



Microfinancing Palestine Under a Restricted Regional Economy

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Microfinancing Palestine Under a Restricted Regional Economy

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Abstract

Political instability, conflict, sanctions, and regulatory constraints have been a common characteristic of the Palestinian economy for the better part of the 20th and 21st centuries. Nowhere are the impacts of the political instability and sanctions felt more than in the region's credit market. Credit availability and financial inclusion in Palestine are some of the lowest among comparative, developing economies worldwide. However, it is notable that despite the geopolitical complexities and restrictions on Palestine's economy, the region's microfinance sector continues to achieve positive financial performance.

The Palestinian microfinance industry emerged in the 1980s and gradually grew into one of the fundamental pillars of the Palestinian economy today. The industry provides a critical supportive structure for the region's private sector and the vast majority of medium- and small-sized enterprises. Nevertheless, there is a dearth of literature that explores the dynamics involved in the historical growth of the industry. The extant research also pays little attention to the impact of sanctions and regulatory constraints on the performance of Palestinian microfinance.

This thesis seeks to fill the said gap in the current body of knowledge by leveraging the tools of historical and document analysis. Of interest to the analysis herein are four lines of inquiry, namely:

- the growth, development, and performance of Palestine's microfinance sector;
- the impact of the microfinance sector in Palestine;
- the exogenous and endogenous factors influencing the performance of Palestine's microfinance sector; and
- the limitations currently experienced by the region's microfinance industry and the potential, pertinent solutions.

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Chapter I

Contextual Setting

The Occupied Palestinian Territories, also called the Palestine Territories or simply Palestine, consist of three geographic areas in the Middle East region: East Jerusalem, the West Bank, and the Gaza Strip. The name Palestine formally describes these three areas of the Middle East that have been occupied by the Israeli government since the Six-Day War in 1967.¹ Following several dialogues between the Israeli government and the Palestine Liberation Organization (PLO) at Oslo in 1993, the territories were given limited political and economic autonomy under the administration of the Palestine National Authority (PNA).² At the same time, Israel continues to maintain complete civil and military control over more than 60% of the West Bank area.

Since the signing of the Oslo Accords in 1993, Palestine has experienced a prolonged period of political volatility characterized by a perpetuation of military conflicts that have drawn extensive investigations by scholars in the academic world at large. Whereas the extant research on Palestine reveals in-depth explorations of the political and social contexts of Palestine, it also shows that scholars have paid little attention to the dynamics of the Palestinian economy and its underlying business

¹ Adi Ophir, Michal Givoni, and Sārī Ḥanafī, eds., *The Power of Inclusive Exclusion: Anatomy of Israeli Rule in the Occupied Palestinian Territories* (New York: Zone Books, 2009), 15.

² Paolo Di Martino, and Shaker Sarsour, “Microcredit in Palestine (1995–2008): A Business History Perspective,” *Business History* 54, no. 3 (2012): 444.

environment.³ Notably, the existing literary material on Palestine largely neglects two fundamental thematic areas that are critical to a sufficient comprehension of the Palestinian economic context.

The first neglected subject area concerns the impact of restrictions and sanctions on the economy of the Palestinian territories. Since 1967 when Israel first occupied East Jerusalem, the Gaza Strip, and the West Bank, it has undertaken incremental military and economic measures that have been detrimental and inhibitive to various sectors of the Palestinian economy.⁴ The little empirical evidence that is available shows that Israel's restrictive measures have resulted in several negative economic consequences for Palestine, including economic disequilibria, underdevelopment, and irreversible de-development in some cases.

The second neglected scholarly topic in terms of the Palestinian economy concerns the development of the credit sector, in particular the nature and dynamics of the economy's microfinance and microcredit institutions.⁵ The dearth of knowledge about this second area of interest inhibits a broader understanding of the Palestinian economy, given that there is a robust body of scholarly evidence showing that the credit sector has a critical and active role in fostering macroeconomic performance.⁶ Specifically, developing countries like Palestine do not conform to the loci used in the vast majority of macroeconomic studies, which typically focus on the formal banking system and the

³ Ophir, et al., *The Power of Inclusive Exclusion*, 17.

⁴ Ophir, et al., *The Power of Inclusive Exclusion*, 17.

⁵ Di Martino and Sarsour, "Microcredit in Palestine," 445.

⁶ Nigel Parsons, and Mark Salter, "Israeli Biopolitics: Closure, Territorialisation and Governmentality in the Occupied Palestinian Territories," *Geopolitics* 13, no. 4 (2008): 701.

stock market in their explorations of a given region's credit sector. Rather, the functioning of the credit market in developing economies depends on the distinctive roles of not-for profit institutions, including microcredit institutions (MCIs).⁷

Scholarly interest in Palestine's microfinance and microcredit sectors is bolstered further by the fact that microfinance is undoubtedly a primary source of financing for the broader Palestinian economy. Palestine's informal sector accounts for 40% of the economy and employs approximately one-third of the region's working population located in the private sector.⁸ Additionally, 90% of the region's private sector is composed of small and medium enterprises (SMEs). Palestine's commercial banks are hardly involved in financing these SMEs, particularly those in the informal sector, thereby positioning microfinance at the forefront of financing the mainstay of the Palestinian economy. Furthermore, it is notable that despite the geopolitical complexities and the sanctions and restrictions on the Palestine economy, which cumulatively create a difficult business environment, the region's microfinance sector continues to achieve positive financial performance.⁹

Despite the incontestable scholarly relevance of the two topics expounded above, there is virtually no literature covering the development, dynamics, and impact of Palestine's microcredit and microfinance sectors. Even more scarce is information regarding how the region's microfinance industry has managed to grow, expand, and record positive performance under the current business environment that is crippled

⁷ Di Martino and Sarsour, "Microcredit in Palestine," 446.

⁸ Di Martino and Sarsour, "Microcredit in Palestine," 445.

⁹ Di Martino and Sarsour, "Microcredit in Palestine," 446.

substantially by sanctions and restrictions.¹⁰ This thesis seeks to fill that existing gap in the body of literature by combining micro and macro approaches to analysis, and by exploring the relationship between macroeconomic variables and the various factors at play within the microfinance industry in Palestine. It further focuses on the importance of interactions between the region's microfinance organizations and the corresponding performance at the industry level, based on case studies of three leading Palestinian MCIs: the Arab Centre for Agricultural Development (ACAD), Reef Finance Company, and Palestine for Credit and Development (FATEN).

The research spans the period between the Oslo Accords in 1993 and 2010. Although these seven years constitute a relatively short time frame, this period featured a sequence of significant economic, social, and political transformations within Palestine. Consequently, the time period is a good fit for a detailed study using various tools of historical analysis.¹¹ Furthermore, setting the study within a specific temporal context offers a clarity through which one can observe how microfinance and microcredit institutions respond to rapid changes in their external and internal environments.

The remainder of this introductory chapter sets a comprehensive context of the Palestine economy. The subsequent chapters of this thesis explore the evolution, influences, and impact of the Palestinian microfinance sector.

¹⁰ Di Martino and Sarsour, "Microcredit in Palestine," 446.

¹¹ Parsons and Salter, "Israeli biopolitics," 704.

The Geography of Palestine

The current geographical delineation of Palestine has two different areas: the Gaza Strip and the West Bank including East Jerusalem. Palestine's boundaries are based on the "Green Line" drawn according to the 1949 Armistice Agreements.¹² These agreements between the Military Coalition of Arab States and the declared State of Israel were instrumental to ending the 1948 war and hostilities over the former British colony of Palestine.¹³

The West Bank shares its eastern border with Jordan, where it is bound naturally by the Jordan River; it shares its northern, southern, and western boundaries with Israel. The Gaza Strip is limited to the south by its border with Egypt, and is bounded to its west by Mediterranean Sea.

Like the West Bank, the Gaza Strip shares its northern and eastern boundaries with Israel. Palestine covers a total land and water mass area of 6,220 square kilometers, with 5,860 km² in the West Bank and 360 km² in the Gaza Strip.¹⁴ The region's largest cities are Hebron, Gaza, Khan Yunis, and Nablus. Figure 1 below provides a map of Palestine in its current (2020) form.

¹² Parsons and Salter, "Israeli Biopolitics," 706.

¹³ Parsons and Salter, "Israeli biopolitics," 708.

¹⁴ Palestinian Bureau of Statistics (PCBS), *Palestine in Figures, 2017* (Ramallah: PCBS, 2018). Available from: <http://www.pcbs.gov.ps/Downloads/book2362.pdf>.

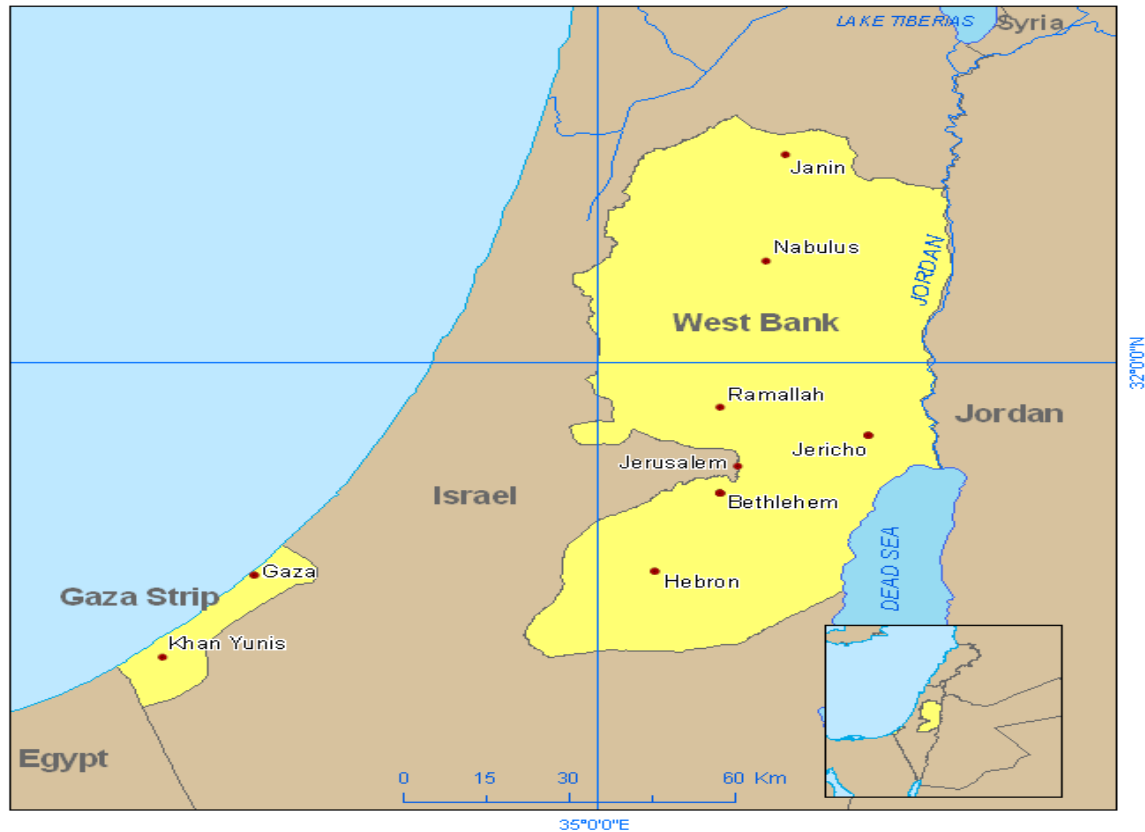


Figure 1. Palestinian Territories according to the Green Line Definition.

Source: PCBS, *Palestine in Figures*, 42.

Demographics

According to 2014 census data from the Palestinian Central Bureau of Statistics (PCBS), there were approximately 4.45 million Palestinian people residing in the Palestinian territories as of 2014.¹⁵ Of these, 1.7 million lived in the Gaza Strip, and 2.8 million lived in the West Bank.¹⁶ The United Nations estimates that nearly 1.2 million Palestinian refugees reside in camps within the territories of neighboring countries, while

¹⁵ PCBS, *Palestine in Figures*, 8.

¹⁶ George Leeson, "MENA: The Demography of Youth, the Demography of Aging," *Population Horizons* 14, no. 2 (2017): 35.

another estimated 5.6 million Palestinian refugees reside in foreign countries, not in refugee camps. The PCBS indicates that Palestine had a total population density of 654 persons per square kilometer as of 2014.¹⁷

Additionally, the U.S. Census Bureau indicates that Palestine has the fastest population growth in the region, approximately 2.4% annually, equating to a birth rate of more than four children born to every Palestinian woman.¹⁸ In addition, the Palestinian population is the most youthful in the region with individuals under the age of 14 years accounting for 40% of the total population, and those over 65 years constituting only 2.9%.¹⁹ The proportion of men to women in the Palestinian territories is roughly equal: the 2014 census estimates that men constituted 50.70% of the total population and women made up 49.30%.²⁰ Table 1 presents historical projections of population data based on UN estimates.

¹⁷ PCBS, *Palestine in Figures*, 58.

¹⁸ Leeson, "MENA," 37.

¹⁹ United Nations, *2017 United Nations Demographic Yearbook* (New York: UN, 2018). Available from: <https://unstats.un.org/unsd/demographic-social/products/dyb/dybssets/2017.pdf>.

²⁰ Leeson, "MENA," 38.

Table 1. Palestinian Population by Year.

Year	Population	% Male	% Female	Density (km ²)	Population Rank	Growth Rate
2019	5186.79	0.507103	0.492895799	833.89	121	0.026522846
2018	5052.776	0.507122	0.492880547	812.34	121	0.026835888
2017	4920.724	0.507135	0.492864668	791.11	121	0.027139847
2016	4790.705	0.507147	0.492852513	770.21	122	0.027412434
2015	4662.884	0.507157	0.492843485	749.66	123	0.027731671
2010	4066.829	0.507158	0.492841474	653.83	128	0.0260477
2005	3576.17	0.507134	0.492865272	574.95	130	0.021013131
2000	3223.009	0.506971	0.493031202	518.17	131	0.042481274
1995	2617.702	0.506631	0.493365937	420.85	134	0.044969627
1990	2100.883	0.50608	0.493919937	337.76	137	0.03622254
1985	1758.477	0.505591	0.49440567	282.71	141	0.031048174
1980	1509.183	0.505292	0.494710052	242.63	141	0.026928342
1975	1321.421	0.505328	0.494671267	212.45	142	0.032772917
1970	1124.649	0.505889	0.494111496	180.81	142	-0.01146273
1965	1191.384	0.507226	0.492768914	191.54	138	0.021854683
1960	1069.316	0.509661	0.490341489	171.92	138	0.015993492
1955	987.76	0.513375	0.486617194	158.8	137	0.01170481
1950	931.928	0.518789	0.481207776	149.83	136	0

Source: World Population Review, 3.

