

Navigating through COVID-19:

A snapshot on how the pandemic affected MSMEs in **Iraq**

Middle East & Africa COVID-19 Business Impact Series: Note #4

The COVID-19 pandemic is impacting businesses on a national and global scale. As governments introduced measures to contain the domestic spread of the virus, restrictions on trade have impeded the flow of goods and services and intensified global uncertainty. As a consequence, businesses, financial institutions, state agencies, associations, and other public and private enterprises need to find new ways to cope with the pandemic.

This note focuses on how micro-, small-, and medium-sized enterprises (MSMEs) are affected by the pandemic and are dealing with its impact in **Iraq**. This note is part of a series that provides snapshots of the state of MSMEs' business operations and how they are navigating their way through the COVID-19 pandemic in countries across Africa and the Middle East.

These assessments draw on data from a standardized survey of MSME clients of financial institutions throughout the Middle East and Africa. The assessments, therefore, primarily reflect the impact of the pandemic on banked enterprises.

The country snapshot assessments focus on three main aspects: First, the financial health and resilience of the MSME sector in the country; second, the crisis response and future plans of businesses; and, third, businesses' needs and required support from governments and financial institutions.

KEY RESULTS FROM IRAQ

Impact of COVID-19 on MSMEs' Financial Health

Business Operations



85%

of businesses reported a **decrease in profits, on average by 46%**.



About two thirds of MSMEs have current cash flow problems. The proportion is higher among small businesses than among micro businesses.



MSMEs expressed a pessimistic outlook for the three months after the survey, which was conducted in July and August 2020.

Digital Solutions



The **majority of businesses benefitted from using digital tools** to offer their products and services online.



Retail businesses were far more likely to **benefit from digital tools** than businesses in other sectors.

Business Needs

Future Risk Mitigation



Financial institutions are the most important source of business advice for MSMEs followed by the internet.

Help Received & Primary Needs



Two thirds of businesses said they have **received government support**, mostly debt moratoria.

Almost all have received bank support with restructured bank loans being the most important support.



58%

of businesses report **needing further debt moratoria** from the government and

83%

additional loan restructurings from banks.

COVID-19 AND THE MSME SECTOR IN IRAQ

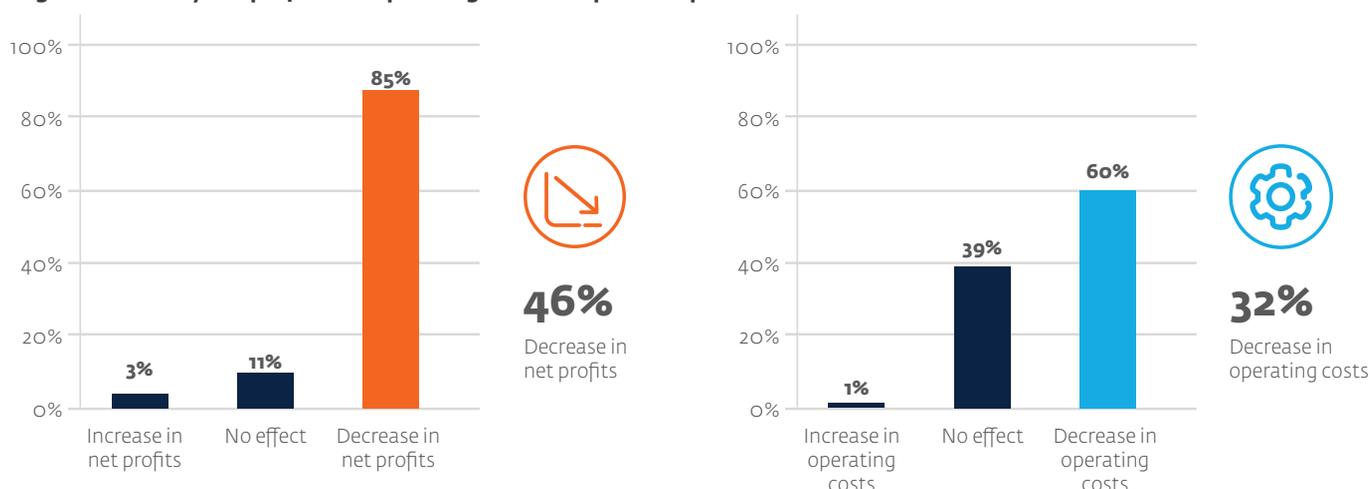
For this survey, business owners of 95 Iraqi MSMEs (24 percent women-led) were interviewed across the country, more than half of them located in the capital Baghdad.^{1,2} The largest proportion of interviewed MSMEs are in the retail and wholesale trade industry (31 percent); work in accommodation, tourism or catering (14 percent) as well as the construction industry and health sector (11 percent respectively).

