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Exploring the roles of informal, formal and semiformal microcredit in Jordan

Author:
Mikael Fridell

Supervisor:
Alia Ahmad

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It is important to realize that this thesis is not the result of the work of one person only, but also the product of one person standing on the shoulders of others. It is obvious that without the help of all the organisations that I met with, the people I interviewed and the respondents to my short questionnaire, I would not have been able to complete this project. I only hope I do not misrepresent any data that I have been given, and that the results can be interesting reading for some.

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Abstract

As the title suggests, this thesis is an exploration of the roles of different sources of microcredit in Jordan. These sources include the informal, formal, and semiformal sectors of microcredit. The theoretical part looks into developing financial markets with a focus on microcredits, common topics of the roles of microcredit providers, and two relevant contextual features. Then the case study introduces the Jordanian economy and microcredit market, and puts the common topics to a test keeping the context in mind. The results above all confirm that traditional informal sources of credit are highly relevant in Jordan for many people; that the characteristics of the formal and informal sectors of credit providers are perceived to broadly, but not strongly, conform with empirical findings elsewhere; that the semiformal MFIs are focused on sustainability and access to credit for poor individuals; that it is principally the semiformal sector that directs the purpose of their credits towards business; that simultaneous borrowing is not unusual; and that there is potential for substantial improvements in outreach. Moreover, the religious factor is highly relevant as Islamic financial principles seem to determine borrowing behaviour for many Jordanians and thus affect the roles of microcredit sources. The results lead to a few suggestions to promote Islamic microcredits, knowledge spread, and the linking of borrowers and lenders.

Keywords: Interaction, Islamic Financial Services, Jordan, Microcredit, Middle East

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1 Introduction

In most developing countries' financial markets, informal and formal sectors exist alongside each other as part of the transition from traditional to modern economies. Similarly, state- or donor-sponsored banks and Microfinance Institutions (MFIs) are not alone in providing microcredit for the poor in developing countries. They have an antedating informal counterpart that seems to stay relevant and even thrive as well (see for instance Jain & Mansuri 2003). This coexistence provides for substantial scope of interaction (Bell et al 1997, p 557).

The survival of informal microcredit provision despite the introduction of formal and semiformal microcredit in developing countries has proven that these three sources have differing strengths, and that they can coexist and have differing roles on the same market. Their products offer different characteristics and are demanded in different ways. The most cited differences are probably that the informal sector has an easier time dealing with problems regarding information and enforcement of contracts, while the formal sector can take advantage of economies of scale and the intermediation of funds over a longer period of time (see for example Jain & Mansuri 2003). However, it has usually been the case in developing countries that informal and formal credit alternatives have not been able to sufficiently serve all those in need of credit services, particularly the poor. For instance, the scale and scope of informal credit may not be sufficient and formal alternatives frequently exclude those that cannot provide traditional forms of collateral. This is why recent decades have seen the development of MFIs and NGOs that provide microcredit in a new way. They try to learn from both informal and formal sector experiences and try to provide those not sufficiently served with credit through innovative solutions for deficiencies that informal and formal sectors face. These NGOs and MFIs that provide microcredit are therefore referred to as semiformal. This is further appropriate as they, unlike the formal sector, are usually not under the purview of a Central Bank.

Unfortunately it is common that financial markets experience market failure. Market failures give rise to inefficiencies, which in the financial markets may mean the unsatisfied demand of poor people. The development of the semiformal sector is a response to such inefficiencies. As functioning financial markets can promote economic growth and economic growth is

uncontroversially crucial in fighting poverty, it is critical to strive towards solving these market failures to improve living standards. Learning more about developing financial markets may therefore help fight poverty. Microcredit has the potential of satisfying the credit demand of the poor, as is shown by success stories like the Grameen Bank in Bangladesh, and can thus reduce the problems that financial markets in developing countries face. A clearer picture of microcredit markets may help give rise to strategies that can improve the provision of microcredits, and thereby reduce inefficiencies in financial markets as well as promote economic growth.

Frequently, studies of the roles of informal, formal, and semiformal sources of microcredit focus on South and East Asian countries. As results can be contradicting depending on the country studied and factors considered, it is interesting to gain perspectives from other parts of the world and see if common empirical conclusions have wider relevance. The country of Jordan has economic, cultural, and religious features that may differ from countries that have led to existing theory, making it interesting for a case study. Even though there has technically been microcredit provision present in Jordan for many decades, the country did not experience serious development of more sustainable microcredit provision until the late 1990s. Moreover, Jordan has proven to be relatively economically and politically stable in a region plagued by conflict, also making it regionally suitable for field work.

1.1 Outlining the study

This thesis explores different sources of microcredit and looks into their respective roles in Jordan. This exploration will be guided by and address the following broad sub-questions:

- In what market climate does microcredit lending operate?
- What are the common features of microcredit borrowers and lenders?
- How are the roles of the three microcredit sectors commonly described?
- What does the microcredit market environment look like in Jordan?
- What are the characteristics of microcredit providers in Jordan?
- Do common descriptions and topics in the literature find empirical support in Jordan?

The roles of microcredit providers will be explored through the sub-questions. At some points

formal sector bank loans will be referred to, which is not to be equated with formal microcredit. Microfinancial services in Jordan are exclusively related to credit and therefore the focus in this study will be on microcredits with little reference to other aspects of microfinance, like savings or insurance. Microcredits in this thesis will simply be defined as relatively small loans that through their methodology are made available to poor individuals and households, mostly for productive activities, and that are to be repaid within shorter periods of time. Definitions of microcredits differ and may take size, target users, purpose of credits, or terms for borrowing into consideration. This thesis implicitly focuses on microcredits as meaning credits suited for the local conditions available for poor people.

The structure of this thesis will firstly cover the theoretical background and framework of microcredit as it relates to the sub-questions. Then it will describe the milieu and microcredit actors, as well as explore the roles of the three sectors in Jordan. Finally, there will be a section for conclusions that relate the theoretical points to the empirical findings in Jordan.

2 The theoretical background and framework

This section will look at the first three sub-questions. It will outline the theoretical background through discussing developing countries' financial markets, microcredit borrowers, and informal, formal, and semiformal microcredit providers. Then it will look at how the roles of sources of credit and their interaction is commonly outlined in the literature, and finally at the Islamic financial feature.

2.1 Financial markets and developing countries

A country that wants to promote economic development and efficient allocation of resources needs a functioning financial market that links savings with lending (Todaro & Smith 2006, p 741). Development involves the accumulation of physical and human capital, and the financial market is one vehicle for this (Bell 1988). When cash on hand is not enough for an investment and without present or previously saved capital, the remaining solution for any citizen is credit transactions (Rutherford 2003). Developing countries are usually described as having a dual economy and this by no means excludes the financial markets in these countries. The process of economic development entails a structural transformation of industrialization and a move from traditional to modern forms of organisation, as is outlined by the Lewis Theory of Development (Todaro & Smith 2006, p 108ff). While these forms coexist during transition there is this dual economy, and it often includes a traditional informal and a modern formal sector (Ibid, p 328). The informal sector represents the economic activity that is unregulated by society's institutions. It is not taxed or overseen by government. The formal sector is the opposite. For the financial market this means financial products being offered from both informal and more formal sources.