The overwhelming majority of the Palestinian population consists of Sunni Muslims, although a few Ahmadiyya Muslims reside in the West Bank. Christians make up roughly 1% to 2% of Palestine's population.²¹ The PCBS also estimates that the number of Jewish settlers in East Jerusalem and in the West Bank exceeded 600,000 by December 2014.²²

The official language of Palestine is Arabic. However, English and Hebrew are also widely spoken as the second or third languages of a significant proportion of the population.

Macroeconomic Context

The economy of the Palestinian territories is relatively small. According to 2016 economic data from the PCBS, the gross domestic product (GDP) of Palestine stood at about \$8 billion, with a GDP per capita of approximately \$2,279.²³ The growth of real GDP in the country has been extremely unstable in the last decade, given that such growth is outside the jurisdiction of the Palestinian Authority (PA) and is decided mostly by an unstable political environment and unpredictable donor support. An analysis of GDP trends over time shows that the instability of the political environment has had a substantial impact on the country's economic performance. As shown in Figures 2 and 3 below, the three regions of the Palestinian territory each experienced robust economic

²¹ World Population Review, 3.

²² World Population Review, 3.

²³ George Abed, *The Palestinian Economy (RLE Economy of Middle East): Studies in Development under Prolonged Occupation* (New York: Routledge, 2015), 44.

performance between 1995 and 1999, which were periods of relative political stability.²⁴

Conversely, between 2000 and 2002, and 2006 and 2014, the region witnessed prolonged episodes of economic contractions generated by military and political confrontations.

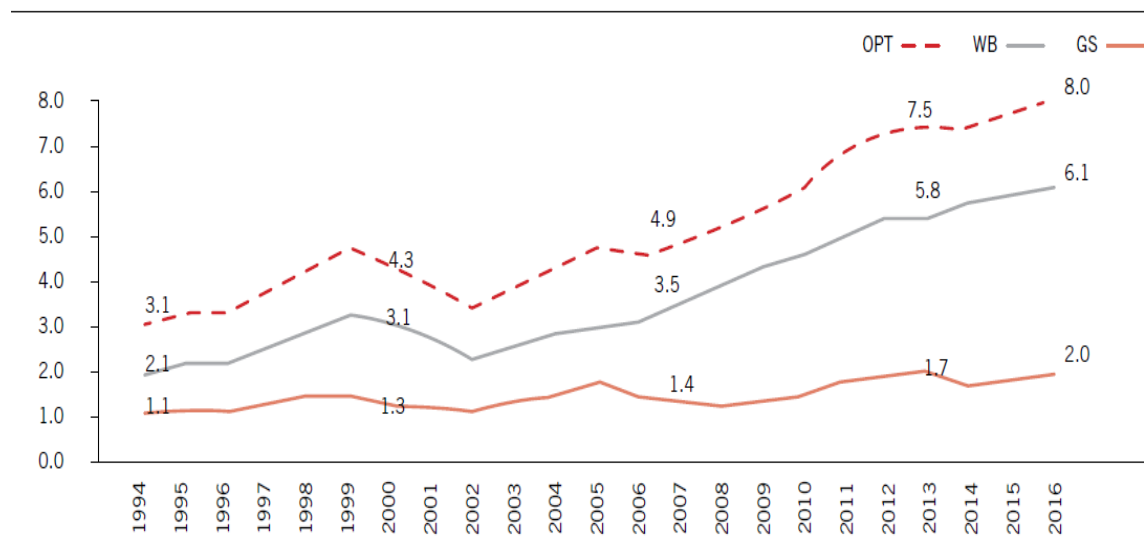


Figure 2. Real GDP in Palestine, by Region (1994-2016).

Legend:

OPT: Occupied Palestinian Territories

WB: West Bank

GS: Gaza Strip

Source: ILO, 2018: 25.

²⁴ ILO (International Labor Organization), *The Occupied Palestinian Territory: An Employment Diagnostic Stud* (Beirut: ILO, 2018), 24.

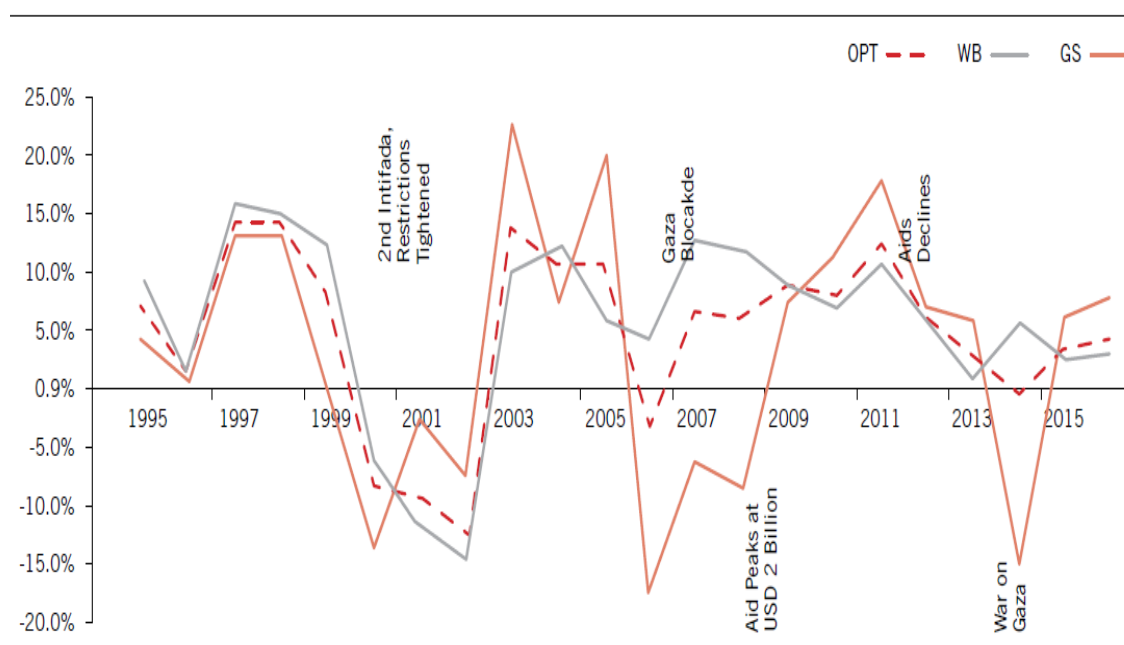


Figure 3. Real GDP Growth in Palestine by Region (1994-2016).

Legend:

OPT=Occupied Palestinian Territories

WB: West Bank

GS: Gaza Strip

Source: ILO, 2018: 25.

The Palestinian economy slid into recession following the Gaza War of 2014. Nevertheless, it rebounded, achieving a growth in real GDP of up to 3.5% and 4.1% in 2015 and 2016, respectively.²⁵ However, the drivers of this growth in the four years since have proven unsustainable, given that the expansion was fueled primarily by increased household consumption financed by loans and an expansion in the construction sector, which was the result of a temporary increase in the ingress of construction materials into Gaza.

²⁵ Abed, *The Palestinian Economy*, 44.

Nearly 26% of people residing in the Palestinian territory survive under the poverty line.²⁶ The available data shows that in the West Bank, poverty affects more than 15.8% of the population, and similarly affects at least 34% of Gaza Strip's populace.²⁷ Additionally, 7% of the West Bank and 20% of the Gaza populations suffer from extreme poverty. Figure 4 below illustrates the incidence of poverty in Palestine.

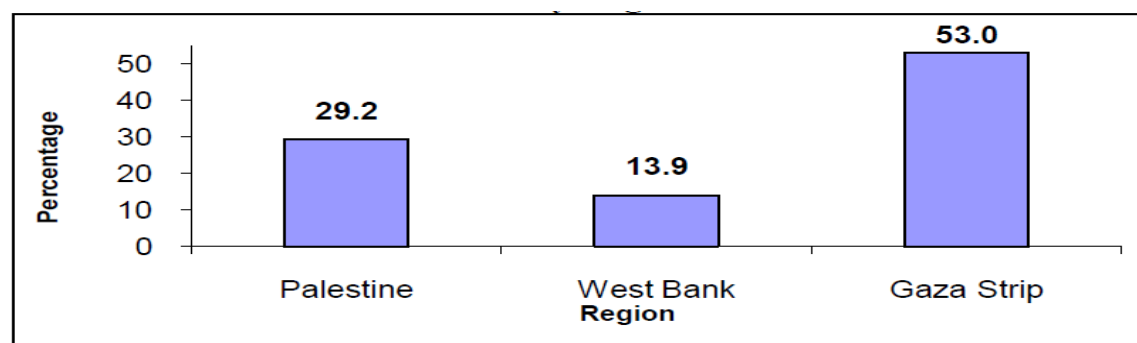


Figure 4. Incidence of Poverty in Palestine, based on Household Consumption (2017).

Source: PCBS, *Palestine in Figures*, 29.

Employment

Regarding employment and unemployment, the rate of participation in the Palestinian labor market as of Q1/2017 was 45.8% for individuals age 15 and higher.²⁸ The total labor force of the Palestinian territories consisted of approximately 1.4 million people.²⁹ The rate of participation in the labor market was similar for both the West Bank

²⁶ Palestinian Central Bureau of Statistics (PCBS), "Poverty Profile in Palestine, 2017," 3.

²⁷ PCBS, *Palestine in Figures*, 1.

²⁸ PCBS, *Palestine in Figures*, 1.

²⁹ ILO, *Occupied Palestinian Territory*, 35.

and Gaza, standing at an estimated 46%.³⁰ Palestinian men had a substantially higher labor-force participation rate compared to women in these two territories. The labor market is especially untraversable for women and youth who experience various barriers to their involvement in the workforce. For example, the labor participation rate was comparatively low for youth, particularly among those ages 15 to 19. The estimates for the Gaza Strip and the West Bank from Q1/2017 stood at 18.1% and 15.0%, respectively.³¹ The West Bank had an unemployment rate of 18.8% in Q1/2017 and that of besieged Gaza was 41.1%.³² Notably, the unemployment rate for men was lower than for women in both Gaza and the West Bank in Q1/2017.³³ The unemployment rates for women were 31.2% and 67.4% and in the West Bank and Gaza, respectively, compared to 15.9% and 32.7% for men, respectively.³⁴ Figure 5 below summarizes the labor participation and Figure 6 illustrates the rate of unemployment in the region.

³⁰ ILO, *Occupied Palestinian Territory*, 36.

³¹ United Nations Special Coordinator for the Middle East Peace Process (UNSCO). *Overview of the Palestinian Economy in Q1/2017* (Ramallah: UNSCO, 2017). Available from: https://unsco.unmissions.org/sites/default/files/unsco_socio-economic_report_q1_2018.pdf.

³² UNSCO, *Overview of the Palestinian Economy*, 5.

³³ ILO, *The Occupied Palestinian Territory*, 41.

³⁴ ILO, *The Occupied Palestinian Territory*, 41..

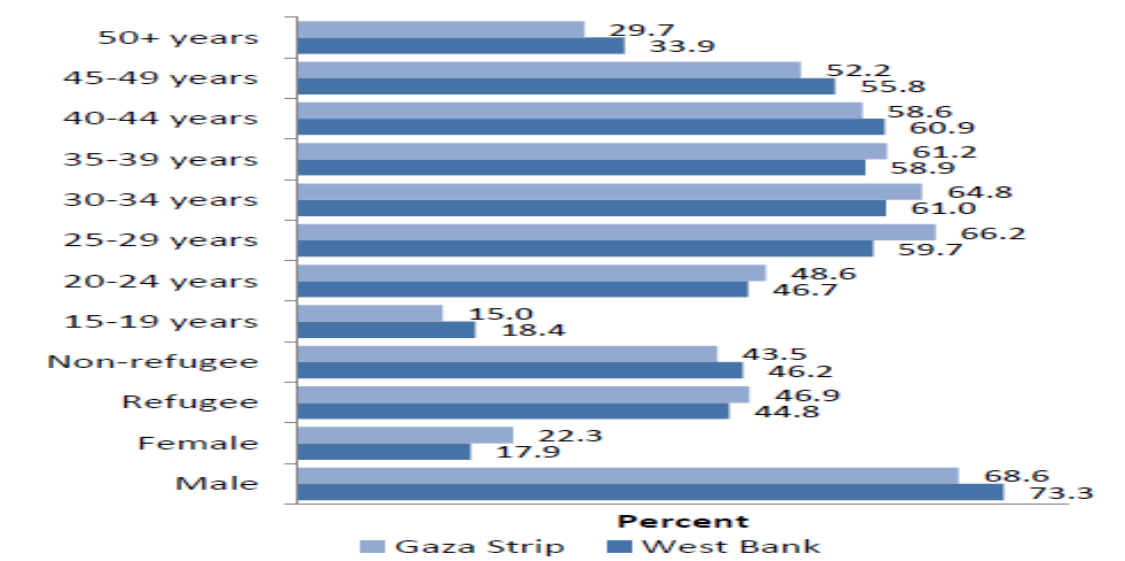


Figure 5. Labor Force Participation Rate (%) in Palestine (Q1/2017).

Source: UNSCO, *Overview of the Palestinian Economy*, 4.

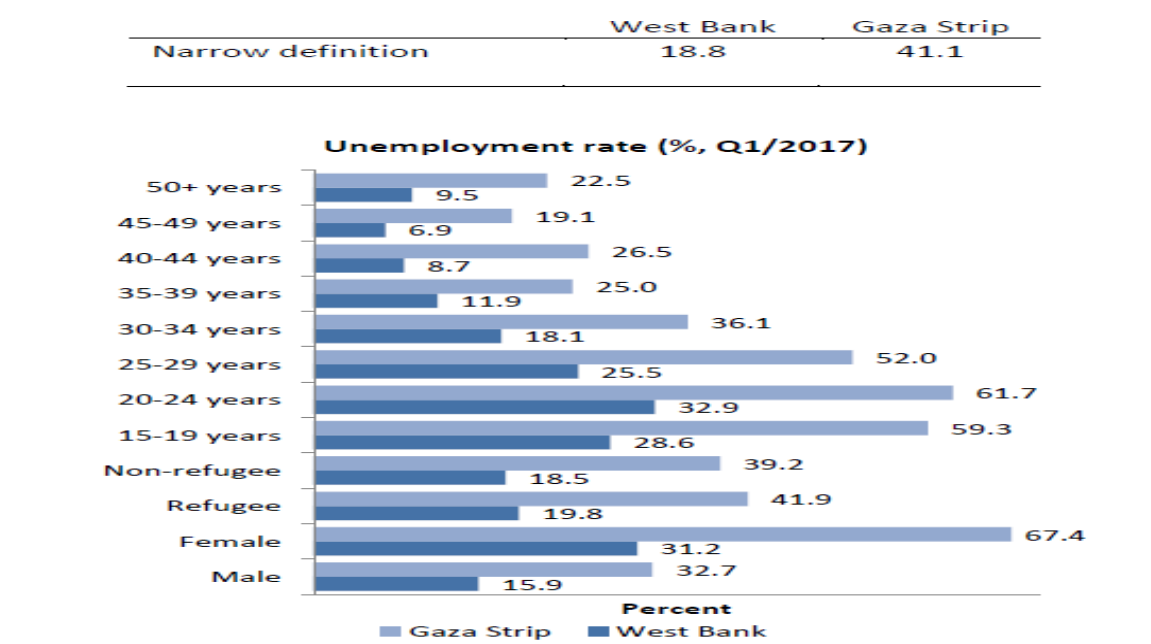


Figure 6. Unemployment Rate (%) in Palestine (Q1/2017).

