



RETHINKING
YEMEN'S ECONOMY

Microfinance in Yemen:
**AN OVERVIEW OF
CHALLENGES AND
OPPORTUNITIES**



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Yemeni farmer collects arabica coffee beans at
the plantation in Taiz, Yemen
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EXECUTIVE SUMMARY

In 1997 microfinance was introduced to Yemen. The government, supported by international donor states, viewed it as a strategic tool to alleviate poverty and reduce unemployment by expanding financial services to small and micro entrepreneurs to increase their share of the national economy. However, persistent challenges facing the microfinance industry have stunted its development, reach within the population and overall socioeconomic impact. More recently, the institutions, businesses and individuals involved have also faced challenges associated with the ongoing civil war and regional military intervention.

Structurally, the microfinance industry in Yemen can be separated into two distinct institutional groupings: the formal sector, composed of microfinance banks; and the informal sector, made up of microfinance institutions (MFIs).⁽¹⁾ The primary difference is that microfinance banks are regulated by the central bank and permitted to finance their activities by mobilizing public savings and deposits. MFIs operate outside the central bank's governance and are thus almost wholly reliant on external donor funds and programs channeled to them through the Social Fund for Development (SFD), a semi-autonomous public institution with the primary mandates of poverty reduction and job creation.

The formally regulated microfinance industry, given its stronger institutional framework and governance, has garnered a relatively more advantageous environment to develop capacities and strategies to react to local demand, making it more resilient to shocks and adverse events, such as the ongoing conflict. Meanwhile, the informal sector's dependence on international donor funding – which comes with these foreign organizations' implementation requirements – has left MFIs with reduced say over the programs they implement and the populations and markets targeted, thereby hindering MFIs' ability to pursue consistent strategies and specialization. This, in turn, has limited their competitive position, overall impact and organizational development.

This paper explores the historic development of the industry and its players, as well as the impacts of the ongoing conflict. It then makes recommendations in four areas – capacity building, financing, program design and research – to help create a more conducive operating environment for microfinance overall. This would better place the industry to achieve its socioeconomic aims in the near term and contribute to Yemen's recovery post conflict.

1) In this report MFIs include all non-banking entities involved in microfinance in Yemen, including some programs that do not have legal status as a financial institution.

INTRODUCTION

The launch of microfinance in Yemen was intended to spur development in the Arab world's least developed country. Following the unification of Yemen in 1990, the government faced perennial fiscal constraints, as the majority of the state budget was allocated to salaries for military personnel and subsidies for fuel and food.⁽²⁾ Lack of funds for public spending, along with ineffective governance and law enforcement systems, prevented the implementation of state-led development projects to address issues such as inadequate infrastructure or the largely low-skilled labor force in the country. During this same period, microfinance became increasingly popular internationally as a mechanism for promoting sustainable development in the developing world. Microfinance initiatives, meaning “the provision of financial services to low-income poor and very poor self-employed people,” sought to empower populations that lacked access to capital to allow them to better participate in the economy and society.⁽³⁾

In 1997, the Yemeni government established the Social Fund for Development (SFD), with the fund's primary mission to combat poverty and augment the Yemeni population's limited social safety net. Early on, the SFD identified poor people's access to financial services to be an important component of a social safety net, by helping to increase poor people's coping options and reduce their vulnerability to macroeconomic shocks.⁽⁴⁾ This led to the creation of the Small and Micro Enterprises Development (SMED) program, a unit of the SFD with the purview to manage microfinance in the country.⁽⁵⁾

2) Ali Alshebami and Dr. V. Rengarajan, “Microfinance Institutions in Yemen, Hurdles and Remedies,” *International Journal of Social Work*, 2017, Vol.4 No.1, https://www.findevgateway.org/sites/default/files/publication_files/5th_paper_published.pdf. Accessed December 17, 2019.

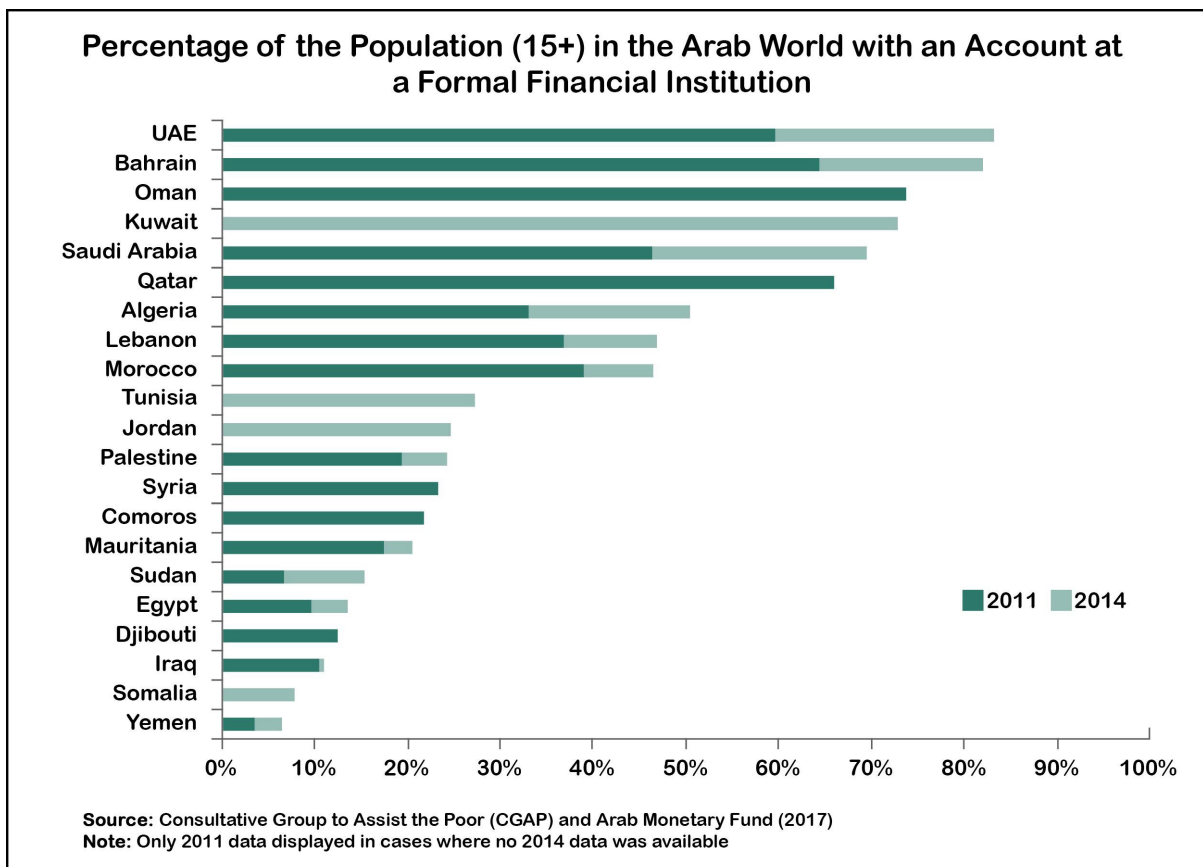
3) Maria Otero, “Bringing Development Back, Into Microfinance,” *Journal of Microfinance*, 1999, *ESR Review*: Vol. 1: Iss.1, Article 2, p. 8. <https://scholarsarchive.byu.edu/esr/vol1/iss1/2>. Accessed December 17, 2019.