Traditionally in developing countries, local informal borrowers and lenders developed long-term relationships and stayed in the same place for a long time, and developing, particularly rural, credit markets are therefore fragmented into segments that have high entry barriers (Bell 1988). This enables nearly perfect information within each segment, which is a difficult barrier to overcome for a new formal alternative (Bell 1988). Informal credit providers like friends and family automatically have close to perfect information. On the other hand, the more formal

lenders have to consider information asymmetries like moral hazard and adverse selection in their lending activities.

The crucial issue in financial markets is this issue of asymmetric information. Information about potential borrowers is scarce both with regards to how a loan will be put to use and if it will be repaid (Ray 1998, p 540). Learning more about a potential borrower's characteristics can reduce this problem and therefore lenders need to screen borrowers to determine if they should lend to them. It is not unreasonable to think that potential borrowers wish to hide information that would be unfavourable in the loan application process. As the borrower has more information about her- or himself than the lender and may wish to hide it, the problem of adverse selection arises (Bell 1988). The quality and quantity of information about borrowers will determine how serious this problem will be. This is of course one of the principal differences between informal and other lenders, as informal lenders have better information about their clients.

Lenders also need to make sure that contracts are enforced, but when lenders cannot control borrowers' activities there is a problem of moral hazard (Jain & Mansuri 2003, Bell 1988). To reduce moral hazard some MFIs use conditional lending to try to make sure that borrowed capital is used for productive investments. To further reduce the risks of lending, lenders use instruments such as interest rates to cover the risk of loans defaulting, and collateral to screen borrowers and to make enforcement of contract less critical. Joint liability schemes and regularly scheduled repayments are other ways by which to reduce moral hazard problems (Jain & Mansuri 2003).

The informational barriers may give rise to inefficiencies on the financial market, which can be reduced through favourable legal and regulatory frameworks (Yaron et al 1998, p 147). The quality of these frameworks can often be improved in developing countries, especially for developing rural areas (ibid). For example, lenders need a legal and regulatory framework that enables enforcement of financial contracts. If this does not exist, then high risk and cost of enforcement will depress the lending supply and have negative effects on formal sources of credit. Other factors such as education, infrastructure, communication and transportation are also important for the functioning of financial markets (Besley 1994, p 33). For instance, the potential of microcredit activities will reasonably increase if capacity is built in the form of improved social and physical infrastructure (National Strategy for Microfinance). It is not that farfetched to think that running businesses benefit from improvements in infrastructure like more efficient

government bureaucracy and better roads. Like any other market, the financial market is controlled by supply and demand forces, but inefficiencies seem to manifest themselves as the exclusion of some from the credit market, particularly the poor. The microcredit providers try to solve this problem. Now let us turn to borrowers and lenders specifically.

2.1.1 General characteristics of microcredit borrowers

Being poor means spending what little you have on essential products like food, shelter, and fuel (Rutherford 2003). If a larger expenditure or investment opportunity arises and there is no cash or savings available, which may be a likely situation for poor individuals, credit is needed (Ibid). Ideally, to sidestep current budgets and enable intertemporal budgets, people borrow money, pay it back with future pay-off from investments, and grow economically. The characteristic low-income borrower demands working capital to make continuous investments in productive activities like buying up a stock of goods that can be sold in the short term (Ray 1998, p 531). Capital may also be demanded to cover private consumption if for example sales are temporarily low for an entrepreneur (Ibid). In start-ups or expansions of production there is the further possibility of capital being demanded for the longer term to be invested in machinery or other fixed inputs (Ibid).

Microcredit borrowers are typically poor individuals that lack access to formal bank loans, and that may not be sufficiently served by informal sources of micro-sized credit (National Strategy for Microfinance). They are often self-employed and household-based shopkeepers, service providers and street vendors in urban areas, and small farmers, food processors or traders in rural areas (Ibid). The microcredit clients represent an often otherwise excluded financial market segment (Ibid). However, all poor individuals are not necessarily suitable for microcredit borrowing. For example, having undependable incomes or not having an identified economic opportunity may mean that one is unsuitable as a microcredit client, at least for the existing array of credit products (Ibid). These people may need financial aid, social safety nets, and technical assistance to start with instead (Ibid). This is not to say that not everyone can become suitable clients. To find the preferable microcredit borrowers it is again instrumental to have a screening process. Key for the microcredit phenomenon is that it tries to apply another form of screening process to get around information problems that cause formal banks to avoid lending to poor

individuals. This particularly concerns getting around the problem of collateral requirements and higher cost per loan for smaller-sized loans, while at the same time maintaining the formal lender capacity that informal alternatives may lack (Gonzalez-Vega). The higher costs of the microcredit endeavour is often reflected in higher interest rates at sustainability-oriented MFIs compared to formal bank loans, but frequently it is proven by today's MFIs that poor borrowers can pay relatively high interest rates due mainly to quite high profit margins and low absolute interest rate payments.

There is usually a relatively high level of defaults in developing countries' formal financial sectors (Ray 1998, p 545). Risky activities or investments in education that are hard to turn into monetary means may be reasons for this. Developing countries also often experience shocks like bad weather conditions and changed commodity prices, and this can be another explanation for higher defaults (Besley 1995, p 116ff). When default occurs the borrower has either involuntarily or strategically defaulted (Ray 1998, p 529). If the borrower values his or her collateral, reputation, and future access to credit, the borrower will only default if he or she does not have any money (Bell 1988). This is involuntary. On the other hand, the strategic defaults occur if default is voluntary. Here enforcement of contracts becomes a key factor as it reduces moral hazard problems and thereby the potential for strategic defaults being profitable (Ray 1998, p 529f).

It is also important to realize the differences between rural and urban areas, especially with regards to the geographical access to formal financial sources and the fact that formal lenders require, often illiterate, potential borrowers to provide detailed and relatively costly documentation (Adams et al 2003, p 432). Rural borrowers are typically disadvantaged with regards to access to suitable and more formal sources of credit (Ibid). Another important issue is the gender bias at home and in the workplace. The skills women possess have often led them to public sector employment, informal sector employment, or unpaid labour like some agricultural activities (Ghazaleh 2004, p 35). This together with lack of enough gender-sensitive projects is a natural explanation for a gender bias against women's borrowing in many places (Ibid).

2.1.2 General characteristics of informal microcredit

Despite the introduction of formal credit to most developing country markets, informal financial markets seem to remain strong alongside their more formal alternatives (Ghate 1992, p 859). In large scale financing of projects for economic development it is obvious that the formal sector is the superior credit provider, but in relation to microcredits the informal sources have advantages and a welfare-improving role (Gonzalez-Vega). The informal sector responds relatively well to rural short-term financing opportunities, and it allows people to access services that would otherwise not be available (Bouman 1989). Antedating its formal counterparts, it resides in people's indigenous environments and it survives without subsidies through competitiveness, financial viability, and low-cost operations (Ibid). Informal sources of credit are either part of a network of family, friends or neighbours, or tend towards being costly (Gonzalez-Vega). The costly versions include private moneylenders that charge high interest rates. When family or other network resources are not available or sufficient, the demand for lower-cost, more reliable credit of the formal and semiformal institutions is increased.