Source: UNSCO, *Overview of the Palestinian Economy*, 4.

Macroeconomic Structure and Sectoral GDP

Historically, Palestine's agricultural and manufacturing sectors have been the mainstay of the region's economy. However, Palestine's economic structure has deteriorated increasingly since the 1990s, catalyzed by the diversion of investment toward the services and residential construction sectors at the expense of manufacturing and agriculture sectors.³⁵ Moreover, a large proportion of the region's labor force was previously and is currently employed in the manufacturing and agricultural sectors. The result of the diversion of investment toward the non-tradable goods sectors of the economy has largely been increasing unemployment and causing stagnation of the previously vibrant agriculture and manufacturing industries. For instance, manufacturing share of the GDP—a key indicator of export-driven, macroeconomic growth—declined from 21% in 1994 to 14% in 2016.³⁶ Similarly, the agricultural sector shrank from 12% to just 3% during the same period. Cumulatively, these declining trends have resulted in high rates of unemployment in the Palestinian territories.

In Q1/2017, private investments accounted for of 15% of the region's GDP.³⁷ These investments have been concentrated around low-capital and low productivity economic activities that have low exposure to political risk. Accordingly, Palestine's services sector currently contributes an average of 51% to the region's GDP, which is

³⁵ Palestinian Monetary Authority (PMA), *Economic Forecast Report*, 2017. Available from: [http://www.pma.ps/Portals/1/Users/002/02/2/Publications/English/Annual%20Reports/Economic%20Forecast%20Report/Economic%20Forecasts%20report%202018%20\(English\).pdf](http://www.pma.ps/Portals/1/Users/002/02/2/Publications/English/Annual%20Reports/Economic%20Forecast%20Report/Economic%20Forecasts%20report%202018%20(English).pdf).

³⁶ ILO, *The Occupied Palestinian Territory*, 12.

³⁷ PMA, *Economic Forecast Report*.

unhealthy given the constraints posed to further expansion of the sector.³⁸ Furthermore, the traditional service sub-sectors that constitute the broader services sector in Palestine have a limited capacity for increasing productivity and are also less dynamic than agriculture and manufacturing. Table 2 and Table 3 below highlight the contributions to the GDP from the different sectors of Palestine's economy.

Table 2. Contribution to GDP by Economic Activity (2010–2016).

Economic Activity	2010	2011	2012	2013	2014	2015	2016
Agriculture, forestry and fishing	5.5	5.9	4.9	4.1	4.4	3.3	2.9
Mining, manufacturing, electricity and water	12.9	12	11.9	15.5	14.1	13.4	13.9
Construction	9.7	14	14.1	10.1	7.3	8.3	7.5
Wholesale and retail trade, repair of motor vehicles	9.4	14.1	14	17.3	17	17.7	17.2
Transportation and storage	2.1	1.9	1.8	1.7	1.9	1.9	2.2
Information and communication	6.7	6.9	6.9	6.1	5.9	5.9	5.5
Services, including financial and insurance activities, public administration and defence, and government revenue	53.7	44.7	46.4	45.2	49.4	49.5	50.8
Total	100	100	100	100	100	100	100

Source: ILO, *The Occupied Palestinian Territory*, 27.

³⁸ ILO, *The Occupied Palestinian Territory*, 27.

Table 3. Key Economic Indicators for Economic Sectors in Palestine (2016)

Indicators	Economic sector			
	Construction	Industry	Services	Internal Trade
No. of Enterprises	594	19,367	40,230	81,193
No. of Employed Persons	11,316	98,776	153,540	185,088
Compensation of Employees (1000 USD)	75,787.8	489,128.3	660,371.9	473,522.6
Output (1000 USD)	684,600.5	4,191,767.4	2,231,377.1	3,944,123.2
Intermediate Consumption (1000 USD)	381,525.8	2,415,100.2	581,021.5	731,735.7
Value Added (1000 USD)	303,074.7	1,776,667.2	1,650,355.6	3,212,387.5
G.F.C.F (1000 USD)	1,713.5	40,046.9	71,068.4	30,060.9
G.F.C.F: <i>Gross fixed capital formation</i>				

Source: ILO, *The Occupied Palestinian Territory*, 27.

Nearly 50% of Palestine's total exports consist of agricultural products and limestone with finite processing and low value addition.³⁹ However, the region continues to witness growth in some high-value sectors including information and communication technology (ICT) services, pharmaceuticals, agribusiness, and furniture. The current growth in the high-value sectors indicates a future potential for some high value-added industries in the region. Figure 7 below illustrates the value of imports, exports, and net trade balance in Palestine between 1994 and 2016.

³⁹ PMA, *Economic Forecast Report*.

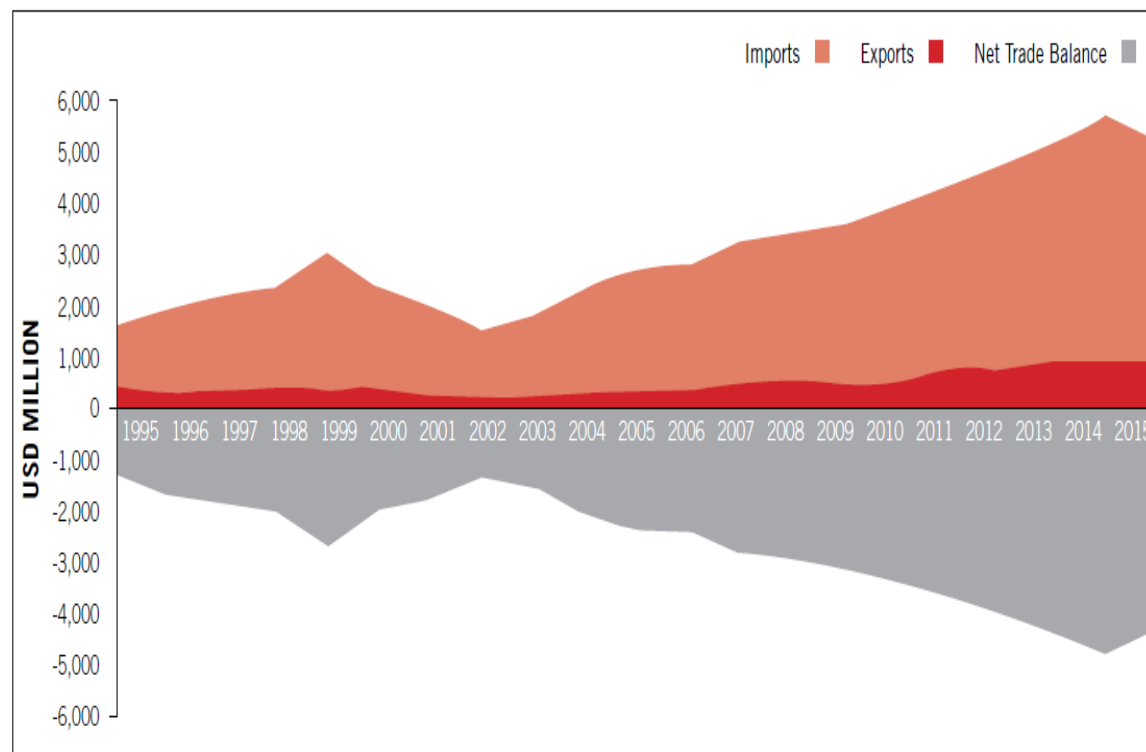


Figure 7. Values of Imports, Exports, and Trade Balance, 1994-2016 (US\$ million).

Source: ILO, *The Occupied Palestinian Territory*, 28.

Israel's Economic Sanctions

Palestine's macroeconomic indicators show a country burdened by poor economic performance and highly volatile, cyclical fluctuations within the economy. This is principally attributable to Israel's economic sanctions against the region, and the overall Israeli policy of limiting the free movement of goods to and from Palestine.⁴⁰ On the other hand, Israel's highly restrictive policies toward Palestine closely reflect the region's political instability. For instance, Israel's aggressive stance toward the Palestinian economy worsened in early 2000 and in 2006, which were periods that featured the so-

⁴⁰ Arie Amon, "Israeli Policy Toward the Occupied Palestinian Territories: The Economic Dimension, 1967-2007," *Middle East Journal* 61, no. 4 (2007): 574.

called Second Intifada, and the election of Hamas in the Gaza Strip.⁴¹ Israel responded to these two political developments by imposing curfews and laying siege in several towns, including Bethlehem, Nablus, and Jenin. The subsequent new restrictive policies made it even more difficult for people and goods to transit through Palestine's borders with Israel. Israel's policy of restricting free movement in the region worsened even further with the erection of a wall aimed at completely separating Israel from the West Bank.

Overall, the impact of Israel's sanctions and other similarly inhibitive policy actions reduced the mobility of resources to and from Palestine, thereby increasing the underlying transaction costs and generating distortions in the utility of the factors of production within the Palestinian economy.⁴² This impact was most apparent in the loss of labor income and the rise of unemployment in the Palestinian territories, primarily owing to Palestine's dependence on Israel's labor market.

Although the issue presented by Israel's policies toward Palestine was already apparent throughout the 1990s, the situation was exacerbated in the 2000s with the freezing of international support to Palestine after the election of Hamas in the Gaza Strip in 2006.⁴³ Israel imposed further limits to free movement in the region and also declined to transfer value-added taxes and other customs taxes that it collected on behalf of the PA as the administrative authority of Palestine.⁴⁴ These policies caused a severe fiscal crisis in Palestine, marked by difficulties in the payment of salaries in the public sector,

⁴¹ Amon, "Israeli Policy," 581.

⁴² Kenneth Barden, "Both a Borrower and Lender Be: Can Islamic Microfinance Bring Peace to Palestine?" *World Policy Journal* 27, no. 1 (2010): 98.

⁴³ Barden, "Both a Borrower and Lender Be," 99.

⁴⁴ Barden, "Both a Borrower and Lender Be," 101.

reduced liquidity, and instability in the region's credit stability.⁴⁵ These negative effects were more pronounced in the Gaza Strip than in the West Bank, resulting in declining living standards that persist today. Cumulatively, the sanctions and restrictive policies caused and compounded the decline of Palestine's economy.

In addition to the exogenous problems facing the Palestinian economy, some endogenous aspects also contributed to the current poor economic performance. One is the behavior of the banking system in Palestine. Palestine's economy is not only highly unstable, but it also lacks its own individual currency, and thus has parallel use of multiple currencies, including the US dollar, the Israel shekel, and the Jordanian dinar.⁴⁶ This makes interbank lending and the implementation of monetary policy virtually impossible.⁴⁷ Consequently, banks in Palestine apply a very limited approach to their operations, which in turn causes a limited supply of credit within the Palestinian economy.

However, the number of banks operating in Palestine since 2000, including international banks, has remained relatively stable to date, which is indicative of a fairly stable financial system despite the prevalent instability in the operating environment.⁴⁸ In fact, the existing banking institutions in Palestine have expanded their capacity, as evidenced by increased numbers of branches both in the West Bank and in Gaza, and the

⁴⁵ Amon, "Israeli Policy," 583.

⁴⁶ Dimitris Bouris, *The European Union and Occupied Palestinian Territories: State-Building Without a State* (New York: Routledge, 2014), 7.

⁴⁷ Amon, "Israeli Policy," 584.

⁴⁸ Bouris, *The European Union*, 13.

rise in the volume of bank deposits as a percentage of GDP.⁴⁹ However, ordinary banks in Palestine have not seen a similar upward trend in their provision of loans and credit, and therein lies a problem for the Palestinian economy. The availability of loans from banking institutions in the past two decades correlates with the prevailing macro-economic performance.⁵⁰ During economic contractions, banks were less willing to offer credit, demonstrating that the problem with the Palestinian economy was not the lack of savings but rather the limited ability to reinvest the collected deposits into the real economy.⁵¹ Therefore, the behavior of the banking system in Palestine leaves the economy with a lack of financial resources to reinvest into the local economy.

Research Problem

Overall, Palestine is an economy that became poorer, with a worsening macroeconomic environment in which the banking sector is limited in its ability to transform deposits into loans. The themes of macro instability and the behavior of ordinary banks are especially important in the context of Palestine's microcredit sector. Theoretically, it would be expected that the space left by market-based banking intermediaries, in combination with the worsening economic situation, would promote the expansion of Palestine's microcredit sector.⁵² However, the unstable macroeconomic

⁴⁹ Amon, "Israeli Policy," 585.

⁵⁰ Marilyn Manalo, *Microfinance Institutions' Response in Conflict Environments: Eritrea-Savings and Micro Credit Program, West Bank and Gaza-Palestine for Credit and Development, Haiti-Micro Crédit National, SA* (New York: World Bank, 2003).

⁵¹ Amon, "Israeli Policy," 587.

⁵² Di Martino and Sarsour, "Microcredit in Palestine," 450.

environment also could have affected microcredit and microfinance institutions negatively, thereby discouraging growth in the sector.⁵³

Palestine's microfinance sector has experienced considerable growth over the course of the region's economic history, despite the inhibitive conditions in the finance industry and the macroeconomic environment. Regardless, this growth cannot conceal the problem of limited expansion over time and its inherent limitation to act counter-cyclically.⁵⁴

These considerations encourage an exploration of Palestine's microfinance industry by focusing primarily on the sector's evolution under the prevailing constraining conditions, and the possible impact that organizational theory, structure, and governance have on the sector's performance. Given that available literature is limited both in scope and breadth, this thesis will contribute to the evidence-based body of knowledge in the subject area.

Research Objectives

The following objectives guide this pursuit of creating evidence-based knowledge on the evolution of Palestine's microfinance industry:

- explore the growth, development, and performance of Palestine's microfinance sector;
- ascertain the impact of the microfinance sector in Palestine;
- determine the interaction between Palestine's banking and microfinance sectors;

⁵³ Amon, "Israeli Policy," 590.

⁵⁴ Di Martino and Sarsour, "Microcredit in Palestine," 454.