4) Judith Brandsma and Laurence Hart, “Making microfinance work better in the Middle East and North Africa,” Washington, DC: World Bank, 2004, p. 40 <http://documents.worldbank.org/curated/en/889971468774294069/Making-microfinance-work-better-in-the-Middle-East-and-North-Africa>. Accessed December 17, 2019; also see: Adel Mansour, “Small and Micro Enterprises Development in Yemen and Future Prospects,” *The Social Fund for Development – Yemen*, 2011, <https://www.sfd-yemen.org/uploads/issues/SMED%20Book%202011-20120716-142650.pdf>. Accessed December 17, 2019.

5) The SMED program is tasked with developing the entire microfinance industry in Yemen, and as such it acts as the main arm for direct economic development at the SFD. Specifically, it is mandated to: finance micro and small enterprises; facilitate business development services (BDS); promote institutional capacity building, sector advocacy and the creation of an enabling environment; introduce new players in the small and microfinance industry; and develop its own expertise in the fields of small and microfinance. For details see: Adel Mansour, “Small and Micro Enterprises Development in Yemen and Future Prospects,” *The Social Fund for Development – Yemen*, 2011, <https://www.sfd-yemen.org/uploads/issues/SMED%20Book%202011-20120716-142650.pdf>. Accessed December 17, 2019.

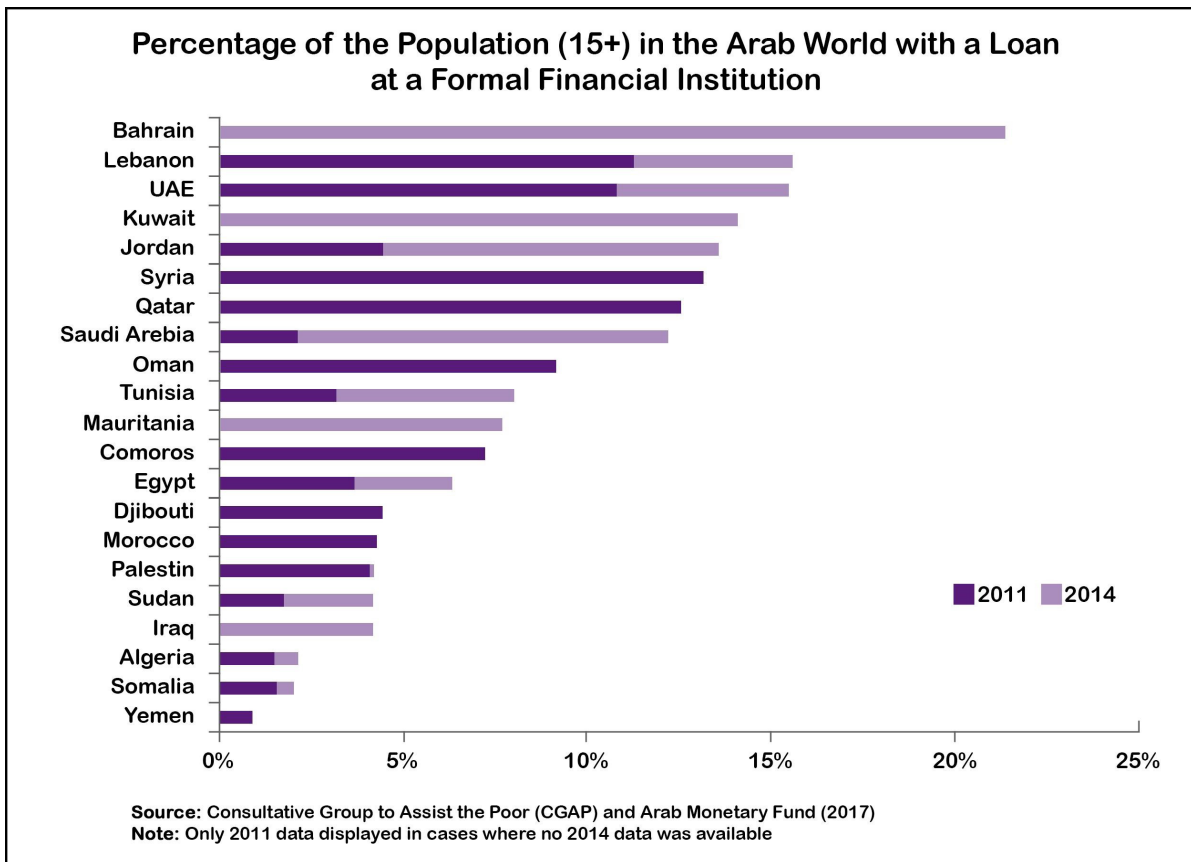
Increasing ordinary Yemenis’ access to capital and financial services was an urgent need that was not being met by the country’s commercial banks. This was due to the fact that the mainstream Yemeni banking sector has been defined by its risk aversion. Yemeni banks historically invested much of their capital in treasury bonds. Issued by the Central Bank of Yemen (CBY) to cover the government’s perennial budgetary deficits, treasury bonds generally entailed less risk and higher returns than commercial loans. Commercial lending, therefore, was generally limited to name lending – the practice of loaning to large, well-known actors in the market – or those who had abundant capital to put up as collateral. This steered away much-needed funds from the vast majority of businesses, hindering their ability to develop and compete. Given the lack of competition and minimal engagement in crediting lending, there was also little need for banks to develop innovative and responsive products and services or expand to new markets. As a result, the banking industry remained underdeveloped with limited outreach, with less than 10 percent of the country’s population benefiting from banking services as of 2014.⁽⁶⁾

Figure 1: Percentage of the Population (15+) in the Arab World with an Account at a Formal Financial Institution



6) Nadine Chehade, Antoine Navarro, Yisr Barnieh and Habib Attia), “Financial Inclusion Measurement in the Arab World”, CGAP and Arab Monetary Fund, January 2017, https://www.cgap.org/sites/default/files/Working-Paper-Financial-Inclusion-Measurement-in-the-Arab-World_1.pdf, Accessed December 17, 2019.

Figure 2: Percentage of the Population (15+) in the Arab World with a Loan at a Formal Financial Institution



Given the commercial banking sector’s lack of reach and coverage, the SFD viewed the introduction of microfinance to Yemen as a unique opportunity. Since Yemen was not “tainted by worst practices,” as numerous officials involved in microfinance described it to this author, the SMED was able to build up the sector utilizing best practices internationally from the start.⁽⁷⁾

In addition to providing capital to the poor to combat poverty on an individual level, microfinance is seen as being able to play a role at the institutional level of a country.⁽⁸⁾ By addressing a gap in the market – the provision of financial services to poor populations that are underserved

7) Author interviews with Omar al-Absi (former Project Officer, Social Fund for Development), Ali Abu Taleb (Managing Director, Yemen Microfinance Network), Abdullah al-Qirbi (Manager, Loan Compensation Fund – Yemen Emergency Crisis Response Project) and Ibrahim al-Sukhaimi (Managing Director, Azal Microfinance Program), March, April, and May 2019.