The informal sector lenders are dependent upon good information for screening and monitoring purposes and as the information costs get higher with distance, informal microcredit activities tend to be restricted to the close proximity to the microcredit provider (Ibid). In effect, this means that the informal sector cannot reallocate purchasing power that would increase the productivity of available resources and contribute to economic growth throughout a country (Ibid). The more formal sectors have wider scope and can do this better. For example, a commercial bank can lend excess savings from the northern part of a country to borrowers in the southern part, as well as have access to other capital markets. Lacking access to formal capital markets, informal lenders may have credit ceilings and thus not have enough resources to finance multiple borrowers and business opportunities (Daly 2002, p 22). They can however borrow from formal sources and lend to their clients.

It is also important to note that informal finance will likely never disappear, even if its character is changed to give way to formal alternatives. A daughter borrowing from her father for a new bicycle is technically an informal loan and will reasonably happen even if she has access to more formal microcredits. Also, the informal credit providers are individual lenders, associations, and

firms (Germidis 1990). Individual lenders can be commercial and non-commercial (Ibid). Professional moneylenders, traders, landlords, rich people, and storeowners are commercial individual lenders to small businesses, farms, and households (Ibid). Non-commercial lenders include family, friends, and neighbours (Ibid). The informal associations that provide financial services are mainly ROSCAs¹, informal credit unions, and savings clubs (Ibid). Finally, indigenous bankers, pawnbrokers and suppliers are examples of firms that provide informal credit (Ibid). The point here is that the non-commercial informal lenders, as an example, have continued to stay relevant even in developed countries.

2.1.3 General characteristics of formal microcredit

The formal or institutional lenders include government banks, commercial banks, credit bureaus, and special banks that target the needs of poor and rural people (Ray 1998, p 532). Formal lenders usually wrestle with the issue of lacking personal knowledge of the characteristics and activities of their clientele (Ibid). Therefore they use advanced application processes to avoid defaults.

If a borrower could be made to repay a loan no matter what, there would be perfect certainty on the market and screening of borrowers would be unnecessary (Ray 1998, p 533). Perhaps this would be possible for relatively rich borrowers, but lending is generally an uncertain business. As there is uncertainty with regards to use and repayment, institutional profit-maximizing lenders usually require some form of collateral (Ibid). But since poor people have specific kinds of collateral they are usually discriminated against by the commercial banks and other institutional lenders (Ray 1998, p 534). Poor people may have small pieces of land, labour, or only recorded cash-flow figures as forms of security. This may be more acceptable for informal lenders that have better information about clients. The inability of the formal sector to provide enough credit for the poor spurred the development of semiformal initiatives to include the poor. Due to this problem formal microcredit from traditional institutions often seems only modestly significant, while formal bank loans naturally have vital roles for those who can access them.

¹ In a Rotating Savings and Credit Association members take turns borrowing from mutually saved capital. Some of these initiatives are supported by donors and may then border on being semiformal sector activities.

There are special banks that target the poor with subsidized credit without necessarily the criteria of sustainability. These often include agricultural and rural banks, development funds, and other institutions that are created to aid poor people. Unfortunately, there are many examples where outreach and success of these institutions are limited (see for instance Adams et al 2003, p 432), but they do provide poor individuals with microcredit. The special banks can also support the semiformal MFIs or even informal credit providers through assistance such as subsidized capital.

2.1.4 General characteristics of semiformal microcredit

Microfinance Institutions (MFIs) make up the bulk of the semiformal microcredit providers. MFIs refer to microfinance programs set up by government or donors, usually aiming at allowing poor individuals to run a business that will generate income. These types of semiformal activities have developed over roughly the past three decades with four principal actors involved. Firstly, there are the MFIs. The general recipe has been for sustainability-oriented MFIs to charge interests that cover risks, to demand regular repayments, and to focus on clients otherwise left with informal borrowing. Often, innovative methods, like joint liability schemes, have been used. Secondly, there is growing involvement of formal public banks and different national development banks. They often act as financiers of MFIs, but can also act through direct formal microcredit provision. Thirdly, there are commercial banks involved in a similar way through financing MFI activity or offering their own formal microcredit services. Finally, donor countries are very active in developing and supporting microfinance projects as part of their international cooperation strategies.

Now, these initiatives try to keep the institutional characteristic of formal sector lending while attempting to use the advantages of informal activities such as the informal community information bases. To illustrate this there is an obvious example in Bangladesh. There, the Grameen Bank initiated group lending without collateral, i.e. a loan with limited but joint liability. A small group of people takes on a joint loan and gain access to the capital in sequential order. In the event of a default by any group member, no one in the group is allowed further loans. This gives an incentive for each group member to carefully scrutinize other members and pair up with people of reasonable risk level (Ray 1998, p 580). It also opens up for peer monitoring as members have a vested interest in keeping other members from taking excessive

risks (Ibid). Group lending thus uses information not accessible by traditional formal lenders to lend to a previously not served clientele and can thereby avoid some information asymmetry obstacles while gaining help with enforcement from borrowers. A loan with limited liability gives incentives for more risky activities as the potential loss is not borne solely by the borrower, which can also be said for any one person in a borrowing group (Ibid). Peer selection and monitoring counter this effect. Other disadvantages exist, but the fact that group lending can enable lending to poor is the crucial aspect.

The issue of subsidized credit is widely debated and concerns another central issue. Subsidies come particularly from government-run development and agricultural banks. The problem is whether loans that are unsustainable or in effect are never repaid are actually a sensible strategy as it hurts sustainability-oriented institutions and promotes unsustainable borrowing behaviour. The objectives of the microcredit projects can on the one hand be acute social intermediation and welfare. On the other hand they can be more long-term sustainability and development. Subsidized credit may make sense if the goal is to aid the poor in the short term, even though it is not sustainable over longer periods of time.

Turning to NGOs it is obvious that they frequently offer microcredits as part of their activities, often when they target a certain segment of a population (see for example National Strategy for Microfinance). Many times this is subsidized without a strong sustainability focus. Referring back, the informal sector microcredit providers could be roughly divided into commercial and non-commercial lenders. Similarly, it is clear that the semiformal sector (and the formal for that matter) clearly has sustainable and more commercial, as well as unsustainable and more non-commercial lenders.

To summarize, informal lenders seem to have the informational advantage, cost less to do business with (not counting interests rates) and reach rural people better (Ray 1998, p 537). The formal lenders on the other hand appear to have the scope, reliability, and the lower cost of credit in their favour. Semiformal lenders use innovations like group lending to give insufficiently served people access to credit. Now let us look at topics describing the roles of microcredit sectors.

2.2 Common topics on roles and interaction

As the focus on microfinance has grown in the past decades, so has the understanding of the impact of new financial institutions on the environment in which they are established. One group of literature on this topic focuses on the reaction and interaction of the informal financial sector to the emergence of a formal and semiformal counterpart or other informal lenders. This literature looks at the roles of different sources of credit and seeks to explore outcomes of new establishments in relation to their interaction with the antedating informal sector. As the sectors operate alongside each other, there is substantial scope for interaction between them (Bell et al 1997, p 557) and existing theory outlines their various roles as well as different forms of interaction. In the attempt to explore the Jordanian case this study (inspired by Besley et al 2001) will investigate topics that frequently turn up as results in the theoretical literature and see if they find empirical support in Jordan. Together with the Islamic feature, these topics are the focus of the case study and the other background information is there to increase the understanding of this focus.

