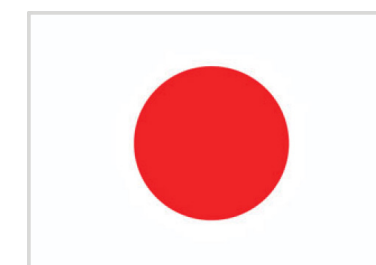




# Market Bite Iraq

*Economic Recovery Creates Opportunity to  
Invest in Small and Medium Businesses*

November 2022





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## 01

## Executive Summary

## Economic Recovery Creates Opportunity to Invest in Small and Medium Businesses

Iraq is one of the most oil-dependent countries in the world. Over the last decade, oil revenues have accounted for more than 99 percent of exports, 85 percent of the government's budget, and 42 percent of gross domestic product (GDP).<sup>1</sup> While the recent rebound in oil markets has significantly improved Iraq's economic outlook, the future remains uncertain and volatile without investment in a more diverse economy. Small and medium enterprises (SMEs) are key to this.

Though there is no reliable official measure of the size of the SME sector, this study estimates that there are between 377,000 and 840,000 small and medium enterprises in Iraq.<sup>2</sup> They account for a large part of employment and play a critical role in non-oil economic growth and innovation. Iraqi SMEs operate in a challenging environment, but also exhibit remarkable resilience.

This report shares the results of an IFC survey of 827 SMEs in August and September 2021, focusing on the financial health and access to finance for SMEs.<sup>3</sup> Results show that although average sales turnover for SMEs are not yet back to pre-COVID-19 pandemic levels, they recovered to some degree in 2021. Medium companies appeared to be recovering faster than small businesses.

To continue a growth trajectory, many SMEs will need access to finance. More than half of the surveyed enterprises expressed that they had plans to borrow in the next five years, yielding a potential aggregate market for SME finance of up to \$11 billion. Despite several initiatives by the Central Bank of Iraq (CBI), very little of this is currently being met, and lack of access to finance remains a key barrier to sustainable and inclusive economic growth.

Though they play a central role in the economy, SMEs are not yet well integrated into the formal financial sector. Of the SMEs surveyed by IFC, only 8 percent had a business bank account while 16 percent held a personal bank account, sometimes used for business. Even fewer had sought and received finance from formal financial institutions. Reasons for this include widespread informal lending, high interest rates, and low levels of trust and satisfaction in bank services.

There are several measures that regulatory authorities, financial institutions, and other financial sector stakeholders can take to change this. Some of the recommendations put forward at the end of this report include improvements to credit infrastructure and regulations governing the use of collateral, as well as strengthening the capacity of financial institutions to serve SMEs with innovative products, channels, and credit assessment tools.

Oil price volatility and the COVID-19 pandemic have placed severe strain on Iraq's economy in recent years, leading to a precarious fiscal position and threats to peoples' livelihoods. As economic growth now rebounds on the back of rising oil prices, there is opportunity to invest in a diversified private-sector-led economy driven by the country's small-scale entrepreneurs to support broad-based development.

<sup>1</sup> *Iraq's Economic Update: April 2022, World Bank*

<sup>2</sup> *Using the Iraqi definition: small (3–9 employees) & medium (10–29 employees).*

<sup>3</sup> *Of the total number of surveyed SMEs, 585 were based in Iraq and 242 in the Kurdistan Region.*



# 02

## SME Market Context

### Economic Rebound Sets Opportunities for SMEs

#### Economic Outlook: Recovering From Twin Shocks

Following a long, turbulent period characterized by the 2014 oil price drop, war against the Islamic State in Iraq and Syria (ISIS) and war in neighboring Syria, as well as the global COVID-19 crisis, Iraq’s economic outlook appeared to improve somewhat towards the end of 2021, largely on the back of recovering oil prices and a possible retreat of the COVID-19 pandemic.

The impact of the COVID-19 pandemic was particularly harsh as it coincided with a sharp decline in oil prices. Oil GDP shrunk by 17 percent in 2020, while the non-oil economy contracted by 9 percent. Revenue from religious tourism was also diminished, while the services and hospitality sectors were particularly hard hit by successive lockdowns and restrictions.<sup>4</sup> SMEs surveyed for this publication reported an average drop in turnover of about 30 percent during the pandemic (see figure 1).

Iraq’s economy is gradually recovering. The World Bank projects that Iraq’s GDP will have grown by up to 2.7 percent in 2021 and will grow by a further 6 percent in the period 2022 to 2023.<sup>5</sup> SMEs are expected to play a key role in recovery, employing about two thirds of the work force.

As shown in figure 1, enterprises surveyed by IFC have reported a relatively swift recovery from the low point of the pandemic, but turnovers have not yet returned to pre-pandemic levels.

#### Enabling Environment: Gaps Exist in Regulatory Framework for SME Finance

In terms of regulations, SMEs are treated the same as corporates. They are not given tax benefits but pay the same corporate tax rate of 15 percent as larger corporations. SMEs are also not afforded any preferential treatment in the consideration of government contracts and tenders, unlike other countries where it is often a requirement that smaller companies be brought in as part of larger consortia to promote broad based development.

There is no shared, or commonly accepted definition of SMEs in Iraq. The lack of a common definition means different actors use different parameters to define SMEs in terms of number of employees, turnover and loan size, for example. Iraq’s Central Statistics Office (CSO) considers firms with less than 10 employees a small enterprise, and those with 10 to 29 employees are medium sized enterprises.

However, aggregate CSO data appears to grossly underestimate the number of SMEs in the country.<sup>6</sup>

