OCCASION

This publication has been made available to the public on the occasion of the 50th anniversary of the United Nations Industrial Development Organisation.

DISCLAIMER

FAIR USE POLICY

CONTACT

Please contact publications@unido.org for further information concerning UNIDO publications.

For more information about UNIDO, please visit us at www.unido.org

UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
Vienna International Centre, P.O. Box 300, 1400 Vienna, Austria
Tel: (+43-1) 26026-0 · www.unido.org · unido@unido.org

United Nations Industrial Development Organization
PROGRAMME OFFICE for IRAQ

Lesson Learnt in implementing an Enterprise Development Credit Facility for Iraq

March 2013

List of Contents

1. Background

The EDIP Credit Facility is a financial tool of **1 MLN USD** embedded within the "Enterprise Development and Investment Promotion Project for the SME sector in Iraq" (EDIP) that was created to ensure that an appropriate **funding opportunity** is provided to **support SMEs** supported through the project activities in three Iraqi Governorates (Erbil, Baghdad and Thi-Qar).

- Initially conceived in 2008, the SME credit facility was technically redesigned by UNIDO in 2009 due to unclear provisions in the project document regarding the fund ownership, UNIDO exit strategy and the operational disbursement (loan/grant) arrangements with the financial institution.
- These issues were clarified by the Programme Steering Committee in April 2009 comprising the Italian Government, UNIDO and representatives of the Government of Iraq. It was decided that the fund (1 MLN USD) is a UNIDO owned fund asset. UNIDO would disburse it to the selected financial institutions as an interest-free loan to make it available to be used by them to provide loans to SMEs and project beneficiaries in Iraq according best practices involving SMEs, and covering their costs and profits through the interest earned. It was also agreed that after a period of two years, the selected financial institution must return the funds to UNIDO.
- The credit facility was then tendered for the second time amongst local banks and international financial institutions.
- The management award was gives to Amalkom, an Iraqi headquartered and managed member of the CHF International family of microfinance institutions. Amalkom was selected based upon several factors including geographic reach, technical expertise and prior and ongoing success in lending in Iraq.
- The contract with Amalkom came into effect on February 20th 2010, and covers a period of twenty-four months. In accordance to the contract signed with UNIDO, the financial institution was tasked to deliver a **minimum of 60 loans** to project beneficiaries in the three project governorates. In the early weeks of March 2010, Amalkom established a separate sub-account at the Bank of Baghdad for the specific purposes of this fund. However, general issues with interbank transfers into Iraq delayed the funds transfer from UNIDO to Amalkom until July 2010.
- On September 2010, the first loan was disbursed. As of May 2011, 64 loans have been disbursed, exceeding the target of minimum number of loans to be disbursed.

1.1. Iraqi SMEs: Financing Sector

The SME financing sector in Iraq has shown substantial progress in the past years, thanks to efforts undertaken by the Iraqi Government and international donors.

The **Iraqi government** established its first new initiative, a tentative foray into SME financing through its National Micro-lending Programme. In February 2007, the Prime Minister approved the assignment of US$ 30 million from *Rafidain Bank* as loans to be managed by the Ministry of Labour and Social Affairs (MOLSA). The loans would range from IQD 3-10 million for new businesses or developing an existing business in Baghdad. Loan duration was set at 5-8 years, with a grace period of 6-12 months, at an administrative charge rate of 6% total, 2% paid by the borrower and 4% by the Ministry of Finance, who also guaranteed any loan losses. A similar program has been established within the Ministry of Industry and Minerals (MIM), with a budget of US$ 408 million in 2008 (loan range 25,000-50,000 USD).

Despite the initial enthusiasm surrounding the initiative of the two Ministries, some limitations have emerged during the implementation phase, which have slowed the progress and inhibited results. A comprehensive effort to improve the management of this government-guaranteed Micro-Lending Programme implemented by MoLSA and MIM will be designed and implemented by the UN within the framework of the Private Sector Development Program.

International donors also recognized the needs of the SME sector through the International Compact for Iraq and the main international actors in supporting Iraq's SME sector are the World Bank, United Nations, USAID and Iraq Middle Market Development Fundation. (IMMDF).