8) Elizabeth Littlefield and Richard Rosenberg, “Microfinance and the Poor,” International Monetary Fund, June 2004, <https://www.imf.org/external/pubs/ft/fandd/2004/06/pdf/littlefi.pdf>. Accessed December 17, 2019.

by the mainstream banking sector – in a financially sustainable manner, informal microfinance institutions (MFIs) have the potential to be integrated into the formal financial system of a country. This would allow MFIs access to additional sources of financing beyond donor funds (such as private deposits or direct investments), increasing their capacity to serve a larger audience and offer financial services beyond loans and savings, and subsequently help build a stronger and more resilient industry. This ultimately fulfills microfinance’s larger goal of combating poverty through the creation of sustainable financial markets.

THE DEVELOPMENT OF FORMAL AND INFORMAL MICROFINANCE STREAMS IN YEMEN

The first microfinance initiatives in Yemen were launched by the SFD in 1998. Phase 1 piloted income-generating programs, which mainly targeted poor women in rural areas. In 2000, phase 2 introduced microfinance programs in Sana'a, Aden, Abyan, and Hadramawt governorates. Phase 3 saw the institutionalization of the first informal microfinance institutions (MFIs), with the National Microfinance Foundation (NMF) established either in 2002 (according to the SFD)⁽⁹⁾ or October 2003 (according the Yemen Microfinance Network),⁽¹⁰⁾ followed by the Al-Awael Microfinance Company, formed in 2000 and registered as a company in 2004, in Taiz.

The SFD had immense influence over the creation of the nascent industry. This was largely due to its broad mandate to lead the formation of MFIs outside the formal banking sector, channel donor funds to these entities, monitor spending and supervise their performance. Via the SMED, the SFD held seats on the board of directors of MFIs and led recruitment efforts for top management positions. As part of its efforts to provide technical support, the SMED also took a lead role in capacity building by setting up management information systems and core banking system infrastructure.

As the primary body receiving international funds for programs intended to help alleviate poverty and reduce unemployment in Yemen,⁽¹¹⁾ the SFD also had sole authority to allocate funds to MFIs for microfinance projects. This was done through the provision of loans on behalf of international donors to implementing partners (MFIs). The overall purpose of the financial and technical support was to provide a foundation for MFIs, with the expectation that in the future they would operate as independent, financially and institutionally stable institutions,⁽¹²⁾ though almost no MFIs achieved financial self sufficiency.⁽¹³⁾ Thus, while the SFD has tended to steer away from exerting overt interference in the industry so

9) Adel Mansour, "Small and Micro Enterprises Development in Yemen and Future Prospects", The Social Fund for Development – Yemen, 2011, <https://www.sfd-yemen.org/uploads/issues/SMED%20Book%202011-20120716-142650.pdf>. Accessed December 17, 2019.

10) "National MF Foundation," Yemen Microfinance Network, <http://yemennetwork.org/en/national-microfinance-foundation/>. Accessed December 17, 2019.

11) In 2011, international donor funds represented 90 percent of SFD's financial resources. Source: Adel Mansour, "Small and Micro Enterprises Development in Yemen and Future Prospects," The Social Fund for Development – Yemen, 2011.

12) Ibid, p. 10.

13) Analysis by the author based on official figures published by the SFD and mixmarket.org.

as to not affect market dynamics,⁽¹⁴⁾ the body retains an indirect power to influence overall strategies and operations at MFIs.

The SFD also actively encouraged the private banking sector to enter the microfinance industry to create a competitive environment. Through more competition, the SFD hoped to stimulate innovation and efficiency across the entire sector and widen outreach, with the broader goal of increasing the sustainability of Yemen's MFIs. In 2006, Tadhamon International Islamic Bank established a loan program to serve small and micro enterprises (SMEs). In 2007, Yemen's first dedicated microfinance bank was established: Al-Amal Microfinance Bank. A second dedicated microfinance bank, Al-Kuraimi Islamic Microfinance Bank, began operations in 2007 and was licensed by the CBY in June 2010.⁽¹⁵⁾ As part of efforts to promote microfinance within the formal banking sector, the CBY, in cooperation with the SFD, formulated a law regulating microfinance activities within the formal banking sector, which was passed by parliament in 2009.⁽¹⁶⁾

Microfinance institutions can be separated into two distinct groups: the formal sector (microfinance banks) and the informal sector (MFIs). The main difference between the two is that microfinance banks are regulated by the central bank under the 2009 law governing microfinance activity. As a result, they have the ability to finance their activities by mobilizing public savings and deposits, and are free to budget for activities and investments according to internal goals and strategies. This is not possible for MFIs operating outside the central bank's governance, which makes them almost wholly reliant on external funds and programs channeled to them through the SFD. Instead, MFIs are governed by Law No.1 of 2001, which covers associations and foundations such as NGOs and charities.⁽¹⁷⁾

14) Author interviews with Omar al-Absi (former Project Officer, SFD), March 2019, and Ali Abu Taleb (Managing Director, Yemen Microfinance Network), May 2019.

15) Adel Mansour, "Small and Micro Enterprises Development in Yemen and Future Prospects," The Social Fund for Development – Yemen, 2011, p. 26-27, <https://www.sfd-yemen.org/uploads/issues/SMED%20Book%202011-20120716-142650.pdf>. Accessed December 17, 2019.

16) Author interview with an official involved the drafting of the microfinance law.

17) Theodore Nikwenti, "Country Reports: Middle East and North Africa Yemen," The International Journal of Not-for-Profit Law Volume 3, Issue 3, March 2001, <https://www.icnl.org/resources/research/ijnl/country-reports-middle-east-and-north-africa>. Accessed December 17, 2019.

ANALYZING THE INDUSTRY'S PERFORMANCE

Underdeveloped Even Prior to the Conflict

The microfinance industry in Yemen was far from reaching its potential even before the outbreak of the current conflict. This can be seen by judging the progress in the areas of focus for the industry outlined by the SFD's SMED unit in 2011. These included: building the institutional capacity and capitalization of MFIs; offering diversified financial services (notably downscaling banks and upscaling MFIs to offer mid-sized loans sought by small and medium-sized enterprises); and targeting rural populations and the ultra poor.⁽¹⁸⁾

By examining studies into the microfinance industry – including those produced by the SFD, Yemen Microfinance Network (YMN), Consultative Group to Assist the Poor (CGAP) and the World Bank – one can conclude that little progress has been made in achieving any of the SFD's goals.⁽¹⁹⁾ MFIs remain limited in their outreach and lack the financial products and services required to meet the needs of their target markets, especially in rural areas. Poor infrastructure for financial services and high operating and financing costs also directly affect the sustainability of MFIs and their programs. The lack of strong and effective governance and management also serves as an impediment to the overall development of the sector. Some of these challenges are typical of those faced by MFIs in other developing countries. However, the microfinance industry in other countries has shown better progress in terms of outreach, in addition to performance, program sustainability, the utilization of technology to offer innovative financial products and services, and the development of innovative solutions to existing challenges than MFIs in Yemen.⁽²⁰⁾

18) Adel Mansour, "Small and Micro Enterprises Development in Yemen and Future Prospects," The Social Fund for Development – Yemen, 2011, <https://www.sfd-yemen.org/uploads/issues/SMED%20Book%202011-20120716-142650.pdf>. Accessed December 17, 2019.

19) Ibid; "Microfinance in Yemen – Hopes vs. reality – A first insight into the impact of war on the industry," The Yemen Microfinance Network, 2015, http://yemennetwork.org/en/wp-content/uploads/2015/08/Microfinance-in-Yemen-Impact-of-War_-YMN-July-20151.pdf. Accessed December 17, 2019; Nadine Chehade, Antoine Navarro, Yisr Barnieh and Habib Attia Chehade, "Financial Inclusion Measurement in the Arab World," CGAP and Arab Monetary Fund, January 2017, https://www.cgap.org/sites/default/files/Working-Paper-Financial-Inclusion-Measurement-in-the-Arab-World_1.pdf. Accessed December 17, 2019.