The importance of the sectors

The first topic considers the importance of the respective financial sectors. It is often mentioned that despite an influx of formal capital into a financial market, the informal financial sector remains well off (see for example Ghate 1992, p 859; Ray 1998, p 536f). Informal finance thus seems to remain relevant despite formal and semiformal alternatives during developing country transitions from traditional to modern economies. Evidence from, for example, Nepal shows that informal sources of credit are actually the most frequently used despite formal and semiformal alternatives (Besley et al 2001, p 2ff). This can tell us about the modern economy's progression or outreach and about actual traditional economy relevance. It is therefore interesting to look into the prevalence of the source of loans and try to determine their relative importance. The question is, which source of microcredit is the more important for people in Jordan?

Moreover, due to transaction costs and application requirements, it would seem plausible that a formal or semiformal sector loan is more attractive if it is larger, as then the costs are lower in relation to the loan (Ibid). The formal sector also has a better possibility of financing larger loans (Gonzalez-Vega). But as larger loans cease to be micro-sized and may not use microcredit

methodologies, the full effect of this is outside the aspirations of this study.

Common advantages and disadvantages

The second topic concerns the existence of certain advantages and disadvantages of the informal financial sector and corresponding advantages and disadvantages of the formal sector. Some characteristics seem to keep informal sources relevant as an alternative in developing financial markets. Most appear to agree that the informal sector has often nearly complete information about borrowers and that they thereby have a better ability to enforce contracts (Jain 1999; Jain & Mansuri 2003, p 256). It is also often stated that the informal sector offers lower transaction costs and is more accessible geographically (Adams et al 2003). Informal finance may further offer more flexible products, particularly when it comes to repayment (Jain & Mansuri 2003, p 271). On the other hand, informal sources are said to have disadvantages of high interest rates (Adams et al 2003, p 431), capacity directed towards small-scale borrowing (Besley et al 2001, p 5f), and perhaps social barriers that are relevant. These are some of the problems that justify the introduction of more formal alternatives that can offer lower interest rates (Gonzalez-Vega), and sufficient scale and reliable availability of funds (Daly 2002, p 22). However, formal alternatives perhaps have problems with accessibility (Adams et al 2003, p 432), rigid products (Jain & Mansuri 2003), and higher application costs (Adams et al 2003, p 431). Confirming if these examples of advantages and disadvantages are part of the perceived reality of people can further explain the roles of microcredit lenders in Jordan. Thus the question is, do they find support in Jordan? In line with this, it is interesting to see if the semiformal alternatives actually use methods like group lending to acquire informal sector advantages and avoid institutional disadvantages.

Purposes and source of microcredit

As a third topic, there may be differences with regards to what the borrowed means will and can be used for. This may demonstrate the inability so far of formal and semiformal sources to cover all areas of informal finance. Formal and semiformal microcredits appear more likely to be used for productive purposes and informal credit for private consumption, like financing social events (Besley et al 2001, p 5).

Moreover, purposes may differ as a consequence of the structure of the microcredit. For example, a longer term or seasonal investment like planting crops will take time to pay-off and may

therefore be difficult to finance with a formal sector loan that requires repayment starting the first week or month (Jain & Mansuri 2003). The purpose may thus not only depend on the issue of productive versus consumption investment, but also on the structure of the offered products.

The purposes may also be controlled, using loans that are extended on the condition of productive investments, which is frequently the case with MFI loans. By contrast, informal lenders often tailor the attributes of a loan and usually permit the use of funds for consumption or social events (Adams et al 2003). However, it should be nearly impossible to make sure that a loan for a business investment actually goes to that investment only. Part of the loan may even indirectly pay for a tuition fee if capital is taken from a family business for this purpose. The question is if different sources are utilized for different purposes?

Simultaneous borrowing from microcredit sectors and actors

As a fourth topic, it is widely reported that borrowers borrow from more than one source at the same time (Jain 1999; Adams). This can take horizontal as well as vertical forms (Barnebeck Andersen & Malchow-Møller 2006). An important phenomenon here is credit rationing in its different forms. For instance, borrowers who experience partial credit rationing from a formal or semiformal source may turn to the informal sector to cover remaining demand. This is a horizontal link. They can also experience full credit rationing, basically meaning that loans are not granted. Further, there is price rationing, where interest rates are used as a tool in controlling the size of loans demanded. Credit rationing can be a result of private informal lenders not being effectively regulated, and that their regulated formal and semiformal counterparts often have interest rate ceilings (Bell et al 1997, p 557). This can give rise to segmentation as the formal and semiformal segment will ration the quantity of credit given to perceived unsafe borrowers if interest rates cannot sufficiently cover the increased risk that they represent (Ibid). The remaining demand will then spill-over to the informal segment and, if exclusive contracts are not enforceable, some partially rationed clients may obtain credit from multiple segments (Ibid). For example, a study made by the International Food Policy Research Institute 1994-1995 concluded that, within the MFI target groups, not only do MFI borrowers borrow from informal sources as well; they borrow larger amounts from informal sources than non-MFI borrowers. Jain and Mansuri (2003) furthermore suggest that borrowers may need informal loans to cover the first instalments of formal and semiformal sector loans that have strict repayment schemes.

The vertical link between informal and formal or semiformal sources is characterized by the borrowing from the formal or semiformal sector by those better endowed, and then using these funds to lend to those unable to secure a formal or semiformal sector loan (Ray 1998. p 573; Barnebeck Andersen & Malchow-Møller 2006). This is possible due to the informational advantage of the informal lenders (Ibid). For example, a shopkeeper or supplier may take a formal loan and use it to grant customers credit. The vertical interaction thus gives rise to a possible strategy for credit market development other than the horizontal. Here there would not be a replacement of the traditional economic informal system, but it would improve the traditional sector by giving it access to capital from outside (Ibid). However, looking at borrowers, the question is if they practise simultaneous borrowing and if this is to co-finance an investment or for separate purposes?

Outreach

Finally, a fundamental idea of microcredit provision is to reach a previously excluded segment of potential borrowers. Thus an objective of most MFIs is to improve the living conditions of poor people. This is the fifth topic. Findings suggest a relationship between reported income and the sector borrowed from (Bose 1998; Ray 1998, p 572f). It is reasonable to think that a wealthier person has an easier time getting a formal or semiformal loan than a poorer person, and therefore has less need for informal lending. But if, as has been reported, you are more likely to obtain a more formal loan if you are richer and a less formal loan if you are poorer, then outreach of formal and semiformal credit may be too shallow. According to Tsai (2004), government sanctioned microfinance programs often fail to serve the intended clientele and this leaves informal sources as the only alternative, unless there are semiformal sources that can reach out as well. However, as ability to repay a loan depends upon factors like a dependable income or a viable business idea, microcredits may not be suitable for everyone. Some may need other types of assistance at first, which may make a less formal loan if you are very poor more likely.

One way to look at outreach of microcredits to the poor is to investigate the relationship between relative wealth and source of microcredit. The question is if wealth means that you are more likely to borrow more formally and less likely to borrow informally? Even though wealthier people logically have an easier time obtaining a loan, they may not abandon informal sources altogether, and even though poorer people may borrow more informally it could of course be because of the advantages of informal borrowing. But, this definition of outreach implicitly

means that if poorer people do not use formal or semiformal microcredit then they are not reached, regardless of the reason why. It is also possible to compare satisfied and potential demand. Now let us turn to the Islamic financial feature as a case-specific topic.