The **United Nations** has been working on a private sector development strategy through its Economic Recovery and Development Sector Outcome Team (ERDSOT) in collaboration with the Prime Minister's Task Force with SME related objectives including surveying the sector, improving legislative structures and strengthening access to capital. This project is anticipated to begin preliminary activities this year. Other United Nations actors involved in the SME sector include UNIDO through its Enterprise Development and Investment Promotion project, which has supported the formation of three Enterprise Development Units (EDUs), which are providing training to entrepreneurs and SMEs. The EDUs have an overall small and medium-sized enterprise focus. ILO and UNOPS have established partnerships with three Chambers of Commerce/Industry in Sulaymaniyah, Hillah and Basrah with a view to strengthen their service delivery capacity to member businesses (largely SMEs). Through the establishment of Business Information and Development Centres (BICs) housed within the partner Chambers of Commerce/Industry, UNOPS/ILO endeavoured in providing business counselling, management training, advice on accessing finance, fostering public-private dialogue, and developing investment promotion tools. The endeavour, as with UNIDO's EDUs is planned to be self-sustaining in the near future.

The latest and largest initiative in the SME financing sector is the re-establishment with the support of **World Bank** of the Iraqi government sponsored Economic Development Fund (EDF) capitalized with $100m, and specifically tasked with facilitating financing to SMEs in addition to legal and regulatory reform of the sector. Under the relevant law, EDF loans are to be provided at the "national debt rate" plus 1%, though this issue is yet to be finalized it is anticipated that loans will be below market rates at between 9-11% per annum. The targeted clients include Iraqi trading and service enterprises with up to 50 employees and Iraqi manufacturing enterprises with up to 250 employees. Loans can be provided for between $25,000 and $500,000 and up to five year period. Supported by the World Bank the EDF began SME lending activities in March 2009 and has began intensive marketing nationwide through private business associations and with the aid of Ministry of Planning offices. It is slated to transition from direct lending to on-lending as the private banking sector develops.

USAID TIJARA is also one of the most active players in the field of SME financing in Iraq. The project aims at targeting the three key pillars of SME financing namely:

- facilitating the establishment of an indigenous loan guarantee institution
- Improving the capacities of the private sector banking system to lend to SMEs
- facilitating access of banks to affordable capital

In 2007, the Iraqi Company for Bank Guarantees was established as an effort to insure loans to SMEs, since such loans carry a higher risk than other forms of lending. The ICBG provides loan insurance for up to 75% of the principle amount and has guaranteed. As of April 2009, it has provided guarantees for 200 loans to SMEs, amounting to $5.5m. Recently, the Central Bank of Iraq stipulated that loans guaranteed by the ICBG will be exempt from normal bank provisioning requirements thereby increasing bank working capital and providing an incentive for lending to SMEs.

Working to overcome general reluctance of the banks to engage with SME lending, which is perceived to be riskier, the USAID program engaged nine private sector banks to establish SME lending units (Ashur Bank, Bank of Baghdad, Basrah Bank, Gulf Commercial Bank, Iraqi Middle East Bank, North Bank, Mosul Bank and National Bank, all members of the ICBG) with selected staff being trained and a SME lending unit established within the Headquarters of each bank. The network of SME lending units currently covers 12 Iraqi governorates through 33 branches (excluding Al Anbar, Kirkuk, Karbala, Diyala, Muthana and Maysan).

The last pillar of USAID's SME support efforts will be the establishment of the Iraq Company for SME Finance, NBFI, owned by the nine banks involved in SME lending. This facility will provide attractively priced financing to banks engaged in SME lending. While the initiative is yet in its infancy, it is envisaged that the NBFI will lend at 4% while limiting the on-lending rate to 10%, allowing a six percent earnings spread for the on-lending institution. The initiative aims to have 240 SME loans or approximately $7m in financing extended by the end of 2011.

The only other major participant in the SME sector is the **Iraq Middle Markets Development Fund**, a joint initiative of CHF International, OPIC and Citibank. IMMDF is the largest private sector SME lender in Iraq with an outstanding portfolio of $8m as of May 2009, and loans spread throughout the country with offices in Hilla, Erbil, Suleimaniya and Baghdad. Loan sizes are between $35,000 and $500,000 with an interest rate of 15%.

Concurrently, **building the capacity of micro- to small-sized businesses** training centres and business consultants were supported by the United Nations, USAID, World Bank and the Iraqi American Chamber of Commerce and Industry (I-ACCI) covering almost all governorates. The UN Business Information Centres and USAID's Small Business Development Centres cater mainly to start ups, micro- and small-sized enterprises (SMEs up to thirty staff) through established training centres. The World Bank and I-ACCI programs target small to medium enterprises (SMEs up to 250 staff) with trained business consultants providing training in ad-hoc locations including visiting businesses to provide customized analyses and solutions to improving clients' business.