- determine the interaction between the macroeconomic environment in Palestine and the region's microfinance sector;
- determine the impact of exogenous and endogenous factors on the performance of Palestine's microfinance sector;
- determine how organizational theory, structure, and governance affect the performance of Palestine's microfinance sector;
- explore the limitations to and the potential for further expansion in Palestine's microcredit sector, with the objective of replicating the sector's positive impacts and success stories.

Significance

This research contributes to the creation of a body of knowledge needed for bolstering microfinance experiences and enhancing the effectiveness, profitability, and performance of the microfinance sector. The insights gained from the study of Palestine will be beneficial not only at the individual level but also at the organizational and macroeconomic levels. Additionally, the knowledge generated by this study is valuable both for Palestine and for other regions around the globe, particularly developing countries with unstable economies, as microfinance strategies have shown to be replicable across multiple regions and contexts.⁵⁵

⁵⁵ Di Martino and Sarsour, "Microcredit in Palestine," 459.

Chapter II

The Palestinian Banking Sector

The previous chapter elaborated on the contextual setting of Palestine as a region, with particular emphasis on the prevailing macroeconomic context. Some of the key insights that emerged from Chapter I include the critical role of microcredit and microfinance in the broader Palestinian economy, the dynamics at play in the country's macroeconomic environment that are pertinent to the microfinance sector, and the sanctions and inhibitive regulatory environment that cumulatively limit the growth and development of the sector of interest.

This chapter focuses specifically on the microfinance sector in Palestine. It explains the nature and strategic role of the sector in relation to the region's overarching financial environment. The goal is to provide a historical background of the sector's development and to explore its current positioning vis-à-vis the region's economy. Accordingly, the chapter first expounds upon Palestine's banking sector and its relationship to the microfinance sector before delving deeper into a dissection of the intricacies of microfinance in Palestine.

Structural Overview

Even though Palestine is plagued by geopolitical complexities and uncertainties, the region manages to maintain a well-established and regulated financial industry. Palestine's regulated financial system is made up of the banking and insurance sectors,

mortgage finance entities, specialized lending institutions, a stock exchange that is operated privately, money changers, and other related finance organizations.⁵⁶

Microfinance institutions (MFIs) are located outside of this regulated system and include nongovernmental organizations (NGOs), savings and credit cooperatives, and not-for-profit companies. These are detailed in subsequent sections of this chapter. The Palestinian banking system utilizes four currencies: the U.S. dollar, the Euro, the Jordanian dinar, and the Israeli shekel.

The 1993 Oslo Accords between the PLO and the State of Israel facilitated the inception of a banking sector in the Palestinian Territories for the first time in more than three decades.⁵⁷ The newly established sector experienced rapid growth over the subsequent decade, expanding to 22 banks by December 2004.⁵⁸ This rapid growth was based on the strategic approaches taken by banking institutions in earlier years to expand their branch networks to small towns located outside of the region's major cities under the oversight of the PMA.⁵⁹ In 2006, for example, the PMA approved more than 15 new branches by leading players in the banking sector.⁶⁰

By December 2006, there was 22 banks in operation in Palestine.⁶¹ Of these, 12 were international institutions, 11 of which were rooted in the Middle East and North Africa (MENA) region. More specifically, 10 banks were of Jordanian origin and one

⁵⁶ Alkhatib, and Harasheh, "Financial Performance of Palestinian Commercial Banks, 176.

⁵⁷ Madi, et al., "Employees' Perception, 299-311.

⁵⁸ Di Martino and Sarsour, "Microcredit in Palestine," 447.

⁵⁹ Di Martino and Sarsour, "Microcredit in Palestine," 448.

⁶⁰ Kullab and Yan, "Soundness of Palestinian Banks," 16-29.

⁶¹ Di Martino and Sarsour, "Microcredit in Palestine," 447.

was Egyptian, and their credit policies were determined by their headquarters in Amman and Cairo, respectively. There were individual policies implemented in addition to the PMA policies and regulations.⁶²

The remaining 11 consisted of 10 local Palestinian banks and one international bank headquartered in London.⁶³ The number of banks in the region by December 2008 was indicative of the sector's stability. Between 2001 and 2008, the sector maintained a consistent number of banks, as shown in Table 4 below. Although the number of banks remained constant during these seven years, the timeframe was characterized by incremental growth in the number of branches from 124 to 190. Of these, 144 operated in the West Bank and 46 in Gaza.⁶⁴

Table 4. Number of Banks and Branches in Palestine (2001-2008).

	Number of banks	Number of bank branches		
		West Bank	Gaza Strip	Total
2001	21	89	35	124
2002	20	89	36	125
2003	20	94	37	131
2004	20	96	37	133
2005	20	101	38	139
2006	21	111	40	151
2007	21	119	41	160
2008	21	144	46	190

Source: DiMartino and Sarsour, 444.

However, Palestine's banking sector also has experienced several exits and new entries since 2008, albeit with a minimal impact on the sector's structure. According to the PMA, the total number of banks in Palestine as at the end of 2015 was 16, with 7

⁶² Kullab and Yan, "Soundness of Palestinian Banks," 18.

⁶³ Di Martino and Sarsour, "Microcredit in Palestine," 447.

⁶⁴ PMA, *2017 Annual Report*.

local banks and 9 foreign banks.⁶⁵ Of the 16 banks, 14 were conventional banks that controlled 90% of the region's banking assets, and two were Islamic banks that handled the remaining 10%.⁶⁶ Additionally, the banking sector had 300 money changers and 13 specialized lending institutions by the end of 2015.⁶⁷

Based on the 2017 estimates by the PMA, the structure of Palestine's banking sector has experienced relatively small changes since 2015. Seven local banks and eight foreign banks are currently operating in the region, plus 392 individual and company money changers, and six specialized lending institutions.⁶⁸ Figure 8 below is a visual representation of the sector's present structure, including names of current banking institutions, their years of establishment, and number of branches that each operates in the Palestinian territory.⁶⁹

⁶⁵ Kullab and Yan, "Soundness of Palestinian Banks," 18.

⁶⁶ Di Martino and Sarsour, "Microcredit in Palestine," 450.

⁶⁷ Kullab and Yan, "Soundness of Palestinian Banks," 19.

⁶⁸ Madi, et al., "Banking Sector in Gaza," 300.

⁶⁹ Kullab and Yan, "Soundness of Palestinian Banks," 20.



Figure 8. Structure of the Palestinian Banking Sector (2017).

Source: PMA, 2017 *Annual Report*, iii.

An elaborate financial infrastructure supports the region's banking sector. This infrastructure is provided by the PMA in the form of a payment and credit information system, and the infrastructure is also enabled and facilitated by audit firms.⁷⁰ Although currently there is no shared infrastructure to facilitate interbank transactions, each bank is connected by the SWIFT system.⁷¹ Additionally, the PMA offers a valuable payment system infrastructure since each institution keeps accounts with them.⁷² Moreover, the PMA functions as the sector's principal credit bureau of sorts. It gathers information regarding loans with a principal amount in excess of \$10,000 and maintains a blacklist of

⁷⁰ World Bank, *West Bank and Gaza Financial Sector Review*, 2008. Available from: <http://siteresources.worldbank.org/INTWESTBANKGAZA/Resources/WBGFSRreportNov.08pdf.pdf>.

⁷¹ Alkhatib and Harasheh, "Financial Performance of Palestinian Commercial Banks," 179.

⁷² Madi, et al., "Banking Sector in Gaza," 306.

fraudulent transactions, such as those involving the issuance of problematic checks.⁷³ The organization provides this information to banks only for their confidential use. It also is working on instituting a private credit information market in collaboration with the International Monetary Fund (IMF) and the International Finance Corporation (IFC).⁷⁴ Furthermore, Palestine's Ministry of Finance, along with the PA and the World Bank, have accredited six audit firms that aid in regulating the sector.⁷⁵ The Ministry of Interior requires all banks and NGOs to undergo annual financial audits from an audit firm or from any registered and certified Palestinian public accountant.⁷⁶

Performance Overview

Palestine's banking sector dominates the region's financial system, and it appears to have maintained a relatively stable and sound performance.⁷⁷ One statistic that indicates this is the collection of deposits, which increased (although not linearly) between 2001 and 2008⁷⁸ (see Figure 9 below). However, the increase in deposits was not matched with a similar trend in the volume of loan provisions by the banking institutions.

⁷³ Di Martino and Sarsour, "Microcredit in Palestine," 447.

⁷⁴ PMA, *2017 Annual Report*.

⁷⁵ Kullab and Yan, "Soundness of Palestinian Banks," 27.

⁷⁶ Kullab and Yan, "Soundness of Palestinian Banks," 27.

⁷⁷ Alkhatib and Harasheh, "Financial Performance of Palestinian Commercial Banks," 179.

⁷⁸ Alkhatib and Harasheh, "Financial Performance of Palestinian Commercial Banks," 183.

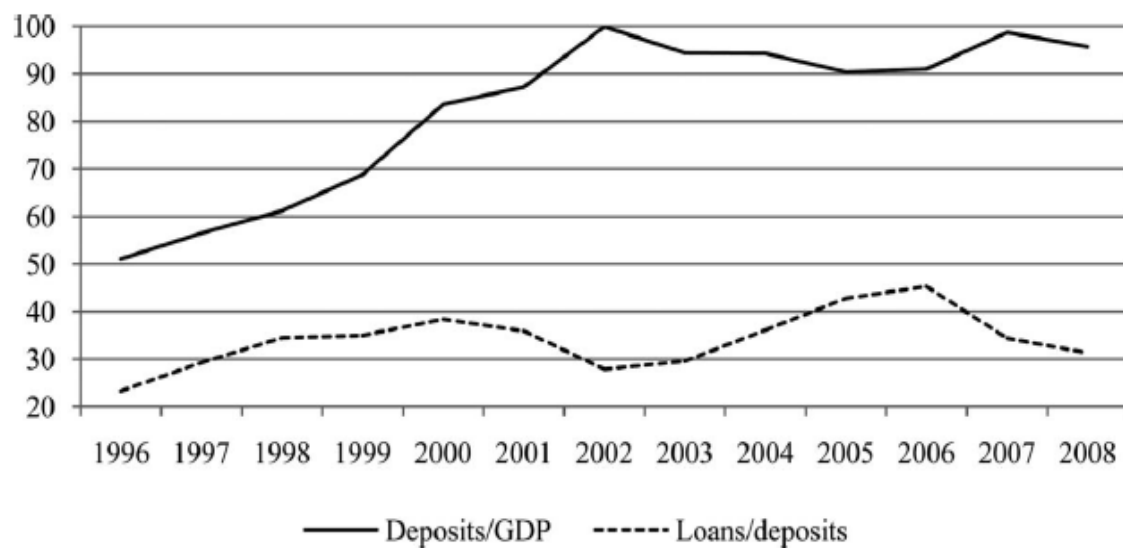


Figure 9. Bank Deposits/GDP (%) and Bank Loans/Deposits (%) (2001-2008).

Source: Di Martino and Sarsour, 445.

Moreover, the sector's total assets increased steadily between 2004 and 2007, from \$4.9 billion to \$6.8 billion (see Table 5). As shown in the table, the sector's net income rose from \$36 million to \$68 million over the same period.⁷⁹

Table 5. Total Assets and Profits of Banks in West Bank and Gaza (2004-2007)

	(in thousands of USD, as of end year)			
	2004	2005	2006	2007
Total net assets	4 884 635	5 398 530	5 522 219	6 703 853
Net interest	96 890	139 688	173 258	205 475
Net profits	35 965	111 018	51 500	68 225

Source: World Bank. *West Bank and Gaza*, 1.

⁷⁹ Kullab and Yan, "Soundness of Palestinian Banks," 28.

The average return on assets and equity of banks operating in West Bank and Gaza nearly matched that of the overall MENA region by 2007, at 1.3% and 15.9%, respectively.⁸⁰ Palestine's banking sector also had a relatively sound loan portfolio quality between 2004 and 2007 (see Table 6), specifically in a cross-regional comparison of non-performing loans and watch list loans (see Figure 10).⁸¹

Table 6. Aggregate Loan Portfolio Quality of Banks in Palestine (2004-2007)

(in thousands of USD, as of end year)				
Classification	2004	2005	2006	2007
Performing	1 217 702	1 585 454	1 420 912	1 390 145
Watch list (1 – 3 months)	5 916	7 884	225 634	118 009
Subs. & Doubtful (3 – 12 months)	9 763	2 104	37 631	16 091
Loss (> 12 months)	138 993	145 932	159 204	180 923
Total loans	1 372 374	1 741 375	1 843 382	1 705 168
NPLs loans	148 756	148 036	196 835	197 014
NPLs + watch list	154 672	155 920	422 469	315 023
Specific provisions	133 780	139 784	151 793	192 499
Paid-in capital	277 284	316 270	481 566	530 393
<u>Ratios (%)</u>				
NPL ratio	10.8	8.5	10.7	11.6
NPL + Watch list ratio	11.3	9.0	22.9	18.5
Coverage ratio NPL	89.9	94.4	77.1	97.7
Coverage ratio NPL + Watch list	86.5	89.7	35.9	61.1

Key: NPL = non-performing loans; WL = watch list loans

Source: World Bank. *West Bank and Gaza*, 2.

⁸⁰ Alkhatib and Harasheh, "Financial Performance of Palestinian Commercial Banks," 181.

⁸¹ Madi, et al., "Banking Sector in Gaza," 310.

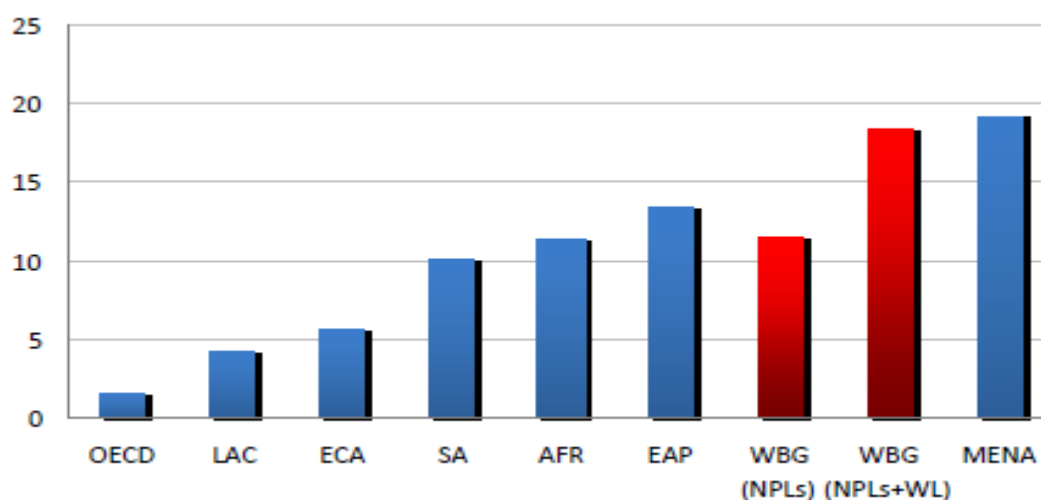


Figure 10. Non-Performing Loans, % of Total Loans across Regions, 2007.

