CHAPTER 4

Do Financial Systems in the Region Provide Access?

This chapter assesses the performance of MENA financial systems, with a focus on their capacity to provide access to finance. It examines whether these undiversified, heavily bank-based financial systems have delivered access to credit and other financial services to enterprises and individuals.

The analysis of access outcomes is based on a battery of access indicators based on enterprise- and bank-level data. These indicators include the share of enterprises with a loan, the sources of investment financing, the number of bank deposit and loan accounts, loan concentration ratios, the volume of small and medium enterprise and mortgage lending in loan portfolios, and the reach of the microcredit industry. Some of these indicators can be considered final outcome indicators; others can be viewed as intermediate outcome indicators. However, combined they form a coherent picture of the progress achieved in providing access to finance.

The chapter shows that access outcomes have been generally disappointing in most MENA countries. Although MENA banks are generally well capitalized and the ratio of credit to GDP is generally high by international standards, the region does not compare well with other regions in access outcomes. The volume of bank credit may be large by international standards, but credit is much more concentrated than in other regions. Many important segments, such as small and medium enterprises, remain deprived of credit, and alternatives to bank finance are generally lacking, even for larger enterprises. Housing finance is still undeveloped. The outreach of the microfinance industry is limited.

The findings in this chapter are fully consistent with those of a recent World Bank flagship report on private sector development (World Bank 2009) that notes the existence of two private sectors in the region. The first consists of older, well-connected firms that face little competition. The second consists of new and younger investors, who generally manage smaller firms and struggle to expand. The private sector development report notes that productivity gains and growth are more likely to come from the generation of new investors than the expansion of existing firms. This chapter shows the access-to-finance restrictions facing this new generation of investors.

The chapter also shows how traditional indicators of financial development can be deceptive. The literature on financial development frequently relies on depth indicators, such as the ratio of private credit to GDP or the ratio of market capitalization to GDP as key measures of financial development. The literature recognizes that depth and access are two different dimensions of financial development and have to be assessed separately but the two dimensions are expected to be correlated. The MENA region provides a good example of how the two dimensions can be disconnected. It also shows the importance of a holistic assessment of the financial sector with the use of a wide variety of indicators.

The chapter is structured as follows. The first section analyzes enterprise-level indicators, built on enterprise surveys conducted by the World Bank. The second section reports a battery of bank-level indicators, including the number of deposit and loan accounts, loan concentration ratios, and the volume of small and medium enterprise and mortgage lending. The third section examines access in the small but important microcredit sector. The last section discusses the lack of access in areas where good indicators are not available. The evidence provided in this chapter paves the ground for the next chapter, which addresses the central question posed in this report, namely, why access to finance is so restricted in MENA.

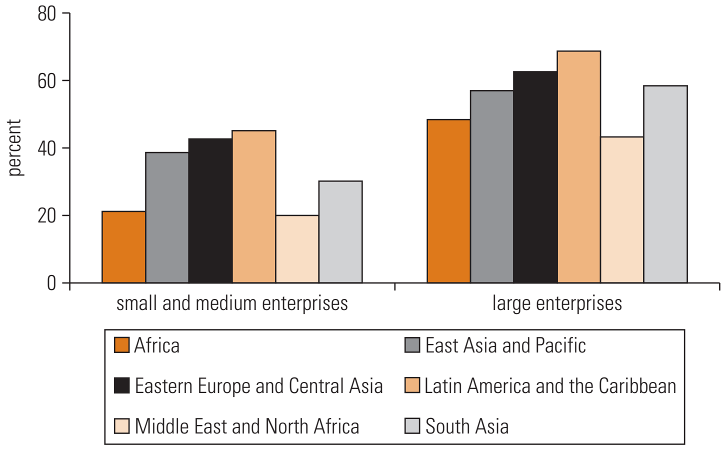
Enterprise-Level Indicators of Access

Enterprise-level surveys conducted by the World Bank show that MENA enterprises, especially small and medium enterprises, are financially constrained. Just 20 percent of small and medium enterprises in MENA have a loan or line of credit, a significantly lower share than in all other regions except Africa (figure 4.1). A larger share of large enterprises in MENA has a loan or line of credit (about 42 percent), but the region does not compare well at this level either, having essentially the same average share as Africa and a much smaller share than other regions. These data suggest that even among large enterprises, firms with better-established connections have captured most of the credit, a possibility that is consistent with the very high loan concentration ratios shown below.

Relative to businesses elsewhere in the world, enterprises in MENA rely more on internal sources of finance for their working capital needs, which account for 84 percent of working capital finance for small and medium

FIGURE 4.1

Share of Enterprises with a Loan or Line of Credit, by Firm Size and World Region



Source: World Bank surveys conducted between 2005 and 2010.

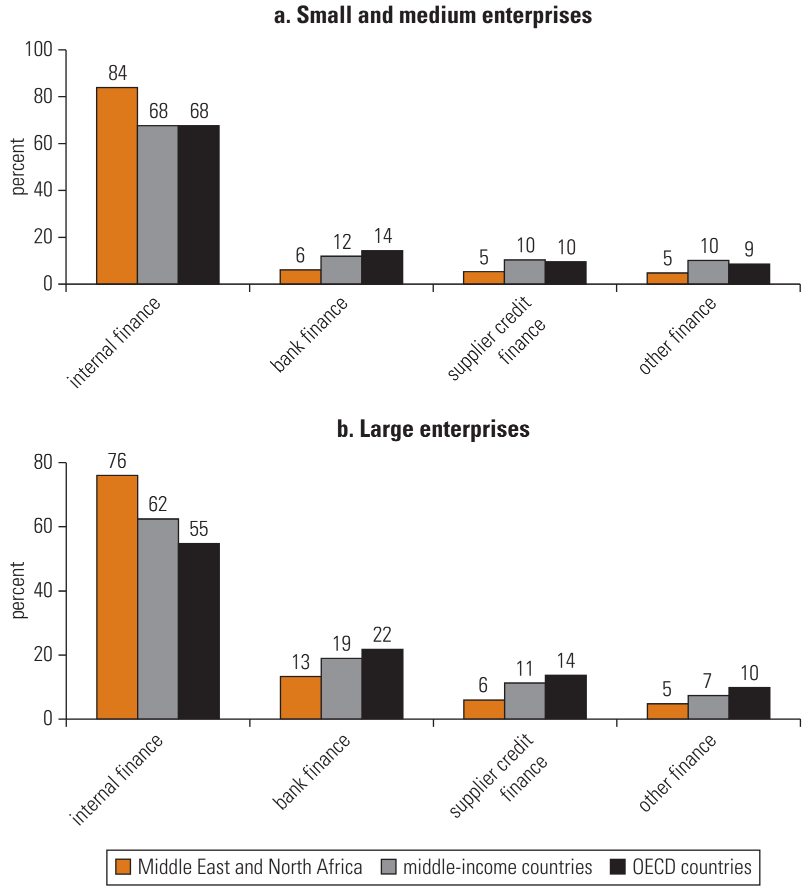
enterprises and 76 percent of working capital finance for large enterprises (figure 4.2). These shares are larger than in other emerging economies, reflecting the greater scarcity of external sources. Access is more restricted for small and medium enterprises, but access by large enterprises in MENA also seems more restricted than in other emerging economies.