In conclusion, while the SME financing sector in Iraq is in its infancy (approximately $20m outstanding portfolio), its key structural components (loan guarantees, on-lending via commercial banking institutions, lending windows and borrower education) have been established. Ongoing and planned training programs by various international donors include support to private sector banks actively involved in SME lending (USAID), continued support to the Economic Development Fund (World Bank), technical and legislative support to the GOI microfinance programs (UN PSD) and numerous business training centres supported by various donors and spread throughout the country .

Box: Interest Rate impediment: something is changing

*The current interest rate policies in Iraq can be regarded as an **impediment** to the encouragement of SME lending. The drop in Iraqi **inflation, which fell from 65% in 2007 to 4.2% in 2010 made it possible for the Central Bank of Iraq to lower its benchmark overnight rate from 20% in 2007 to 6% in April 2010**, while at the same time, the **required reserve ratio has been reduced from 25% to 20%.** (The required reserve ratio is a percentage of deposits that commercial banks are required to hold as reserves at the central bank.)*

*Cuts in the central bank's **benchmark interest rate are particularly significant because cash, rather than loans, is the biggest asset of the Iraqi banks.** (Their main operating businesses consist of charging fees for services such as wire transfers.) Since there is limited lending, either inter-bank or to non-financial companies and individuals, central bank reserves are the banks' main source of interest income. Lowering the benchmark rate reduces this income stream, thereby forcing them to extend credit to the market.*

While much of the rest of the world continues to deleverage, in Iraq the trend is thus in the opposite direction—from a state of practically zero leverage to one where the banks play their normal role as financial intermediaries. This is clearly positive for the stock market because a general increase in the supply of credit naturally means that more funds will be available for local investors to buy shares—either because they buy with borrowed money or because taking out loans frees up their existing cash holdings. In addition, the banks will now push more liquidity in the market which will provide funds for domestic investment leading to employment generation and economic growth.

2. Loan Product

2.1. Loan Product Details

Amalkom agreed to implement a loan product that **conforms to international microfinance best practices** while providing favourable terms to lower-risk clients such as those from the EDIP program. The loan is directed both to start up and existing business. The terms of the AMALKOM product are listed in the table below.

	Loan range	Grace Period	Repayment Period	Interest Rate
Start Up Business	0 - 4,000 USD	**2 month fixed grace period**	Loan terms of up to **21 months** to be **negotiated** between Amalkom and the client	**12% Interest rate** on the loan, **3% adm. fee**
Existing Business (in existence longer than 6 months)	5,000 USD – 25,000 USD	**0-2 month grace period to be negotiated** between Amalkom and client	Loan terms of up to **21 months** to be **negotiated** between Amalkom and client	**12% Interest rate** on the loan, **3% adm. fee**

From the outset of the loan facility, a balance had to be maintained between providing favourable terms to clients who had participated and benefited from business training and skills development through the EDIP programme, while avoiding subsidies that are unsustainable in the micro-finance sector.

The rationale behind the final decision in linking the EDIP training and the financing facility was that EDIP clients had undergone substantial business training and mentoring, had developed detailed business plans and received considerable professional support. Together, these elements should lower the borrower’s risk profile and thereby improve the risk exposure of the underwriter. Thus every party benefits. For Amalkom, the business skills training reduce risk, making EDIP clients more attractive. For UNIDO, it highlights the benefits of undertaking business planning and management training by borrowers, contributing to the program’s aim of a sustained revitalization of enterprises.

Eligibility criteria

- SME business owners requiring funding for business activities located in the three Governorates of ThiQar, Baghdad and Erbil;
- Should attend UNIDO entrepreneurship trainings (according to EDIP methodology)
- The business is owned and managed by the recipient of the loan;

Prioritization criteria

- Highest Priority: Existing EDIP beneficiaries as clients
- Alternate Priority: Other clients identified by the Selected Bidder are to be considered after the exhaustion of potential existing EDIP Beneficiaries. These clients will be required to attend UNIDO supported EDIP trainings/counselling.

Box: Loan Interest rate

The cumulative administrative rate of 15% (12% in Erbil) upfront adopted by Amalkom has been found to be competitive in the Iraqi market while remaining sufficient to ensure financial sustainability of lending operations. The three main microfinance providers in Iraq, CHF International and their partner institution Amalkom, ACDI/VOCA's Al Thiqa and Relief International, all have lending rates at between twelve and twenty percent.