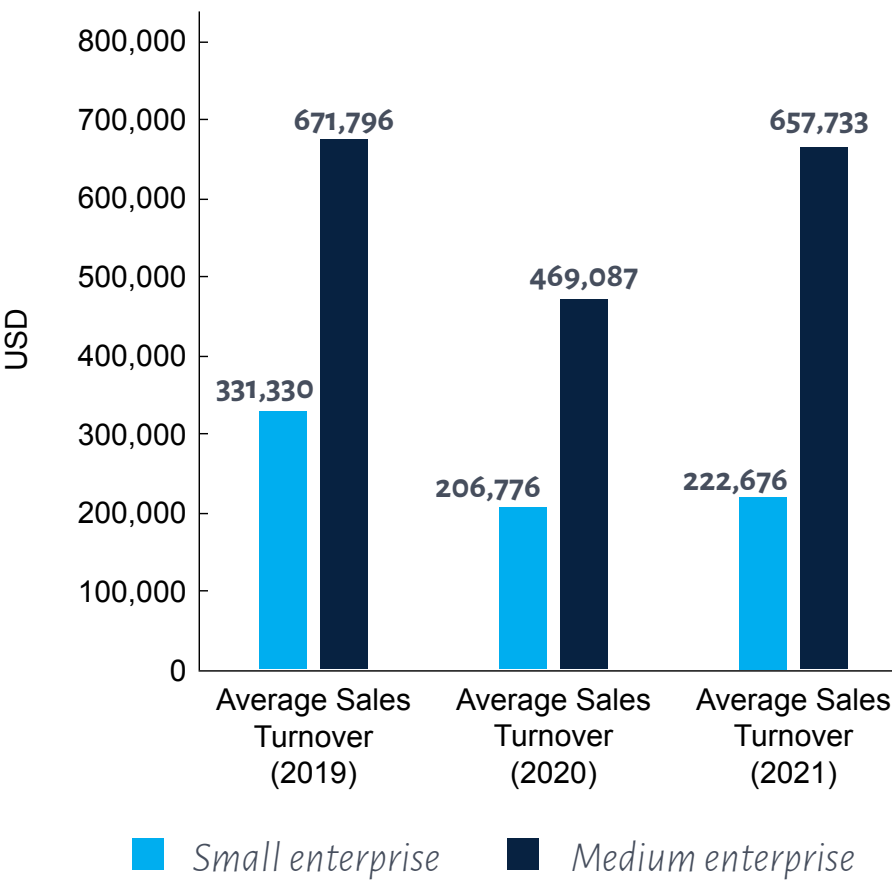
In terms of regulations supporting SME access to finance, Iraq does not currently have a fully developed credit information infrastructure, nor does it have a comprehensive security interest framework. In 2016, the government launched a new credit registry managed by the CBI, but as of 2019 public credit registry coverage was only 1.3 percent of adults.<sup>7</sup> In effect, this narrows the number of SMEs able to seek finance to those who can provide traditional collateral.

The use of traditional collateral is limited by challenges relating to both valuation and appropriation of real estate. As per Iraqi law, a creditor cannot claim immediate ownership of collateral in the case of default but needs to apply for the mortgage to be put up for public auction by the Real Estate Registration Director, a process that is both time consuming and uncertain. Iraqi law also limits eviction from residence, which further hinders the appropriation of houses used as collateral.

Additionally, there is a lack of professional evaluation of real estate used as collateral. To cover their risk, lenders tend to underestimate the value of real estate.

Figure 1. Average Sales Turnover from 2019 to 2021 by Company Size

N=539



4 Iraq’s Economic Update: April 2021, World Bank

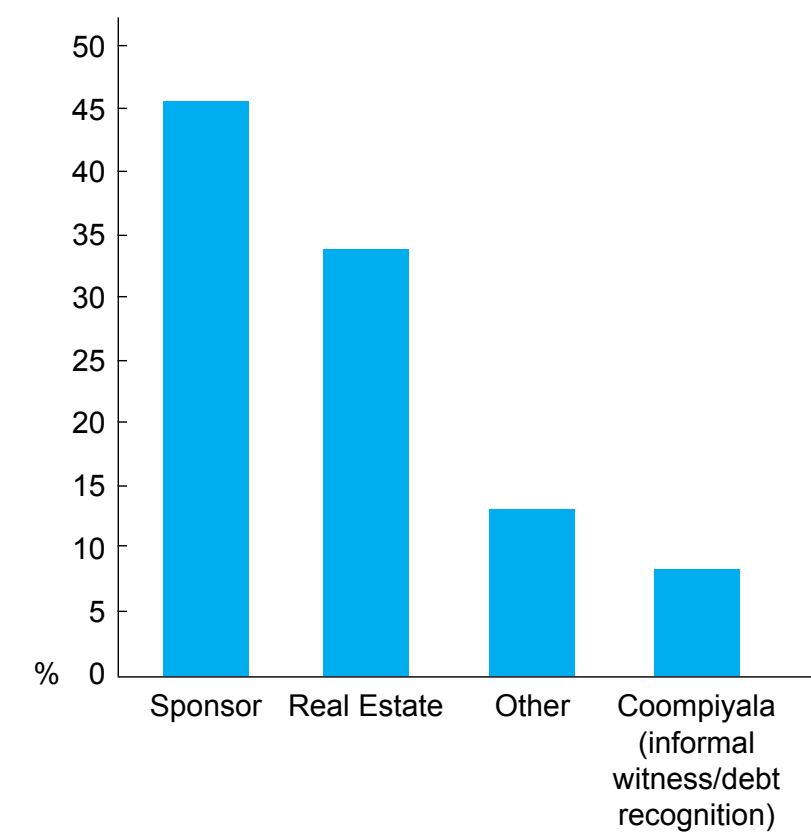
5 Iraq Economic Monitor: The Slippery Road to Economic Recovery, Fall 2021, World Bank

6 In federal Iraq, 198 medium industrial enterprises, compared to 25,747 small industrial enterprises in CSO data (2018 احصاء المنشآت الصناعية المتوسطة لسنة 2018 and 2018 جداول المنشآت الصناعية الصغيرة لسنة 2018). In KRI, 421 medium industrial enterprises (KRSO, Medium Industrial Establishments Statistics in Kurdistan Region 2018) and 11,293 small industrial enterprises (KRSO, Small Industrial Establishments Statistics, 2012 – most recent source found)

7 Public credit registry coverage (% of adults) – Iraq, 2019, World Bank

Figure 2. Guarantees for Long-Term Loans

N=21



This leads to over-reliance on personal guarantors (*kafeel*), usually a government employee with stable salary, which limits loan sizes and creates schemes where companies enlist relatives etc., to serve as guarantors (see figure 2). In parallel, there is only limited use of gold, bonds, accounts or similar as collateral.

Support for the SME Market: Financing Initiatives Exist but Training is Lacking

The launch of the One Trillion Dinar Initiative by the CBI in 2015 is one of the largest interventions on the part of the Iraqi government to support the SME sector in recent years. With more than \$540 million of the earmarked \$840 million extended in subsidized loans through commercial banks, the uptake has accelerated significantly since 2020. It now also covers housing loans, a category that has overtaken SME loans.

Although housing loans were only introduced in 2020, by the third quarter of 2021 they represented 32 percent of all cumulated loans during the program since 2015 – with a total of \$175 million in housing loans, compared with \$171 million for SMEs in the commercial sector,

\$120 million to the services sector, \$67 million for the industrial sector, and \$7 million to agriculture. With the facility doubling to 2 trillion dinar in 2022, housing loans are expected to continue to dominate.

