



DEVELOPING MICRO, SMALL & MEDIUM ENTERPRISES IN JORDAN: THE ROUTE TO SHARED PROSPERITY

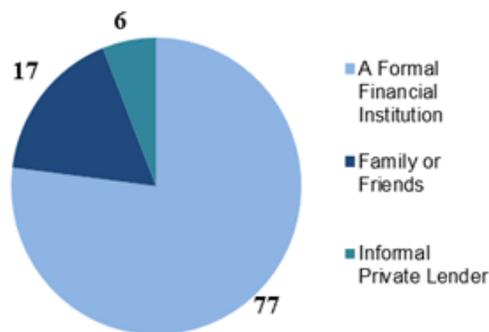
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Introduction - Inclusive Economic Growth: A Key Priority for Jordan: The Arab uprisings and the global financial and economic slowdown have negatively impacted the Jordanian economy and highlighted demands for a more level economic playing field and equity in access to economic and social opportunities. Already challenged in providing jobs to the more than 60,000 youth who enter the labor market annually, Jordan has seen unemployment rising. Youth and women were most affected, with unemployment, reaching 22.8 percent and 22.3 percent, respectively. Moreover, regional disparities continue to pose additional challenges. Limited private sector jobs are available in the outlying governorates, where employment relies largely on the civil service and other public sector jobs. At the same time, the private sector is hampered by difficulties in the business environment and inadequate access to finance.

Job creation and economic inclusion are key priorities for Jordan today – these goals will be advanced by improving access to finance, enhancing competitiveness, and fostering sustainable, private sector-led growth. To face the central challenge of unemployment, it is critical to promote private sector investment and encourage fast-growing micro, small and medium enterprises (MSMEs), the most significant employment generators. MSMEs are major contributors to the Jordanian economy, enhancing its competitiveness and creating

jobs.² There are around 150,000 registered enterprises in Jordan and MSMEs account for over 99 percent. The majority of jobs are generated through MSMEs, employing around 71 percent of private sector employees, with SMEs accounting for 32.7 percent and 38.7 percent for microenterprises. MSMEs are also a leading source of exports in Jordan and play a key role in the shift to high-value growth sectors. This is initially achieved through enterprise creation and then through provision of services and inputs, and increasing productivity by adopting and applying innovations.

Figure 1: Sources of Loans in Jordan (2012)
(percent)



Source: Investment Climate Survey 2012, The World Bank

Access to Finance for MSMEs in Jordan: Smaller firms in Jordan grow at faster rates than larger ones and create more new job opportunities; however, they are confronted with numerous hurdles. Inadequate access to finance is frequently cited as one of the main constraints. Financial intermediation, in

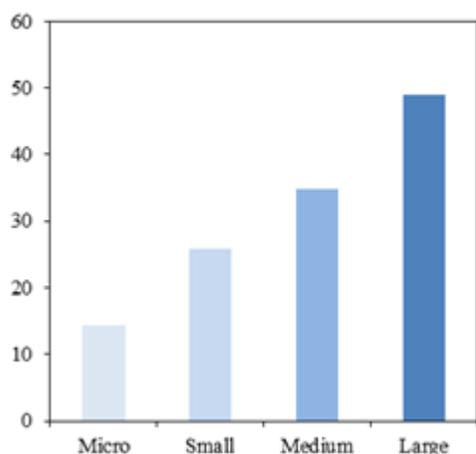
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² SMEs are defined as those firms with between 5 and 100 employees, and microenterprises as enterprises with less than five employees.

general, is very low in Jordan compared to other developing economies. Access to finance is substantially more of a challenge for MSMEs than it is for large firms. The financial system is dominated by the banking sector, which is less competitive and plays a limited role in financial intermediation, compared to other MIC countries.³ Enterprises often resort to the informal sector or family and friends for needed finance (Figure 1). Private sector credit-to-GDP is relatively low at 80 percent, which is largely allocated to large corporations.

