



IFC and Fransabank Supporting Job Creation in Lebanon

CASE STUDY

Acknowledgements

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Executive Summary

IFC, a member of the World Bank Group, seeks to promote private sector led growth in order to support job creation and inclusive growth. In this context, an important priority of IFC in Lebanon is to support small and medium enterprises (SMEs).

In Lebanon, SMEs represent 97 percent of the total formal enterprises, employ more than 51 percent of the working population, and are mostly family-owned. Supporting Lebanese SMEs is therefore an important mechanism for increasing employment opportunities, and improved access to finance for SMEs is an essential factor allowing SMEs to grow. As part of its activities in Lebanon, IFC partners with local banks and other financial institutions to (i) broaden their networks and facilitate greater outreach to SMEs; and (ii) offer innovative products that expand financing options for SMEs.

Fransabank and IFC have had a long-standing relationship dating back to the 1990s. In 2007, IFC supported Fransabank under the Lebanon Rebuild Program with two facilities including a risk-sharing facility to support the bank's lending to SMEs. IFC's counter-cyclical support not only provided liquidity but also helped restore investor confidence in Lebanon and its private sector in a post-conflict situation.

Measuring the impact of IFC's investment and advisory activities can be complex. With the idea of quantifying job creation through financial markets investments in Lebanon, IFC and Fransabank have undertaken this in-depth study. The key objectives of the study are (i) to measure the job impact on SMEs from increased access to finance; and (ii) to understand the broader development outcomes facilitated by engagements in the financial sector. The results are based on a survey implemented in March 2013, which sampled 73 companies that received loans from Fransabank during 2008 and 2011. The enterprises ranged from very small to medium firms in the service, agribusiness, and manufacturing sectors across the five regions of Lebanon.

Despite the challenging operating environment and economic conditions, the study found encouraging job creation effects as well as provided unique insights on the dynamic nature of the Lebanese economy and its SMEs. Between 2009 and 2012, the surveyed firms reported to have created 473 full-time jobs with a compound annual growth rate of 13 percent over the analyzed period. However, part of the job creation was in the form of low-skilled jobs for "non-Lebanese" workers which could potentially lessen the impact of job creation for "Lebanese" workers in this report. Small firms contributed most to full-time job creation, predominately in the retail and tourism sectors as well as towards the employment of women and youth. Most firms in the sample reported a skills gap, such as lack of communication skills and computer proficiency. Furthermore, most firms cited political uncertainty as an obstacle to growth, especially due to the spillovers from Syria.

While it is difficult to draw any definitive conclusions from these findings, the results validate that SMEs are vital and have the potential to contribute significantly to job creation. The findings should also encourage financial institutions like Fransabank to continue supporting SMEs through financing and other services to promote sustained job growth in Lebanon.



IFC and Fransabank

Background

Following the conflict in 2006, IFC scaled up its activities in Lebanon in response to the country's reconstruction efforts. IFC's work included providing much needed long-term funding to private enterprises struggling to recover from the crippling effect of the conflict, as well as building relationships with local banks looking to develop their SME programs and expand regionally. An important aspect of IFC's strategy in Lebanon was promotion of risk sharing facilities (which included IFC and donor sponsored first loss tranches) to local banks, as well as providing technical assistance to strengthen Kafalat (a quasi-governmental SME guarantee organization) and other organizations that support SMEs.

Fransabank was one of the banks which benefited from two IFC facilities in 2007 including (i) a \$25M credit line to support existing and new commercial clients affected by the conflict; and (ii) a Risk Sharing Facility of \$20M for SMEs. The use of IFC's risk sharing facility was part of Fransabank's strategy to scale up its outreach to SMEs as it sought to expand beyond the traditional corporate and commercial markets that dominated the Lebanese banking sector at the time. During this period, Fransabank established a dedicated SME department, which has since grown significantly and its portfolio has increased more than two-fold, (i.e. increased from \$140 million to \$421 million as of December 2012). Fransabank's SME strategy is centered around (i) accessibility – a widespread network including branches in difficult regions; (ii) product diversification – offering a variety of credit facilities; and (iii) outreach and awareness – organizing seminars with different sectoral associations, including trade, agribusiness, industry, and tourism. Fransabank's reputation, transparency, and client relationships are considered its areas of competitive advantage. Since 2006 to June 2013, IFC has committed over \$260 million to Fransabank, mostly in guarantees.

