

Should banks in Palestine invest in microfinance market?

Prior to determining if the bank should engage in the microfinance market, the bank's management should address important question: *Does the bank have the strategic vision to become a major retail bank?*

Generally, Microfinance is a group of financial services such as credit, savings, cash transfers and insurance to poor or low-income people.

Surveys in Palestine indicate that the estimated number of microfinance borrowers stand at 190,000 and potential market size amounts to USD 280 million. In other surveys, the estimated demand is USD 80 million annually and the MFI's provide less than 30 Million.

Banks must know their competitive advantages when entering the microfinance market compared to MFI's: Physical Infrastructure (Network of branches & offices), variety of financial & banking services, human resources and their knowledge in local markets, their capacity to create a specialized unit, the existence & brand recognition in market, liquidity & availability of Funds and in general banks have lower operating cost structure. But on the other hand, banks face obstacles in the Microfinance market, these obstacles are information asymmetry about the market, credit methodology (banks try to adapt the traditional credit methodology for microlending), banks vision towards the technology and undesirable labor-intensive nature of microfinance, conservative corporate culture, bank employees and officials not feeling at ease with Micro-scale lending, Small-scale lending cost, downscale problems, traditional view of high risk of micro businesses.

There are many proposed methods for banks to enter microfinance. First by creating an internal specialized unit in the bank (downscaling), but this method has a number of problems and is rarely successful. To succeed however, it needs high commitment of senior level management, independent governance for the unit, adapting the bank culture, creating independent leadership for the unit and avoiding the traditional credit methodology used in banks.

Other proposed methods are the establishment of a financial subsidiary or an MFI. Purchasing shares or equity in existing MFI, Strategic alliance with MFI's which allows the MFI to carry out all credit administration and let the bank do the funding mission. *Service company model* is a new and effective model which allows the bank to establish a Non-financial service company that provides the bank with all credit administration, promotion, evaluating, tracking and collecting and the banks do the funding and other operations. Finally, the simplest way is lending for MFI's directly but this method may not have value-added to the market.

The current poor performance of MFIs in Palestine does not reflect the potential that a profitable market does in fact exist. All the methods mentioned above could be applied in different ways with different levels of success but the trick is in which method and how to enter this market effectively. Banks should determine what targets and goals to establish, select the right clusters and sectors, create a retail strategy and choose the optimal method to enter this market in effective ways.

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