Preceding this program, several initiatives backed by the United States Agency for International Development (USAID) in collaboration with private Iraqi banks have sought to expand access to credit for SMEs. The Iraqi Company for Bank Guarantees (ICBG) and the Iraqi Company for Financing SMEs have offered loans in the range of \$5,000 to \$250,000. The latter is now restructuring under the supervision of the CBI, and in future is likely to distribute loans directly to the market.

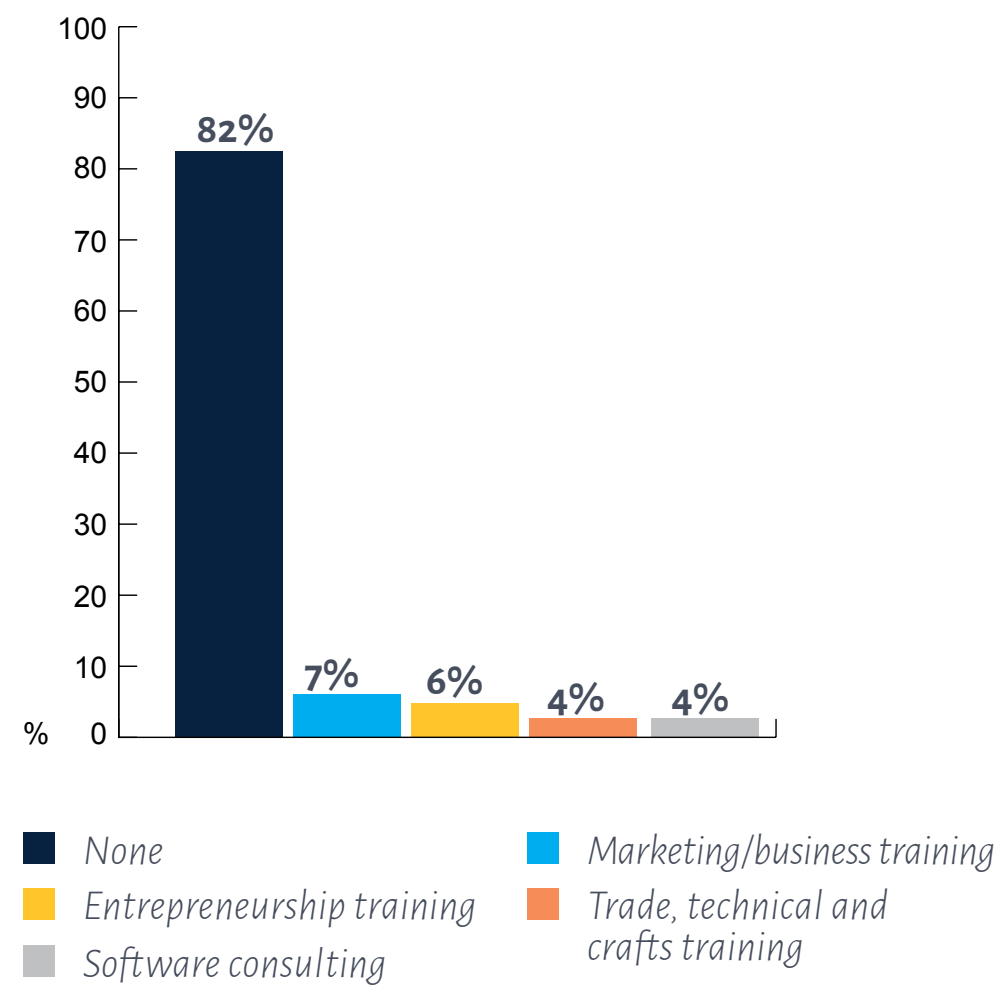
The Iraq Middle Market Development Foundation (IMMDF) was set up in 2004 as a vehicle to finance upper-medium sized companies with a total portfolio of around \$80 million, and is now restructuring into Bell Finance. GroFin, launched in 2013 to finance lower-medium size enterprises, offers an average loan size of \$600,000 and has a portfolio of about \$6 million.

Under the umbrella of the Iraq Governance and Performance and Accountability program (IGPA), some training has been provided to commercial banks around different aspects of SME financing, though much remains to be done to ensure bank staff are proficient in conducting financial analyses when assessing SME credit applications.

The Ministry of Labor and Social Affairs provides mentorship and incubation support directly to SMEs, while some non-governmental organizations (NGOs), the Chamber of Commerce, as well as vocational training centers provide training in various aspects of business support. Uptake on the part of the SMEs has tended to be low (see figure 3), though more than half of IFC survey respondents said they would like to receive training in areas such as marketing or business (25 percent), entrepreneurship (19 percent), and consulting and study development (14 percent).

Figure 3. Which Non-Financial Services Have You Used?