2.3 Islamic financial services and microcredit

Different kinds of Islamic financial services have evolved as a response to market demand and regulatory environments. To better understand the market climate in an Islamic country like Jordan it is necessary to be aware of the country's religious context and how it influences views on financial services. In Islamic societies charging and paying interest is banned under religious law as it is regarded as usury (Ray 1998, p 563). It is also the traditional perception in India and China that when the poor lack access to formal credit they are vulnerable to exploitation by usurious moneylenders (Tsai 2004). The idea of Islamic financial services considers the Islamic prohibition of engaging in transactions that have elements of *riba* or *gharar* (El-Hawary & Grais 2005). The principle of *riba* has many features. It basically means a transaction based on exchanging a commodity of the same nature, like money for money, but doing so with unequal quantities or at different points in time (Ibid). Exchanging money for more money is then one example of *riba*. The prohibition of *gharar* means the prohibition of transactions where the outcome is significantly uncertain (Ibid). *Riba* and *gharar* aim for fair conduct of business and can be transformed into four principles that should guide Islamic financial services (Ibid). Firstly, there has to be symmetrical risk-reward-sharing in relation to each party of the transaction (Ibid). Secondly, a financial transaction needs to be directly or indirectly linked to a real economic transaction (Ibid). Thirdly, no party should be exploited as a result of the transaction (Ibid). Finally, *haram* or sinful activities such as producing alcoholic beverages cannot be financed (Ibid).

Traditional commercial microcredits are interest based loans where a borrower assumes the risk of repaying debt regardless of the performance of his or her project, the transaction is little linked to a real material transaction, and exploitation can possibly occur. Thus these credits may not accommodate the Islamic principles above (Ibid), particularly since there is a change in the amount of money for money and the outcome may be quite uncertain. Instead, Islamic financial arrangements have been developed. The principles of Islamic lending can be facilitated in

microfinance products (Ibid) and there are examples of this. However, Islamic microcredit does not seem widespread, and is even likely to be non-existent in Jordan (Magableh 2004, p 193).

3 Empirical section: The Case of Jordan

The following section of the text will outline the empirical information gathered on Jordan. Thus it will address the last three of the sub-questions outlined in the introduction. It will start off by reflecting on the material. Then it will describe briefly the Jordanian economy, significant features of the country, and its microcredit market. It will continue by looking at the actors on the Jordanian microcredit market and then discuss if the common topics in the literature find empirical support in Jordan. Finally, it will separately reflect upon the unavoidable religious and cultural context.

3.1 Material discussion

The collection of data for the case study was done on location. It features three types of material and samples from four populations, including a national population sample, a sample of microentrepreneurs, one of semiformal lenders, and one of microcredit clients. Firstly, the empirical material consists of reports, studies, and insights collected from the various companies and organizations visited. These include Ahli Microfinance Company, the Central Bank of Jordan, the Development and Employment Fund, Hashemite University, the Jordanian Ministry of Finance, the Jordanian Ministry of Planning and International Cooperation, the Loan Guarantee Corporation, Microfund for Women, Middle-East MicroCredit Company, the National Microfinance Bank, Tamweelcom, the United Nations Relief and Works Agency, and the United States Agency for International Development. This material contains two particularly important studies including the national and the microentrepreneur samples. Naturally, the strength of the material in backing up conclusions depends on its level of representativeness and these two samples have gone to great lengths to ensure this.

Secondly, to get a better idea of how microcredit providers perceive the microcredit market and the common topics, highly ranked representatives from six microcredit providers were interviewed. These providers include Ahli Microfinance Company, National Microfinance Bank, Microfund for Women, Middle-East MicroCredit Company, Tamweelcom, and the United

Nations Relief and Works Agency. They thereby cover all sustainable MFIs as well as one international institution. These interviews, together with the questionnaire below, complement the more extensive studies with the national and microentrepreneur samples by asking questions more directly related to the common topics in the literature outlined above. The representativeness of the interviews is difficult to measure as the selection process was based on engaging knowledgeable microcredit providers, but at least they gave no contradictory answers. During each interview a template of questions was used² directly relating to the common topics. Out of respect for market competition, the points made during these interviews will be presented without assigning names or organisations to statements.

Thirdly, a short questionnaire was distributed to 51 microcredit clients at the branches of four principal MFIs in Jordan. These were Ahli Microfinance Company, Midde-East MicroCredit Company, Tamweelcom, and the United Nations Relief and Works Agency program. The distribution has a clear urban bias including branches only in Amman, Aqaba, Irbid, and Zarqa as MFI operations are concentrated to urban centres. Microcredit clients gain better knowledge of the credit market³ and they have experience of borrowing, which hopefully gives increased understanding of the questions asked. There was purposely no specific strategy when the questionnaire was handed out, other than that it was handed out during April and May of 2007 to random microcredit clients that happened to visit the offices of the four microcredit providers. The questionnaire consists of questions relating to the common topics⁴ and was translated under the supervision of a professional translator at the offices of UNWRA in Amman.

Past surveys in Jordan have had problems with time-constraints, suspicion and unavailability of people and data (Daly 2002, p 5). Since my resources and time were limited and the language barrier usually adds to time-consumption, I appealed to four microcredit providers for assistance. They helped with distributing the questionnaires and explaining the purpose to clients. There is always the problem that respondents avoid certain answers, but it was my perception this was the best realistic solution and most likely to gain cooperation, avoid suspicion, and give the most truthful answers. The questionnaire respondents are representative to the extent that there are no systematic differences between clients with different characteristics, as even though the

2 See attachment 1.

3 As was shown by Magableh 2004.

4 See attachment 2 for the English version of the questionnaire.

respondents were randomly picked at various branches, not all microcredit clients in Jordan had the same chance of getting picked. The following will present the result of the collection of this material.

3.2 The Jordanian economy

This sub-section will briefly describe the Jordanian economy, also illustrating factors that relate to the microcredit market. The population of Jordan is estimated to be about six million, growing at about 2.7% annually. As only about a million (less than 20%) Jordanians live in rural areas there is a high degree of urbanization (Seibel & Almeyda 2001, p 1). In the rural areas there are 1097 villages with an average population of 1 000 people or 150 households (Ibid). This further illustrates the low population density in rural areas, the small market segment these areas represent, and the problems posed to outreach of sustainable credit there.

Jordan's economic growth has not been high enough to lead to significant poverty reduction (National Strategy for Microfinance 2005). The economic growth rates have been just above the population growth rates, adjusted for inflation (Ibid). Trade liberalization and privatization of government entities, a low inflation rate and a pegged exchange rate to the US dollar may all be positive developments. However, since the 1990s the unemployment rate has stayed high at around 15% and a high trade deficit, eased by remittances and foreign aid, has dragged on for years (Ibid).