These rates are higher than the middle market lender's rates of 10-12% offered by organizations that have operations in Iraq, such as IMMDF, the World Bank supported Economic Development Fund and the USAID funded Iraq Company for Bank Guarantee supported private lending operations of Iraqi banks. The discrepancy in interest rates is a result of the higher administrative costs associated with lending larger numbers of smaller enterprises loans as opposed to the middle market target of single loans up to values in the millions of dollars.

All interest on loans in Iraq are charged upfront, meaning that the interest is deducted from the original loan while the monthly repayments are fixed based upon the entire loan amount Upfront interest creates a false comparison with standard interest rates which are calculated on a declining balance methodology. The difference means that real interest rates charged by MFIs in Iraq are closer to 14-22% depending upon the term of the loan.

Based upon a USAID report from April 2010, average operating costs amongst Iraq based microfinance institutions is 13.5%. Focused on providing market driven sustainable solutions UNIDO's negotiations with Amalkom over the terms of the loan product, specifically the interest rate, took into consideration operational costs so as to ensure that the loan product was not undermining the sustainability of the financial institution. Amalkom therefore charge rates which are competitive in the Iraqi markets and operates within a cost structure which is in line with other major players in the ground.

2.2. Implementation of the EDIP Credit Facility in Iraq

CHF-Amalkom has **delivered 96 loans** to project beneficiaries. In Thi-Qar Governorate reached the target, last May 2011, disbursing 45 loans to local business community. In Baghdad around 95% of funds has been delivered to 49 entrepreneurs. In Erbil the loan delivery started on December 2010 due to some administrative delays for AMALKOM to get the registration to operate in the area. Just two loans were disbursed till date ($5,100 each).

Table 1. EDIP credit facility in Iraq

Province	# of loans disbursed	Loan Amount Disbursed	Project fund allocated
Erbil	2	10,200 $	318,000 $
Thi Qar	45	417,100 $	318,000 $
Baghdad	49	307,250 $	318,000 $
Total	96	734,550 $	954,000 $

Table 2. Loan Disbursed based on Business Type

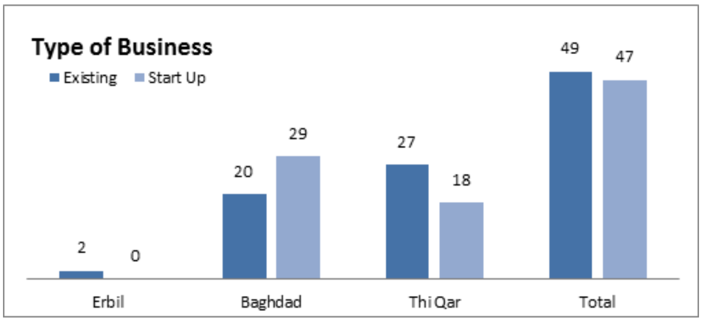
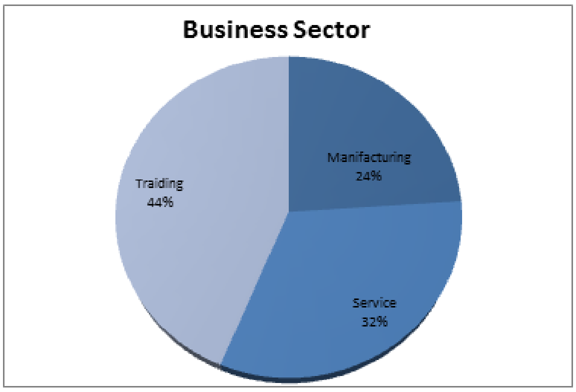


Table 3. Loan Disbursed based on Business Sector



1. The facility has currently supported the **creation and expansion of 96 small enterprises** in Iraq. The majority of the loans were delivered to small size, unsophisticated entrepreneurs operating at local level in the trading sector and production sector. The loan was mainly used to cover working capitals needs of the project beneficiaries. The loans have been contracted mainly by existing entrepreneurs (49) versus whose is starting a new business (47).

2. Considering the 2 month grace period before collection the loan instalments from the borrowers, information related to the loan outstanding suggest that the current trend is that of a full repayment rate.

3. The delivery and promotion of the loans, in the framework of the EDIP programme, have to be considered as incentive for the credit facility's success among the involved SMEs business community and as informal assurance for the financial institution delivering the loan. The project has created a community of entrepreneurs that is interconnected and has a constant working relationship with the local EDU. As a result, EDUs play a monitoring and advisory function for the entrepreneurs benefiting from Amalkom's loan.