Source: World Bank. *West Bank and Gaza*, 2.

Currently, the latest estimates by the PMA and the World Bank show that the Palestinian banking sector continues to thrive. The sector's total assets exceeded \$15 billion by the end of the first half of 2017, reflecting growth of 13% compared to June 2016.⁸² The credit-to-deposit ratio ranged between 50% and 60% after 2007 and grew to 66% by June 2017.⁸³ The sector maintained non-performing loans at 2% between 2007 and 2017.

The banking system overall is considered liquid at present, as evidenced by the latest stress tests results from the PMA.⁸⁴ By the end of the Q1/2018, bank deposits were 7.7% higher than Q1/2017 levels, having increased to \$12 billion, with a corresponding

⁸² PMA, *Palestinian Banking Sector*.

⁸³ PMA, *2017 Annual Report*.

⁸⁴ Madi, et al., "Banking Sector in Gaza," 310.

loan-to-deposit ratio of 68.1%.⁸⁵ Growth in deposits was concentrated in the West Bank (8.6%), although a 0.9% growth rate was also observed in Gaza. Key indicators of the banking sector's performance are shown in Figures 11, 12, and 13 below.

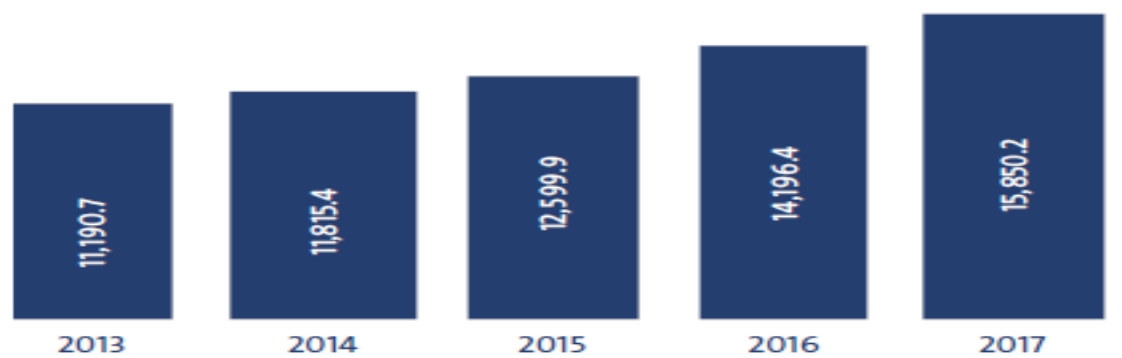


Figure 11. Total Assets, Palestinian Banking Sector, \$US millions (2013-2017).

Source: PMA, 2017 Annual Report, 70.

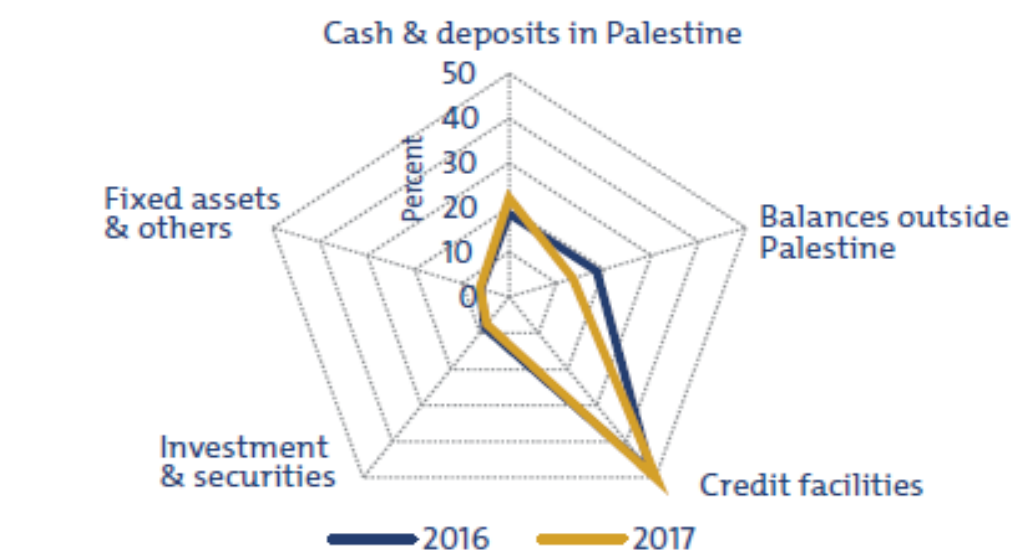


Figure 12. Uses of Funds Available to Banks (2016–2017).

Source: PMA, 2017 Annual Report, 71.

⁸⁵ Alkhatib and Harasheh, "Financial Performance of Palestinian Commercial Banks," 185.

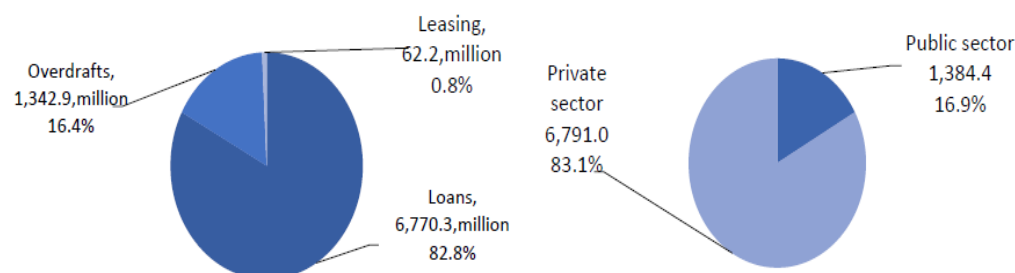


Figure 13. Distribution of Bank Credit by Type; Distribution of Bank Deposits by Sector (\$US million/percent, Q1/2018).

Source: UNSCO, 2018.

Underlying Factors Relative to Microfinance

The previous section shows that the banking sector in Palestine is stable and continues to grow with the admission by the PMA of well-managed foreign and local banks. Most important, the sector has witnessed the expansion of a wide range of financial products, primarily in the West Bank but also in Gaza.⁸⁶ Among the services currently available are debit cards, nationwide ATMs that accept international cards, saving accounts, and money orders.⁸⁷ A few institutions also offer telephone and Internet banking facilities, and all the banks in the region provide overdrafts and loans.

However, the sector also has several deficiencies in the supply and demand sectors of the credit market. Notably, all banks in the region suffer from obstacles that have pressured them into adopting conservative and strict credit policies. Presently, the institutions focus on short- to medium-term credit facilities that are directed mainly to the commercial and public sectors. The major constraints that provoke such a policy stance are the absence of political and economic stability in the region because of the current

⁸⁶ Kullab and Yan, "Soundness of Palestinian Banks," 28.

⁸⁷ Madi, et al., "Banking Sector in Gaza," 310.

Israeli sanctions and regulations on the Palestinian economy that elevate the pertinent investment risks.⁸⁸ For example, only 9 of the 16 banks in the region offer mortgage loans to consumers.⁸⁹ Moreover, very few banks provide leasing facilities, and they too often propose overdrafts where term loans would be more suitable to the needs of Palestinian businesses.⁹⁰

The conservative policies of Palestine's banks have a direct impact on the region's microfinance sector. Notably, Palestine's banking sector has the lowest ability to convert deposits into private-sector loans compared to its neighboring financial systems.⁹¹ Estimates from 2017 show that credit from the banking sector to the private sector accounted for only 24% of the region's GDP,⁹² while the same statistic reached much higher values of 95%, 85%, and 74% in neighboring Israel, Lebanon, and Jordan, respectively. Furthermore, the private sector credit-to-deposit ratio averaged a mere 23% in Palestine, much lower than MENA region's average of 60%, or that of emerging economies worldwide (80%).⁹³ According to the IMF, the poor performance of the Palestinian private sector relative to the banking sector is attributable not only to the

⁸⁸ UNSCO, *Socioeconomic Report*.

⁸⁹ Madi, et al., "Banking Sector in Gaza," 309.

⁹⁰ Madi, et al., "Banking Sector in Gaza," 310.

⁹¹ World Bank, *Economic Monitoring Report to the Ad Hoc Liaison Committee*, September 2018. Available from: <http://www.worldbank.org/en/country/westbankandgaza/publication/economic-monitoring-report-ahlc>.

⁹² Alkhatib and Harasheh, "Financial Performance of Palestinian Commercial Banks," 186.

⁹³ Madi, et al., "Banking Sector in Gaza," 310.

prevailing, conservative credit policy, but also to heavy public-sector borrowing, which has been rising since 2010.⁹⁴

The picture painted above says a lot about the performance of Palestine's banking sector. The current state of affairs is especially problematic because more than 90% of the region's private sector is composed of small and medium-size enterprises (SMEs).⁹⁵ The smaller businesses need financing, but the Palestinian banking sector is largely uninvolved. The main driver of banks' reluctance with private-sector financing is their risk-averse behavior. However, it is equally true that within the current business environment, it is easier and more profitable for banks to lend to the government and to private consumption segments because of the lower risk inherent in such investments and the significantly lower transaction costs.⁹⁶

In recent years, however, the PMA has implemented several strategies to stimulate private-sector lending by banks to the more than 100 SMEs operating in the region, including lowering the upper legal limit to deposits held abroad by Palestinian banks from 65% to 55%. The lower limit reintroduced approximately \$750 million back into the Palestinian banking sector.⁹⁷ Despite such efforts, much of the enhanced credit facilities still do not translate into SME financing and investment. High-growth sectors such as agriculture, tourism, and manufacturing, wherein many SMEs are concentrated,

⁹⁴ World Bank, *Economic Monitoring Report*.

⁹⁵ Alkhatib and Harasheh, "Financial Performance of Palestinian Commercial Banks," 179.

⁹⁶ Kullab and Yan, "Soundness of Palestinian Banks," 28.

⁹⁷ Alkhatib and Harasheh, "Financial Performance of Palestinian Commercial Banks," 179.

continue to receive only marginal portions of the total bank credit in the region, standing at 1.3%, 0.8%, and 4%, respectively, based on the latest estimates by the PMA.⁹⁸

Consequently, a major issue within the Palestinian territory is that the overwhelming majority of firms remain excluded from the credit market in the banking sector. The World Bank found that SMEs whose applications for bank loans were rejected identified a lack of adequate collateral and guarantees as the reason for rejection.⁹⁹ Those SMEs also cited their inability to meet the minimum required conditions for qualifications owing to the banking sector's conservative credit policies. Furthermore, the fact that many of the region's major banks are located in foreign countries, particularly Jordan, makes it harder for these banks to make decisions regarding lending to Palestinian SMEs. Overall, the behavior of ordinary banks means that the majority of the players in the region's private sector must rely on sources of financing other than the formal and regulated banking system. According to the PMA, 60% of private-sector firms claim that they need external financing, but 80% of SME funding is drawn from personal contributions, with only 8% coming from bank credit.¹⁰⁰ The remaining gap in funding is filled by the microcredit and microfinance sectors, as explained in the next section.

⁹⁸ PMA, *2017 Annual Report*, 70.

⁹⁹ Kullab, "Soundness of Palestinian Banks," 28.

¹⁰⁰ Kullab, "Soundness of Palestinian Banks," 28.

Microfinance in Palestine: 1990–2011

“Microfinance” is a term used to describe a set of financial services, including savings, credit, insurance and cash transfers that are offered to SMEs and low-income individuals by specialized financial institutions.¹⁰¹ This section discusses the microfinance industry in Palestine.

The origins of the microfinance industry in Palestine are rooted in several local and foreign NGOs that were operating in the West Bank and Gaza before and during the first Palestinian Intifada.¹⁰² The First Intifada refers to the initial uprising of Palestinians against the Israeli occupation of Gaza and the West Bank, which commenced in 1987 and ended in 1993. Palestinian microfinance institutions began operating within the Occupied Palestinian territories in the mid-1990s and drew their support principally from international donors such as the USAID and similar European-funded NGO initiatives.¹⁰³

According to a survey of the MENA region by the World Bank, “Three traditional micro-lending and three very small business-lending programs with an aggregate of almost 14,000 clients” operated in Palestine by 2000.¹⁰⁴ They served more than 7,000 active borrowers with a cumulative loan portfolio value of approximately \$2 million. These programs were run by three players who had the deepest reach in the West Bank

¹⁰¹ Facility for Euro-Mediterranean investment and Partnership (FEMIP), *A Review of the Economic and Social Impact of Microfinance with Analysis of Options for the Mediterranean Region* (Luxembourg: FEMIP, April 2009).

¹⁰² International Finance Corporation (IFC), *Microfinance Market Survey in the West Bank and the Gaza Strip* (St. Ouen: IFC, 2007).

¹⁰³ Sharif M. Abu Karsh, and Anan Y. Deek, “Microfinance Institutions: Its Role in Palestine Economic Development,” *International Business Research* 12, no. 2 (2019): 166.

¹⁰⁴ Osama K. Najjar, “Should Banks in Palestine Invest in Microfinance Market?” December 2009. Available from SSRN: <https://ssrn.com/abstract=1553731> or <http://dx.doi.org/10.2139/ssrn.1553731>.

and Gaza regions: (1) FATEN (Palestine for Credit and Development), which governed 70% of the microfinance market; (2) UNRWA (United Nations Relief and Work Agency) which governed 26% of the market; and (3) USAID through the Bank of Jordan and the Arab Bank with the remaining 4% of the market.¹⁰⁵ These programs' clients were located in the poorest segments of the region, with an average loan balance of \$294, which was 17.5% of the GDP and 41.8% of the poverty line.¹⁰⁶ Such programs at the time targeted only women and operated under prevalent best practices.

However, the subsequent years featured significant growth and expansion in the sector. In 2002, nine microfinance institutions and programs joined to form a common networking body known as the Palestinian Network for Small and Microfinance Institutions, herein referred to as "Sharakeh." The nine institutions behind the initiative were FATEN, UNRWA, ANERA (American Near East Refugee Aid), ASALA (The Palestinian Businesswomen Association), PARC (Palestinian Agricultural Relief Committees), ACAD (The Arab Centre for Agricultural Development), YMCA (Young Men's Christian Association), PDF (Palestinian Development Fund), and CHF (Ryada Cooperative Housing Foundation). The Palestinian Ministry of Interior recognized and registered the Sharakeh network as a non-profit NGO in 2004. Sharakeh commenced coordinating Palestinian MCIs from 2004 to present. Since its formation, the network has operated a service delivery program aimed at enhancing the performance of financial institutions in the region's microfinance sector and aiding them to reach their overall

¹⁰⁵ United Nations Development Program (UNDP), *The 2014 Palestine Human Development Report*. (Ramallah: UNDP, 2015).