N=827





## 03

## Market Insights

## Majority of Iraqi SMEs Seek Credit

Figure 4. Demand For Finance Among Iraqi SMEs, 2021

N=432

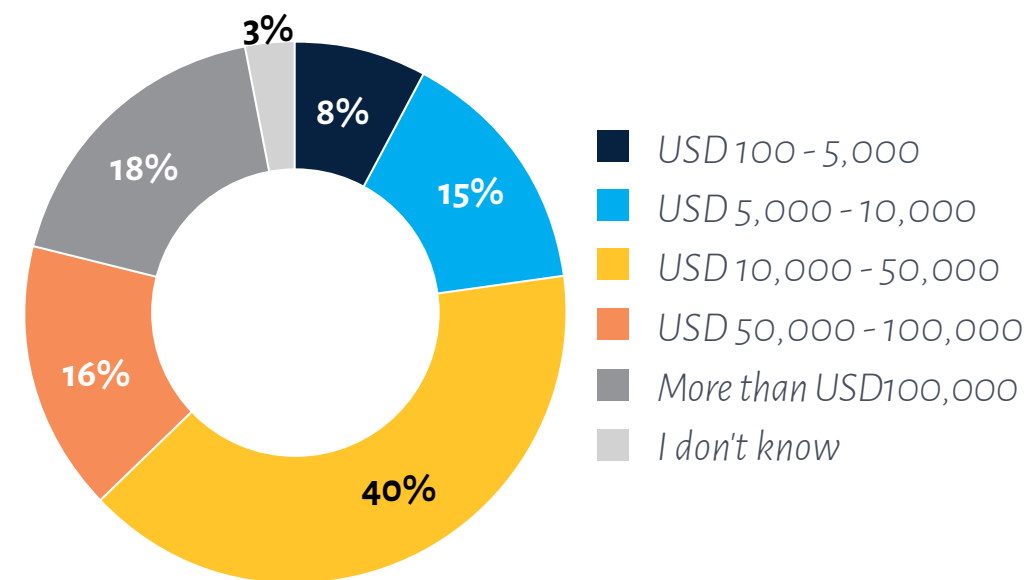
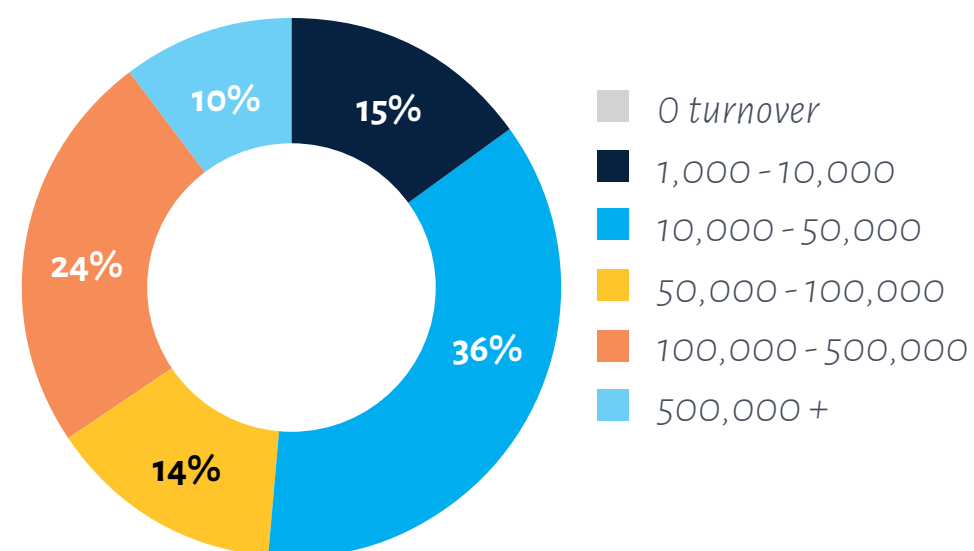


Figure 5. What Is The Sales Turnover Projected For Your Main Business In 2021?

N=492



## SME Market Size

Official data from the CSO and the Kurdistan Region Statistical Office (KRSO) only includes industrial SMEs, arriving at a total count of 37,000 SMEs representing 117,000 employees in the country. This only accounts for about one percent of the total workforce of 10 million, which does not seem realistic. IFC estimates that there are about 608,500 SMEs in Iraq, which is the basis for the calculations used to estimate the market size in this report (see How the Research Was Done on page 10 for full details).

Although SME density is markedly lower in Iraq than elsewhere in the Middle East and North Africa region (there are five times as many SMEs in Turkey, for example, and twice as many in Algeria<sup>8</sup>), it is still a sizeable market segment. Just over half of the SMEs surveyed by IFC (52 percent) expressed plans to borrow in the future. The appetite for financing is strongest in Central and Southern Iraq, and most SMEs express a desire to borrow between \$10,000 and \$50,000 (see figure 4).

Based on an estimate of 608,500 SMEs and the median loan size expressed in the IFC survey, \$35,000, the total demand for SME finance is \$11.1 billion, equal to about 6.6 percent of GDP.

Only a small part of this is currently being met. Based on survey results, IFC estimates that Iraqi SMEs are currently receiving about \$200 million in short term finance and \$371 million in long term finance from banks, and \$900 million and \$3.4 billion from money exchange shops and friends and family respectively. Theoretically, this leaves a funding gap of about \$6 billion.

## SME Market Characteristics

SMEs are present in all areas of Iraq's economy except for the export-oriented oil and gas sector, which is dominated by larger companies. The IFC survey was conducted in the governorates of Babylon, Baghdad, Basra, Erbil, Karbala, Ninewa, and Sulaymaniyah, with the randomly selected SMEs primarily active in the wholesale and retail trade sector (33 percent), hospitality (15 percent), and information and communication (7 percent). Other service activities accounted for 9 percent of the sample. Iraqi SMEs are predominantly very small. Of the 827 enterprises surveyed by IFC, the large majority were small companies with three to six employees (77 percent). Medium enterprises were still overrepresented in the sample, accounting for about 11 percent of respondents as compared with about 1.6 percent of the SME body, as per CSO and KRSO data.<sup>9</sup>

The average self-reported expected sales turnover of small enterprises in 2021 was about \$220,000, and approximately \$660,000 for medium sized enterprises (see figure 5). About a third of the surveyed enterprises had been started in the past five years, while almost half were at least 10 years old. The impact of the COVID-19 pandemic has been severe across the board, with average sales turnover dropping by 28 percent between 2019 and 2021. While medium sized enterprises appear to be recovering fast, reporting turnovers in 2021 of just below that of 2019, small companies remained at about \$100,000 below the 2019 average turnover levels in 2021.

The definition of business formality is not entirely clear in Iraq, but only 6 percent of the survey sample stated they completely lacked any form of official registration. Others said they were registered with one or more of, for example, the Ministry of Trade (24 percent), Ministry of Tourism (19 percent), Ministry of Industry (16 percent), Chamber of Commerce (6 percent), a union or syndicate (4 percent), or other ministries.

<sup>8</sup> European Union, MED MSMEs website, Algeria, 23 May 2022, <https://www.medmsmes.eu/algeria>