MENA enterprises seem to face more restricted access to all external sources of finance. They generally make less use of bank finance, supplier credits, and other sources of finance than their counterparts in other emerging regions. The limited access of small and medium enterprises to bank credit to finance working capital needs is noteworthy. Their lack of access to factoring (an alternative source of short-term financing for small and medium enterprises in many countries), reflected in the low shares of financing from suppliers' credit and other finance, is consistent with the limited development of the factoring industry in the region shown in chapter 3. The situation of large enterprises is better than that of small and medium enterprises but worse than that of large enterprises in other emerging economies.

Relative to businesses in other regions, enterprises in MENA also rely more on internal sources of finance for their investment needs. Internal sources account for 85 percent of investment finance among small and medium enterprises and 75 percent among large enterprises (figure 4.3). Enterprises in other regions also rely extensively on internal finance to implement their investment programs, but the shares for emerging economies and developed countries are much smaller.

FIGURE 4.2

Sources of Working Capital Finance, by Firm Size and Country Group



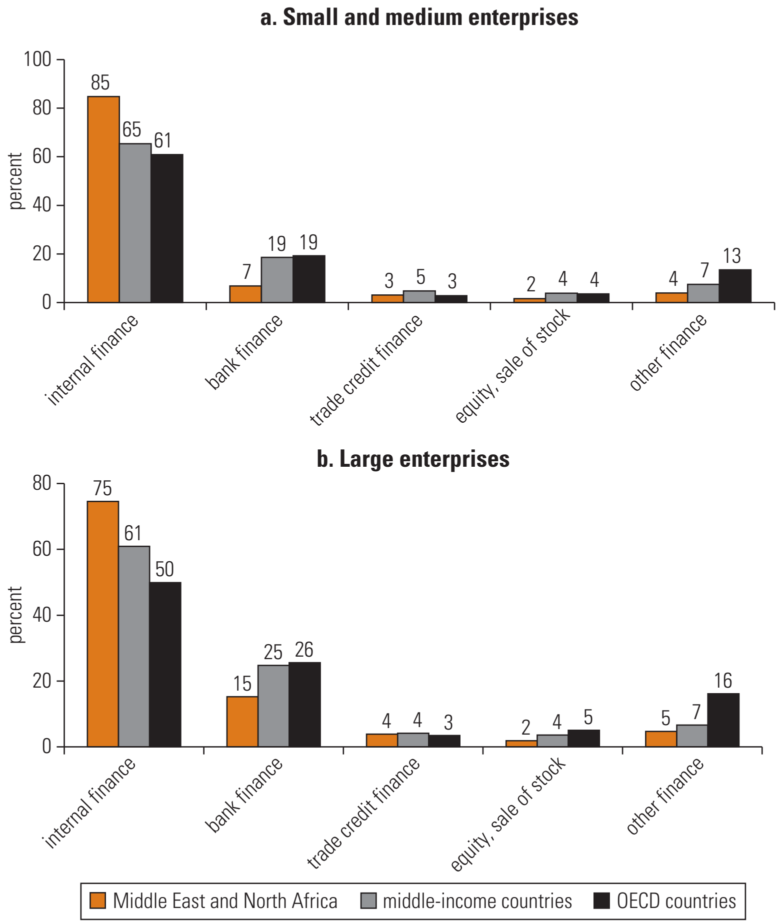
Source: World Bank surveys conducted between 2005 and 2010.

Note: OECD = Organisation for Economic Co-operation and Development.

The region's small and medium enterprises have little access to bank credit to finance their investment programs. The share of equity finance is also smaller, partly reflecting the more limited development of the private equity industry and the modest results of the dedicated exchanges for small and medium enterprises in the Arab Republic of Egypt and Tunisia.[1] Small and medium enterprises also have less access to other sources of finance, a residual category in enterprise surveys that captures a variety of sources, including leasing. This result is consistent with the limited development of the leasing industry shown in chapter 3. Large enterprises also report less recourse to equity finance, a finding that is consistent with the modest capitalization of enterprises in industry and services shown in chapter 3. They also report less recourse to other sources of finance.

FIGURE 4.3

Sources of Investment Finance, by Firm Size and Country Group



Source: World Bank surveys conducted between 2005 and 2010.

Note: OECD = Organisation for Economic Co-operation and Development.