Jordan is often described as a liberalized, open, and stable economy (see for example Seibel & Almeyda 2001). The growth rate for 2005 was 7.2%, a bit less than the 7.7% of 2004, but seemingly good considering the shocks faced by the economy. These shocks include increased oil prices, less foreign grants, and political and military turmoil in the region (CBJ 2006, p 7). Naturally the instability of the region has depressing effects on the economy, especially as the vital tourism sector has suffered and as Jordan's largest trading partner has traditionally been Iraq, from where Jordan most importantly used to get cheap oil (National Strategy for Microfinance). The present low investment levels from outside sources are also currently reflected in hesitating domestic investments, which decreases general private sector consumption and investment levels (CBJ 2006, p 7). This greatly affects small and micro-sized enterprises through lower turnovers

(Ibid). The wave of immigration from Iraq amounting to up to one million people means significant effects on a country with an estimated population of roughly six million (BBC 2007; CIA). A commonly cited effect is that this pushed up real estate price levels. Still, the prevailing growth rates may be attributed to, among other factors, the relatively stable and secure environment that Jordan has managed to preserve.

Data from official sources say that the percentage of the population living in poverty declined from 21.3% in 1997 to 14.2% in 2002, with a poverty line defined as 392 Jordanian dinars per capita and year (National Strategy for Microfinance). In Jordan, the incidence of poverty is positively correlated with the larger size of households and lower educational levels (Ibid). Though not quite statistically proven, as the number of female-headed households is very low, women seem more affected by poverty than men (Ibid). Poverty is also more prevalent in rural than in urban areas (Ibid). Thus, it is important to note that Jordan is a middle-income country, but still faces problems of poverty, unemployment, price increases, shocks, and foreign debt. Being a middle-income country it gives Jordanian microcredit providers the possibility of increasing sustainability through offering larger loans that increase the profit margins across the board, and this should benefit the more formal alternatives. But not only is poverty problematic for economic progress; it disturbs efforts for peace and order. An example is the bread uprisings in the early 1990s. Microfinance facilities are an acknowledged strategy by the Jordanian government to fight the persisting problems of poverty and much attention is now directed towards this.

The formal banking sector is quite developed with 23 banks, of which 2 are Islamic banks, operating 513 branches and 96 representative offices around the country (Seibel & Almeyda 2001, p 1). However as deposits exceeded outstanding credit by around 70% in 2005, weaknesses with regards to intermediation of credit is indicated (CBJ 2006, p 30f).

A feature in Jordan that differs from many other countries is the religious determinants of Islamic borrowing, which were explained above, and the culture of *wasta*. *Wasta* is a concept that may be defined as using informal contacts to acquire personal advantages and this is widely spread in all levels of Jordanian society. According to a study made by UNDP, 90% of respondents believed that they needed *wasta* to reach their goals, and over 40% felt it was impossible to do business in the private or public sector without it (Report on Jordan 2006).

3.3 The microcredit market in Jordan: a background

For a developing financial market like the Jordanian, weaknesses in the delivery of credit obstruct expansion of credit outreach. In the past, credit programs directed towards the poor have often not been able to achieve sustainability in Jordan, as costs have been too high and repayment rates too low (National Strategy for Microfinance). Many Jordanians have considered these programs to be social intermediation, where repayments were not required (Ibid). Apart from making these programs unsustainable, it distorted the market to the detriment of more sustainability-oriented alternatives (Ibid).

Only commercial banks in Jordan can mobilize funds from the public and extend loans, but they tend to avoid poor people by referring to high risks and operational costs (Ibid). They focus on the commercial and industrial sectors instead (Ibid). Since MFIs have not been formally recognized like commercial banks they have so far been unable to mobilize funds through deposits. Together with problems of primarily institutional capacity, these are the principal limits to outreach of the MFIs that have most vigorously tried to serve those excluded from credit services (Ibid). In any case, the deficiencies in the formal sector and inability of the informal sector to sufficiently serve as a substitute leaves a demand for semiformal financial intermediation of microcredit.

Most microcredit providers in Jordan aim for the economically active poor, or poor people with businesses, and it is of course possible that, for example, MFI lending can benefit a small- or even medium-sized enterprise, an SME. However, due to the relatively dense network of commercial bank branches it is likely that SMEs with some savings have access to these banks' facilities (Magableh 2004, p 47).

The government of Jordan has launched an *Enhanced Productivity Program* to develop and promote strategies that will improve the regulatory framework (Ibid). Interest rate ceilings will be lifted further and licensing for MFIs will get easier (Ibid). This illustrates that the government has realized that its role is more efficient when acknowledging the semiformal MFIs as more formal financial institutions, in order to promote expansion and outreach (Ibid). The formal side of the government thus more and more assumes the role of facilitating a conducive regulatory market

environment. This has also sparked a few commercial banks to look into involvement in microcredit lending as part of their services (Ibid). A few banks have actually engaged the microcredit sector already, including Cairo Amman Bank, Bank of Jordan, and Jordan National Bank (Magableh 2004, p 191). This positive development is however still impeded by the subsidized direct credit programmes of the government (National Strategy for Microfinance).

It is also important to recognize the gender aspect of microcredits, especially in a country like Jordan. A large portion of Jordanian women are not active in the labour market (Ibid), and face social and religious barriers to informal and formal lending (Ghazaleh 2004, p 36). Enabling women to generate an income has both an effect on economic growth as a higher proportion of the population is engaged in productive activities, and a social effect of empowerment (Ibid). Semiformal sources of credit can have, and have already had, an enabling role in this regard. Furthermore, increased income generation has many positive spillover effects on areas like children's education and health, food security, and country business activity (Ibid).

According to the National Microfinance Strategy in Jordan, its microfinance sector is developing through four phases. In the start-up phase institutions are set up, tested, and improved. Then, in the expansion phase already tested operations are expanded and replicated, which allows for increased income and sustainability. Up until this phase the institutions are still allocated grants and subsidized loans for financing. The focus on sustainability comes in the third phase of consolidation, where a general process of formalization takes place. Subsidies fade out and competition increases. Existing markets are penetrated, new ones may be discovered, and activities are adjusted to ensure profitability and growth. This is where the MFIs in Jordan are today. The last phase is integration, which, if Jordan is to enter it, requires a regulatory framework that allows MFIs to fully become part of the formal financial sector under the oversight of, for example, the Central Bank of Jordan. Here capital from commercial sources can be attracted and subsidies can disappear. These phases are relevant for the semiformal sector in particular.

The National Strategy for Microfinance in Jordan focuses on the economically active poor and thus realizes that merely extending credit to the poorest will not be an adequate solution. Technical assistance and aid are among the vital instruments for the less economically active poor and, for instance, a national aid fund is set up for that purpose. The strategy explains and to

some extent predicts the roles of actors on the microfinance market as follows:

- Semiformal MFIs will engage in providing microfinance services, following best practice.
- The government will provide a market-oriented financial and credit policy environment.
- The established on-lending unit, the Development and Employment Fund, will provide funds on commercial terms to MFIs that cannot access funds from commercial banks.
- Formal commercial banks will provide funds and financial services to MFIs, perhaps take equity positions in them, and maybe even provide microfinance services themselves.
- The expanding Microfinance Association of Jordan (MAJ) will consider industry issues like capacity building, networking and transparency.
- Semiformal NGOs will provide technical assistance to link borrowers and lenders, as well as capacity building and other non-credit assistance to the economically active poor.
- Donors will provide assistance to further develop the microfinance sector and its services.

This relates little to the informal sector, but otherwise introduces the market actors fairly well. These actors will now be further detailed.