2.3. Implementation challenges

The most substantial challenge in the implementation of EDIP Credit facility was the initial negative reaction by project beneficiaries to the decision to adopt a market-based administrative charge rate (12-15%). In fact a high percentage of project beneficiaries had expected more favourable terms from a UN-backed loan program and most of them would have preferred to receive it as a grant. In this regard, it is worth mentioning that besides the limited range of tools available for the enterprises to finance their business ideas in the market, entrepreneurs were used to receive financial support from the government in the form of subsidies and grants. **The EDIP credit facility, designed to operate according market-based rules, was therefore seen as a negative exception to the common practices in Iraq**. This expectation of a grant has been compounded by the fact that UNIDO partners in the EDIP project implementation are mainly government institutions or ministries.

Moreover, as part of the outreach activities, Amalkom recorded the feedback from those entrepreneurs who indicated that they would not be applying for the loan. This feedback can be used to design subsequent products to better target the needs of EDIP clients. In Nassariyah, the main issue was the perception of high interest rates and a low grace period, possibly a reflection of the tighter economic conditions faced in the governorate as none of the Erbil based clients cited this as a reason. In Baghdad, the majority of clients not interested in the loans cited too short a repayment period, probably reflecting the uncertain security environment in Baghdad and the likelihood of long periods of businesses being closed. Erbil, again reflecting the surrounding economic conditions, had a large number of clients seeking loans above the $25,000 cap placed on the UNIDO-Amalkom product.

3. Impact of the Credit Facility in the Iraqi Contest

The credit facility has been a major step forward in encouraging financial inclusion of a segment of the Iraqi society that is not covered by the conventional banking system. The collateral-free credit provided has helped the existing SMEs and start-ups to finance their business needs, which would have been rejected by the conventional banking system due to lack of collateral.

The EDIP credit facility has proven to be a useful market-based financial tool for supporting enterprise development. Thus far, the facility has supported the creation or business expansion of more than 90 small companies.

Most of the enterprises supported are unsophisticated small-size businesses operating in the trade and services sectors. This is hardly surprising considering the poor diversification of the Iraqi economy, current trade policies and unattractive Iraqi investment climate (Iraq ranked 153 in the "Doing Business 2010" World Bank report), which have weakened the productive sectors and continuously increased the country's reliance on imports. In addition, it is important to highlight that the un-organized sector of the economy is as usual beyond the reach of the conventional banking system. The prerequisite of providing collaterals and business history to commercial banks for loans excludes this group of small enterprises, who neither have collaterals to provide or sustainable business assets to back their requests.

In order to maximize the impact among the most vulnerable segment of the SME sector, the current loan product has been designed to support the development of small enterprises. The financial needs of medium-size enterprises in Iraq range well above the current loan products ceiling. Erbil project beneficiaries, who are mainly comprised of medium-size companies, showed no interest in the loan product mainly because of its limited size and high administrative charge. It is worth noting here that even if some pioneer private banks are starting to provide credit to small- and medium-sized enterprises, the SME financing sector in Iraq is in its infancy (approximately $20m outstanding - 2010 data).

The inclusion of a loan facility within the EDIP program served not only for enterprise development endeavours, but also has provided other broader benefits to development efforts in Iraq. Project beneficiaries with a credit history through a financial institution such as Amalkom are more likely to access lower interest rates, in the future, from some of the conventional banking institutions listed earlier. This will help ease the transition of EDIP clients from small-sized businesses to medium-sized enterprises beyond the life of the project.

The establishment of the facility is a first in Iraq, as it couples a UN technical assistance program with an Iraq-based lending institution. This partnership model is common throughout the world and can prove highly successful in Iraq with continued support from international donors. Moreover, UNIDO's decision to adopt an interest free-loan for the capital to be loaned to beneficiaries as opposed to a grant is a strategic move towards breaking the dependency of microfinance institutions upon international donors. Interest-free loans are an interim solution between grants that are often provided during start up years. This credit modality is particularly important at a time when Iraqi Financial institutions are weak, and while access to international financial markets is limited considering the high perceived risks associated with Iraq and the on-going credit shortage due to the international financial crisis.

The specificity of the Iraqi context has proven the importance of combining BDS services and financial assistance in fragile states. Iraq has a embedded entrepreneurial mentality weaknesses and weak financial banking sector(especially in supporting SMEs) Combining enterprise development technical assistance, combined with financial assistance, like in the case of the project, has proven to be a short-medium term solution in providing tangible supports to entrepreneurs . The financial assistance provided through credit is not a stand-alone facility, but designed in such as way that it supports the assistance provided to entrepreneurs through business training and counselling services in turn, ensuring that the entrepreneur exercises good judgement in utilizing the credit received.