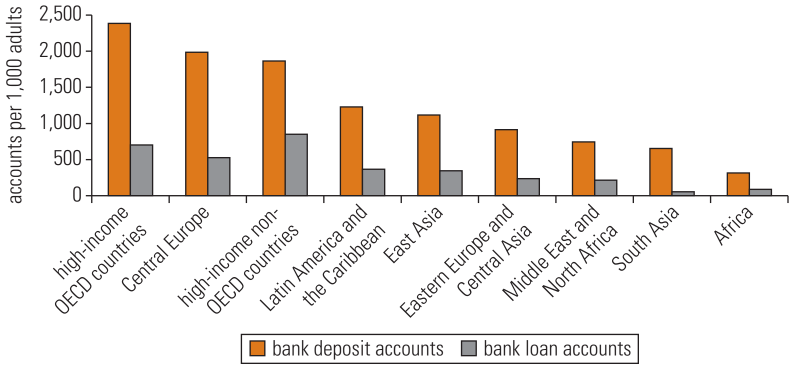
Bank-Level Indicators of Access

Number of Deposit and Loan Accounts per Adult

The number of deposit and loan accounts per adult in MENA is lower than in all regions except South Asia and Africa (figure 4.4). These important indicators reflect both limited banking penetration and restricted access to credit. Most countries in the region are below a simple regression line that shows the values predicted by income levels (figure 4.5). Lebanon, whose banking system is very large relative to the country's per capita income, is one of the notable exceptions.

FIGURE 4.4

Number of Bank Deposit and Loan Accounts, by World Region, 2009



Source: CGAP 2010.

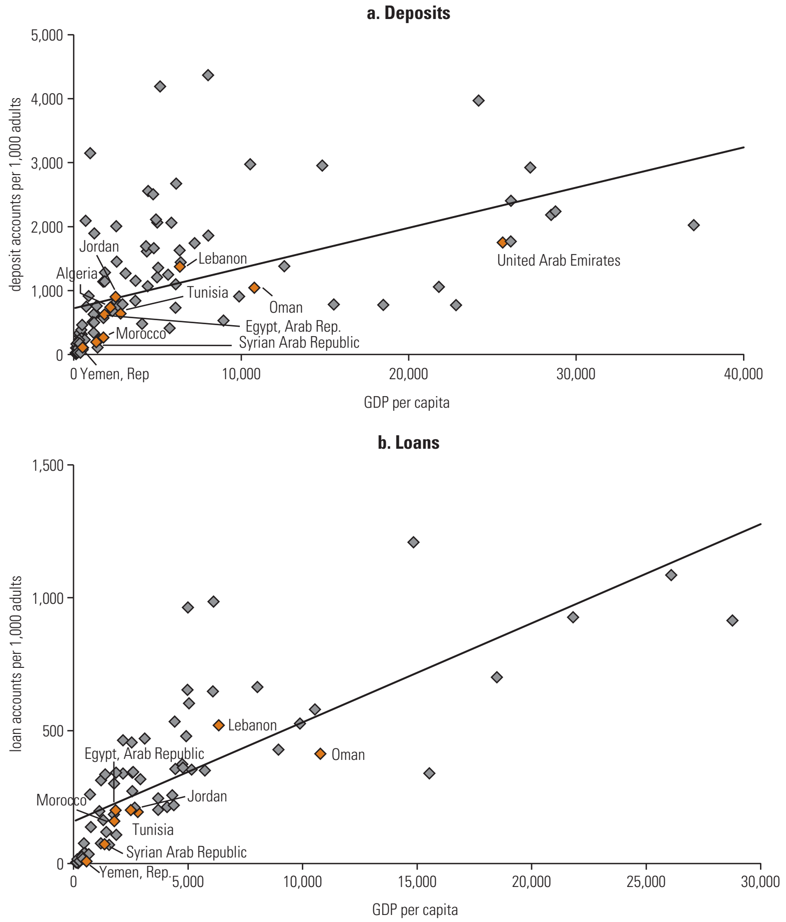
Most countries in the region compare even more poorly with other regions considering the large size of their deposits and credits relative to GDP. Figure 4.6 plots the number of deposit accounts per 1,000 adults against the ratio of deposits to GDP. Figure 4.7 plots the number of loan accounts per 1,000 adults against the ratio of private credit to GDP. Both figures show a positive association between these variables, but most countries in the region fall well below the regression line. This result is revealing, reflecting the lack of a close correlation between depth and access in MENA and the comparatively large average value of deposits and loans in the region. It is noteworthy that Lebanon's large deposit base is not matched by a commensurate number of deposits, possibly reflecting the large average value of deposits of nonresidents.

Postal savings banks and post offices are important providers of savings and payment services for the low-income population in MENA. Several countries in the region, including Egypt, Morocco, Tunisia, and the Republic of Yemen, have postal networks that provide financial services to the population. The financial services provided by the Moroccan post office are being transferred to a new postal bank created with the objective of expanding banking services in remote areas. If the accounts of these postal offices and banks were included, deposit penetration figures would improve significantly for these countries, but the benchmarking sample would need to include the deposits of postal offices and banks, as well as the deposits in savings and credit cooperatives in all the other countries, to ensure a fair comparison.[2]

Mobile phone banking, which could significantly increase banking penetration, has not yet taken off in MENA. Promising countries for

FIGURE 4.5

Correlation between Number of Bank Deposit and Loan Accounts per Adult and GDP per Capita in the Middle East and North Africa, 2009

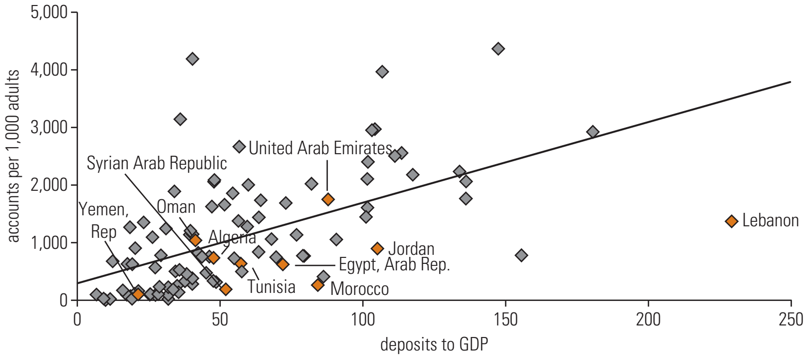


Source: World Bank staff calculations based on data from CGAP 2010 and World Bank 2010.

mobile banking include Egypt, Jordan, Morocco, Tunisia, and the Republic of Yemen, all of which have large rural populations and high mobile penetration, but few mobile phone–based financial services have been launched. However, regulators in high-potential markets such as Egypt and Morocco are starting to ease regulatory constraints and allow banks to link with mobile operators to launch financial services through mobile phones. An emerging example of the harnessing of technology in MENA is the use of electronic wallets linked to cards and mobile phones that can be used to withdraw cash, pay bills, make deposits, and send or receive money transfers.[3]