20) Author's analysis based on interviews with multiple officials working in Yemen's microfinance industry.

Figure 3: Microfinance Outreach in Select MENA Countries (2010)

Country	Number of active borrowers	Active borrowers as a percentage of the working age population	Operating expenses as a percentage of total loan portfolios
Egypt	868,315	1.69	20
Iraq	27,708	0.16	15.4
Jordan	134,037	3.7	24.9
Lebanon	23,678	0.84	18.3
Morocco	1,241,957	5.96	23.6
Palestine (The West Bank and Gaza)	34,265	43.2	26.9
Syria	22,149	0.18	4.5
Tunisia	94,959	1.32	17.2
Yemen	24,976	0.2	43.6

Source: World Bank Group⁽²¹⁾

Quantitative Analysis of the Microfinance Sector

An analysis using recent data paints a more nuanced picture of the health of Yemen's microfinance sector, with formal microfinance banks outperforming their informal MFI counterparts in terms of overall portfolio value, number of borrowers, and, in particular, the number of active savers. There are 10 microfinance entities active in the sector today (three banks and seven MFIs).

All 10 are based in urban areas of the country while only two service rural areas – where more than two-thirds of Yemenis reside. Approximately 93 percent of clients were located in urban areas.⁽²²⁾ As of December 2019, there were almost 88,000 active borrowers, with a total portfolio amount of YR19,192,000,000 (approx. US\$32 million).⁽²³⁾ Since the introduction of microfinance to the country in 1997, there have been 832,176 total loans

21) Douglas Pearce, "Financial Inclusion in the Middle East and North Africa: Analysis and Roadmap Recommendations," World Bank Group, March 2011, p. 9, <http://documents.worldbank.org/curated/en/830211468051845285/pdf/WPS5610.pdf>. Accessed December 17, 2019.

22) "Market Research Report - Islamic Microfinance Products in Yemen," Center of Islamic Banking and Economics – Pakistan, May 13, <http://yemennetwork.org/en/wp-content/uploads/2015/02/Islamic-Micorifinance-products-study-eng.pdf>. Accessed December 17, 2019.

23) Calculated at the exchange rate of YR600 per US\$1.

disbursed, with a total portfolio amount exceeding 120 billion Yemeni rials (approx. US\$200 million). As of December 2019, active savers in the microfinance industry reached nearly 1.3 million. The average loan size was YR89,072 (approximately US\$148) with an average interest rate of 18 percent. Notably, women comprise 35.4 percent of the loan recipients.⁽²⁴⁾

List of Microfinance Banks and Institutions in Yemen



Al-Amal Microfinance Bank

Year Established: 2007

Classification: Bank⁽²⁵⁾

Established by: Joint cooperation among the Yemeni government, the Arab Gulf Program for Development and the private sector, as the culmination of Saudi prince Talal Bin Abdulaziz's initiative to establish banks for the poor in the Arab region.

Number of Branches: 16

Number of Governorates Present (outreach): 9



Al-Kuraimi Islamic Microfinance Bank

Year Established: 2007 (began operations), 2010 (licensed by the CBY)

Classification: Bank

Established by: Al-Kuraimi Exchange

Number of Branches: Over 100

Number of Governorates Present (outreach): 22



Tadhamon Microfinance

Year Established: 2006

Classification: Bank⁽²⁶⁾

Established by: Tadhamon International Islamic Bank

Number of Branches: 16

Number of Governorates Present (outreach): 9

24) Social Fund for Development official figures 2009-2018, unpublished figures for 2019.

25) Al-Amal Microfinance Bank is not included among the list of members on the Yemen Microfinance Network website.

26) Classified as a bank on the YMN website, although Tadhamon Microfinance is not officially licensed as a bank, but rather exists as a unit within Tadhamon International Islamic Bank.



National Microfinance Foundation

Year Established: 2002 (SFD), 2003 (YMN)

Classification: Foundation/NGO

Established by: Collaboration among government officials, including former Yemeni prime minister Dr. Abdul Karim Ali Al-Eryani, academics, prominent businessmen and bankers.

Number of Branches: 17

Number of Governorates Present (outreach): 10



Alawael Microfinance Company

Year Established: 2000 (formed), 2004 (officially registered)

Classification: Company

Established by: Ministry of Labor and Welfare, with funding from the United Nations Development Programme (UNDP) and SFD

Number of Branches: 5

Number of Governorates Present (outreach): 1



Nama'a Microfinance Foundation

Year Established: 2000

Classification: Foundation

Established by: Agreement between the United Nations Development Programme (UNDP) and the Charitable Society for Social Welfare (CSSW) within the micro-star program in Yemen.

Number of Branches: 13

Number of Governorates Present (outreach): 5



Azal Islamic Microfinance Program

Year Established: 2001

Classification: Program

Established by: Collaboration between Yemeni non-governmental organization SOUL For Development and the SFD

Number of Branches: 7

Number of Governorates Present (outreach): 4



Hadramawt Microfinance Program

Year Established: 2000

Classification: Program

Established by: Social Fund for Development (SFD) and Alnahda Social Foundation

Number of Branches: 1

Number of Governorates Present (outreach): 1



Union Microfinance Program - Abyan

Year Established: 2003

Classification: Program

Established by: Under the platform of the Yemen's Women Union.

Number of Branches: 6

Number of Governorates Present (outreach): 3



Aden Microfinance Foundation

Year Established: 2005

Classification: NGO

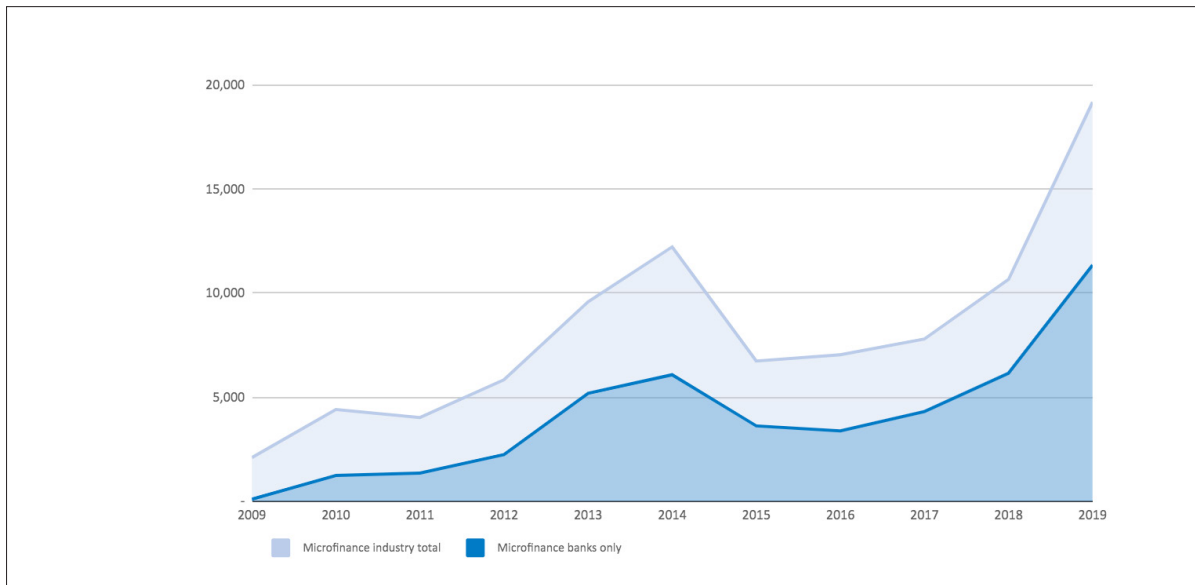
Established by: Social Fund for Development (SFD)

Number of Branches: 8

Number of Governorates Present (outreach): 3

Source: Official data from the Social Fund for Development SMED program quarterly newsletters (2009-2018), unpublished SFD 2019 data, and the Yemen Microfinance Network website.

