

Islamic Finance and SME Financing

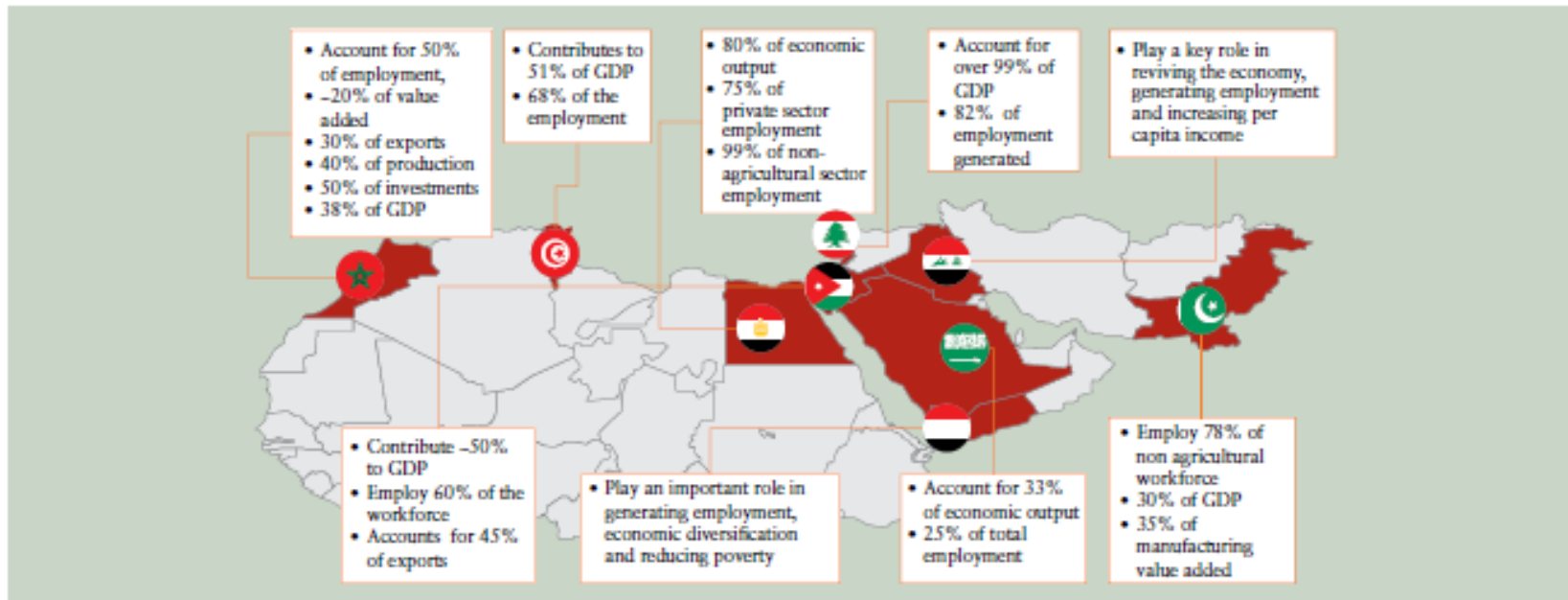
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Growing Importance of SMEs...”Engine for Growth”

- ✓ SMEs are the flagships of the economies of emerging markets
- ✓ Recent IFC study covering Egypt, Iraq, Jordan, Lebanon, Morocco, Pakistan, Saudi Arabia, Tunisia, and Yemen finds out that the proportion of SMEs in GDPs of countries ranges from 33% to nearly 99%.
- ✓ SMEs are also key actors in terms of private employment, investments, and exports.

SME Contribution to GDP in MENA Countries



Note: Statistics on the contribution of SMEs to the economies of Yemen and Iraq are unavailable
Source: Islamic Banking Opportunities across Small and Medium Enterprises in MENA, IFC, 2014

Key Challenges faced by SMEs...

- ✓ *Lack of enough funding is a key challenge for SMEs at every stage of their evolution especially during inceptions and development stages*

Inception Stage

- Lack of Initial Capital for Setting up the business
- Bureaucratic processes when formally registering the business
- Lack of well-trained labor force
- Unstable political environment

Development Stage

- Lack of funds to expand the business
- Lack of enough business skills
- Insufficient infrastructure
- Lack of well-trained labor force
- Weak business environment and corruption

Maturity Stage

- Insufficient demand conditions
- Unstable political environment
- Insufficient infrastructure
- Threats from informal sector
- Lack of intra-industry partnerships

Why low penetration of SME financing?