The first case of the COVID-19 virus in Iraq was confirmed in late February 2020. One month later, there were confirmed cases across all governates and the government enacted travel restrictions and temporary regional lockdowns, bans on gatherings, and closures of schools and universities. Moreover, a sharp decline in the price of oil at the beginning of 2020 exacerbated shocks to the Iraqi economy. Oil prices have since rebounded. However, the interviews for this analysis were conducted in July and August 2020 in this context of uncertainty.

FINANCIAL HEALTH AND RESILIENCE

The study shows that nearly all Iraqi businesses were in some way affected by the outbreak of the pandemic. Lower revenues were the most common impact. This finding is also reflected in the change in monthly net profits compared to pre-crisis levels in 2019: Eighty-five percent of MSME owners reported a decrease in profits while only three percent increased their profits. The remaining businesses experienced no changes (Figure 1). On average, profits almost halved for interviewed businesses compared to pre-pandemic levels in 2019. Over the same time horizon, 60 percent of the MSMEs saw their operating costs decreasing. Operating costs decreased for different reasons including employee layoffs and reduced expenses for inputs due to a lower demand.

Figure 1: Monthly net profits and operating costs compared to pre-crisis levels



Note: The figures display the proportion of businesses that experienced changes on their profits and operating costs. The icons show the extent of the respective decrease.

These findings suggest that the absolute decline in turnover outweighed the absolute reductions in operating costs. The resulting negative effect on profits also coincides with serious financing problems of businesses since the outbreak of the pandemic. While more than 90 percent of the interviewed businesses that borrowed money in 2019 reported timely repayments, the majority of those businesses surveyed most recently said they experienced cash flow problems and problems with overdue loans. When asked about sources of additional funding, business owners reported relying primarily on loans from financial institutions and capital injections from private savings. However, more than half of the MSME owners said they expect difficulties when applying for bank funding. Most notably, every third business owner anticipates problems in the application process due to a lack of collateral. For businesses that consider taking a loan, meeting financial institutions' collateral requirements constitutes the most serious challenge.

These results were confirmed by another ongoing IFC-commissioned market research study on the Iraqi MSME sector. That study found that small enterprises are often unable to access collateral-based lending due to the low value of their collateral. The value of the collateral, if available, rarely adds up to 150 percent of the loan value, which is the standard amount required to obtain a loan. At the same time, banks are reluctant to relax lending requirements due to a lack of information caused by poor financial reporting standards; an absence of credit and collateral registries; and weak institutional frameworks related to enforcing contracts and managing insolvencies. Accessing loans is therefore a systemic challenge for Iraqi MSMEs, which the COVID pandemic has further aggravated.

CRISIS RESPONSE AND FUTURE PLANNING

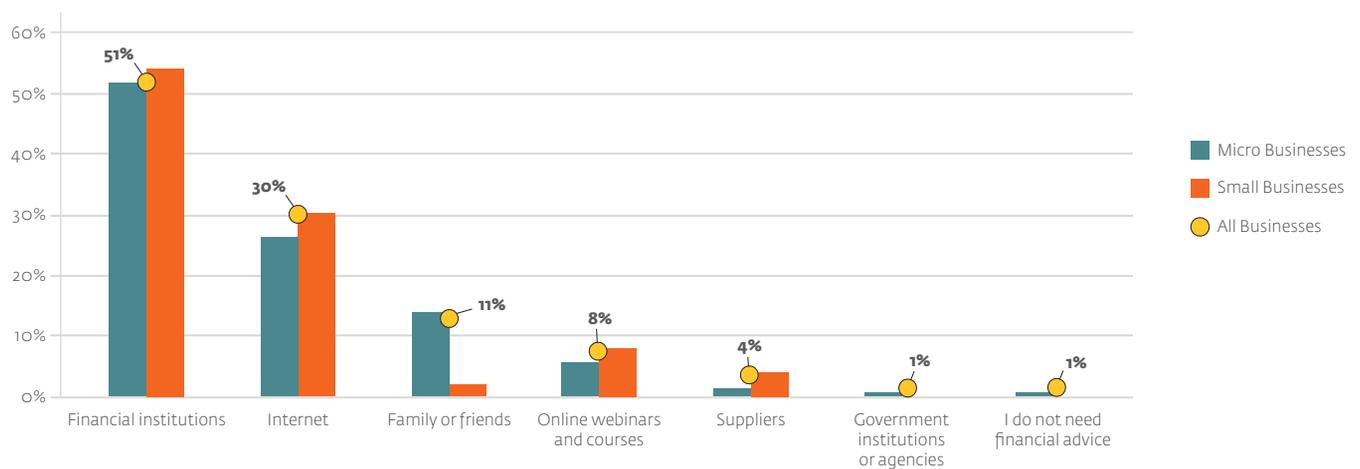
This study finds that owners were pessimistic at the time of the survey about the prospects for their businesses over the subsequent three months. Nevertheless, almost two thirds of the business owners said that digital solutions and tools proved to be helpful in navigating through the crisis. Iraqi business owners particularly benefitted from offering their products and services online during the periods of temporary lockdowns and other restrictions. This is above all the case for retail businesses. Marketing via social media also helped businesses to create visibility for their range of products and services. While digital payment services theoretically present a viable option for contactless and long-distance payments in times of a pandemic, business owners barely made use of digital payment solutions.