Figure 4: Value of Outstanding Loan Portfolio (Million YR)



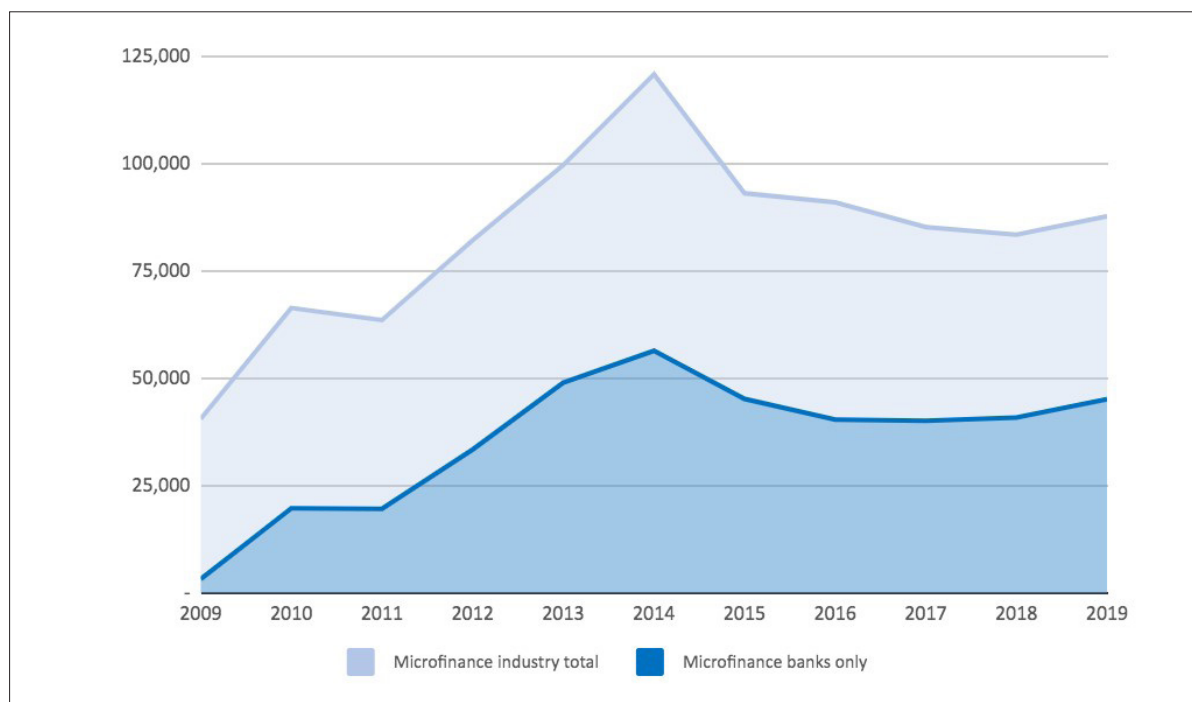
Value of Outstanding Loan Portfolio (Million YR)	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Microfinance industry total	2,104	4,413	4,030	5,846	9,590	12,226	6,741	7,045	7,800	10,667	19,192
<i>Microfinance banks only</i>	99	1,243	1,357	2,247	5,191	6,084	3,624	3,381	4,311	6,156	11,354
Al-Amal	99	556	534	956	1,904	2,765	2,414	2,324	2,285	2,601	3,402
Al-Tadhamon	-	607	750	732	1,433	1,272	430	245	616	1,167	1,795
Al-Kuraimi	-	80	75	559	1,854	2,047	780	812	1,410	2,388	6,157
<i>Percentage of industry total</i>	5%	28%	34%	38%	54%	50%	54%	48%	55%	58%	59%
<i>Portfolio Value: MFIs</i>	2,005	3,170	2,673	3,599	4,399	6,142	3,117	3,664	3,489	4,511	7,838

Source: Social Fund for Development official figures (2009-2018), unpublished SFD data for 2019

Judging from the outstanding loan portfolios in the microfinance industry, microfinance banks have demonstrated a better resilience over time, particularly in response to the adverse conditions brought on by conflict from 2015 onward. Despite the steep drop in the industry’s total loan portfolio value from 2014 to 2015, microfinance banks maintained a market share between 48 and 59 percent since. This can be mainly attributed to the regulated environment, which has allowed for the development of capacities and strategies to react to local demand, as well for the application of corrective action when necessary without needing to adhere to external dictates. Nonetheless, conflict did hit both

the formal and informal industry hard, decreasing their respective total loan portfolios by roughly half each from 2014 to 2015. However, while microfinance banks managed to reach their pre-war portfolio levels in 2018 before experiencing a nearly 87 percent increase in 2019 compared to 2014 figures, total portfolio value for the informal industry barely managed in 2019 to finally climb above their pre-conflict value.

Figure 5: Number of Active Borrowers



Number of Active Borrowers	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Microfinance industry total	40,630	66,419	63,618	82,206	99,726	120,839	93,118	91,017	85,259	83,490	87,791
<i>Microfinance banks only</i>	3,298	19,774	19,650	33,420	49,008	56,455	45,230	40,438	40,172	40,875	45,175
Al-Amal	2,691	14,730	15,939	26,154	34,374	40,819	37,671	35,152	34,098	33,502	34,958
Al-Tadhamon	607	4,810	3,381	5,437	8,787	7,886	3,873	2,119	2,696	3,618	4,817
Al-Kuraimi		234	330	1,829	5,847	7,750	3,686	3,167	3,378	3,755	5,400
<i>Percentage of industry total</i>	8%	30%	31%	41%	49%	47%	49%	44%	47%	49%	51%
<i>No. of active borrowers excluding banks</i>	37,332	46,645	43,968	48,786	50,718	64,384	47,888	50,579	45,087	42,615	42,616

Source: Social Fund for Development official figures (2009-2018), unpublished SFD data for 2019

The Impact of the War on the Microfinance Industry

The number of active microfinance borrowers (individuals with a loan at a microfinance bank or MFI) peaked in 2014, the year before the conflict in Yemen began. From 2009 to 2014, the total number of microfinance borrowers increased by 196 percent. Following the onset of war in 2015, the number of active borrowers declined each year through 2018, with total borrowers growing slightly in 2019. Since 2013, banks and MFIs have been relatively equal in terms of total borrowers, holding a market share between 44 -51 percent and 49-56 percent, respectively.