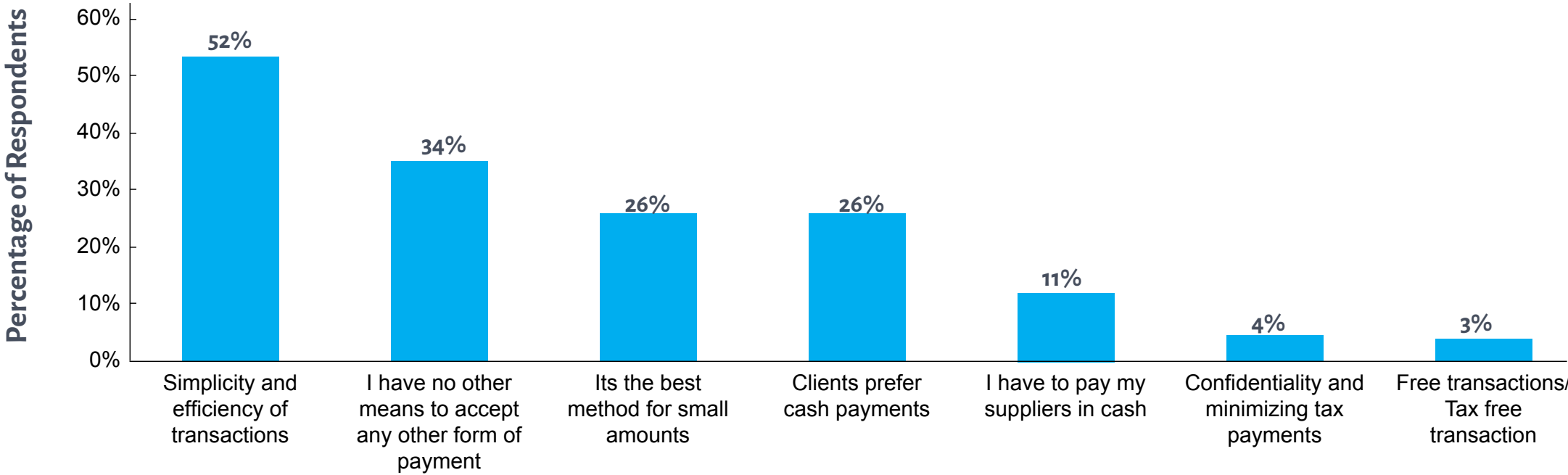
<sup>9</sup> CSO (2018) and KRSO (2012)

Very few of the surveyed SMEs are engaged in export, while 38 percent of the survey sample import goods. Most SMEs procure goods through Iraqi wholesalers, but a significant proportion is also in direct relation with wholesalers abroad. In terms of clients, SMEs mostly do business directly with consumers, rather than serving other businesses or government. However, medium enterprises have a more balanced client portfolio.

The survey presents a picture of a generally well-educated business class, with more than half of SME owners and managers holding a university or doctoral degree (45 percent) or some form of professional qualification (9 percent). While the data shows that women in the SME sector are better educated than men (58 percent of women hold a university degree), SME ownership is heavily skewed in favor of men. Women, found primarily in the services sector, are more often non-owning managers and manage enterprises with lower annual turnovers. All surveyed medium-sized enterprises were managed by men.

SMEs in Iraq generally operate in cash. The dominant payment terms, both from clients and to suppliers, are cash on delivery and upfront payments (see figure 6). Transfers, mostly hawala but also bank transfers, are sometimes used to pay suppliers. SMEs prefer cash, mostly for perceived simplicity, but a significant proportion also reports not having other payment means.

**Figure 6. Reasons for Receiving Cash Payments from Customers**  
N=821





# 04

## SME Financing

### SMEs Rely on Informal Sources for Finance

#### Demand for SME Financing

Most surveyed SMEs are formally unbanked. Only 8 percent hold a business bank account and 16 percent have personal accounts, which in practice are often used for business (see figure 7). Still, in a national context of low financial inclusion, use of banks accounts among SMEs is not negligible. It is significantly higher among medium enterprises compared with small enterprises. The use of personal accounts for business is convenient for the main business type (single owner-manager).

Survey results suggest one of the reasons for the low account ownership is a widespread mistrust in banks. Around one third of respondents have little or no trust in banks, a further 10 percent has little trust, and 18 percent are neutral. The figure is not significantly lower among the most educated, or among medium companies. Therefore, it seems that the sources of low confidence are on the banking side rather than in lack of financial literacy (see figure 8).

A significant proportion of surveyed SMEs use short-term financing (25 percent), but mostly from acquaintances (19 percent), rather than from banks (3 percent) or from the ubiquitous money exchange shops (5 percent).

Short term loans average \$30,000 in general, but only \$10,000 from banks. On average, SMEs reimburse 10 to 13 percent more than they have borrowed. For bank loans, reimbursement is on average 18 percent higher, reflecting very high non-performing loans and interest rates.

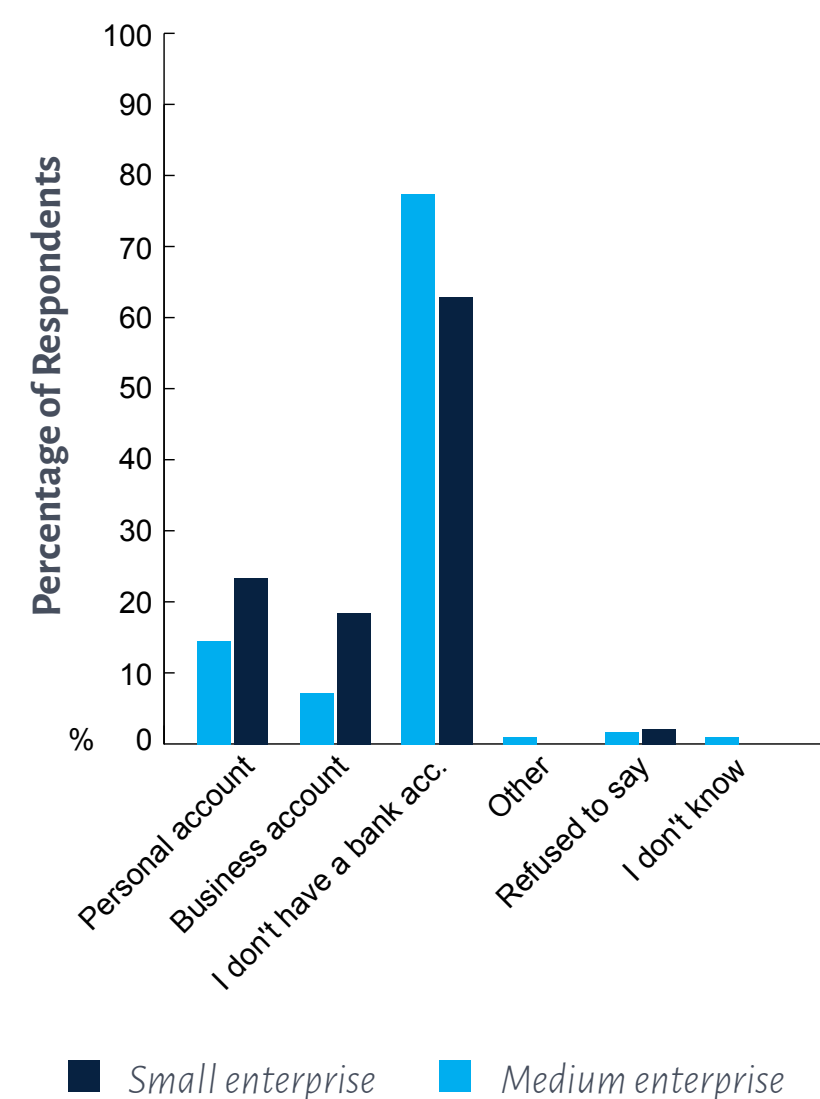
This is to large extent a supply issue. SMEs would be eager to borrow more from banks, and many could borrow more and repay. The fact that they resort to loans from family and friends, but also from money exchange shops, results from this lack of supply of credit from banks. Surprisingly, medium companies borrow smaller amounts than small companies and not necessarily from banks. The reason might be that they have more available cash, or are better capitalized, and therefore have less need for working capital.