IFC's partnership with Fransabank fits within the broader strategy for Lebanon which focuses on the financial markets sector (including trade finance) with a special emphasis on increasing access to finance for micro, small, and medium enterprises (MSMEs). Over the last three fiscal years alone, IFC has committed almost \$1 billion in the financial sector in Lebanon, mostly in trade finance which helps SMEs enter new markets and trade across borders. In addition, IFC has made equity investments both in the financial sector and in firms in the manufacturing and service sectors, particularly in companies pursuing regional growth strategies. IFC's advisory activities focus on long-term reforms to remove obstacles to growth for MSMEs and encourage innovation. The integrated investment and advisory program promotes innovative engagements that leverage the dynamism of Lebanon's private sector in areas such as climate change, women in banking, insurance, and investment climate reform.

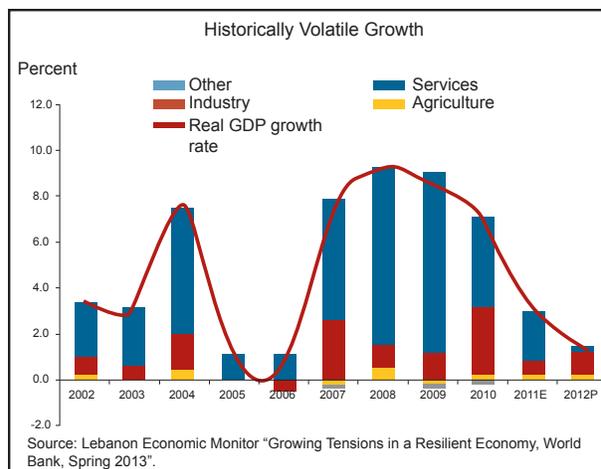
Country context

Economy

Lebanon is a small but highly urbanized middle income country of 4.4 million people with a GDP of around \$43 billion (GDP per capita of \$10,311). The country has weathered several crises over the past decade including the 2006 conflict that severely hampered economic activity. Similarly, the most recent wave of regional and domestic unrest beginning in 2011 has increased Lebanon's macroeconomic vulnerabilities. The conflict in neighboring Syria has exacerbated the security, political, and economic issues facing the country, and resulted in a further decline in tourism, private investment and foreign direct investment (FDI). This has culminated in economic growth falling sharply from the 7-9 percent growth rates experienced during 2008-2010, to 1.5 percent in 2012 – the lowest growth performance since the 2006 conflict.

This deterioration deepened in the second half of 2012, following a downturn in the security situation.

The service sector, which has been the strongest growth driver historically (accounting for approximately 75 percent of GDP) witnessed a sharp deceleration in growth in 2012. Tourism has been one of the sectors especially hard hit by the domestic and regional tensions with estimated losses at around 0.5 percent of GDP in 2012. Inflationary pressures also rose as a result of increased wages/salaries, and an influx of Syrian refugees, leading to a jump in domestic prices of goods. Fiscal and current account deficits also remain high. The progress made in decreasing Lebanon's public debt-to-GDP ratio was reversed and increased for the first time since



2006 to 134 percent of GDP in 2012. Investor confidence has deteriorated sharply as evidenced by a significant drop in FDI (68 percent drop in 2012 year over year). On a positive note, remittances have remained robust and reached \$6.8 billion at the end of 2012. Lebanon's medium-term outlook is uncertain and depends on improvements in the political and security situation and the depth and duration of the Syrian crisis. GDP growth is forecast to remain at 1.5 percent in 2013-14 with the economy susceptible to risks, including a worsening security situation and increasing social and economic costs as a result of the Syrian crisis. The North and Bekaa regions bordering Syria have felt the most impact. The majority of the 845 thousand registered and unregistered refugees (as of early December 2013) are sheltered in these two regions, increasing pressure on public expenditure and social cohesion.

Employment

The Lebanese labor market is similar to that across the MENA region, characterized by high levels of unemployment, especially among women and youth. The overall unemployment rate in Lebanon is estimated at 11 percent and stands at 18 percent and 34 percent for women and youth, respectively. Labor participation is also low with only 70 percent of working-age men¹ and 24 percent of women active in the labor force. The majority of jobs generated by the economy have been in low productivity² sectors which employ 35 percent of wage employees and 61 percent of the self-employed. On the other hand, high productivity sectors account for 14 percent of wage employees and only 3 percent of self-employed.

One of the major constraints to supporting high productivity job creation is the skills of the labor force. The majority of workers (around 65 percent of both employees and the self-employed) in Lebanon have received a secondary education or less, and around 40 percent of the labor force has no education or only a primary education. Employers also identify several skill gaps in their employees across a variety of occupations. For instance, employees in managerial positions lack familiarity with computers and have poor numerical abilities, while non-managerial skill gaps include professional communication skills, problem-solving skills, and numerical skills. This mismatch between skills and labor market needs has contributed to increasing unemployment rates.

