraqi microfinance industry, please visit:

<http://izdihar-iraqknowledgeportal.com>

<http://www.imfi.org>

<http://www.tijara-iraq.com>

³ Other grant funders of MFIs include local PRTs, CMOC/RTI, US Army and Coalition Provisional Authority. In addition, UNOPS, Kiva has provided one loan of \$ 100,045 to one MFI.