4. Recommendation for design and implementation

Almost two years have passed between launch of the project and the delivery of the first loan to the beneficiaries. This delay was mainly due to incomplete design of the loan facility in the programming phase and legal clearance required to make this innovative tool operational. Beyond the specificity of EDIP program, the facility was the first in Iraq to partner a UN technical assistance program with an Iraqi lending institution.

Despite this delay, the pilot SME credit facility has supported the creation and expansion of more than 60 small and medium enterprises by covering fixed assets and working capital needs of project beneficiaries. The loans have been contracted almost equally by existing and start-up companies.

Considering the above outcomes and the experience developed from the implementation of the EDIP Iraq Credit Facility, the recommendation below may be useful for project managers to properly design and implement similar SME credit facilities in other countries.

4.1 Credit facility design

Proper design of the credit facility within the project document is absolutely crucial. The project document should clearly elaborate on:

1. *Ownership of the fund (including obligation of UNIDO vis-a-vis the donor)*
2. *Mode of disbursement (grant/loan) that UNIDO can follow with the selected financial institution. The preference should be for a reimbursable loan, and not a grant. The cost of the loan should be sufficient to cover the administrative and lending costs of the intermediary financial institution.*
3. *Financial management of the fund after the completion of the project (Exit strategy) should be designed into the project.*
4. *Probably the most important issue is the combining of Business Development Services with a financing window. The most important aspects of designing this connection is to maintain connection while retaining independence of the evaluation of loan applications and administration, from the project that provides BDS. The linkage of the BDS project to a financing window should not be prejudicial to the best practises in the extension of credit to SMEs.*

Ownership of the fund
In the case of Iraqi credit facility, the fund capital was embedded as a component of a technical assistance project. Nonetheless, in no part of the project document it was specified that the funds were provided by the donor as grant to UNIDO. It was also unclear about UNIDO's liability vis-à-vis the donor. The donor regarded the money as transferred and administered through UNIDO. The donor did not expert repayment. Therefore, as far as the donor was concerned, UNIDO was under no obligation of repayment of the amounts recovered from enterprises using the credit facility."

Mode of disbursement
Based on the experience of the Iraqi credit facility, it is advised for the fund to be disbursed by UNIDO (or the administrative agent) to the selected financial institution as *interest-free loan for the capital to be loaned* with the clear stipulations of the amount and kinds of loans to be provided to project beneficiaries. UNIDO's decision to adopt an interest free loan as opposed to a grant to the implementing institution was a timely move towards breaking the dependency of financial institutions (especially microfinance) on international donors. Interest-free loans can be an interim solution between grants that are often provided during start up years and accessing financing on the international markets.

On the other hand, the financial institution which is receiving the capital for the loan from UNIDO interest-free should cover the administrative and operational through the interest received by the beneficiaries (enterprises). This interest rate should be in line with market rates. This will ensure sustainability of operations during and after the completion of the project in the case it will be decided that the fund should become a "revolving" one.

It is suggested that initially a small portion of the fund (to be mutually agreed between parties) will be transferred to the selected financial institutions as a pilot case to monitor and evaluate the performance of the institution in disbursing the money to the beneficiaries of the fund. Before requesting and receiving the next tranche, UNIDO must be satisfied with the way disbursements were made in the first tranche. The number and size of these tranches, loan size, interest rate for beneficiaries and lock-in period of the fund should be negotiated by UNIDO as part of the contract agreement.

Financial management of the fund after the completion of the project (Exit strategy)
The ownership of the funds, once transferred to the selected financial institutions for use under the conditions of the agreement, would lie with the selected financial institution for a lock-in period to be mutually agreed in the contract upon by the parties. At the end of lock-in period or termination of the project (whichever comes first), the performance of the fund and its management will be evaluated by the project and submitted to the recipient government and Donor for a decision on how to proceed. Based on the performance evaluation, the contract can be extended (revolving fund case) or the funds returned to UNIDO to be used for the technical assistance (BDS) project. This clause should be written into the contract with the managing institution.