3.3.1 Microcredit providers in Jordan

In Jordan there is the more traditional finance of government institutions such as the Agricultural Credit Corporation (ACC) and the Development and Employment Fund (DEF). The ACC has been the principal microcredit provider to agriculture, but has severe financial problems, negligible outreach to women, and problems of customer defaults (Seibel & Almeyda 2001, p 3ff). DEF provides direct and indirect loans as well as technical assistance to develop and provide financing for small businesses. These must be considered formal institutions.

Then there is the more modern finance of formal commercial banks mostly, and they are expansive and profit-oriented. Here we also find the MFIs, most of which focus on sustainability and outreach as well. It is clear that ACC is the main outreach to the rural agricultural areas and that the MFIs have not penetrated this segment yet (Seibel and Almeyda 2001, p 3). The sustainability focus of MFIs has led them to the more densely populated areas. There are also the more modern NGOs, like the Jordanian Hashemite Fund for Human Development and the General Union of Voluntary Societies. They offer subsidized credit including loans to agricultural and micro enterprises in remote areas, but they have limited outreach (Ibid).

Formal governmental microcredit began in 1959 with the launching of the ACC. There are six governmental or semigovernmental institutions that offer microcredit as part of their activities. They include ACC, Industrial Development Bank, National Aid Fund, Orphan Fund, Development and Employment Fund, and Housing and Urban Development Corporation.

The commercial banks in Jordan may well extend credit to SMEs, but due to collateral requirements they play a small role in extending microcredits and servicing the microentrepreneurs (Magableh 2004, p 47). To overcome this problem the Jordan Loan Guarantee Corporation was established to cover the risk of borrowing, but this is directed towards SMEs (Ibid, p 48) and thereby not clearly a microcredit project.

The semiformal microfinance sector in Jordan includes a number of different providers. There are four really sustainability-oriented commercial MFIs, all supported by a USAID-funded initiative called the Achievement of Market-friendly Initiative and Results (AMIR) programme including Ahli Microfinance Company, Microfund for Women, Middle East MicroCredit Company, and Tamweelcom. Last year the government set up the National Microfinance Bank, which also aims to be a sustainable MFI.

Then there are about a dozen or so organizations that provide microcredits as part of their activities. Of these, the international institutions include the United Nations Relief and Works Agency, Near East Foundation, Save the Children Foundation, Cooperation for Development, and Care International, and the national NGOs include the Jordanian Hashemite Fund for Human Development, Noor Al-Hussein Foundation, Queen Alia Fund for Social Development, and the General Union for Voluntary Services. Compared to the MFIs these institutions have very limited outreach, but are part of the semiformal sector.

Finally, there are about 200 micro credit schemes like organized cooperatives on the local level. These provide savings and credit opportunities, and some are supported by donor funds. They are sometimes borderline informal sector. More information on the informal sources in Jordan is part of the next sub-section.

3.4 Study evidence relating to the common topics and the context

There are studies that have researched the microcredit market in Jordan in order to get a better understanding of the relationship between borrowers and lenders from the different sectors. It is to two of these, as well as to the interviews and the questionnaire, that I turn next by relating their results to the common topics and the context.

3.4.1 The importance of the sectors

Informal credit in Jordan is widely available. In a national population sample, Magableh finds that preferred, requested, and actually used sources of credit conform, and the sample ranks informal sources before semiformal and formal. This is illustrated in table 1 below.

Table 1 Preferred, requested, and actually used source in the national sample

Preferred source	Requested source (% of sample)	Actually used source
1. Informal sources	Informal sources (62.2)	1. Informal sources
2. Microcredit providers in general	Semiformal sources (45.6)	2. Semiformal sources
3. Cash and returned earnings	Formal sources (19.8)	3. Formal sources
4. Formal bank loans		
5. Rotating savings		

Source: Magableh 2004, p 93ff

Survey evidence on microentrepreneurs from Daly suggests that about 37% of microentrepreneurs have access to credit from family, friends, and neighbours, and 47% have access to credit from suppliers, but the role of moneylenders is insignificant (Daly 2002, p 1). Most of those that have access to these sources also use them, but rarely for amounts over 650 Jordanian Dinars (Ibid). Interestingly, there is no real rural-urban difference here for informal borrowing (Ibid, p 16). However, even though 11% of the sample claim access to moneylenders, a mere 2.7% have actually borrowed and virtually none of this took place in rural areas (Daly 2002, p 15).

Daly's survey further suggests that about 53.8% of microentrepreneurs are willing to borrow from banks, NGOs, and MFIs (Daly 2002, p 18). But it turns out that actual borrowing from NGOs is virtually insignificant (a bit over 1% of microentrepreneurs); less than 10% of

microentrepreneurs have obtained traditional bank loans (mostly due to collateral problems), and almost 12% have obtained loans from MFIs (Daly 2002, p 25). It is worth noting for microentrepreneurs that men, formal businesses, and people in rural areas are more likely to have a bank loan than an MFI loan, while women, informal businesses, and people in urban areas are more likely to have an MFI loan than a bank loan (Ibid). Due to social and religious barriers female microentrepreneurs are nationally less likely to apply for informal loans (Magableh 2004, p 164).

Magableh (2004, p 190) also asserts that formal banks play only a modest role in the microfinance market in Jordan, due to lending as well as borrowing behaviour. With regards to lending behaviour there are many potential specific reasons for this modest role, including transaction costs, risk level, interest rate, and collateral factors, but also lack of experience with microcredit activity (Ibid). The recent engagement of the microcredit sector by a few banks may be the start of a stronger role of commercial banks in the Jordanian microcredit market. The use of bank loans is therefore not appropriate to equate with formal microcredit and points to the limited role of the formal sources of microcredits. Regarding the borrowing behaviour, there are strong feelings of commercial lending being *haram*, forbidden by Islamic principles. Religious barriers are actually frequently found to be the most important factors that determine willingness to apply for credit (Ibid, p 191; Daly 2002, p 19).

The above information indicates that the general population feel that informal microcredit is more important than semiformal, which is more important than formal. If importance of source of credit is measured in frequencies, the above information further indicates that for microentrepreneurs in general semiformal sources are more important than formal. It would then also indicate that informal credit is the most important source as more microentrepreneurs use this source than any other. Going deeper and differentiating the samples we find that importance of sources may differ between groups of borrowers. For instance we see that for microentrepreneurs formal traditional loans may be more important (i.e. more frequently used) than semiformal microcredits for men, formal businesses, and rural areas, while it seems to be the opposite for women, informal businesses, and urban areas.

Looking closer, the average size of loans is larger in the formal sector, followed by semiformal and informal (Magableh 2004, p 107ff). Thus, to satisfy larger credit demands the formal sector

may be the more important, but then we are moving away from microcredits.

Primary material

The interviewed microcredit providers were asked about which source of credit was most important for poor individuals and, as a measure of importance, most frequently used by them. However, the interviews did not give measurable statements on this issue for two reasons. Firstly, it is extremely difficult to monitor frequencies of informal borrowing. No one knows about each time someone borrows money from a parent or buys groceries on credit for example. Secondly, finding out about it is even more difficult since the issue is perceived to be a sensitive subject. The informal sources that were commonly mentioned by the interviewed were family, friends and, for enterprises, suppliers. These sources are perceived to be dependent upon trust and strength of social bonds.