Demand side factors

- High interest rates
- High collateral requirements
- Cumbersome processes
- Lack of customized processes
- Financial literacy
- Religious belief

Supply side factors

- Unavailability of reliable credit history
- Weak management
- Lack of financial documentation
- Conservative lending approach
- High NPLs

- ✓ *The SME penetration within the total lending is still at very low levels despite the remarkable increase in Islamic banking assets. For example, penetration in Pakistan, Egypt, Jordan, Yemen, and Morocco is 7.3%, 8.0%, 12.5%, 20.3%, and 24.0% respectively.*

Islamic finance has certain features which give it the potential to effectively support SME financing, and economic growth and development

Participatory and risk-sharing financing

Emphasis on materiality (asset-based)

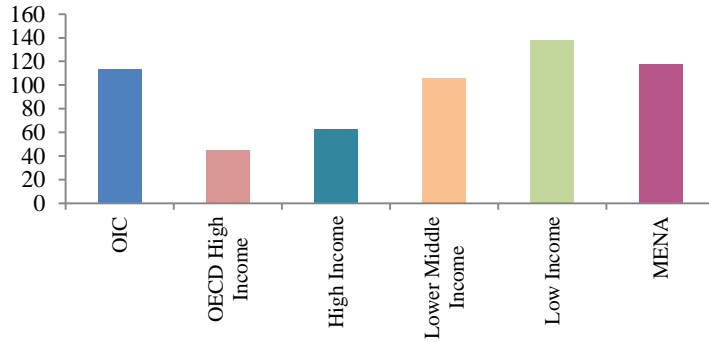
Real Sector Financing

Entrepreneurship

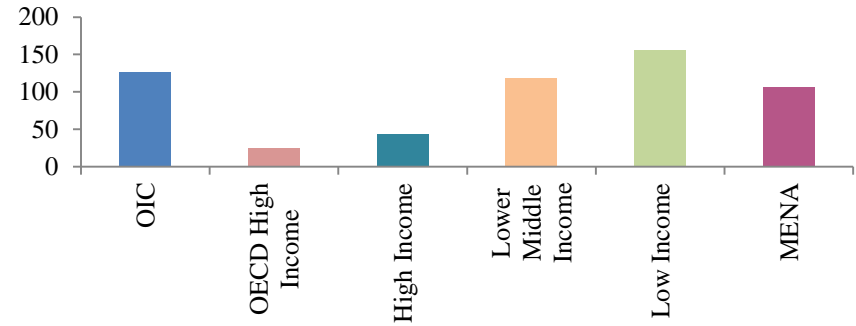
Notion of Economic and Social Justice

SME's – Conventional or **Islamic** are facing challenges due to lack of enabling environment in OIC countries