1 For this analysis, the following business segmentation based on the total employee size was used: micro (< 10), small (10 - 49) and medium (50 - 300).
2 The sample is not necessarily representative of the MSME sector as a whole.

The other IFC-commissioned market research survey of 804 Iraqi individuals, including a subsample of 99 entrepreneurs, further investigated usage and perceptions towards digital payment solutions. The survey found that 12 percent of the individuals have a mobile money account while account ownership is about four percentage points higher among entrepreneurs. Even though most survey respondents consider mobile money as a trustworthy, relevant, comprehensible and accessible method of payment, they have a more critical attitude towards the pricing of mobile money services that potentially hinders its usage. In this context, the Central Bank's decision in reaction to the current pandemic to eliminate commissions on electronic payments for six months (from June 2020 on), is intended to boost the uptake of digital financial services.

In terms of future risk mitigation in reaction to the pandemic, almost all surveyed MSME owners expect to take actions – primarily by creating business continuity plans – that will better prepare them for future crises. The majority of micro and small businesses interviewed for this survey consider financial institutions as their most important source of business advice (Figure 2). Aside from financial institutions, business owners turn to the internet to seek advice while family and friends are a significant resource for micro businesses. Almost all businesses acknowledge the need for external business advice to run their operations effectively.

Figure 2: Sources of business advice by business size



Note: The figure does not include medium businesses because of their low representation in this sample.

FINANCIAL AND NON-FINANCIAL NEEDS

From the beginning of the COVID-19 pandemic through August 2020, a large majority of interviewed enterprises had received support from financial institutions, mainly in the form of restructured loan terms. Moreover, about two thirds of the businesses reported to have received government assistance. Moratoria on debt repayments were the most cited form of government support. Nevertheless, most owners expressed a need for further loan restructurings and debt moratoria.

From a bank perspective, this analysis helps to better understand the challenges that their clientele is currently facing. More generally, the findings demonstrate the need for improved access to finance for the Iraqi MSME sector. At the same time, banks face multiple obstacles to extending more loans to the MSME sector. The obstacles range from a lack of credit bureaus and collateral registries to inadequate legal arrangements related to property rights, contract enforcement and insolvency.

To encourage banks to increase financing for MSMEs, several policies and initiatives have been launched. The Iraqi Company for Financing SMEs (ICF-SME) and the Iraqi Company for Banking Guarantees (ICBG) were set up to jointly support MSMEs. ICF-SME is currently restructuring. Moreover, in 2015, the Central Bank of Iraq launched an initiative called *Tamwil* to promote the development of the private sector through offering subsidized loans to SMEs and young entrepreneurs. However, the disbursement of the fund's one trillion dinars (\$840 million) has progressed slowly. A comprehensive private sector diagnostic conducted by the Emergency Cell for Financial Reform, a committee of key ministries and the Central Bank, was published in October 2020. This report also identified a need to particularly support SMEs and create a favorable environment for the uptake of digital financial services. In response to the COVID-19 crisis, the Central Bank announced moratoria on interest and principal payments of loans granted through the *Tamwil* initiative and similarly encouraged banks to extend maturities and restructure loans.

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