4.2 Credit facility implementation

Criteria for selecting financing institutions

Amalkom, an Iraqi headquartered and managed independent member of the CHF International family of microfinance institutions, was chosen as the implementer of the credit facility on behalf of UNIDO after two international bids. Amalkom was selected based on several factors, including geographic reach, technical expertise and prior and ongoing success in lending in Iraq. Their ability to lend in different areas in Iraq, both as a result of an existing infrastructure as well as community and religious acceptance, was a crucial factor in the assessment and selection process of the tender. Their technical expertise was similarly considered as an important factor as UNIDO's program required an implementing partner capable of amending and redesigning loan products after initial outreach provided feedback from EDIP beneficiaries.

It is therefore suggested to select the financial institutions through international bidding process. The financial institutions should operate according best SME lending practices and operate in the country according market based interest rate. An international SME Lending expert with experience in country should be recruited to support the project manager during the technical evaluation of proposal and technical start up of the program (loan products definition, reporting templates, and outreach strategy).

Work to avoid misplaced expectations

The largest challenge for the EDIP Credit Facility has been a potential negative reaction by the EDIP project beneficiaries/clients, in the case they did not see tangible benefits from the time invested with the technical assistance component (training, counselling), in the form of receiving preferential loans conditions. Most of project beneficiaries' had expected more favourable terms from a UNIDO-run loan program. The challenge emerged when balancing the expectations of project beneficiaries while retaining best SME lending practices in managing the loan fund, including not imposing unsustainable loan conditions on the lending institution. To mitigate this risk, it is suggested the project conveys clear directions on the benefits of the facility and the terms and conditions of the loan. Therefore, the business development services and financial institutions outreach to client entrepreneurs should convey the fact that a loan facility is available to trainees but it should not be taken for granted that all trainees will automatically have access to loan financing. Their business plans/soundness of business etc. will be the criteria for securing loan financing.

Reduce potential Threats of Reneging on Repayment:

If the UNIDO project ends before the loan fund, there will be a risk that borrowers will renege on repayment under the false impression that there will not be any follow up. The consequence would be that the equivalent in microfinance terms as a run on a bank, where rumours of closure spread and borrowers will delay in repaying loans. To mitigate this risk UNIDO will ensure that ownership and control of the funds is known to lie with Amalkom, an institution that will remain in Iraq beyond the term of the EDIP program. In fact, in the public eye, the loan managing institution should be the institution dealing with the borrower, and it should be made clear to borrowers that they have to conform to the stipulations of loan agreements established by the lender. UNIDO should be see as a facilitating agent rather than the lender or manager of funds.

Annex I: Example of operational process for approving loans

1. Amalkom operational process for approving loans

1. The loan officer works directly with clients to promote loans, determine client credit worthiness, complete loan applications, conduct client follow up and manage his/her assigned loan portfolio performance.
2. The Data Entry Officer and the Business & Operations Coordinator are to enter the loan decision into the loan tracking system which will create a loan number ID which should be entered into the contract and subsequently used to track the loan.
3. The Office Managers prepare and sign the loan contracts, guarantor and/or collateral documents, and checks. The amount of the check should be the value of the loan less the interest and fees. The contract number should match the loan number as generated by the loan tracking software.
4. A messenger is to deliver to the branch office the loan contracts (if applicable) and loan checks.
5. Office Managers or Credit Assistants must review the loan contracts and checks to ensure that they are complete and correct before contacting the client.
6. The Office Manager for Baghdad, Hillah and Karbala must stamp the checks with the ACSI stamp.
7. The Loan Officer is to notify the applicant that his/her loan was approved including the approved loan amount, term and guarantee. The Receptionist, Credit Assistant, Loan Officer or Loan Officer Supervisor is to set up a meeting with the client and guarantor in coordination with the Office Manager and/or the Credit Assistant. The Office Manager or Credit Assistant should set aside some time per contract (although the disbursal process may not take this long). The client and guarantors should be told to bring all of their IDs

   At the meeting, the client and guarantors should have with him/her the following official documents. At least one ID should have a recent photo.
8. The Office Manager or Credit Assistant is to prepare the payment vouchers, attach the form that explains how to use the vouchers and staple the vouchers and memo at the top in sequential order using the loan voucher program. The user will only need to enter the loan amount, client name, loan number and due date into the program.
9. The Office Manager or Credit Assistant should check if the ID number of the client and guarantors matches the one listed in the contract. as well as ask the client questions to verify that he/she is the person who applied for the loan and that the client meets the eligibility requirements. In the case of the guarantors, the Office Manager or Credit Assistant should verify that the guarantors know the client and understand their commitment.
10. In the meeting with the borrower and the guarantor, the Office Manager, Credit Assistant or ACSI lawyer is to:
    - Review the disbursal process,
    - Give the client and guarantors time to read through the contract,
    - Review the loan contract and ensure that all parties understand what they

are signing,

- Review the fees including that the fees are taken from the loan amount and the late fees,
- Give the borrower the payment vouchers,
- Review the repayment process including that all payments should be made in the bank and the loan repayment, and due date. Emphasis must be placed on the importance of on-time repayments and what happens when the borrower does not pay on time,
- Explain to the guarantor(s) the procedure followed when the borrower is delinquent in repaying his/her loan.