The Jordanian Banking Sector and Access to Finance issues: Banks are the principal source of external finance for SMEs, yet, only 11 percent of bank lending goes to SMEs, compared to 25 percent in emerging markets. The 2012 Jordan Investment Climate Survey (ICS) shows large disparities in terms of access to credit by size of firms. Only 27 percent of small firms have a loan versus 38 percent of medium-sized firms and 53 percent of large corporates (Figure 2). In terms of physical outreach, overall branches are distributed in line with the population, although Governorates such as Irbid and Zarqa, both of which have active SME populations, are relatively less well served by bank branches compared to Amman.

Figure 2: Access to Bank Loans, by Firm Size



Source: Investment Climate Survey 2012, The World Bank

³ There are 26 commercial banks, including four Islamic banks, offering *Shari'a* compliant products. At the same time, non-bank financial institutions (NBFIs) are underdeveloped and are playing a limited role in financial intermediations.

In addition to regulatory hurdles, on the supply side, few banks have established dedicated SME departments or have the capability to lend to SMEs. Several banks rely primarily on collateral-based lending rather than creditworthiness, leaving creditworthy SMEs unfinanced. Most loans require collateral, equal to approximately 23 percent more than the loan amount, with small firms reporting to be providing higher collateral than large firms. Moreover, the enforcement of basic contractual rights is cumbersome, time consuming and costly, representing a significant disincentive when lending to SMEs. To address this issue, several Jordanian banks use internal rating systems for SME lending based on a financial and qualitative analysis of SMEs. However, banks often use outdated techniques that do not effectively help in risk management or in lowering costs. Another challenge revealed by the World Bank's recent enterprise survey (2012) is that SMEs often refrain from applying for bank loans due to their religious discomfort with interest-based borrowing. There has been a growing demand for *Shari'a* compliant financial products in Jordan, however, these are offered by only a limited number of banks.

On the demand side, MSMEs do lack necessary business skills. They often do not have sufficient knowledge of financial products on offer and when they do, they do not always have the skills to fill out loan application forms. Furthermore, they usually lack the funds to have audited financial statements or the collateral for a loan.

Recent Reforms to Develop MSMEs: Despite these challenges, there is, nevertheless, potential for growth of the MSME sector in Jordan. Jordanian authorities have recently made significant strides to improve the enabling environment for MSMEs, including steps to improve SMEs access to finance. Key steps that have been taken include:

- Strengthening the capacity of financial institutions, banks, and Non-Governmental Organizations (NGOs)-MFIs, to enhance MSMEs access to finance.

- Finalizing a partial guarantee scheme with the US Overseas Private Investment Corporation (OPIC), which was led by the Ministry of Planning and International Cooperation, aiming at improving access to finance for medium enterprises.
- Preparing a National Startups and MSME Strategy, that is led by the Jordan Enterprise Development Corporation (JEDCO).
- Improving the business environment for SMEs, especially fast-growing innovative ones through regulatory reforms related to red tape, etc.
- Approving basic mobile phone payments, and the enactment of its guidelines.
- Working on adopting a comprehensive secured transactions law and the development of a collateral registry.
- Under a new revitalized management, the Jordan Loan Guarantee Corporation (JLGC) has refocused its attention on SME lending, developed a new Islamic product, and signed new agreement with three banks to extend guarantees to their SME lending.
- Strengthening the financial institutional infrastructure, including, lowering the threshold for reporting to public credit registry.
- In the process of establishing the first private credit bureau that would help in improving banks financial intermediation, and enhance the accuracy and timeliness of the information on client credit worthiness.
- Issuing Circular No. (10/5/436) dated 2011, setting a standard definition for SMEs.
- Modernizing the reporting and monitoring system for banks.
- Enhancing the capacity of banks to enable them to increase their share of lending to the MSME segment through adopting more advanced transaction-lending techniques.
- Licensing of new bank branches in Governorates that were underserved to reach out to the marginalized segment of enterprises.
- Entry of new Islamic banks to cater the growing needs for *Sharia* compliant products.
- The Association of Banks in Jordan has also developed a directory of products and services provided by banks operating in Jordan with a specific section dedicated to MSME products.
- Issuance of “Treating Customers Fairly Instructions”, which aims at enhancing consumer protection.