Overall, loan amounts vary by governorate and source; larger amounts are lent by money exchange shops in Baghdad and Basra, larger amounts by family and friends in the Kurdistan region, and in Anbar SMEs rely only on family and friends. Nine percent of surveyed SMEs use personal loans for business purposes, with such loans averaging around \$21,500.

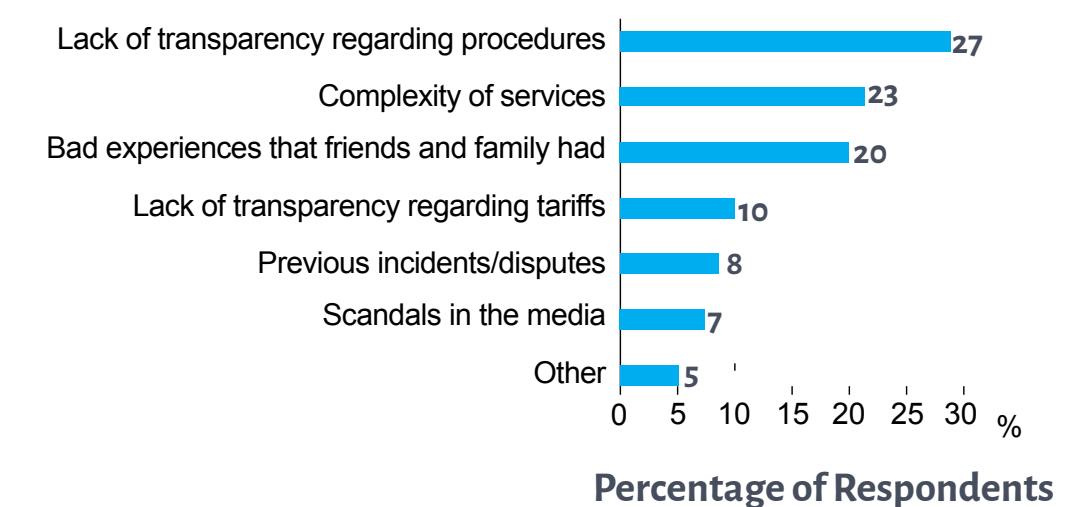
The use of collateral varies by funding source. Banks rely mostly on personal sponsors (kafeel, primarily

someone earning a government salary), and only secondarily on real estate, while money exchange shops have diversified guarantees, and borrowing from family and friends is mostly based on trust. The fact that most banking credit, even for enterprises, is secured by personal sponsors is evidence that lack of traditional collateral is a key barrier to accessing finance. This limits both the numbers of eligible borrowers to those who can source a kafeel, and the amount of a loan since a government salary only provides limited cashflow.

**Figure 7. Usage of Bank Accounts**  
N=827



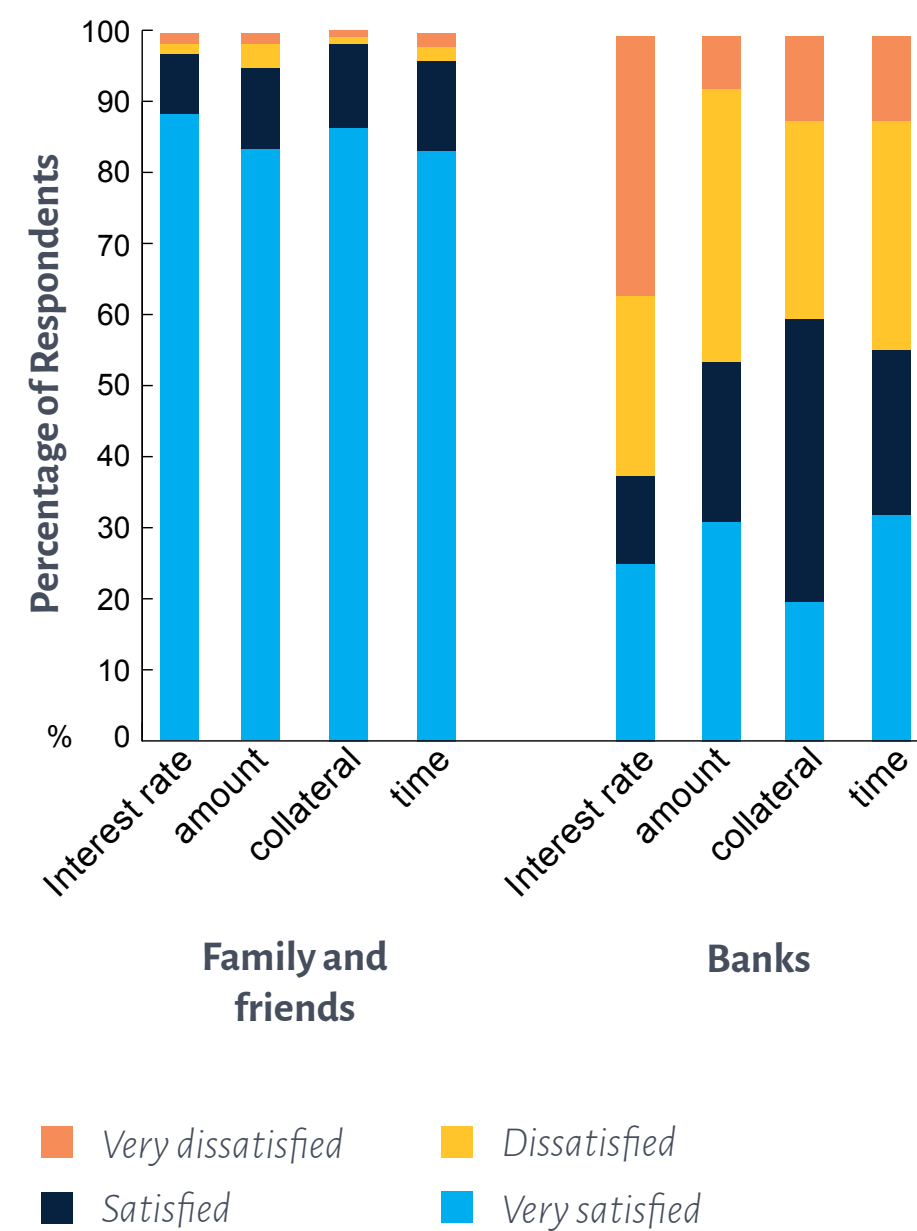
**Figure 8. Reasons For Lack Of Confidence In Banks**  
N=633