FIGURE 4.6

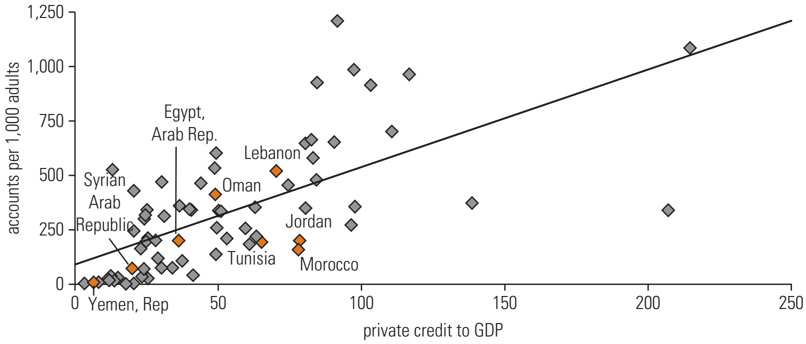
Correlation between Number of Deposit Accounts and the Ratio of Deposits to GDP, 2009



Source: World Bank staff calculations based on data from CGAP 2010 and World Bank 2010.

FIGURE 4.7

Correlation between Number of Loan Accounts and Ratio of Credit to GDP, 2009



Source: World Bank staff calculations based on data from CGAP 2010 and World Bank 2010.

Loan Concentration Ratios

MENA has a high average loan concentration ratio, measured as the ratio of the top 20 exposures to total equity.[4] The average loan concentration ratio outside of the Gulf Cooperation Council (GCC) is the highest in the world, reflecting the focus of banks on large enterprises and the concentrated loan portfolio of many banks in the region (figure 4.8). The average loan concentration ratio in the GCC is somewhat lower, reflecting the region's greater progress in developing retail lending, especially consumer loans, as well as the larger equity base.

However, the GCC ratio is still high by international comparison, reflecting large loans to real estate developers and companies in the oil and gas sectors and the lack of progress in developing small and medium enterprise and mortgage lending. In both regions, high loan concentration reflects the existence of long-established connections between large banks (both public banks and family-controlled private banks) and large enterprises and economic groups that has been documented in other reports (World Bank 2009).

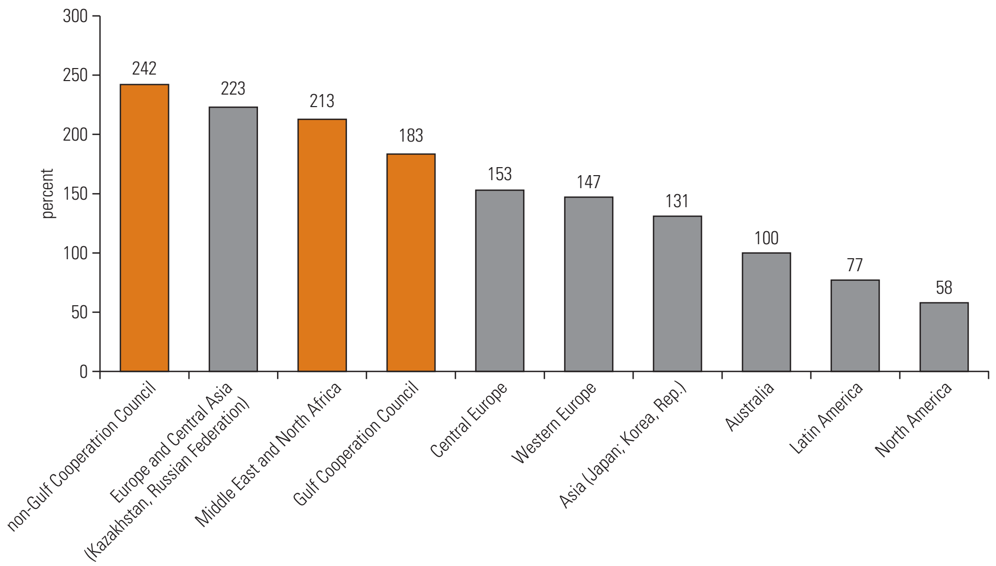
The ratio of top 20 exposures to total loans—arguably a better measure of access[5]—is also higher in non-GCC countries (figure 4.9). (These ratios are not available for regions other than MENA.) High loan concentration could imply that even some large enterprises face restricted access to credit, as noted in figures 4.1–4.3. However, the individual ratios reveal that loan concentration is also associated with little progress in developing business lines such as small and medium enterprise lending and mortgage finance.

Small and Medium Enterprise Lending

Lending to small and medium enterprises is expanding in MENA, but it still accounts for only a small share of the loan portfolio in many coun-

FIGURE 4.8

Top 20 Loan Exposures as a Percentage of Total Equity, by World Region

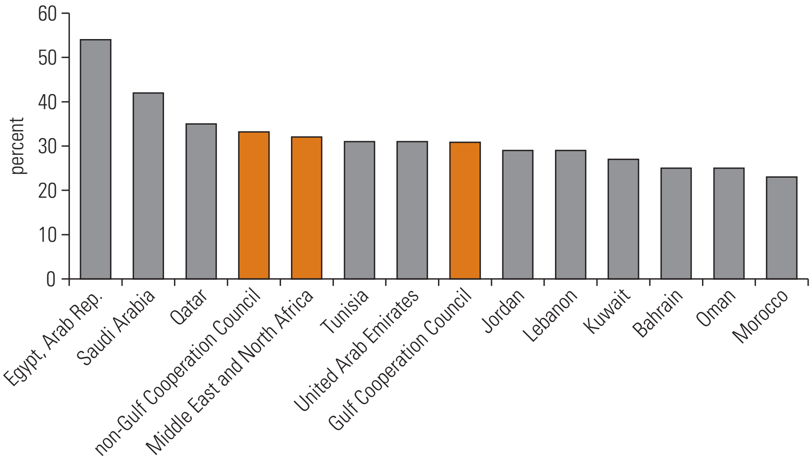


Sources: Standard & Poor's 2005a, 2005b, 2007, 2010.