In researching the impact of war on the microfinance industry, in 2015 the Yemen Microfinance Network identified a number of measures that MFIs had taken in reaction to the conflict, which offer a plausible explanation for the drop in the overall number of microfinance loans. These included the closure of MFI branches in governorates affected by conflict, such as Aden, Taiz, Lahj, and Abyan, and a cessation of loan disbursements, including loan renewals for creditworthy clients in governorates less affected by violence due to market uncertainty. Expansion plans were also suspended, including the anticipated launch of two microfinance providers from the commercial banking sector.⁽²⁷⁾

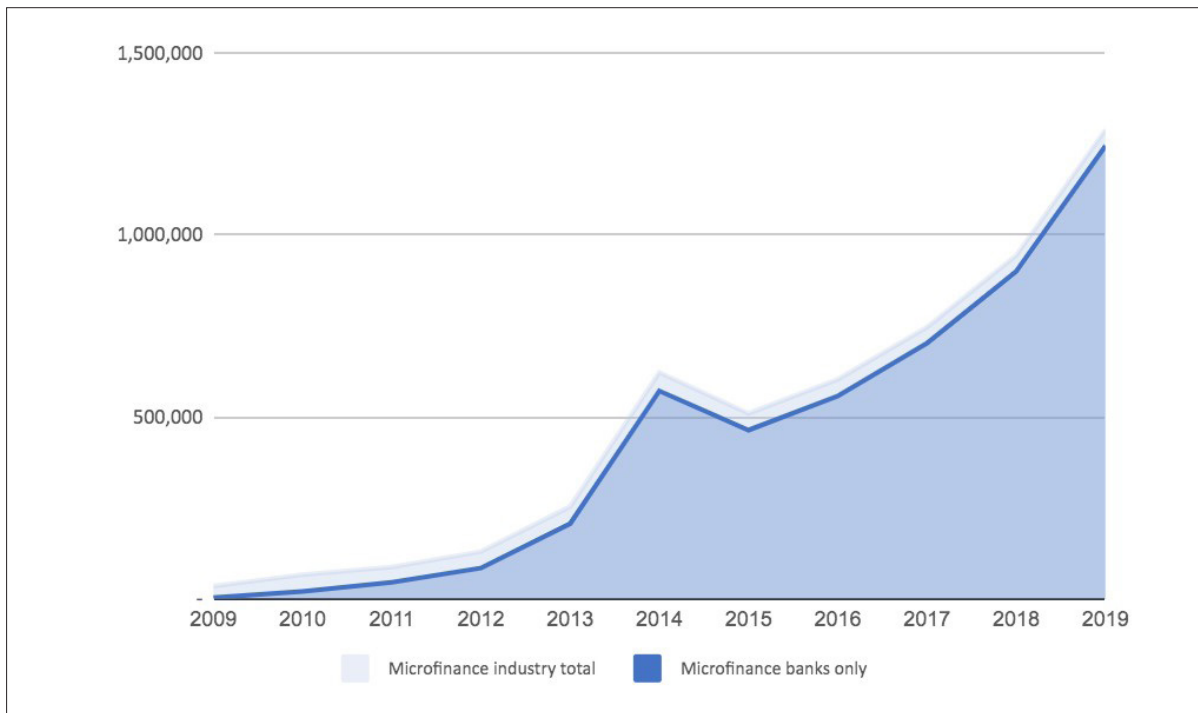
In response to the worsening conditions, microfinance operators in the sector shifted toward short-term sustainability. This led to an increased focus on loan repayment collection, which was made difficult by the internal displacement of clients. Many borrowers saw their income-generating assets destroyed during the conflict or business activity disrupted as a result of the coalition's blockade on the country. These two factors led to unprecedented defaults, according to multiple officials working in the industry. As a result, microfinance providers began writing-off, shifting or rescheduling the majority of loans. Furthermore, staff in the industry have reported an increase in unregulated lenders, such as retailers and foreign exchange businesses, offering credit in rural and urban areas with far easier terms and at competitive rates, which has added further competition to the sector.⁽²⁸⁾

27) "Microfinance in Yemen – Hopes vs. reality – A first insight into the impact of war on the industry," The Yemen Microfinance Network, 2015, http://yemennetwork.org/en/wp-content/uploads/2015/08/Microfinance-in-Yemen-Impact-of-War_-YMN-July-20151.pdf, Accessed December 17, 2019.

28) Author interviews with Taha Iskandar (Head of SME Credit, Al-Kuraimi Islamic Microfinance Bank), March 2019, Mohd Al-Nawa'a (Risk Manager, Al-Kuraimi Islamic Microfinance Bank), May 2019, and Ali Abu Taleb (Managing Director, Yemen Microfinance Network), May 2019.

With defaults and increased competition threatening the existence of many MFIs, an initiative was launched in September 2017 within the Yemen Emergency Crisis Response Project (YECRP) to stabilize the industry. Sponsored by the World Bank and UNDP, and jointly carried out by the SFD and Yemen Microfinance Network through a specialized Yemeni Emergency Crisis Response Unit, the project offers to pay off outstanding loans (and any accrued interest) to MFIs on behalf of borrowers, in addition to providing grants to help beneficiaries resume business activity or start new ventures.⁽²⁹⁾ The compensation project mainly targets two categories of beneficiaries: those who sustained damages as a direct result of the armed conflict (damage to assets or direct damage to the person(s) running the business); and those whose businesses were negatively impacted by the extreme fluctuation in exchange rates and who were not able to mitigate the changes in daily costs and purchases.⁽³⁰⁾

Figure 6: Number of Voluntary Depositors/Savers



29) Author interviews with Abdullah Al-Qirbi (Manager, Loan Compensation Fund – Yemen Emergency Crisis Response Project), April 2019, and Ali Abu Taleb (Managing Director, YMN), May 2019.

30) Author interview with Abdullah Al-Qirbi (Manager, Loan Compensation Fund – Yemen Emergency Crisis Response Project), April 2019.

Number of Voluntary Depositors/Savers	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Microfinance industry total	34,623	66,419	87,277	129,464	253,292	622,114	509,590	603,012	746,387	943,830	1,289,251
<i>Microfinance banks only</i>	<i>2,678</i>	<i>19,601</i>	<i>45,106</i>	<i>84,130</i>	<i>206,513</i>	<i>571,069</i>	<i>463,452</i>	<i>557,052</i>	<i>702,314</i>	<i>900,248</i>	<i>1,244,914</i>
Al-Amal	2,678	18,513	32,720	44,336	57,894	93,053	122,377	125,296	127,940	129,801	181,952
Al-Tadhamon ⁽³¹⁾											
Al-Kuraimi		1,088	12,386	39,794	148,619	478,016	341,075	431,756	574,374	770,447	1,062,962
<i>Percentage of industry total</i>	<i>8%</i>	<i>30%</i>	<i>52%</i>	<i>65%</i>	<i>82%</i>	<i>92%</i>	<i>91%</i>	<i>92%</i>	<i>94%</i>	<i>95%</i>	<i>97%</i>
<i>No. of depositors excluding banks</i>	<i>31,945</i>	<i>46,818</i>	<i>42,171</i>	<i>45,334</i>	<i>46,779</i>	<i>51,045</i>	<i>46,138</i>	<i>45,960</i>	<i>44,073</i>	<i>43,582</i>	<i>44,337</i>

Source: Social Fund for Development official figures (2009-2018), unpublished SFD data for 2019

While microfinance loans have been curtailed during the conflict, the number of microfinance savers overall has actually risen, with microfinance banks assuming a dominant market share of 97 percent in 2019. The overall number of active savers (individuals with a savings account at a microfinance bank or institution) rose by over 600 percent from 2011 to 2014, including by 146 percent from 2013 to 2014 alone. Total savers decreased in 2015, the year the Saudi-led coalition began its military intervention, but increased to over pre-conflict levels in 2017. From 2015 to 2019, the number of active microfinance savers more than doubled. Compared to microfinance banks, active savers at MFIs have made up a negligible share of the overall market since 2014, and registered only 3 percent in 2019.