The building blocks above have contributed to MSMEs growth and expansion in Jordan, and resulted in the emergence of a more positive enabling environment, which should help these enterprises in contributing to job creation, and overall economic growth.

World Bank Lending Support to MSMEs in Jordan: The World Bank is committed to this sector, most recently through the *Jordan MSME Development for Inclusive Growth* project which provided a US\$70 million loan to the Government of Jordan in 2013. The project aims at contributing to the improvement of access to finance for MSMEs in Jordan. Through improved financial intermediation, the project enhances the creation of private sector job opportunities, contributing to inclusive economic growth and supporting poverty eradication efforts. Governorates outside Amman were given special emphasis to promote growth in these districts to address the issue of regional disparities.

The Project will also enhance the banking system’s capacity to evaluate the effectiveness of its MSME support; improve the incentives for banks to expand into MSME lending; incentivize and support the design of new financial products, including Islamic products; and ensure better opportunities for rural and underprivileged areas to meet citizens’ needs and establish income-generating projects for sustainable and balanced development. Moreover, the project will contribute to achieving inclusive growth through addressing gender disparities Women suffer more from constrained access to finance compared to men and the project aims to mainstream gender both through its main component as well as by

Box 1: Women's Access to Finance in Jordan-Supporting Gender Mainstreaming

The female labor force participation rate in Jordan is among the lowest in the region and in the world, at around 15 percent. The situation is particularly difficult for young women, whose unemployment rate is 36 percent compared to 19 percent for young men. Young women account for only nine percent of the economically active population. Moreover, regional disparities persist, as Jordan lags behind in female representation in employment in nonagricultural sectors.

While access to finance remains a business constraint for both men and women, evidence suggests that women face higher hurdles, particularly for those who own MSMEs. Women suffer more from constrained access to finance compared to men in the cost of finance, in gaining approval for financing, or in legal disputes and conflict resolution in case of bankruptcy. In addition, banks request stricter collateral requirements when dealing with women who are perceived as higher risk. Women often have difficulty in providing collateral. Although the law gives women ownership rights they often lack independence in managing these assets. In the credit market, limited access by women precludes learning about their potential performance as borrowers, including their ability to repay. Social norms exacerbate this problem.

Through its gender mainstreaming, the MSME Development for Inclusive Growth Project will contribute to promoting women's economic empowerment. This is especially important in the microfinance sector, as women entrepreneurs account for 71 percent of all microfinance clients. The project both mainstreams gender through the main components, as well as, directly targets women through some innovative sub-components such as designing new products that target women, encouraging banks to have special windows for women, especially in the marginalized governorates where there are more social barriers. Other new products such as Islamic financing will also significantly benefit women. Enhancing the active participation of women in entrepreneurship activities and giving them access to markets is essential, as it leads to a rise in the number of economically active members in the society and will ultimately result in long-run economic prosperity.

specifically targeting women through its innovative sub-components (Box 1).

Moving Forward: Additional steps are needed to strengthen develop the MSME sector in Jordan. Banks and other financial institutions need to develop a more sophisticated approach to SME financing, with specialization in market segments, and the introduction of products such as factoring and start-up or risk finance. The Government and financial regulators need to support financial institutions with effective supervision. Also, regulators need to develop a more effective framework for consumer protection as more microenterprises and SMEs make greater use of the new financial services.

The World Bank is working closely with the Jordanian authorities and stakeholders in meeting the aspirations of the people for equal access and opportunities, as well as improved standards of living and maintaining social stability in previously marginalized areas and among the underserved segments of society.

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