**Figure 9. Satisfaction Levels For Family And Friends  
Vis-à-Vis Banks**

N=223



Money exchange shops are almost as fast as family and friends to grant a loan, while banks are slower. The persistence of informal lending from family and friends can be explained by high levels of satisfaction compared with other sources (see figure 9).

Long-term financing is significantly less common and most often sourced from banks. Only 2.5 percent of survey respondents reported the use of long-term loans, with 76 percent of these sourced from banks. The average loan amount was \$76,000, reimbursed at an average premium of 26 percent. Real estate is more often required as collateral for long term funding than for short term finance, but guarantees include the borrowers' salaries.

As mentioned above, there is a strong appetite for credit among surveyed SMEs. More than half of respondents, 52 percent, would like to borrow in the future. In general, they are seeking loans in the range of \$10,000 to \$50,000 over one to five years. Small enterprises are more eager to borrow than medium ones, which might indicate a lack of working capital. Demand is strongest in Central and Southern Iraq.

The main purpose of loans is to expand existing businesses. Growth strategies are mainly commercial, focusing on outreach to new clients and expansion of products and services offered. A lack of public infrastructure, such as electricity and roads, is seen as the main obstacle to business growth, while lack of

demand and purchasing power among customers are also significant. Insecurity is only considered a threat to business by 4 percent of surveyed SMEs.

Not all SMEs have been able to pay back on previous loans, with 14 percent of respondents acknowledging past delays on repayments and 9 percent reporting past defaults. This is in line with the high level of non-performing loans reported on the supply side (37 percent) although this includes personal and corporate loans.

Only 12 percent of surveyed SMEs use insurance, with a higher proportion of medium enterprises subscribing to such services. The most common policies are to protect a company's buildings and stocks, followed by health insurance. The hospitality sector relies on insurance much more than others. This might relate to higher perceived risks and hazards to the premises due to their being frequented by the public. It might also relate to stricter obligations of insurance and controls by the authorities.

### Supply of SME Finance

While a large number of banks operate in Iraq, banking penetration is low by regional standards with only five commercial bank branches per 100,000 people. In general, private banks are small with limited capital, with seven public banks holding about 90 percent of

banking assets. Credit is low compared with GDP, and only 9 percent of lending currently reaches the SME sector. Most banks that lend to SMEs do so through the One Trillion Dinar Initiative, with the National Bank of Iraq being the dominant provider.

Generally, the credit market is characterized by high interest rates and high ratios of non-performing loans. Bank lending to SMEs is generally focused on loans of less than \$50,000, overlapping with offers from microfinance institutions (MFIs) that also serve the lower end of the market. There are some specialized SME lending institutions in the \$500,000 to \$1.5m bracket, but with a very small total volume. There is virtually no financial institution specializing in loans from \$45,000 to \$500,000.

MFIs largely provide micro loans to businesses in the services sector, as well as personal loans for education, housing, and vehicle finance. The overall microfinance market is small, estimated at around \$150 million compared with, for example, \$350 million in Jordan.<sup>10</sup> With limited capital markets and tough conditions for loans, most MFIs can only count on their own revenues to finance expansions.

<sup>10</sup> Microfinance in JORDAN Developments, Challenges and Future Prospects, 2019

# 05

## Serving the SME Market in Iraq

### Conclusions & Recommendations

A number of challenges, on account of borrowers and financial institutions, limit SME finance. Most SMEs do not have audited accounts or employ a formally trained accountant, limiting the ability of banks to estimate the profitability and capitalization of borrowers. Entrepreneurs are often specialized in one sector, which limits them to small, unscalable projects. Family-run enterprises are sometimes lacking in formal management structures and face succession problems.

Banks, on their side, often lack skills to conduct financial analysis of SMEs. This can lead to over-reliance on collateral and personal guarantors at the expense of profitability and cash flow analysis. Under the One Trillion Dinar Initiative, banks have been disbursing relatively small loans although they are generally not equipped with MFI strategies and tools such as outreach officers and group lending.

The entire architecture for SME financing needs support from more targeted liquidity facilities, regulatory incentives, bolstered credit guarantee companies, and SME banking champions in the financial sector. Some of the measures that can be taken by regulatory authorities and financial sector actors include:

#### 1. Strengthen the national strategic framework for SME finance

- Iraq needs a coherent strategy to enhance and support SME finance, and an explicit champion to lead and implement such a strategy.
- Measures can also be taken to revive the SME Finance Company which can act as an apex institution to channel funding to financial institutions.

#### 2. Diversify and streamline the use of collateral

- Government could revamp and expand the credit risk guarantees program to reduce reliance on collateral for SME lending. This may include recapitalizing the Iraqi Company for Bank Guarantees (ICBG).
- Regulatory authorities could introduce legislation to enable the use of movable collateral for lending and establish a collateral registry to encourage financial institutions to make use of such collateral when lending to SMEs.

- The absence of a functioning credit bureau leads to over-reliance on personal and real estate collateral. Ideally, the government makes provisions for the establishment of modern credit infrastructure with private credit bureaus. If this is not possible at a national level, it could at least build a mutualized database of loan performance among a pilot group of banks, for example participants of the One Trillion Dinar Initiative, or other relevant groups.
- Regulatory authorities could reform administrative procedures for the appropriation of collateral. If possible, public auctions should be replaced with direct appropriation by the creditor.
- Government could work to strengthen and harmonize expertise in the real estate and financial sectors to ensure the appropriate valuation of real estate for collateral.

#### 3. Better inclusion of MFIs in the financial sector

- Government could bring MFIs under the supervision of the central bank rather than the Department of Non-Governmental Organizations and/or enact legislation to regulate non-bank financial institutions so that they can partake in the One Trillion Dinar Initiative.