¹⁰⁶ Portland Trust, *The Credit Market in the Palestinian Economy* (Ramallah: Portland Trust, 2013). Available from: https://portlandtrust.org/sites/default/files/feature_credit_jun_2013.pdf.

strategic goals. Sharakeh seeks to achieve the stated goal through various mechanisms, including the provision of up-to-date financial performance information of its active and associated members.

By the end of 2006, there were 10 MFIs and one commercial bank participating in the microfinance sector. Each of the 10 MFIs operated under various institutional forms as illustrated in Table 7 below. The MFIs operated more than 60 outlets in the region at the time and provided loans ranging between \$200 and \$20,000, principally directed toward consumption, production, and home improvements. The average loan amount was \$1,500 with terms of between three months and three years, and interest rates of between 1% and 2%. Two years later, by the end of 2008, the number of specialized institutions had grown to 13, and the Bank of Palestine also expanded its business interest to include micro-lending.

Table 7. Palestinian MFIs (2006).

Legal Form	United Nations Agency	Int'l NGO	Local Program	Local NGO	Savings and Credit Cooperative	Non-profit Company	For-Profit Company
MFIs ²⁰	UNRWA	ANERA CHF	GWLF ²¹	ACAD ASALA ²² YMCA	PARC cooperatives ²³	FATEN	Al Amin ²⁴

Source: UNDP, 6.

End-of-year data from 2009 indicates that the Sharakeh grew into the most important financial network in the region, comprising 95% of all MFIs in the region. The network estimated that the value of its net active loans was approximately \$45 million. Its

market consisted of 190,000 borrowers, and the potential market size for microfinance services in Palestine exceeded \$280,000.

The network issued a financial indicators report in March 2009, detailing the performance of the leading MFIs from 2007 to 2009 (see Table 8 below). The Sharakeh reported that the total loan portfolio of its members and associates had scaled steeply upward from the previously mentioned \$45 million in 2009 to \$139.7 million dispersed among nearly 48,000 borrowers by the end of 2011. However, there appears to be no data for the sector's performance in 2012 and 2013 based on the author's search for additional statistics.

Table 8. Financial Performance Indicators for Palestinian MFIs (2007-2009).

	2007	2008	Q1/ 2009
Number of Active borrowers	19,750	26,661	28,615
Net loan portfolio USD	26,860,000	43,976,000	46,263,000
Average disbursed loan size - USD	1569	2261	2400
Number of branches	60	68	69
Number of staff	329	381	374
Number of staff in credit & front office operations	165	207	210
Number of loans per employee in credit	121 loans	129	136
PAR* > 180 days	20.1%	10.6%	10.3%
Loan Loss reserve ratio	17.5%	10.8%	10.9%
Yield on Portfolio	11.5%	17.2%	19%
ROE **	-4.4%	+3.9%	+2.9%
ROA **	-4.1%	+3.4%	+2.4%
*PAR: Portfolio at Risk			
** Excluding donations.			

Source: Najjar, 9.

Current Situation: 2014 to Present

Today, all microfinance institutions in Palestine operate under the Sharakeh. The Sharakeh network currently has a total of 13 memberships categorized broadly into nine active microfinance providers and four associate members. In addition to the nine original founders of the network, four micro-lending institutions also acquired membership recently: Islamic Relief Worldwide, Relief International, Ryada as an affiliate of CHF, and PEC DAR (Women's fund).

According to data from Sharakeh, demand in Palestine's microcredit market has increased substantially over the past decade. Notably, the total loan portfolio of the Sharakeh members and MFIs increased by 212% to \$234 million, between 2007 and 2017 as shown in Table 9 below. Active loans in the West Bank and Gaza went up from 43,000 to 90,000 or an equivalent of a 110% increment over the same duration. These statistics are indicative of rising confidence in the microfinance sector, with expectations the Sharakeh forecasting that the number of loans will likely exceed 110,000 by 2020.

Table 9. Number and Value of Microloans (2007, 2017).

	Portfolio Amount	# of active loans	Average size of loan
2007	\$75,000,000	43,000	\$1,744
2017	\$234,000,000	90,000	\$2,600

Source: Karsh and Deek, 6.

A notable sectoral development occurred in 2012 when the PMA began to regulate the microfinance sector and the underlying MFIs. The regulatory oversight was based on a comprehensive regulatory framework created in 2012 to govern the sector. It involves various tools, notably licensing, accreditation, best practices, and guidelines for

institutional governance.¹⁰⁷ The PMA defines MFIs as “special lending institutions”¹⁰⁸ and views them as critical partners of the banking sector, particularly in the areas of economic development and the allocation of financial resources to match the needs of small businesses and marginalized groups within Palestinian society. The goal of PMA’s oversight of the microfinance sector is to increase the size of financing offered by the institutions and to stimulate their financing role in the Palestinian economy, with the overarching objective of leveraging the MFIs as financing channels that complement the role of the banking sector within the broader financial system.

Accordingly, the PMA has increasingly implemented regulations and supervisory instructions for the microfinance sector. By the end of 2014, five MFIs were licensed by the PMA, which grew to six by the end of 2017. Those currently recognized formally by the PMA are: Vitas Palestine, ACAD, Al Ebdaa, Asala, FATEN, and Reef Finance. According to the PMA, the total number of licensed MFI branches and offices in West Bank and Gaza was 84 by the end of 2017.¹⁰⁹ Cumulatively, six institutions employ 652 Palestinians. The number of borrowers by the Q4/2017 was 72,209 (48,936 in the West Bank and 23,373 in Gaza), an increase of 4.8% from 2016. The assets of MFIs increased by 8.3% from 2016 to \$234.5 million by end of 2017. Conversely, the institutions’ liabilities were 66.9% with a 19.6% decline in net profits from the previous year to \$3.2 million. The Gaza Strip accounted for 31.2% of licensed MFIs loan portfolio volume, whereas the West Bank accounted for 68.8% of the same (West Bank \$147.8 million, Gaza \$67.2 million). Commercial loans composed 84.5% of the portfolio (181.7 million)

¹⁰⁷ PMA. *2017 Annual Report*.

¹⁰⁸ PMA. *2017 Annual Report*.

¹⁰⁹ PMA. *2017 Annual Report*.

while Islamic loans amounted to 15.5% (\$33.3 million). Table 10 illustrates the growth of PMA-licensed MFIs from 2014 to 2016. Figure 14 represents the distribution of loans by licensed MFIs by economic sector as of 2017.

Table 10. Microfinance Sector in Palestine (2014-2016).

Description	2014	2015	2016
Number of MFIs	5	6	6
Number of branches and offices	58	64	82
Number of active borrowers	45,153	51,952	68,912
Portfolio in million US\$	97	136.7	199.4
Distribution of loans %			
Agriculture	14	14.9	12.6
Industrial	10.9	5	4.9
Real Estate	30.1	27.9	30.4
Trade	22	24.1	24.9
Services	9.5	9.9	9.2
Tourism	0.6	5.1	4.6
Consumables	12.9	13.1	13.4

Source: World Bank, *Economic Monitoring Report*, 19.

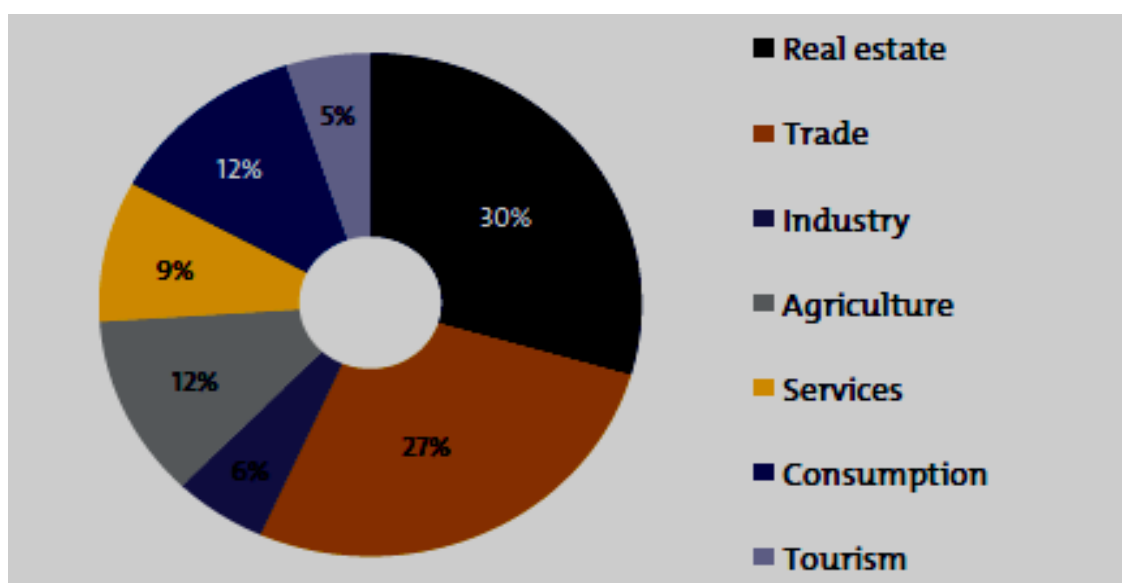


Figure 14. Sectoral Distribution of MFI loans (2017).

Source: PMA. 2017 Annual Report

Chapter III

Methodology

The design of this study is a triangulation of qualitative research methods featuring the integration of primary and secondary sources of data. Qualitative research involves the empirical observation of phenomena with the objective of retrieving non-numerical insights regarding the subject under observation using the scientific method.¹¹⁰ The questions underlying the qualitative approach to research are the what, how, why, and when associated with a subject of interest and not the quantifiable measures of the phenomenon of interest. It is the opposite of quantitative research, which is applied when one is interested in the counts or measures of a phenomenon. Nearly all academic disciplines that focus on the human aspects of the social and natural sciences utilize qualitative research approaches. In the context of finance and economics, the approach has various applications including researching markets, business, and economic environments for aspects that may be more non-numerical in nature such as ethics, consumer behavior, motivation, among other applications.

This study's choice of the qualitative design is informed by the non-numerical nature of its subject, namely, how the microfinance sector in Palestine develops and how MFIs in the region operate. Most important, the qualitative approach has the inherent advantage of providing more depth and detail concerning the subject matter of interest compared to the quantitative alternative.

¹¹⁰ Arthur Blandford, *Semi-Structured Qualitative Studies* (New York: Interaction Design Foundation, 2013), 4.

The concept of triangulation refers to the combination of two or more research methods in a study. It is derived largely from the sociology discipline where it is used in theory development to facilitate the convergence of different theoretical approaches and elements. Essentially, it is the “combination of methodologies in the study of the same phenomenon.”¹¹¹ In qualitative design, the expectation is that the researcher ought to pursue convergence and corroboration by drawing on at least two sources of evidence by utilizing various data and sources.

The rationale underpinning the application of triangulation in qualitative research is that it provides a “confluence of evidence,” thus bolstering the credibility of a particular study. Therefore, through examination of information gathered from different sources and through different methods, the study that employs triangulation can corroborate findings across a more robust collection of diverse data sets, thereby reducing the effects of potential biases and skewing that may exist within an individual study. This paper employs the triangulation of qualitative data sets from primary and secondary sources of data, under the premise of the need to provide more informed, evidence-based insights.

Primary Sources

The conventional definition of primary sources is research material that is new, authentic, or original.¹¹² They consist of first-hand information that is not interpreted previously by anyone else. Some examples of primary sources include journal articles

¹¹¹ Glenn A. Bowen, “Document Analysis as a Qualitative Research Method,” *Qualitative Research Journal* 9, no. 2 (2009): 28.

¹¹² Blandford, *Semi-structured Qualitative Studies*, 5.

that report new findings, magazine or newspaper articles that are published right after the fact, court documents, translations of original documents, interview data, speeches, and other examples. Primary sources are critical to the qualitative approach because they enable the researcher to establish contact with the phenomenon being explored, and thus facilitate a deeper understanding of the subject matter while reducing the risk of incorporating bias from other sources that may have previously drawn subjective conclusions on a topic. I chose to use primary sources collected through a semi-structured methodology as explained in subsequent sections of this chapter.

Secondary Sources

Secondary sources consist of sources of information that interpret and draw conclusions based on contributions written by other authors on a specific topic. In practice, secondary sources are used to present related evidence, to better shape and represent an opinion through citing multiple sources, and to buttress arguments and assertions. However, they are often described as “being one step removed from the fact or actual occurrence”¹¹³ under exploration. Nevertheless, secondary sources are instrumental to exploring the background of a subject area and to broadening the comprehension of it through exposure to the extant perspectives, interpretations, and conclusions on a given topic. In this thesis, secondary sources facilitated the discovery of historical information and their historical analysis thereof, where the latter is a critical component of this thesis. I used document analysis as secondary source of data for this thesis.

¹¹³ Blandford, *Semi-structured Qualitative Studies*, 13.

Overall, the integration of primary and secondary sources through triangulation renders this paper's research design effective as means of generating a robust and evidence-based body of knowledge concerning the phenomenon under exploration.

Figure 15 below illustrates this study's methodological structure.