Taking a closer look at the number of savers by institution reveals that one bank is responsible for most of the growth of active savers in the microfinance industry: Al-Kuraimi Islamic Microfinance Bank. After beginning operations in 2010 with just 1,088 active savers, this figure jumped to 478,016 by 2014. After a decline in depositors from 2014 to 2015, total savers grew above pre-conflict levels in 2017, and, as of the end of 2019, Al-Kuraimi was responsible for 82 percent of total savings accounts in the entire microfinance industry.

31) As part of Tadhamon International Islamic Bank, clients with Al-Tadhamon Microfinance can open a savings account directly with the bank, and thus are not included in the official figures for depositors/savers with a microfinance bank.

This dominant market position is due in part to Al-Kuraimi's extensive network of branches and agents, with a wide outreach in rural areas. In addition, the bank offers complimentary financial services, most importantly money transfers, to customers. In speaking with this author, a senior official at Al-Kuraimi attributed the bank's relative success to its pre-conflict policies. As an Islamic banking institution, the bank did not invest in CBY treasury bonds like many other Yemeni commercial banks. When the central bank was no longer able to cover cash demand, and the banking sector was running out of cash, Al-Kuraimi remained liquid. As a result, many people lost confidence in the banking sector generally and diverted their saving accounts to Al-Kuraimi due to its perceived stability.⁽³²⁾

32) Author interview with Taha Iskandar (Head of SME Credit, Al-Kuraimi Islamic Microfinance Bank), March 2019.

MICROFINANCE CHALLENGES: FINANCING AND PROGRAM DESIGN

Given the underperformance of the informal microfinance industry compared to formal microfinance banks, two major structural challenges to the development of MFIs are identifiable: a lack of access to financing, and poorly-designed international donor programs. These two challenges are interlinked, as MFIs' reliance on donor funds forces them to implement projects irrespective of whether they conform to their overall development strategy, or the projects' sustainability and suitability to the market conditions in Yemen.

The importance of access to financing in terms of sustainability and overall portfolio performance can be seen by comparing formal microfinance banks to their informal counterparts. Banks are permitted to utilize savings as part of the decree passed by the Central Bank of Yemen governing microfinance activity in the banking sector. As a result, they have access to funds not tied to specific programs. This allows them to pursue more effective and consistent strategies and design and deliver specialized financial products and services. Offering products that increase convenience, such as electronic payments and money transfer services, is likely a factor in microfinance banks attracting additional customers compared to MFIs. Banks are also able to be more selective in choosing whether to participate in international donor programs based on alignment with their strategic direction.⁽³⁵⁾

Meanwhile, MFIs lack any regulatory framework that would allow them to mobilize public savings to finance their activities. This is evident in the distribution of active savers' accounts in the microfinance industry, where microfinance banks have an incentive to attract savings – a portion of which can be used for loans – and thus dominate the market. Lack of financing also hinders MFIs' organizational capacities and negatively affects their ability to attract human and capital resources and develop the necessary infrastructure and financial products.

Given their inability to mobilize public savings for activities, MFIs are totally reliant on one source for funding: foreign donors. Foreign donor funds are channeled to MFIs via the SFD and usually come in the form of programs that target specific groups of people or economic activity. To access such funds, MFIs are obliged to implement these programs irrespective of their credit policies, strategies or appetite for risk. Such programs are usually limited in scope and duration, hurting their long-

³⁵⁾ Author's analysis based on interviews with officials working in Yemen's microfinance industry.

term sustainability. At the end of such programs, past beneficiaries may not qualify for further loans, which can leave fledgling households and businesses unable to access much-needed financial support and MFIs without funds to continue financing activities.⁽³⁴⁾

Many international development programs that utilized microfinance did not have the expected long-term impact when implemented in Yemen. One main reason for this is that when international donors have tried to replicate programs from another context, they have done so without thoroughly studying the local market conditions.⁽³⁵⁾ While similar programs may have been successful in other countries or regions, this does not guarantee the same success in Yemen. Another issue with the design of international microfinance programs in Yemen is that targeting a specific economic activity can disrupt local markets. In some cases this has resulted in the creation of outputs that far exceed the market demand. In other cases, foreign programs failed to assess market conditions, such as regular disruptions in production inputs (such as raw materials or semi-finished products that are necessary for production) or other factors (such as fuel or energy shortages).

Another weakness is that many studies in the lead up to program implementation surveyed existing business activities but overlooked changes in local trends. Thus, international programs failed to account for new interests and potential new industries.⁽³⁶⁾ Changing market conditions, as witnessed during the conflict, also affect the viability of local business models. As a result, beneficiaries may seek to change their business model or pursue new opportunities in a different industry, but have been prohibited under the terms of the program financing rules. Thus, in many cases beneficiaries were left worse off than when they started. Stuck with unsold products and income-generating assets that can no longer generate the necessary revenue to sustain the business ultimately resulted in beneficiaries having to sell both at discounts (dumping of products and assets), causing further disruption to local markets and resulting in delinquencies and defaults in loans.⁽³⁷⁾

34) Author interviews with Omar al-Absi (former Project Officer, SFD), March 2019, Samra Al-Shaibani (Comms Manager, World Bank Group, USAID, MOPIC), December 2019, Ibrahim al-Sukhaimi (Managing Director, Azal Microfinance Program), March 2019, and Taha Iskander (Head of SME Credit, Al-Kuraimi Islamic Microfinance Bank), March 2019.

35) Ibid.

36) A notable example is the recent movement toward agriculture, solar power, transportation, and other activities that focus on providing alternatives to existing products that are difficult to supply or have significantly increased in price during the conflict.

37) Author's analysis based on interviews with officials working in Yemen's microfinance industry.

There are numerous examples of microfinance programs that failed to meet their targets in Yemen due to poor planning, design and research. A cattle fattening project in the Tehama region was unsuccessful due to the irregular supply of ingredients used in the feed. A project aimed at promoting handicraft businesses Sana'a did not properly pay attention to the value chain, and beneficiaries were unable to find sufficient buyers for their increased stock of products. Another initiative aimed at Yemen's marginalized population distributed sewing machines to produce clothes and textiles. As was the case with the Sana'a handicrafts, a market saturation occurred, there was a lack of sufficient demand, and beneficiaries ended up selling their machines to generate income. These programs were revealed not only to be unsustainable; they also resulted in an interruption to the livelihoods of beneficiaries and undermined the credibility of microfinance initiatives in the community.⁽³⁸⁾

Another complaint raised by players in the microfinance industry is that international donor programs that assumed all the risk ended up having limited success. Such programs did not instill a sense of ownership or accountability, and as a result, beneficiaries did not display the same resilience and motivation to overcome challenges as entrepreneurs that were financed to meet specific needs. One example cited was an international program that directed implementing MFIs to finance certain activities in Hajjah governorate while offering to cover the risk of running the portfolio. According to industry insiders, beneficiaries, upon learning that their default risk was covered by the donor, did not feel obliged to repay their loans, resulting in defaults in 60 to 70 percent of the cases. Such instances also impact beneficiaries' attitudes toward microfinance as they will expect the same degree of leniency in terms of repayment in the future, which complicates the implementation of other projects in the same area.⁽³⁹⁾

38) Author interviews with officials working in Yemen's microfinance industry that requested anonymity to discuss specific projects.