Note: Data are regional averages computed between 2005 and 2010.

FIGURE 4.9

Top 20 Loan Exposures as a Percentage of Total Loans in the Middle East and North Africa, by Country, 2010



Source: Standard & Poor's 2010.

tries. The average share of small and medium enterprise loans in total loans is only 8 percent for the region as a whole, a low ratio by comparison with other benchmark groups of developed and developing countries (figure 4.10). The average share of small and medium enterprise lending in the GCC region is still very small, amounting to only 2 percent of total loans. The average share in the non-GCC countries is higher, at 13 percent of total loans, but it is still lower than the ratio in other comparator groups.

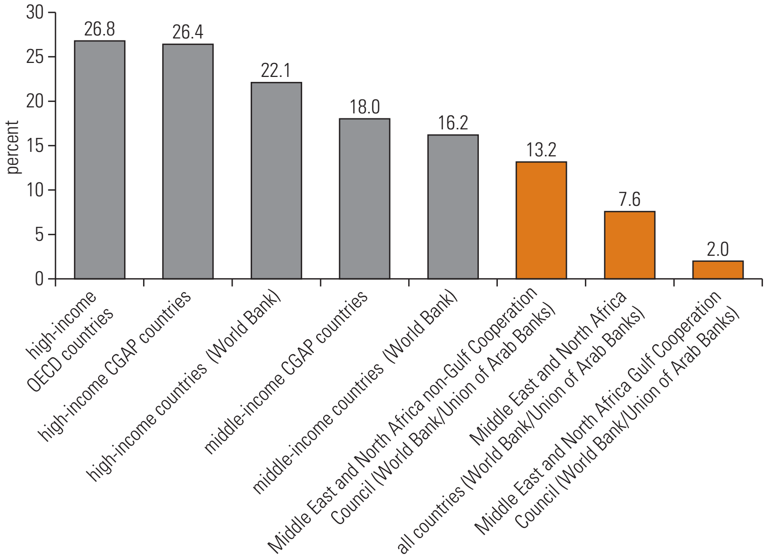
There is a wide dispersion in the share of small and medium enterprise loans among non-GCC countries. In contrast, the share in the GCC is low across all countries (figure 4.11). The share of small and medium enterprise loans ranges from 4 to 24 percent of total loans among non-GCC countries, with Morocco, Lebanon, and Tunisia among the top lenders; the share of small and medium enterprise loans in total loans is small in Egypt and the Syrian Arab Republic.

The various access indicators portray a very consistent picture of the status of small and medium enterprise lending in the region. For example, among non-GCC countries, Lebanon and Morocco have lower loan concentration ratios and the largest shares of small and medium enterprise loans in total loans, as shown in figures 4.9 and 4.11.

Also worthy of note is the broad consistency between the results of enterprise- and bank-level surveys in figure 4.12. This comparison is available only for non-GCC countries (no enterprise surveys have been

FIGURE 4.10

Small and Medium Enterprise Loans as a Percentage of Total Loans, by Country Group, 2005–09

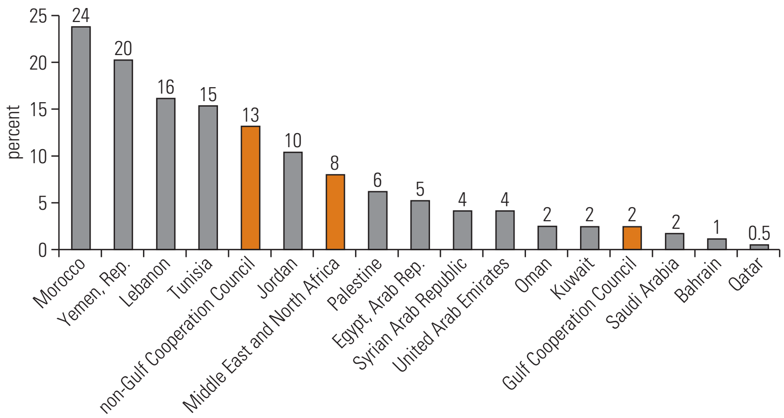


Source: World Bank staff compilation based on data from IFC 2010b; CGAP 2010; Beck, Demirgüç-Kunt, and Martinez Peria 2008; Rocha and others 2011.

Note: Group averages computed.

FIGURE 4.11

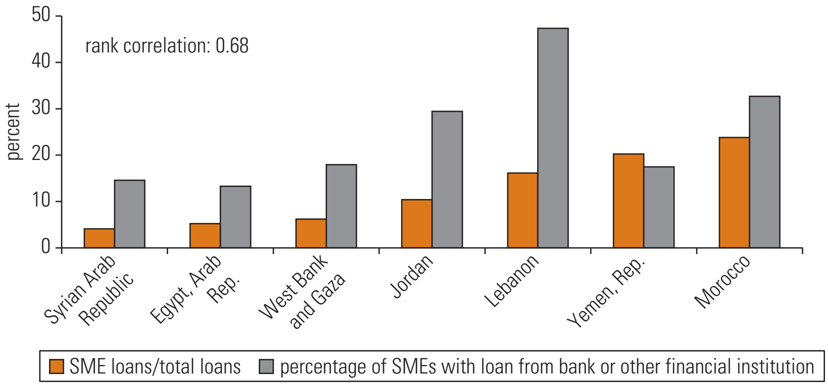
Small and Medium Enterprise Loans as a Percentage of Total Loans in Selected Economies in the Middle East and North Africa, 2009



Source: Rocha and others 2011.

FIGURE 4.12

Loans to Small and Medium Enterprises as a Percentage of Total Loans and Share of Small and Medium Enterprises with Loans from a Bank, in Selected Economies in the Middle East and North Africa



Source: Rocha and others 2011.

Note: SMEs = small and medium enterprise, SME lending in non-Gulf Cooperation Council Middle East and North Africa: Results from two surveys.
SME loans/total loans, 2009; SMEs with loan: average of enterprise surveys, 2005–10.

conducted in GCC countries), but in general, the countries with the largest share of small and medium enterprises with a loan from a bank are also those with the largest share of small and medium enterprise loans as a percentage of total loans (for example, Lebanon and Morocco).