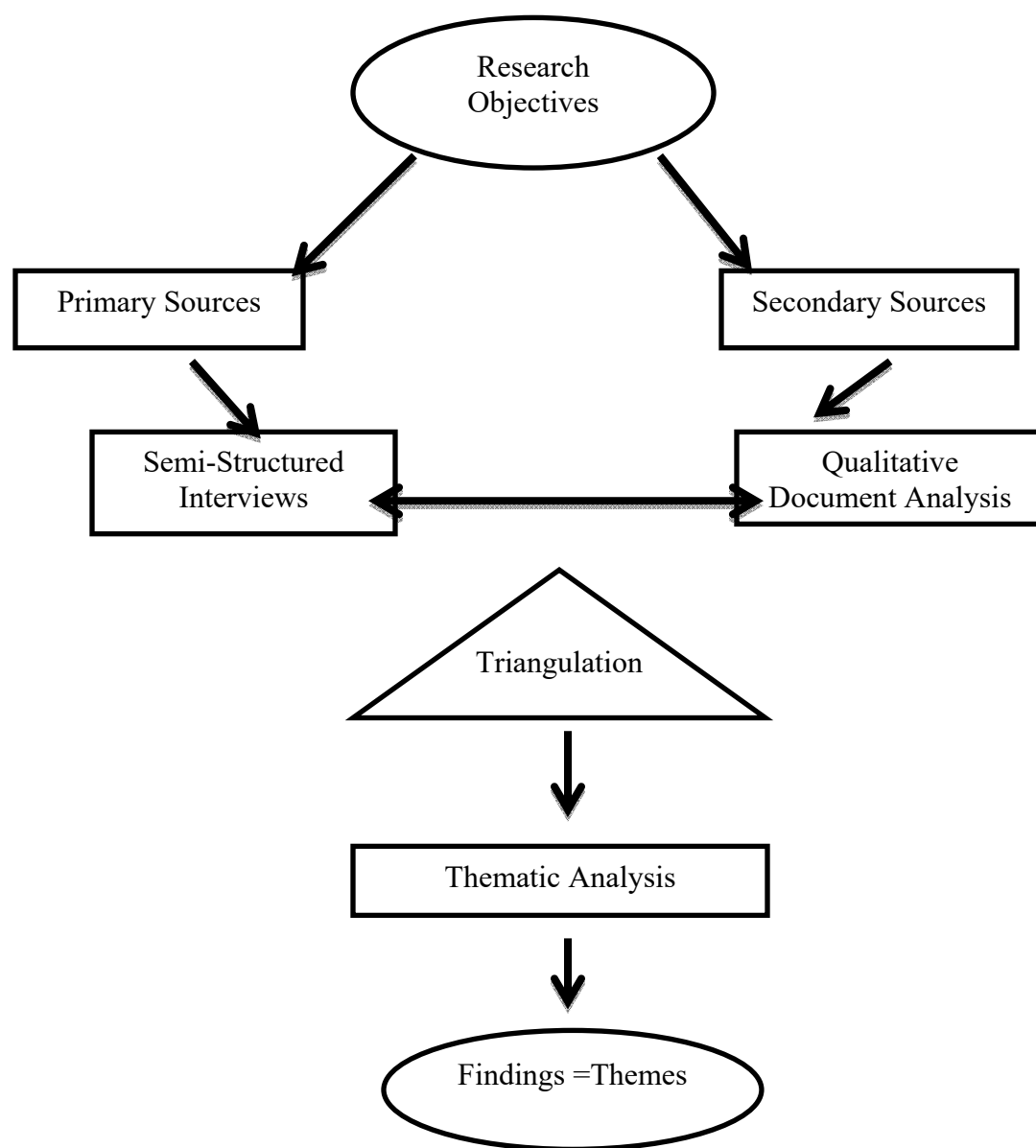


Figure 15. Methodological Structure.

Source: thesis author.

Semi-Structured Interviews

I used semi-structured interviews as my preferred method of data collection from a selected set of primary sources. Semi-structured interviews are utilized frequently in the social sciences, particularly in policy research studies like this one. This method differs from structured and unstructured interviews in one fundamental way: structured interviews have a rigorous matrix of questions from which a researcher must not diverge; unstructured interviews have no such restrictions in the lines of enquiry. By comparison, semi-structured interviews offer a middle ground between the two types of interviews, allowing for structured but also open “think aloud” when collecting qualitative research data.¹¹⁴ The semi-structured approach to interviews provides a vantage point compared to structured and unstructured approaches because it allows for the generation of insight during the course of the interview, depending on the feedback provided by the interviewee. Researchers using semi-structured interviews also prepare a list of topics or thematic areas that must be explored under the open structural framework, thereby eliminating the undirected nature of unstructured interviews.

I used semi-structured interviews as my approach to data collection. That approach not only offered flexibility in the exploration of the topic but also because “it allows depth to be achieved by providing the opportunity on the part of the interviewer to probe and expand the interviewees’ responses.”¹¹⁵

¹¹⁴ Blandford, *Semi-structured Qualitative Studies*, 29.

¹¹⁵ Blandford, *Semi-structured Qualitative Studies*, 30.

Preliminary Preparations

The guiding rubric of the thesis interviews was based on themes outlined in the Research Objectives in the introductory section of the paper. I prepared a list of standard questions to be asked of prospective interview participants. Before deciding on the inclusion criteria for the types of respondents to incorporate into the study, I identified over-arching research questions of interest, taking into account the likely audience of the thesis' output. I also considered numerous sources of knowledge and information that were appropriate to answer the research questions so identified, including various types of potential participants and their resulting subgroups, taking into consideration the characteristics that differentiate the potential respondents.

Population Identification

“Population” refers to the entire set of possible study participants. Based on the above considerations, I identified a target population of interviewees. In the context of this study, the identified population size consisted of 60 players within the Palestine microfinance sector, including the leadership and key personnel of the five leading MFIs in the region, and board members of the two primary sectoral regulators, namely, the Sharakeh and the PMA.

The medium for conducting the data collection was via telephone, given the geographic and physical constraints at play. I conducted a preliminary search of digital and print sources for telephone and email contacts associated with the target population. Notably, all the contact and address data was obtained from official websites on the internet and the Palestine Yellow Pages.

Sampling Procedures

“Sampling” refers to selecting a representative subset from the larger population set defined above; that subset is referred to as the sample. Ideally, the sampling technique should generate a sample that reflects the population’s attributes as closely as possible. This study applied a random sampling technique with the over-arching objective of obtaining a truly random sample while adhering to extant best practices of research methods. Specifically, I randomly selected telephone contacts in an iterative process from the pool of 60 contacts obtained after the process of population identification. After sealing the contacts, I conducted a series of 30 independent draws by which I selected a random telephone or email address from the pool and subsequently made an attempt to contact the selected entity. After each draw, the specific selected contact was returned back to the population pool. The sampling procedure resulted in 30 contacts to different financial institutions in the Palestinian microfinance sector.

I set a time frame of 30 days for gathering responses from the targeted selections. After 30 days, I had scheduled five 30-minute interviews with representatives from the microfinance sector. These included one representative each from three leading MFIs: FATEN, ACAD, and Reef Finance; and two representatives from Sharakeh. The five interviewees constituted this study’s sample of primary sources.

Data Preparation and Analysis

The five semi-structured interviews were scheduled and conducted successfully. I collected data verbatim using a digital recorder while also taking my own notes.

Subsequently, I transcribed each of the five interviews using the InqScribe transcription software, which I chose for its ease of use and availability.

The research objectives outlined in the introduction of this thesis, which also informed the topical areas covered by the interviews, were used to code¹¹⁶ and organize the interview data thematically after I completed transcription. Finally, thematic analysis was applied to evaluate the information emerging from the transcripts.

Document Analysis

I chose document analysis as the methodology for researching my secondary sources. Document analysis is a type of qualitative research involving the interpretation of extant documents on a particular topic. Its objective is to assign voice and meaning to an assessment of the topic.¹¹⁷ It is a systematic procedure, similar to a systematic review, for evaluating printed and electronic material documents concerning a selected topic.

Like all other qualitative, analytical methods, implementing document analysis necessitates examination and data analysis to elicit meanings, formulate empirical knowledge in areas of interest, and gain in-depth comprehension of a specific topic. Documents usually contain text and images that were recorded in the absence of the researcher. Thus, documents are “social facts” that are produced, shared, and utilized in socially organized ways.¹¹⁸

¹¹⁶ John L. Campbell, Charles Quincy, Jordan Osserman, and Ove K. Pedersen, “Coding In-Depth Semi-structured Interviews: Problems of Unitization and Intercoder Reliability and Agreement,” *Sociological Methods & Research* 42, no. 3 (2013): 294.

¹¹⁷ Bowen, “Document Analysis,” 31.

¹¹⁸ Bowen, “Document Analysis,” 31.

There are three principal types of documents: physical evidence, personal documents, and public records. Physical evidence includes objects located within the vicinity of a study's settings, such as posters, training materials, fliers, agendas, and handbooks. They are regularly referred to as artifacts. Public records consist of official organizational documentations of a particular entity's activities, such as annual reports, policy manuals, syllabi, and strategic plans. Personal documents are recorded, first-person accounts of people's beliefs, actions, and experiences. Examples include social media posts, incident reports, reflections, journals, and blogs.

The rationale my use of document analysis was based on my need for triangulation. This study triangulates research insight from secondary and primary sources, and that triangulation provides a channel through which the data collected on the Palestinian microfinance sector can be better understood. The documents analyzed provided data on the context in which this paper's primary sources operate. The secondary sources provided information that was instrumental in generating additional lines of inquiry that were included in the collection of primary data as elaborated. In particular, they were instrumental for generating additional interview questions that were incorporated into the semi-structured interviewing phase of the study. Additionally, the documents furnished this study with supplementary research data which were valuable additions to the knowledge base pursued by the researcher. The documents provided a mechanism for tracking change and development in the topic area of interest. Given the availability of various drafts of particular documents that were included in this study, I was able to make insightful comparisons concerning change over specific time frames of interest. Finally, the secondary, documented sources offered a way to verify the findings

made from primary sources as well as an analytical method of corroborating the evidence gathered from both primary and secondary sources.

Selection and Analysis of Documents

The available literary evidence on the methodology of qualitative document analysis recommends that every study should use a robust body of written sources consisting of a plethora of documents. However, that criterion that should be applied in the process of document selection is one that pays more attention to the quality rather than the quantity of documents. Accordingly, I searched for documents from a wide array of relevant print and digital sources. Specifically, I used the following keywords to conduct a systematic search of literature published between 2009 and 2010 on reputable databases and data indices containing content about the Palestinian economy and microfinance sector:

Israeli occupation
microcredit
MFIs
microfinance institutions
microfinance
micro-lending
sanctions
specialized lending institutions

The following databases were searched:

- AMIR (Access to Middle East Resources) database
- IPS (Institute of Palestine Studies) database
- PAIS index
- UNCTAD (United Nations Conference on Trade and Development) database

- UNISPAL (United Nations Information System on the question of Palestine) database
- World Bank Data Catalogue.

In addition, I explored research publications, working papers, and policy documents published on the PMA, Sharakeh, and various MFI websites.

The preliminary search for literature yielded 34 documents consisting of academic articles, scholarly journals, research papers, and policy documents. These were largely public and personal documents. I refined the selection criteria for the most relevant documents by selecting documents that (1) relied on primary data for their research; (2) were those that addressed at least five objectives of this research; (3) preference was assigned to documents that specifically narrowed their explorations to the context of the Palestinian microfinance industry; and (4) the documents were appraised for quality (explained in the next subsection) and selected for their demonstration of applicable quality measures. Ultimately, I selected 13 documents which met all of the aforementioned criteria. Appendix 1 presents a summary of the documents included for this analysis.

The documents were subsequently analyzed by coding the generated content into themes. These were then integrated with the findings from the primary sources and subjected to thematic analysis, as presented in the next chapter.

Quality Assessment and Validation of Documents

The process of validating documents for inclusion into this study was based on five assessment variables: alignment, authenticity, agenda/bias, latent content, and completeness. Each is defined briefly below.

- *Alignment* refers to the extent to which a document is aligned with the building blocks and objectives of the research. I considered the meaning and context of each documented candidate for inclusion based on a standard framework to ensure that the assessment was impartial and fair. Additionally, to generate an auditable rationale for the evaluation, all assessments for alignments were justified by explanations and quotations from the texts. Accordingly, the resulting alignment of each documents ranged from high to limited alignment. Only the documents with high alignment were included in this study.
- *Authenticity* refers to the originality value of a document. This study assessed each candidate document's authenticity by considering the initial intent of the document, whether the document's author was a first-hand witness of the phenomenon of interest, whether he or she relied on the use of second-hand sources, and whether the document was solicited, edited, and/or was anonymous.
- *Agenda/Bias*. The assessment of agenda or bias relied on evaluating the intent of the creator or author of the document and his or her individual interests in the subject matter under discussion. It also relied on considerations of the document author's subjectivity and the individual biases that he or she may introduce into the document's content.
- *Latent Content*. The evaluation of latent content entailed assessing the tone, facts, and opinions that were evident in the documents.
- *Completeness* was examined by assessing how selectively or comprehensively a study presented its data and information.

Overall, the ten studies that were ultimately selected for inclusion into this study met and surpassed the quality threshold established by these five quality criteria.

Ethics Statement

This study adhered to the principles of informed consent. Each participant in the semi-structured interviews was informed about the study's purpose, protocol, and methodology, and each was provided with a formal consent form in electronic format, to which each one consented. I respected the participants' autonomy by educating them on their rights and privileges, including the right to opt out of the study at any time. Moreover, provisions were made to protect the interviewees' anonymity and the confidentiality of the data. Accordingly, the identity of each of the participants was concealed and coded.

Limitations

This study's methodology has several limitations. These can be attributed to flaws inherent both in the semi-structured interview and document analysis approaches to research, and are identified as follows.

- *Sample Size*: The size of the sample used in the semi-structured interviews is small relative to the broader microfinance sector in Palestine. This reduces the study's statistical power.
- *Randomness*: Although I made comprehensive efforts to enhance randomness in the semi-structured interviews, the defined nature of the population given the use of phone and email data may have precluded true randomness. For example, the

portion of literate members of the population who may not have a presence on the Internet or in the Yellow Pages were inherently excluded from the study.

- *Biased Selectivity*: Despite the elaborate measures taken to achieve a complete collection of feasible documents as secondary sources, the findings from the secondary research are still exposed to the risk of biased selectivity. It is possible, for instance, that the policy documents selected from an organizational context are aligned with the organization's corporate policies and the agenda of its principals, thereby giving a biased view of the broader industry or macro-economic environment in which the organization operates.

It should be noted that these limitations are diminished by the fact that I opted to triangulate two qualitative research methodologies based on two different sources of data. The cumulative result of this triangulation is that the study has two evidence-based levels of corroborative pertinent data and findings. Accordingly, each of the research methodologies works to overcome the limitations of its counterpart, thereby generating a logical and empirically sound methodological framework with a high degree of scientific confidence.

Chapter IV

Findings

As explained in Chapter III, the data collected from primary and secondary sources was coded and subsequently analyzed using thematic analysis. The purpose of thematic analysis is to recognize and identify different patterns within the available data, consequently generating emergent themes that ultimately become the categories for analysis.¹¹⁹ A thematic analysis conducts a close inspection of data based on its characteristics with the objective of uncovering themes pertinent to the phenomenon under exploration. This study uses the research objectives detailed at the outset of the thesis as the set of predefined codes and thematic categories under which the findings from the primary and secondary data are organized. As a recap, this study's objectives are to:

1. explore the growth, development, and performance of Palestine's microfinance sector;
2. ascertain the impact of the microfinance sector in Palestine;
3. determine the interaction between Palestine's banking and microfinance sector;
4. determine the interactions between the macroeconomic environment in Palestine and the region's microfinance sector;
5. determine how organizational theory, structure, and governance affect the performance of Palestine's microfinance sector; and

¹¹⁹ Bowen, "Document Analysis," 31.