39) Ibid.

RECOMMENDATIONS

For MFIs to overcome the challenges facing the industry in Yemen, a better operating environment must be established first and foremost. This should focus on improving organizational and program sustainability and encouraging innovation and the utilization of technologies. To accomplish this, reforms should begin by addressing the lack of financing in the industry and the design of international programs, with the goal of ensuring sustainable development.

On Capacity Building:

- More funds/focus should be dedicated toward building the organizational capacities of players in the industry to create stronger organizations that have the ability and capacity to evolve and innovate while following good practices. Modernization should also be at the forefront of institutions' strategic planning, with a focus on how to incorporate and utilize new technologies to improve capacity and output.
- Improving corporate governance can increase the trust of existing and potential partners/donors, as well as make it easier for organizations to secure funds and projects. Good governance is also a critical step toward the institutionalization of organizations, and for improving strategic decision-making and the execution of plans.
- Studies have shown that the adoption of effective marketing strategies can enhance the growth of microfinance institutions.⁽⁴⁰⁾ Yemeni microfinance banks and MFIs should devote more resources in terms of financial investment and management to marketing that is relevant to target markets and the local environment. Specific elements to consider in marketing strategies include the types of products and services offered, pricing, and investment and adoption of new technologies.

On Financing:

- A more effective regulatory framework that allows non-banking MFIs to mobilize public savings should be provided. The availability of funds not tied to specific projects would offer MFIs alternative sources to fund their activities. This would allow MFIs to pursue additional opportunities and develop sustainable, specifically-designed programs that target

40) Kaburi Murugi, "Influence of Marketing Strategies on Growth of Microfinance Institutions in Kenya," University of Nairobi, December 2017, <https://pdfs.semanticscholar.org/edd0/7c4561dec80379b9c485926795bed98eddf7.pdf>. Accessed December 17, 2020.

specific segments of the market based on the organization's strategic plans and unique characteristics, which would contribute to creating an environment that nurtures growth, diversification and innovation.

- An adequate regulatory and supervisory framework should be established to mitigate the risks associated with tapping public savings for microfinance projects. This could be accomplished by setting a certain benchmark that MFIs must meet to be permitted to finance from the public. Currently, the CBY only governs microfinance banks and the SFD has proven unwilling to formulate regulations for the informal sector. However, it is crucial that an actor take the lead in establishing criteria – which could be similar to the global Basel Framework on capital adequacy, stress testing, and liquidity risk for the international banking sector – and monitoring the activities of MFIs to ensure responsible governance and the public trust.
- Another financing option advocated by the World Bank and other international authorities is obliging or incentivizing the mainstream financial sector of the country to allocate a portion of their assets to finance microfinance activities. This could help ensure that much-needed capital in the market is active, rather than sitting idly in savings accounts. However, in the case of Yemen, any use of commercial bank funds to finance microfinance programs would need buy-in from the central bank.

On Program Design:

- Design and implement more responsive programs that offer MFIs greater flexibility in selecting target segments based on their organizational strategy and market demand. This would facilitate the development of sustainable programs that achieve an impact on the ground.
- Given the changing economic and social landscape as a result of the conflict, it is more critical than ever that microfinance programs take the complete value chain into account while planning interventions. A main focus of any sustainable program should be to ensure that it complements and enhances current conditions and does not warp local market dynamics. To ensure the effectiveness and impact of programs in Yemen, a more significant role should be given to Yemeni specialists in both the design, planning and implementation phase of programs to ensure that local knowledge is utilized and unique factors for each context are taken into account.
- In Yemen, microfinance programs that target specific economic sectors (such as agriculture as a whole and small and micro enterprises) have proven far more effective than programs aimed at specific economic activities. According to local implementers, targeting entire sectors provides flexibility to focus on multiple economic activities in different locations. This grants MFIs more freedom and allows them to better respond to local market needs, creating a greater variety of performing enterprises. This trend should be supported moving forward.

On Research:

- Microfinance in Yemen and its impact on achieving its stated goals – alleviating poverty and enhancing development – remains grossly understudied. Only a handful of large-scale studies have been conducted and this lack of research can be viewed as an indicator of serious underinvestment in the microfinance industry as a national strategy. Promoting further research into the financial sector in Yemen as a whole and the microfinance industry in particular is essential to properly assess the impact of the current conflict on local markets, market mechanisms and MFIs.
- Additional insight into the financial sector and markets would assist scholars, development practitioners and MFIs in exploring how to develop alternative solutions that are tailored to the unique circumstances of the Yemeni microfinance industry today. In particular, more knowledge would help MFIs better confront existing risks, develop alternative solutions to minimize negative impacts, identify new opportunities in the constantly evolving circumstances of conflict, and, in basic terms, learn what works best in Yemen. Strengthened market research through regular and in-depth analysis of different sectors should also be utilized in all future interventions and program designs.

These proposed reforms could have far-reaching effects on the industry in this critical time for Yemen. Allowing for better diversification of funding and specialization in program implementation in reaction to the rapid changes in the country's economic and political scene will increase the resilience and sustainability of MFIs, and can play a critical role in providing a platform for recovery post-conflict. This is essential if microfinance is to achieve its desired impact – poverty alleviation and unemployment reduction through the provision of financial products and services that meet the needs of vulnerable local populations and businesses in both rural and urban areas.

About the Author

Moneef Sultan al-Shaibani is a Yemeni researcher who specializes in financial sector and economic development. He possesses nearly two decades of experience working in Europe, East Africa and the Middle East. He currently serves as the senior advisor for the USAID Yemen Economic Stabilization and Success project.

ABOUT THE “RETHINKING YEMEN’S ECONOMY” INITIATIVE

The Rethinking Yemen’s Economy initiative aims to contribute to peacebuilding and conflict prevention, (economic) stabilization and sustainable development in Yemen by building consensus in crucial policy areas through engaging and promoting informed Yemeni voices from all backgrounds in the public discourse on development, economy and post-conflict reconstruction in Yemen and by positively influencing local, regional and international development agendas. The project is implemented by CARPO – Center for Applied Research in Partnership with the Orient, DeepRoot Consulting and the Sana’a Center for Strategic Studies. It is funded by the European Union and the Embassy of the Kingdom of the Netherlands to Yemen.

The project aims to contribute to peacebuilding and conflict prevention, (economic) stabilization and sustainable development in Yemen by: (1) Contributing to confidence-building and mediation through dialogue and knowledge transfer on the ongoing economic crisis in the country; (2) Building consensus on crucial policy areas by engaging and promoting informed Yemeni voices in the public discourse; (3) Positively influencing local, regional and international development agendas and crisis intervention efforts in order to generate employment and contribute to establishing the minimum conditions for sustainable development; (4) Highlighting local needs and priorities and engaging local expertise in developing new policy proposals; (5) Building the capacities of Yemeni researchers in researching and advocating for social and economic change.

Implementing Partners

The project is implemented by a consortium of the following three partners:



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www.deeproot.consulting



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