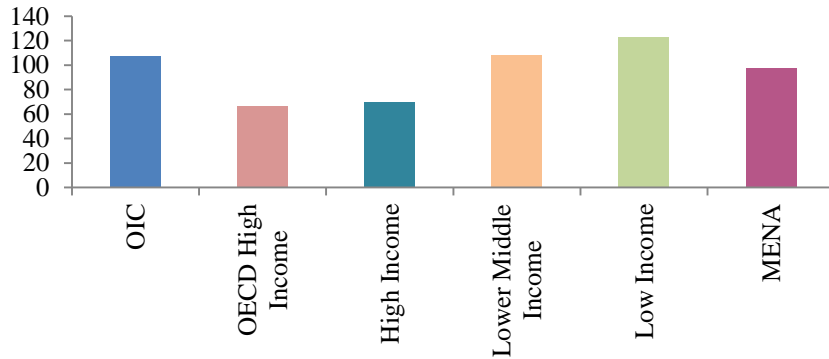
Starting a Business



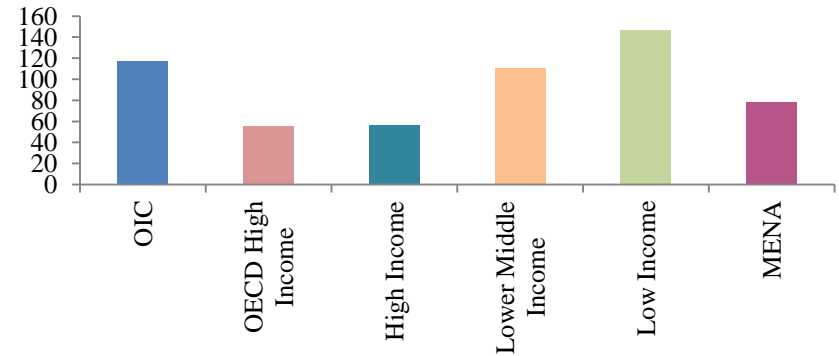
Ease of Doing Business Rank



Dealing with Construction Permits



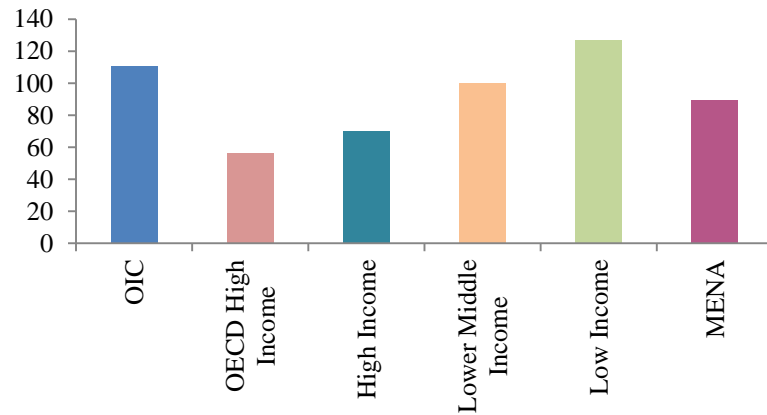
Getting Electricity



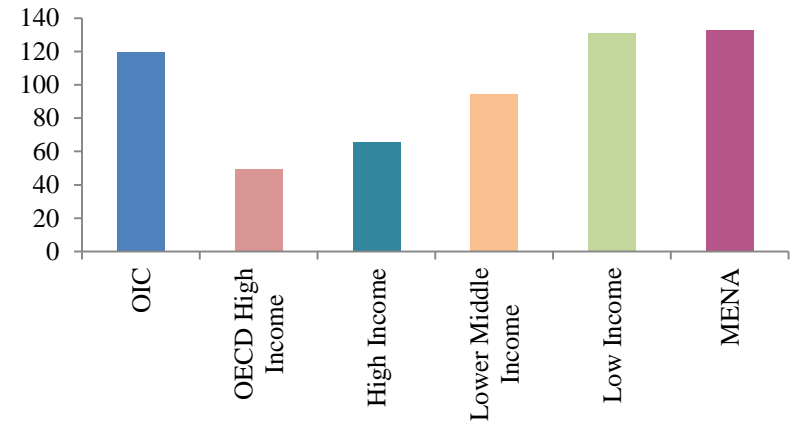
Source: World Bank Doing Business Database (2014)

SME's – Conventional or **Islamic** are facing challenges due to lack of enabling environment in OIC countries

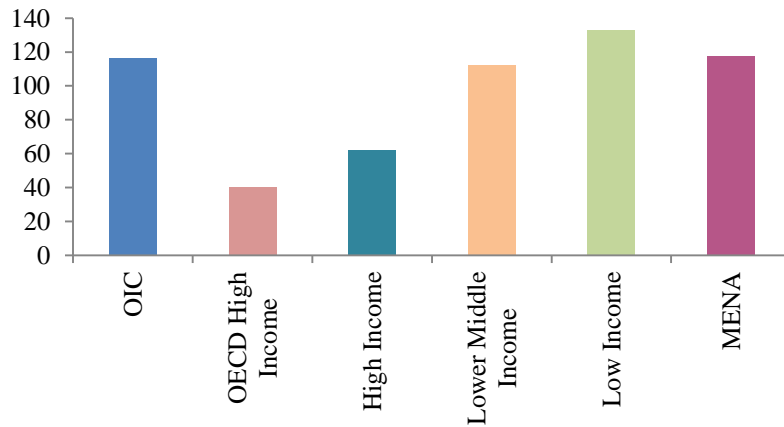
Registering Property



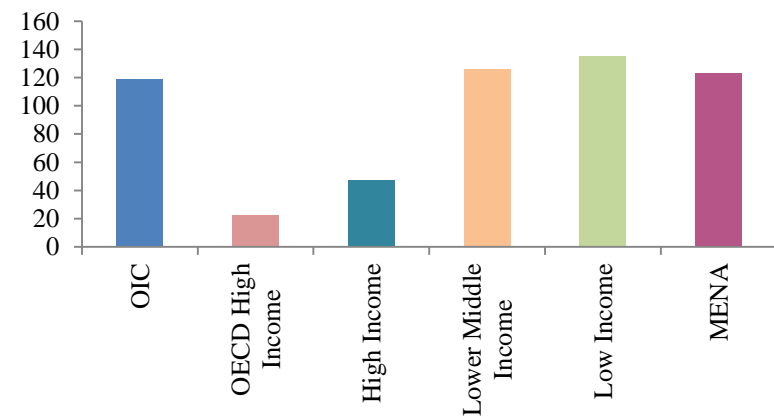
Getting Credit



Enforcing Contracts



Resolving Insolvency



How to mobilize Islamic finance as catalyst for SME Financing?

- Strengthen financial sector, i.e. legal institutions, corporate governance, transparency, and business environment to prepare ground for **risk-sharing** products of Islamic finance.
- Develop national level policy and strategy on enabling environment and regulatory framework for Islamic finance for SME financing.
- Develop **risk-sharing** and **asset-based** products suitable for SME financing.
- Enhance financial literacy to educate investors and borrowers about risk-sharing products.

Thank You

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