11. The client should not sign the loan contract until all of the guarantors have signed the contract. While it is preferred that the borrower and guarantors attend the same meeting, co-signers may sign a contract on an earlier date then when the borrower signs the contract.
    - The client must write his/her full name, title, ID number, date and residence by hand where designated and sign and stamp his/her left thumb print beside his/her name on all contract papers,
    - The client should sign; write his/her full name and date on every page of the contract,
    - Each guarantor must write his/her full name, title, date and residence by hand on the guarantor page and sign and stamp his/her left thumb print near his/her name.
12. The Office Manager, Credit Assistant or lawyer must sign the contract or write the date of contract under the (CHF) representative's signature (depending on his/her authorization) and enter the date of the first repayment on the contract. The date of the contract should also be written on the check the contract date must be the same as the date of the check. The first payment due date should be the same day of the month as the check date and contract date for the following month unless the loan is disbursed between the 26th and the end of the month. In this case follow exception listed above fewer than 4.6.
13. Once all the documents have been signed, the Office Manager or Credit Assistant should review the all documents and the check to ensure that they have been completed correctly.
14. Only once the borrower and all the guarantors have signed all the loan documents and the collateral is secured, and registered, if applicable, either the Office Manager or Credit Assistant provides the borrower with the loan check.
    The Office Manager, Credit Assistant or lawyer should enter the date on the check and the bank letter before disbursing the check and make a photocopy of the loan check, the loan contract and supporting documents.
    On the copy of the check the client should write his/her full name on the copy with phrase "I received the original check which it's copy above on date (__/__/____)," sign his/her name below the statement and stamp his/her left thumb print. This document should be sent back to the bank office with the original contract (effective November 2004).
15. The Office Manager, Credit Assistant or lawyer should make one copy of the contract for the client and his guarantor(s).

16. The original loan contract and signed photocopy of the loan check should be sent back to the back office in Hillah. The documents should be sent in a sealed envelope to ensure documents are not lost.
17. Upon receipt of his/her loan check, the borrower should go to the bank to cash the check. In Baghdad, Hilla and Najaf clients must also provide the bank with a copy of his/her National I.D.

2. Amalkom payment procedure for borrowers:

1. The borrower should bring the payment voucher along with the loan payment to the designated bank. The vouchers are in triplicate. One copy is for the borrower, one is for the bank and one is for ACSI. The voucher must be stamped and signed by the bank for the payment to be considered paid. The bank teller should write the amount received including the late fees paid on the voucher
2. Borrowers should keep their payment vouchers as their proof of payment.
3. A designated ACSI branch office staff member is to go to the bank daily to collect payment vouchers.
4. The Office Manager should post the payment vouchers received that day so that the Loan Officers and Loan Officer Supervisor know which clients paid.
5. The Office Manager should send the payments vouchers to the Back Office daily (transportation permitting) except for offices in Basra, Thi Qar, and Samawa. These offices should submit their vouchers weekly (transportation permitting).
6. Data Entry staff are to record payment in loan tracking system.
7. The Data Entry staff should send the loan payment report to Finance.
8. The filing officer should file the voucher in the specified box files until the loan is paid off, at which point the vouchers should be put in the client file in a separate plastic sleeve.

Annex II

Client Success Story

Iman Hamad is a single woman who lives with her mother and older sister. She is the main provider for the family and the owner of a small home supplies business. She established her business in one rooms of the house because she was not able to afford renting an office. When she first started, she used to buy her supplies on bank credit. This was highly limiting due to high rates of interest. She joined the UNIDO EDIP project to find an opportunity for the development her business. After attending the training sessions, Iman borrowed a $10500 loan, to be repaid after 21 months. With this, she first increased the inventory and widened the collection of goods. Now she is planning to turn the room into a real shop by installing a front window and shutters. An employee will be also hired to help expand her business. The loan had a positive impact on Iman's livelihood and business. She is planning to upgrade her business and she now has a higher ambition for the future.