The differences in lending to small and medium enterprises across countries in the region reflect differences in economic structures as well as differences in financial infrastructure and the scope and nature of policy interventions. The differences between the GCC and non-GCC averages reflect the more concentrated structures of oil economies. But other factors also explain the differences across the two regions and individual countries, including the quality of financial infrastructure; the active role of state banks in some countries, such as Crédit Populaire du Maroc; and the existence of special support mechanisms, such as partial credit guarantee schemes. The factors restraining small and medium enterprise finance and the effectiveness of policy interventions are examined in more detail in chapter 5.[6]

Mortgage Lending

Residential housing finance has started to develop only recently in MENA, at least as a market-based activity. Without taking into

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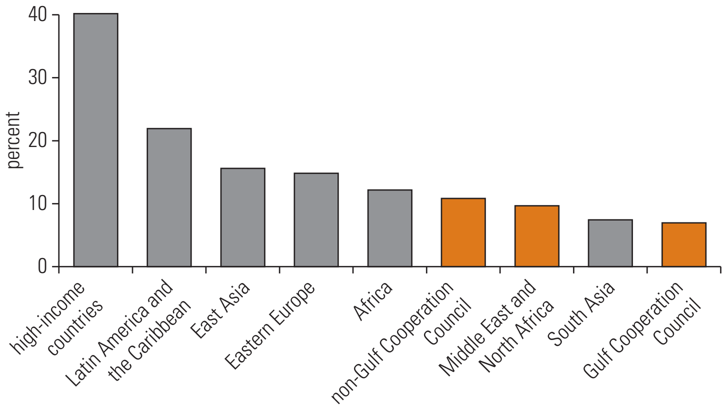
account housing loans directly extended to nationals by government agencies and financed from the budget (a common practice in GCC countries), most countries are still in the infancy phase of market development. The region lags other regions of comparable and even lower income levels (figure 4.13). The lack of adequate mortgage lending is cause for concern, given the region's young population and large housing needs.

Within MENA there are significant differences in the stage of market development. Residential housing loans as a share of GDP and total lending are highly correlated with per capita income and other structural characteristics and therefore amenable to more rigorous benchmarking. Kuwait, Morocco, and Tunisia seem to have made more progress in developing this important business line. Lebanon, Jordan, and the United Arab Emirates have also made progress, although they seem to be performing below their potential (figure 4.14). Note that progress in developing residential housing finance is also correlated with the loan concentration ratios shown in figure 4.9.

Several countries in the region are at an earlier stage of market development, in some cases because of direct financing by the government and the industry's overreliance on nonresidential real estate lending. GCC countries provide subsidized loans to nationals. These programs have met a large share of housing needs, although they frequently entail waiting lists or rationing and can be poorly targeted.[7] Nonresidential real

FIGURE 4.13

Housing Loans as a Percentage of Total Loans, by World Region

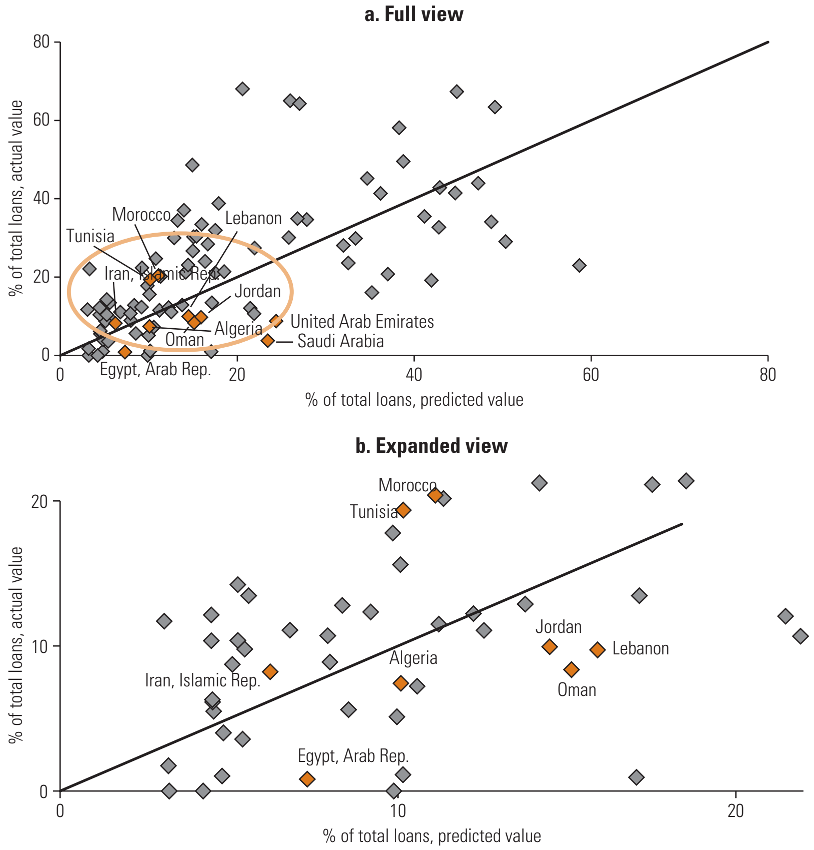


Source: World Bank staff calculations based on data from national sources and the World Bank Housing Finance Unit database.

Note: Data are regional averages computed on 2010 figures or latest available year.