6. explore the limitations to further expansion in Palestine's microcredit sector, with the objective of replicating the sector's positive impacts and success stories.

Chapters 1 and 2 have largely covered and achieved the first objective through a comprehensive review of literature from a wide variety of sources. The extant body of literary evidence was largely disjointed and, as such, this thesis provides a channel through which the development of the Palestinian microfinance sector is charted using historical analysis tools. Integration of the pertinent and relevant literature bridges the knowledge gap that previously existed regarding a comprehensive historical mapping of growth and development in Palestinian microfinance. For these reasons, the first research objective is not included in the subsequent thematic analysis.

Theme 1: Impact of the Microfinance Sector in Palestine

Based on the integration of data from primary and secondary sources, it is evident that the microfinance industry in Palestine has both direct and indirect positive socioeconomic benefits for the region. The most notable of these is the positive impact that the business bears on SMEs across various economic sectors. Current survey evidence of the Palestinian economy indicates that more than 90% of the private sector is composed of small and medium-size businesses. These businesses equally employ about 92% of the total workforce operating in the region. The region's economy, in turn, depends on the private sector as its lifeline.

However, the evidence gathered shows that one of the most critical hindrances facing the SMEs, and consequently the private sector, is the low availability of financing owing to conservative credit policies currently implemented by the ordinary banks

operating in the West Bank and Gaza. Microfinance institutions have emerged over the years as instrumental channels of filling the gap left by ordinary banks in the Palestinian credit market. Subsequently, the microfinance sector is the primary source of funding for the vast majority of Palestinian's critical enterprises within the private sector and is, thus, a major facilitator of the creation of employment opportunities. The implication is that the microfinance sector has an essential role in facilitating the growth and sustainability of the Palestinian economy.

Additionally, the sector's major impact on the Palestinian economy derives from the role it plays in alleviating poverty and promoting financial inclusion, empowerment, and individual/community autonomy.¹²⁰ In particular, the positive impacts on empowerment and financial inclusion apply to the women and youth who constitute the majority of MFI clients and borrowers. These two groups are also the most marginalized and impoverished in Palestinian society. Therefore, Palestinian MFIs have a positive impact on incentivizing social equity and growth, which results in enhanced standards of living and reduced levels of poverty at the household level.

Theme 2: Banking and Microfinance: Interactions and Correlations

The common thematic areas that emerge from exploring the interactions between the Palestinian banking and microfinance sectors revolve around the supply and demand areas of the region's credit market. It emerges that neither sector is sufficiently meeting the region's demand for credit.¹²¹ A common subject that arose both in the interview data

¹²⁰ UNDP, *2014 Palestine Human Development*.

¹²¹ Najjar, "Banks in Palestine."

and in the secondary documents was the need for broader collaboration between players in both sectors. Specifically, it emerged that the prospect of achieving notable increments in the region's financial inclusion was critically dependent upon the possibility of banks funding the microfinance sectors and the current MFIs. Additionally, ordinary banks were noted for having competitive advantages in the microfinance industry deriving from their robust, existing infrastructure, human resources, high capacity, high volumes of deposits, technology, among other factors that are critical for business success in microfinance.¹²²

Theme 3: Microfinance in an Unstable Macroeconomic Environment

The Palestinian microfinance sector operates in a highly unstable macroeconomic environment often characterized by military conflict. All the sources included in the study mentioned the negative impact of the First Intifada on the operations and profitability of the sector owing to the prevailing, inhibitive macroeconomic conditions. A significant majority of interviewees and documents also made reference to the Second Intifada in 2007, which particularly affected FATEN, a major sectoral player at the time.¹²³ The Second Intifada led to a complete flattening of the organization's activities for nearly a year.

However, the MFIs attribute the resilient nature of the sector, despite the harsh environment, to donor funding and flexible approaches to risk management. A common approach taken by leading MFIs to recover after the economic shocks generated by

¹²² Karsh and Deek, "Microfinance Institutions," 168.

¹²³ Di Martino and Sarsour, "Microcredit in Palestine," 446.

macroeconomic instability was proactive consumer education. For this strategy, they encouraged their borrowers—especially those whose economic activities depended on the Israeli economy—to reorient their business and production strategies to a more local focus within the Palestine territories. Some studies indicated that the resilience of the Palestinian macroeconomic sector was the result of the credit gap created in the credit market by banks that adopted mainly risk-averse attitudes toward lending owing to the macroeconomic instability. The banks’ attitude toward risk implied that the microfinance sector was an indispensable part of addressing the market’s demand for credit.

A common area of consensus among all data sources is that the current restrictive Israeli policies toward Palestine are inhibiting the microfinance sector’s potential. Trade blockades, restrictions on labor and product movement, and “dual use” policies stifle all sectors of the Palestinian economy, including microfinance.¹²⁴ As mentioned earlier, MFIs in Palestine primarily serve SMEs and low-income individuals whose growth and development, their demand for credit, and ability to repay are dependent on economic activity. Restricting movement and erecting barriers to trade reduces Palestinians’ ability to engage in expansive enterprise and economic activity, which in turn derails the performance and capability of the microfinance sector at large.

Theme 4: The Organizational Perspective of Palestinian MFIs

One major theme emerged relative to the organizational structure, theory, and governance of Palestinian MFIs: the inability of MFIs to act counter-cyclically.¹²⁵ A

¹²⁴ IFC, *Microfinance Survey*, 47.

¹²⁵ Di Martino and Sarsour, “Microcredit in Palestine,” 448.

notable characteristic among all MCIs operating in the Palestinian region is that they all rely on external donations in one form or another, particularly from international organizations such as the European Union, USAID, and the Islamic Development Bank. However, the implication of such reliance is that the aims and objective of the MFIs, their strategic investment directions, and the level of financial support they receive is substantially determined by foreign investors. The actions of these foreign investors are usually directed by their subjective, ideological, and political views that are often not consistent with the reality on the ground and the business environment in which the MFIs operate.

Conversely, the day-to-day administration of these institutions is in the hands of local managers who, because of the influence of foreign owners, often have little or no say regarding the long-term strategies of MFIs. Moreover, these local managers are often held accountable for the costs and efficiencies of MFI administration and procedures. Therefore, their personal, professional, and financial stability are pegged to the delivery of performance variables that, in reality, they have very little control over.

Thus, the situation generates a structural conflict between the foreign donors' aims and the aims of local managers. While donors pursue their political objectives, emphasizing the constant provision of financial backing to specific areas in the West Bank and in Gaza, they often force the MFIs to engage with risky clients at high transaction costs. Managers, on the other hand, pull in the opposite direction, striving to defend their institutions by promoting financial stability and profitability.

This tension is more visible during periods of enhanced macroeconomic and political instability and was particularly evident during the Second Intifada. The

experiences of FATEN, ACAD, and Reef Finance during this period provides evidence of these conflicting objectives. In the years following 2006, the foreign donors of all the three organizations advocated for counter-cyclical interventions with the aim of providing assistance to the affected, marginalized Palestinians who were unable or unwilling to obtain credit from ordinary banks.¹²⁶ Conversely, local managers understood that this target population presented high financial and portfolio risks to their institutions and thus opted to limit the supply of credit in an effort to mitigate losses. The managers were more inclined to contract the volume of lending in times of macroeconomic instability. From an organizational perspective, the inability of MFIs to act cyclically and the conflicts between managers and donors is a significant issue at play within the microcredit industry.

Theme 5: Challenges Faced by Palestinian MFIs

A content and thematic analysis of the interview data and the secondary document data revealed several common challenges and limitations perceived to be associated with the microfinance sector in Palestine. First, the vast majority of MFIs operating in the Palestinian microfinance sector are NGOs. However, they face various legal and regulatory limitations deriving from the fact that they undertake their operations under the Law of NGOs. This law is the only legal framework available to not-for-profit MFIs in Palestine.¹²⁷ The law is inadequate and some argue inhibits the development of sustainable MFIs in the region for several reasons. For example, the oversight authority

¹²⁶ ILO, *The Occupied Palestinian Territory*.

¹²⁷ PMA, *2017 Annual Report*.

for NGOs under the current legal structure is the Ministry of Interior (MoI), which is not adequately equipped with the knowledge and resources needed to regulate organizations operating in the financial industry. Moreover, the law is inflexible in its requirement that all legal documents be accepted by the chairman of the MFI, that task could ideally be delegated to a proxy. These limitations, among others, demonstrate that the regulation of the microfinance sector is a noteworthy challenge for non-profit MFIs.

Second, the treatment of for-profit MFIs in Palestine is also a challenge faced by sectoral players. Although the current legal regime allows MFIs to register as for-profit entities, thereby avoiding the aforementioned legal problems associated with not-for profit MFIs, the current environment positions for-profit MFIs at a comparative disadvantage relative to other actors in the credit market. This is especially true because NGOs enjoy a tax-exempt status and loan loss reserves for which their for-profit counterparts do not qualify. For-profit MFIs also do not qualify for deductions that are often offered by licensed finance firms and banks in consideration of the value added taxes associated with the workforce salaries.¹²⁸

A third industry-specific challenge stems from collateralized lending. All lending by banks and MFIs in Palestine currently involves collateralized and semi-collateralized credit facilities, with a guarantee as the predominant form of collateral. When guarantees are unavailable, MFIs often require clients to deposit post-dated checks. The lending mechanisms inhibit financial inclusion and promote financial exclusion because the required collateral is often not accessible to SMEs and low-income individuals who are

¹²⁸ Manalo, *Microfinance Institutions' Response in Conflict Environments*.

the vast majority of MFIs' borrowers.¹²⁹ Therefore, collateralized lending is a significant challenge that limits the growth and expansion of the Palestinian microfinance sector.

¹²⁹ PMA, *2017 Annual Report*.

Chapter V

Recommendations and Conclusion

The previous chapter provides an in-depth thematic analysis of written and verbal evidence regarding the microfinance sector in Palestine. The analysis generated five core themes regarding the exogenous and endogenous factors at play within the sector in the context of the broader macroeconomic environment and financial system.

Based on the evidentiary findings presented above and with reference to best practices and success stories within comparative economies and microfinance sectors globally, this thesis makes three recommendations and justifications for sectoral implementation. The objective of these recommendations is to bolster the expansion and performance of Palestinian MFIs, the microfinance sector, the financial system, and the Palestinian economy at large.

Recommendation 1: The microfinance sector should embrace the commercialization of

MFIs in order to cope with the challenges associated with over-reliance on donor funding and the limitations associated with the inability to act cyclically. MFIs can achieve the recommended outcome by collaborating with industry players that are pushing for the same intervention, notably the Expanded and Sustained Access to Financial Service Program (ESAF) and ShoreBank International (SBI).¹³⁰ Further, the fact that a huge proportion of NGO MFIs indicate that they are 100% percent dependent on donor funding is problematic because it exposes

¹³⁰ World Bank, *Economic Monitoring Report*.

them to the risk of unsustainability, especially with the rapidly growing number of microfinance services. In other developing economies with capacities similar to those of the Occupied Palestinian Territory, commercialization has proven empirically to be a potential key to the growth for microfinance institutions, particularly as donors increasingly recognize the socioeconomic benefits of weaning the microfinance sector off donor funding.

Commercialization presents Palestinian MFIs with additional benefits to their sustainability and performance: (1) enhancing accountability to stakeholders and shareholders through additional reporting requirements, thereby incentivizing professional and efficient operations; (2) it bolsters transparency in an institution's governance by making the executive leadership answerable to a board, and the board answerable to stake and shareholders; and (3) it introduces additional players into the institution's governance structure and business model such as internal controls, regulators, and creditors. The cumulative effect of such additions is that the institution is rendered more responsible, accountable, and transparent, hence more effective.

Recommendation 2: There needs to be more collaboration between the banking sector and the microfinance sector in Palestine. Under the guidance of the PMA and Sharakeh, policymakers should endeavor to create an environment that incentivizes more involvement by ordinary banks in microfinance. This is critical because maximizing the capability of the microfinance sector not only depends on the commercialization of MFIs but also on the extent to which MFIs access

commercial funds.¹³¹ While it is important for MFIs to improve their operational efficiencies in order to become sufficiently profitable to cover expenses and the market-based cost of capital, the participation of banks in the microfinance sector is also key. Palestinian banks need incentives and an environment that will enable them to take certain lending risks including the provision of performance-based grants and guaranteed loans to MFIs. One policy action that the regulators of the financial systems can consider, based on successes achieved in African countries like Kenya and Nigeria, is providing a guarantee fund for banks that offer micro-lending and other engagements in the microfinance sector.

Recommendation 3: The microfinance sector in Palestine can be empowered to overcome many of the limitations it currently experiences through robust and efficient capacity building. In particular, the Palestine Authority (PA) should seek to replicate the successes realized in comparative developing countries owing to proactive support by governments to the microfinance sector.¹³² Therefore, the PA should seek to eliminate any regulatory barriers to players within the microfinance sector, and proactively engage global industry experts in the formulation of a more growth-friendly legal framework underpinning the sector.

Additionally, the monetary policy oversight authorities should work to develop a credit information market through the institution of a private credit bureau. This would be instrumental in reducing or eliminating the costs associated with lending in the microfinance sector. With the recommended capacity building

¹³¹ Portland Trust, *The Credit Market in the Palestinian Economy*.

¹³² Barden, “Both a Borrower and Lender Be,” 101.

interventions, the microfinance sector would invariably replicate its current successes in unprecedented ways.

Conclusion

This thesis commenced with the overarching intent of achieving six core research objectives that revolve around the topic of microfinance in Palestine. Through a comprehensive literature review and a thematic analysis of document and interview data, the study has met all of the proposed objectives that were established at the outset of the research.

The literature review in the first and second chapters provided a detailed account of the advancement of the microfinance sector in Palestine in terms of the region's prevailing macroeconomic environment. Although data on the topic was scarce, the review herein provides a cogent and coherent integration of the extant literary evidence from diverse fields of disciplines and research approaches, thereby contributing to the existing body of knowledge on the Palestinian economy.

The insights generated by the thematic analysis can be categorized into three topic areas:

1. The Palestinian microfinance sector has substantial, positive socioeconomic effects in the region. Thus, it is in the best interests of all associated parties to strategize on how to replicate and maximize the positive effects yielded by the sector.
2. The microfinance sector in Palestine responds both positively and negatively to two exogenous factors, namely, the macroeconomic environment, particularly the

Israeli sanctions and restrictions on the Palestinian economy, and the environment within the broader financial system, notably the sector's interactions with the formal banking sector.

3. There are two endogenous factors that influence the microfinance sector, namely, the prevailing regulatory context and the applicable monetary policies and practices.

Overall, based on the knowledge generated in this study, it is my opinion that the implementation of the recommendations proposed herein would foster further growth and expansion of the Palestinian microfinance sector.

Appendix 1

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