#### 4. Enhance SME Banking assessment capacity and expertise to support SMEs

- Financial institutions could train SME banking officers to analyze SME financial statements, and/or adopt innovative approaches to data-driven credit assessments that monitor SME cash-flows before a loan. The shift from collateralized lending to one that is cashflow based is crucial for the proliferation of SME lending. The creation of robust credit scoring models, based on alternative sources of data (eg. through partnerships with SME aggregator platforms such as e-commerce or logistics), should be promoted.
- Additionally, financial institutions could adopt a holistic approach to SME clients and develop and offer non-financial services to complement liability products.

- Banks could also consider measures to address the widespread mistrust of financial institutions among SMEs. Measures could include the creation of specific SME relationship champions and officers, tailor-made products and targeted marketing campaigns, as well as process efficiency and pricing.

#### 5. Use money transfers as a gateway

- Most SMEs use money transfers to pay suppliers in Iraq and abroad, but they prefer hawala over bank transfers. Banks could onboard more SME clients by offering fast and simple transfer procedures, with orders over the phone or by online banking, ideally with cheaper fees than hawala.
- Financial institutions can also mine their existing databases and segment potential clients for a less risky approach to business development.

#### 6. Build a customer journey

- Financial institutions could build and offer a rewarding progression pattern for SMEs: opening of personal account, of business account, savings, progressive transition of transactions to non-cash means, offer of short-term finance, and ultimately offer progressively larger and longer loans. They could also encourage SME clients to progressively transition out of cash transactions to build track records as a guarantee of future loans.

# 06

## How the Research Was Done

This report is based on a survey of 827 SMEs drawn from seven governorates, namely Babylon, Baghdad, Basra, Erbil, Karbala, Ninewa, and Sulaymaniyah. Of the SMEs surveyed, 89 percent were small enterprises, and the remaining 11 percent were medium, based on the CSO definition of SMEs (please see below). The survey was conducted between August and September 2021. In addition, 40 in-depth interviews were carried out with relevant stakeholders (such as banks, MFIs, specialized SME-lending institutions, CBI, international institutions supporting SMEs, and informal lenders) as well as with SMEs themselves. These key informant interviews were carried out between October and December 2020. All findings are supplemented by research of relevant reports and statistics.

### Definition of SMEs

Although they account for the bulk of economic activity in Iraq, a commonly accepted definition of SMEs does not exist among local or international stakeholders or institutions. CSO as well as KRSO define SMEs according to employee count, with a small enterprise denoted as having between one and nine employees, while a medium enterprise employs between 10 and 29 people, including the owners. Though this does not correspond with IFC's definition (micro-enterprises employ less than 10 people, small-enterprises employ 10 to 50 people, and medium-enterprises employ 50 to 300 staff), and while it also does not take into account the turnover of an enterprise when classifying it, this report relies on the CSO definition throughout.

### Market Size Calculations

#### 1. Estimation of the number of SMEs in Iraq

*Method 1:* In the IFC survey sample of 827 SMEs, 43 companies have borrowed from banks for a total of about \$759,000. We assume here that all these loans are from the One Trillion Dinar Initiative, which has disbursed \$346 million from the fourth quarter 2015 to the second quarter 2021 (just before the survey), excluding residential loans and accounting for the historical exchange rates. Assuming constant loan size, that would mean that our sample represents  $759,000 / \$346\text{m} = 0.22$  percent of SMEs in Iraq, meaning that there would be  $827 / 0.22 \text{ percent} = 377,000$  SMEs in Iraq. Since SMEs may have borrowed from banks outside of the One Trillion Dinar Initiative, this figure is a lower bound.

*Method 2:* Iraq total labor force is around 10 million as per World Bank data. Around 3 million are employed in the public sector.<sup>11</sup> There would therefore be  $10 - 3 = 7$  million employees in the private sector. IFC estimates that two-thirds of private sector employment, or 4.7m, is in MSMEs. Workforce in SMEs only (excluding micro-enterprises) would therefore be lower than 4.7m. In our sample, the average number of employees was 5.6. The total number of SMEs would therefore be  $< 4.7\text{m} / 5.6 = 840,000$  SMEs, as an upper bound.

**For next steps,** the middle point of the obtained bracket, 608,500 SMEs, was used.

#### *Estimation of potential demand*

In the IFC survey, 52 percent (of respondents citing a need to borrow) \* 608,500 Iraqi SMEs \* 35,000 USD (median desired loan amount) = about \$11.1 billion. This is the total of the ideal amounts expressed by SME, while actual lending would necessarily be lower after risk assessment. This figure of \$11.1 billion would make up around 6.6 percent of Iraq's GDP (\$167 billion), which is comparatively low but not unrealistic in an oil-dominated economy.

<sup>11</sup> London School of Economics website, *Analysing Growth Trends in Public Sector Employment in Iraq, 2018*



## 2. Estimation of current credit uptake

Assuming there are about 608,500 SMEs, the current short-term loans, based on survey results, would amount to:

Money exchange shops: 5.2 percent (proportion who borrowed from money exchange shops) \* \$28,447 (average amount borrowed) \* 608,500 SMEs = \$900 million.

Family and friends: 18.5 percent (proportion who borrowed from family and friends) \* \$29,977 (average amount) \* 608,500 SMEs = \$3.4 billion.

Banks: 3.3 percent (proportion who borrowed from banks) \* \$9,996 \* 608,500 SMEs = \$200 million.

Long-term loans (mostly from banks): 2.2 percent (proportion who took long-term loans from banks) \* \$27,705 (average amount) \* 608,500 SMEs = \$371 million

When subtracting the above figures (actual lending) from demand, the SME financing gap is about \$6 billion.

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# Acronyms

DEFINITION	
CBI	Central Bank of Iraq
CSO	Central Statistical Organization
DFS	Digital Financial Services
FI	Financial Institution
GDP	Gross Domestic Product
ICBG	Iraqi Companies for Bank Guarantees
ICF-SME	Iraqi Company for Financing Small and Medium Enterprises
IFC	International Finance Corporation
IGPA	Iraq Governance and Performance and Accountability Program
IOM	International Organization for Migration
IMMDF	Iraqi Middle Market Development Foundation
KRSO	Kurdistan Region Statistics Office
MENA	Middle East and North Africa region
MFIs	Micro-finance Institutions
MoLSA	Ministry of Labour and Social Affairs
NFS	Non-financial services





## IFC Market Bites

IFC Market Bites is a series of reports based on comprehensive market assessments conducted by IFC's Financial Institutions Group to provide market knowledge and support financial inclusion.

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