¹Working age is considered to be 15 to 65 years old

² Low productivity jobs refers to those in the wholesale and retail trade, repair of motor vehicles, transportation and storage, accommodation and food service activities, and real estate sectors. High productivity jobs are in sectors such as information and communication technologies, financial and insurances, and those involving professional, scientific and technical. (Source: World Bank 2012)

Financial Sector

Thanks to a prudent regulatory structure and effective banking supervision, the financial sector has been a silver lining for Lebanon. Lebanon's banking sector has positioned itself as a safe haven in the region during times of crises and has consistently attracted inflows from the MENA region and the Lebanese diaspora. Therefore, the banking sector has benefited from high levels of liquidity and weathered exogenous shocks by maintaining profitability and low levels of non-performing loans (NPLs). The banking sector is critical to Lebanon's macroeconomic stability as almost 42 percent of the government debt is financed by the domestic banking sector. However, as in the rest of the region, the financial institutions remain conservative in their lending practices with loans given primarily to large companies, even though 93 percent of private enterprises in Lebanon have fewer than five employees.

Study Objective and Methodology

Objective

The primary objective of this study is to measure the employment contribution of SMEs³ that obtained financing from Fransabank. Specifically, it seeks to (i) analyze total job growth experienced in the SME sector between 2009 and 2012; and (ii) understand the challenges facing SMEs, particularly in light of the slowdown in economic activity due to domestic and regional unrest. The analysis identifies sectors and regions which contributed most to employment creation and highlights various dimensions of job growth by firm size. The results are intended to inform the design of future IFC programs to boost job creation in Lebanon and other emerging markets. It is also intended to support Fransabank's SME strategy via expert analysis catered to Fransabank's unique portfolio.

Methodology

In March 2013, IFC surveyed 104 firms from among a population of SMEs which received loans from Fransabank between 2008 and 2012⁴. Thirty-one of these firms had to be excluded from the analysis due to incomplete responses. The 73 selected firms were disaggregated into three categories for analysis based on the number of employees when they initially received the loan: very small enterprises (one to nine full-time employees), small enterprises (10 to 49 full-time employees), and medium enterprises (50 to 249 full-time employees). Regional diversification was also taken into consideration. The sample selection was randomized on the portfolio provided by Fransabank.⁵

The IFC team conducted field interviews to obtain firm-level data on employment and financial performance for the 2009 and 2012 period. These interviews also gathered qualitative information on several other areas including sources of funding to start and expand business operations, obstacles to growth, and skill sets of employees, in order to provide a more holistic analysis of the role of SME finance in Lebanon.

³For the purpose of this study, firms belonging to the randomly selected sample were divided according to the number of their employees, i.e. very small enterprises (up to 9 full-time employees), small enterprises (10 to 49 full-time employees), and medium enterprises (50 to 249 full-time employees). This categorization differs slightly from Fransabank's definition which looks at annual sales, assets, and loan size for its SME categorization

⁴The survey analyzed employment figures between 2009 and 2012; however, the study interviewed firms who received a loan between 2008 and 2012. The study considered only performing loan clients of Fransabank.

⁵Fransabank's SME definition is based on (i) annual sales (not to exceed \$5M); and (ii) exposure (less than or equal to \$2M)

Caveats

The sample showed promising results. However, the inherent limitations of the data require caution in analyzing the results. Caveats include:

(i) Selection bias: The sample size did not include firms who were driven out of business by the increased competition implied by the expansion of the firms supported by IFC. Furthermore, the sample did not include firms with nonperforming loans, which may have experienced job losses during the period. Although this was controlled for in the extrapolation, the average jobs created per \$100,000 is likely biased upward. On the other hand, only job effects in the enterprises that received financing were assessed, not secondary effects e.g. in their suppliers, or due to increased expenditures of workers.

(ii) Omitted Variable Bias (OVB): The lack of a control group comprised of SMEs that did not receive financing support over the same period make the analysis vulnerable to country-wide shocks that could bias the results. In addition, other observable factors that may have influenced job growth during this period are likely missing from the data. For example, though partially captured by sector categorization, labor intensity in production is a missing variable that might impact both loan size and job growth. Similarly, the age and experience of the business owners are likely causal determinants of both loan size and job growth. The omission of variables such as these from the data set invites OVB and limits statistical inference.