FIGURE 4.14

Actual and Predicted Volume of Housing Loans as a Percentage of Total Loans, 2009



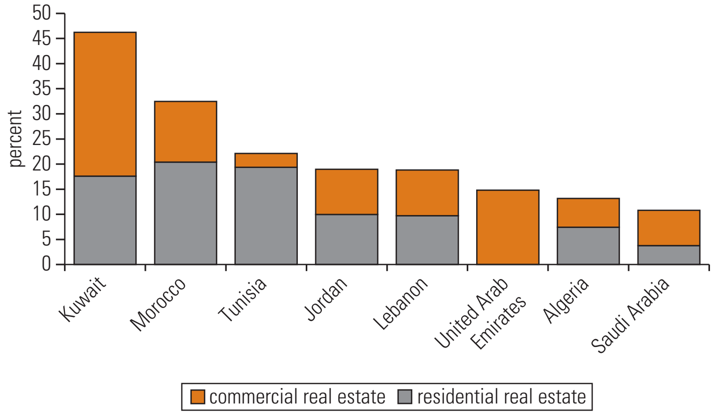
Source: World Bank staff calculations based on data from national sources and the World Bank Housing Finance Unit database.

estate lending (the financing of developers and commercial real estate) is significant in some countries (figure 4.15). This mode of real estate lending can meet the needs of enterprises and households, but it entails much greater risks, as a result of the much larger size of individual loans, the greater risk of mismatches between supply and demand, and the risk of connections between lenders and developers, which increases credit risk at loan origination.

Residential housing finance is a fundamental component of a broader housing finance system. A well-functioning mortgage finance system contributes to both improved access and the mitigation of the risks associated with real estate lending. Developing this system is challenging, however, and still lies ahead for several MENA countries.[8]

FIGURE 4.15

Residential and Commercial Real Estate Loans as a Percentage of Total Loans in Selected Countries in the Middle East and North Africa, 2009



Source: Hassler 2011.

Chapters 5 and 10 examine the problems related to mortgage finance and the roadmap for market development.[9]

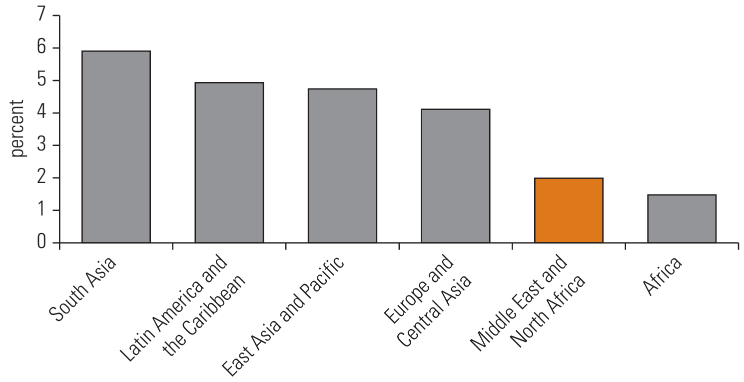
Microcredit Outreach

The outreach of microcredit institutions remains limited. The coverage ratio of specialized MENA microfinance providers is only 1.8 percent, half the proportion in South Asia or Latin America (figure 4.16). The low penetration reflects the limited volume of microcredit relative to GDP and to total bank credit, as shown in chapter 3. The proportion of women clients in MENA (more than 60 percent) is higher than in all regions except Asia (figure 4.17), but the value of this achievement is reduced by the limited total outreach.

Very few countries in MENA have achieved coverage ratios comparable to those in other regions. Morocco and Jordan have achieved high rates of access to microcredit, in line with averages in other regions (figure 4.18). The growth of microcredit in Morocco was impressive, although the foundations for this rapid expansion proved to be flawed. A weak credit information system did not allow microfinance institutions to detect and control multiple borrowings, and the industry structure was too heavily based on nongovernmental organizations, which lacked transparency, sound governance structures, and risk management capacity. The regulatory framework for the Moroccan microcredit sector is being overhauled. Its experience provides valuable lessons for other countries.[10]

FIGURE 4.16

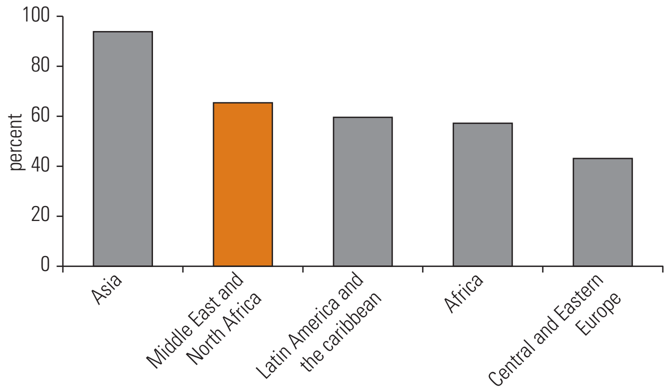
Active Microcredit Borrowers as a Percentage of the Working-Age Population in Selected World Regions, 2009



Source: World Bank staff compilation based on data from Micro Finance Information Exchange (MIX) and World Bank.

FIGURE 4.17

Percentage of Women Microcredit Borrowers in Selected World Regions, 2009



Source: World Bank staff compilation based on data from Micro Finance Information Exchange (MIX) and World Bank.

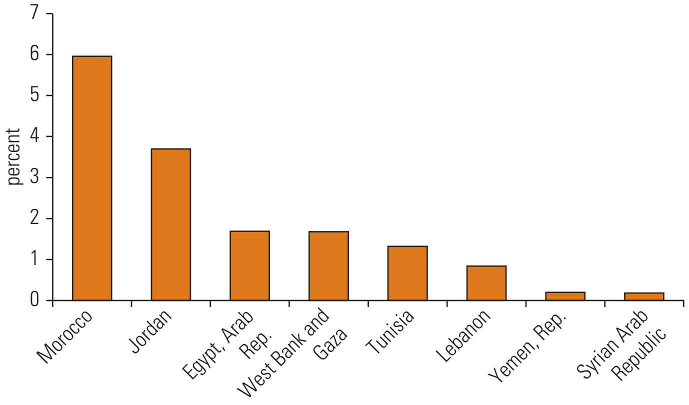
Access to Other Financial Services

Investment and Long-Term Finance

Investment lending in the GCC is frequently provided by specialized state banks or institutions. Commercial banks also participate, through syndications, although the extent of their involvement is difficult to assess, because of deficiencies in data reporting. Specialized

FIGURE 4.18

Active Microcredit Borrowers as a Percentage of the Working-Age Population in Selected Economies in the Middle East and North Africa, 2009



Source: World Bank staff compilation based on data from Micro Finance Information Exchange (MIX) and World Bank.