(iii) Measurement error: Given the nature of the survey, measurement error is a likely issue in the data. Subjective quantitative metrics such as the percentage share in business ownership by women is an inherently noisy measurement.



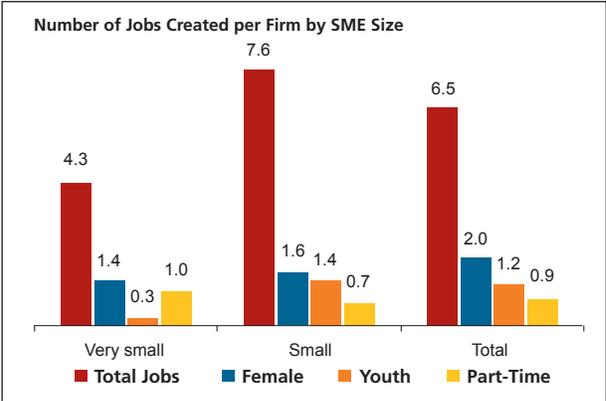
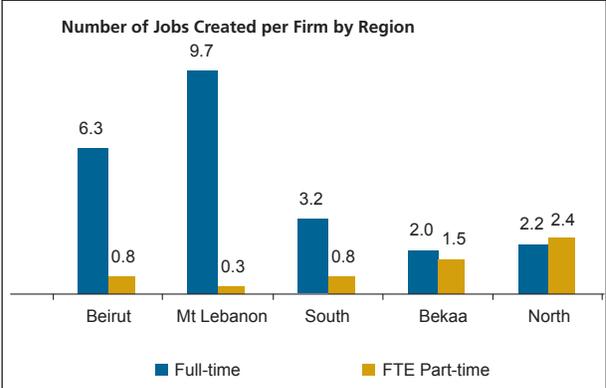
Results

The findings of the study are encouraging, especially given Lebanon’s increased macroeconomic vulnerabilities over the analyzed period. The sample of 73 SME firms that obtained loans from Fransabank created 473 total full-time jobs, with a compound annual growth rate of 13 percent over the analyzed period.

Around 60 percent of the firms interviewed did not identify access to finance as a constraint and noted using their own funds to start their business operations. This could be linked to the fact that the surveyed SMEs had (i) an established track record; (ii) a personal relationship with Fransabank; and (iii) the ability to put up collateral. Given their established relationship, most of the firms reported to be satisfied with Fransabank services and their processing time. However, 36 percent of firms that indicated obtaining access to credit as a constraint cited a number of barriers including limited track record, large collateral requirements, and lack of a personal relationship with the bank.

Some key takeaways include:⁶

- (1) **Small firms contributed to the bulk of the full-time jobs created, adding 7.6 jobs per firm on average** – almost double that of very small enterprises. This is consistent with literature which shows that small firms are drivers of employment generation.
- (2) **Jobs for women and youth were created largely by small firms.** Both women and youth jobs per firm on average were highest for small firms. This finding may be skewed by the fact that service sector firms, particularly retail firms, dominated the sample population and mostly employ women.
- (3) **Female participation in firm ownership and management positions show greater average sales growth and productivity per firm.** Thirty-four percent of the firms had female participation in ownership, and 29 percent of firms had women in management positions. Firms with women in management positions had higher productivity and sales growth than those firms that reported female participation in ownership only.
- (4) **“Non-Lebanese” workers accounted for a considerable portion of the total jobs created.** 11.5 percent of the 473 full-time jobs created were reported to have been for “non-Lebanese” workers. While the survey did not ask to differentiate between the buckets of employment by nationality, many firms noted facing difficulty filling “non-professional” jobs or “low-skilled” work with Lebanese workers due to the cultural mindset and unrealistic expectations.



⁶The study does not have a representative sample of medium-size firms to draw concrete findings in areas of women, youth employment, and regional distribution.

- (5) **Beirut and Mount Lebanon regions were main contributors to full-time job creation.** While this finding could be skewed by the sample composition, it is largely consistent with the regional differences in Lebanon. Beirut and surrounding Mount Lebanon areas are the country's wealthiest regions; they register the lowest poverty rates, and are centers of business activity. Conversely, the fact that the North and Bekaa regions contributed mostly to part-time employment may be a reflection of the current economic and security situation due to the spillover from Syria, and/or be driven by the fact that these regions are comprised mostly of very small firms.
- (6) **The service sector created the largest number of full-time jobs, while industry sectors contributed most to part-time employment.** Of the 473 total jobs created in the sample, 65 percent were in retail, tourism, and wholesale sectors. This is reflective of the Lebanese economy, in which the service and trade sectors account for almost 60 percent of total employment. On the other hand, industry sectors such as manufacturing and construction contributed most to part-time jobs which could be attributable to the cyclical nature of the work as well as indicative of the current economic conditions which have affected these two sectors adversely.
- (7) **Firms reported technical skills as the primary skills gap across most regions,** which is consistent with the skills issue in the MENA region. The lack of technical skills (e.g. computer proficiency, operating machinery) was consistent across the country (with the exception of Bekaa) in both very small and small firms. As a result, many firms engaged in internal training programs to fill this gap. At the sectoral level, firms in the industry sectors noted technical skills as a primary gap; in the service sector both technical skills and soft skills (e.g. communication, interpersonal skills) were also cited as a need.
- (8) **Political instability was identified as the primary obstacle to growth/performance.** Of the firms that responded, political uncertainty was the number one constraint to business operations, followed by policy issues such as custom/inspection regulations and business licensing. When analyzed by region, SMEs located in North and Bekaa areas emphasized political instability as the key obstacle whereas firms in Beirut and Mount Lebanon noted policy issues as a challenge. At the sector level, services (retail, tourism) and industry (manufacturing, construction) reported political instability as a major challenge to operations. Disaggregating by firm size did not yield any significant differences in response.

Jawad Abou Zahar has been a long-standing client of Fransabank. Thanks to the Bank's support and financing over the years, Mr. Zahar has been able to expand his handmade furniture business, Nest, from a single small retail store to a three story showroom. In his showroom, he directly employs around 30 full-time staff (80 percent of whom are women) and around 15 part-time workers. He also subcontracts more than 100 workers for his factories and workshops. Given the successful growth of the business, Mr. Zahar plans to expand his business regionally in the Middle East and Central Asia.



Conclusion and Strategic Implications for IFC and Fransabank

Despite the difficult macroeconomic environment and fragile security situation in Lebanon, the SMEs that received financing from Fransabank had an overall positive impact on job creation in the country. Even with GDP falling to 1.5 percent in 2012 due to political uncertainties and spillovers from the Syrian conflict, the surveyed firms expanded their workforce as well as increased their operations with higher labor productivity between 2009 and 2012. These results help endorse the idea that SMEs are vital for employment generation, private sector development and inclusion (especially among women and youth). They also reaffirm the notion that with increased access to finance from financial intermediaries such as Fransabank, SMEs have the potential to contribute significantly to job creation. Further research is required to assess the job preservation effects that are often at play during periods of political instability and economic uncertainty.

Lebanon is ahead of its regional counterparts in supporting the SME market. The Central Bank and other governmental and quasi-governmental agencies (such as Kafalat) have initiated several programs to promote SMEs and improve their access to finance. Despite these efforts, many of the entrepreneurs and women-owned enterprises that were surveyed cited access to finance as a constraint due to a limited track record, large collateral requirements, and lack of a personal relationship with the bank. In addition, while full-time job growth for women was 17 percent in the sample, women had limited representation as business owners and managers in the surveyed SMEs. Further studies are needed to better understand the challenges facing entrepreneurs and women-owned enterprises and identify ways to support them.

The findings of this study reinforce the following ideas and strategic choices:

- Support to financial intermediaries like Fransabank that provide financing to SMEs in emerging markets can have significant employment creation effects, especially in a private sector like Lebanon which is heavily dominated by SMEs.
- While SMEs are the most vulnerable in fragile economic and security situations, they have the potential to contribute significantly to job creation even in difficult environments.
- In order to promote inclusion, financial intermediaries like Fransabank should continue their support of SMEs, particularly in service oriented sectors which employ women and youth.
- Financial institutions like Fransabank should continue to support very small firms and help them become small sized firms to have the greatest impact not only on employment creation but also for supporting a vibrant private sector, especially in a country like Lebanon. Domestic financial institutions can benefit from the support of international financial institutions (IFIs) like IFC in this process.

Alamco, a unique example of female entrepreneurship

Rima Bohsali embodies the entrepreneurial spirit that is characteristic of the Lebanese people. Rima is the manager and business owner of Alamco, a construction company that supplies time-efficient, energy-sparing, and quality-driven products for the housing and construction market. Alamco has been a client of Fransabank for many years, currently providing jobs to approximately 600 employees. Of Alamco's professional positions, 70 percent are held by women. The company operates in Europe and the Middle East, including in conflict-affected countries, such as Syria.



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