state institutions do most of the long-term lending in the GCC. Private banks participate in loan syndications and usually benefit from some government guarantee. Deficiencies in data reporting do not allow an accurate assessment of the maturity of investment loans, but most private banks do not seem to extend loans beyond five years. Many of these loans are provided at floating rates, exposing the borrower to interest rate risk. Some large institutions have issued corporate bonds/*sukuk*s, but they do not constitute a regular source of investment finance.[11]

Outside the GCC, the role of state banks in investment finance varies significantly across countries. In systems dominated by the state, state banks provide most investment lending. For example, the Commercial Bank of Syria provides 95 percent of investment loans in Syria. State banks are also involved in other countries such as Morocco, where the Caisse de Depôts e Gestion and Crédit Populaire du Maroc provide investment lending and organize syndicates with private banks. In countries without state banks (Lebanon, Jordan), private banks provide all long-term finance. Smaller loans are provided directly; larger loans are provided through syndications (to diversify risks and comply with limits on large exposures). Loan maturities vary from three to seven years but usually do not exceed five years. Banks typically charge the London interbank offered rate (LIBOR) plus a premium.

It is difficult to measure the degree of access to investment finance from bank data, because of deficiencies in financial reporting and disclosure rules. Enterprise surveys indicate that MENA banks provide a small contribution to investment finance relative to banks in other regions (see figure 4.3). Bank financial statements do not provide information on maturities and business lines, preventing an accurate assessment of investment finance from the side of banks (and revealing a deficiency in financial reporting). The limited information available suggests that most large enterprises have access to term finance and that state banks play an important role in this area, especially regarding state enterprises. State banks have been more willing to provide longer tenors and charge fixed rates, whereas private banks usually limit their exposures to five years and charge variable rates. Several state banks are also active with small and medium enterprises: the average share of investment loans in small and medium enterprise loans is 32 percent for state banks and 22 percent for private banks (Rocha and others 2011).

Risk Management

Access to risk management tools is restricted in MENA, limiting private bank participation in some important areas and creating large risk exposures. Long-term funding instruments are not developed, leaving banks and enterprises exposed to interest rate and liquidity risks when they lend long term. Some countries (Egypt, Jordan) have introduced mortgage refinance corporations to deal with these risks, but these arrangements are limited to mortgage finance. In the absence of these arrangements, private banks take defensive positions, shortening their exposures or shifting some of these risks to their customers. Interviews with bank managers and regulators suggest that private banks in MENA are increasing their share of long-term lending for investment and housing. Monitoring and managing these risks will be one of the key challenges faced by regulators in the coming decade, as discussed in chapters 7 and 10.

Emerging derivatives markets have grown rapidly all over the world, but they are a missing market segment in MENA, with meaningful trading only in Bahrain, Saudi Arabia, and the Dubai International Financial Center.[12] Daily turnover of foreign exchange derivatives amounted to US$3.8 billion in Bahrain in 2010, with US$3.6 billion in foreign exchange swaps, a significant increase over previous years. In Saudi Arabia, daily foreign exchange derivatives trading amounted to US$2 billion in 2010, with nearly US$1.3 billion in foreign exchange swaps. Interest rate derivative turnover is very modest in the region.

The foreign exchange derivatives market is the most developed derivative market segment in most emerging economies. It has failed to develop in MENA for a variety of reasons. Most countries in the region have longstanding exchange rate pegs and impose restrictions on capital flows or nonresidents' transactions in local currency, and shallow local capital markets are unattractive to foreign investors who would use foreign exchange derivatives as hedging, speculative, or funding instruments in these markets. Interest rate derivatives are a smaller segment than foreign exchange derivatives in emerging economies, but they have been growing rapidly. Interest rate derivatives are used only sporadically in MENA countries, however, as a result of the lack of deep underlying money and bond markets, benchmark yield curves, and the limited presence of foreign investors in these embryonic local fixed-income markets.

Notes

1. Egypt and Tunisia introduced stock exchanges for small and medium enterprises (NILEX and Marché Alternatif), in an effort to facilitate access by reducing costs and loosening stringent criteria; neither market is particularly active (see chapter 9).
2. MENA countries do not have savings and credit cooperatives, an important sector in many emerging regions, such as Latin America and Central Europe.
3. Pearce (2011) provides a comprehensive analysis of financial inclusion in MENA.
4. The concept of adjusted total equity is elaborated in Standard & Poor's (2004, 2005a, 2005b, 2007). The authors are grateful to the Paris office of Standard & Poor's for the updated figures for MENA reported in figure 4.8.
5. The risks associated with high loan concentration can be offset by a large equity base, leading to lower ratios of the top 20 exposures to equity. However, high loan concentration implies restricted access to credit, especially by small and medium enterprises and individuals, which is captured in the ratio of top 20 exposures to loans, regardless of the size of equity.
6. Rocha and others (2011) provide an analysis of small and medium enterprise lending in MENA based on a joint survey conducted by the Union of Arab Banks and the World Bank.
7. In Saudi Arabia the ratio of nonperforming loans reached 36 percent of total loans in 2006, and there were 450,000 waiting applicants and a 12-year waiting period (World Bank 2006).
8. Egypt has made substantive progress in recent years; Saudi Arabia has started facing this challenge through a comprehensive package of mortgage lending recently prepared by the government.
9. Hassler (2011) provides a detailed analysis of housing finance in MENA.
10. Pearce (2011) provides a detailed analysis of financial inclusion, including the microcredit industry.
11. Large wholesale banks in Bahrain also organize long-term finance for large projects in the GCC, mostly in real estate. The most popular form of project

finance is the special purpose vehicle model. The lead bank identifies a project, raises equity contributions from high-net-worth investors, establishes a special purpose vehicle in which it typically holds a 5 percent stake, and uses the proceeds to finance the project. The special purpose vehicle subsequently raises additional financing from other wholesale banks.

12. The triennial survey of foreign exchange and derivatives markets conducted by the Bank for International Settlement tracks over-the-counter foreign exchange and interest rate derivatives. Of the 53 central banks that participated in the 2010 survey, only two (Bahrain and Saudi Arabia) were in MENA.

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