However, semiformal and informal sources are said to be most important for poor people, as formal financial sources are not really available for the poor. Whether MFIs or informal sources are most important may depend on where in Jordan you are. In the South informal sources are perceived to be relatively more important than in the North, where MFIs are more accessible. Being representatives from the semiformal sector they may have a vested interest in promoting the importance of semiformal credit, but the statements do conform with the study evidence above.

There was unanimous certainty about the ongoing changes in importance. People used to borrow more from family, friends and suppliers, but now life is more complicated. Historically the Jordanian population has been very small. People used to live in the same geographical area for long periods of time and where everybody knew each other. Now the population of Jordan has increased, due to population growth rates and migration waves, and it is more mobile. One geographical location can inhabit people from different regions and cultures.

Since informal lending is considered to be a factor of the strength of social bonds, the changes in the social climate are perceived to cause informal lending to decrease the way it has in industrialized countries. Also, people are more and more being given alternatives to informal borrowing. Formal sector commercial banks exist, but they do not satisfy poor people's demand for credit due to their various requirements. It is the semiformal sector with the MFIs that

represents the alternative to informal lending for the poor and this source should grow as a consequence.

Besides the financial requirements like collateral, there are perceived obstacles to borrowing from the formal sector in the form of religious barriers and the charging of interest, but the climate seems to be changing towards more acceptance of commercial credit. The point was made in the interviews that Jordanians used to borrow more informally, but that this has decreased since awareness has increased from the late 1990s and onwards. The MFIs do face increased demand (the number of microcredit clients in Jordan has doubled between 2003 and 2005). A further reason given for the decreased ability of informal sources to serve the poor is the increasing cost of living. This affects everybody. As all have the same problems they are less able to lend and borrow from each other, which consequently reduces the possibility of informal borrowing. In Jordanian culture family members have traditionally taken care of each other, but lending within families is perceived to be decreasing when social capital, which was previously built through intense interaction, is shrinking. However, it is important to note that those relationships that remain strong continue to function as before.

Table 2 Importance of the sectors

	Perceived most important source (%)	Most frequently used source (%)	Average absolute frequencies
Informal sources	17.4	19.1	1.6
Formal sources	26.1	23.4	2
Semiformal sources	56.5	57.5	3

Looking at the perspective of microcredit clients in table 2, 56.5% of the questionnaire respondents claimed that semiformal credit was most important for them, while 26.1% claimed formal, and only 17.4% informal. This indicates that not only is informal credit less important for the microcredit clients than for the national and microentrepreneur samples, but perhaps also that there is a positive relationship between accessing more formal sources of credit and less dependence on informal borrowing. The perception of importance is consistent with what source is claimed to be the most frequently used by the microcredit clients the past 5 years. Here, 57.5% said semiformal sources, 23.4% formal, and 19.1% informal. The fact that this is quite consistent indicates that frequencies are a reasonable measurement of what sources of credit people feel are

most important. Even the absolute frequencies are consistent with the above as average amounts of semiformal loans received the past 5 years were 3, for formal 2, and for informal 1.6.

3.4.2 Common advantages and disadvantages

The literature suggests that traditional ties and strength of social bonds weaken as societies develop and become more mobile (Ray 1998, p 557). The informational advantage of informal networks will likely also weaken, as has been the case in industrialized countries (Ibid). The sources of informal credit that are prevalent in Jordan include family, friends, colleagues, neighbours, suppliers, and ROSCAs (Magableh 2004, p 47; Daly 2002, p 35). The most preferred informal source by microentrepreneurs was relatives, then colleagues, friends, shopkeepers, and very few reported engaging ROSCAs and moneylenders (Magableh 2004, p 102). If the process of industrialization reduces the informational advantage, these sources that depend on social bonds may indeed face weakened capacities. On the other hand, Magableh's national population sample suggests that the preference for informal credit is the top reason for not applying for semiformal credit and the second (after religious barriers) reason for not applying for bank loans (Magableh 2004, p 95ff). Perhaps semiformal sources can replace weakened informal ones if they are broadly acceptable. As the informal sources above were the most frequently used nationally and by microentrepreneurs, broad accessibility should at least presently be in their favour. But this is less true for those who are already semiformal microcredit clients.

For MFIs that have tried to use informal information bases, strategic defaults of microcredit borrowers have been avoided through collateral arrangements like salary guarantees and group lending. However, the MFIs that have used it are increasingly moving away from group lending as they adjust to market demand (Campion 2002, p 16). Instead they expand their individual lending with other guarantees, which tends to be more profitable, and they thereby avoid losing clients (Ibid). A much cited disadvantage of group lending is the bi-weekly repayment frequency that collides with the common income cycle (Ibid, p 27), but also that it merely offers working capital loans. This demonstrates not only a prevalent strong profitability focus rather than a massive outreach goal, but also that the general semiformal sector does not feel it needs to fully make use of the informal information advantage.

Interestingly, about 95% of respondents' informal loans were lent nationally without security and free from interest (Magableh 2004, p 164). This means that while they are usually smaller and have shorter maturities (Ibid, p 169) most informal loans, commercial as well as non-commercial, are cheaper than their alternatives in Jordan. However, interest rate levels seem to not have any effect on willingness to borrow, suggesting that poor people can and are willing to pay for access to credit once the concept of interest is accepted (Ibid, p 178). For the microentrepreneur sample, there are more ROSCAs where there are less potential borrowers (Daly 2002, p 16). This suggests that the poorest microentrepreneurs and those unwilling to apply for credit use ROSCAs as an alternative. Since ROSCAs can avoid interest rates they should be apt at overcoming religious barriers and this is testament to the reported flexibility of informal sources of credit.

Primary material

To find out more about advantages and disadvantages, the interviewed microcredit providers were asked about the pros and cons of the sectors. An obvious disadvantage for the future of informal sources of credit is its stated dependence on the traditional type of society. The unanimous feeling was that informal sector credit should be decreasing as society changes, and that more formal sources will then take over. This transition was seen as consistent with the transition from traditional and informal to modern and more formal features of the economy.

Looking at the borrower perspective, it was said that a semiformal microcredit gives you cash, which has more flexibility than for example informal supplier credit. The often cited better flexibility of informal credit was here seen as more rigid instead. The same rigidity should go for Islamic microcredit, which avoids transfer of cash. There is a strong feeling of increased competition on the microcredit market, which was thought to promote improvements in the selection of semiformal products in the near future.

As poor people usually cannot access formal borrowing, the obvious disadvantage of the formal sector is its inability to cater to poor borrowers. Another point mentioned was that the formal sector discriminates somewhat against women. Women seem more likely to borrow from semiformal sources than men. Besides being difficult to access, only a few borrow from formal commercial banks as it is often thought of as forbidden by Islamic principles. MFIs are more acceptable due to the social goal of MFIs and that, at least for the non-profits, they merely charge interest rates to cover their cost of operations. MFIs are further preferred due to more favourable

requirements as well as less complicated and less time consuming application processes.

The application costs of the semiformal sector are small or non-existent, even though the application process is the biggest cost, requiring trips and research. The application process is still shorter and less costly for borrowers at MFIs compared to commercial banks. Instead, the disadvantages of the semiformal sector MFIs today seem to revolve around lacking a good system for information sharing like some form of a credit bureau, lack of low-cost funding (meaning loans at more favourable rates than the commercial), a problematic high turnover of employees (due to the desk culture issue, as new graduates want a desk or clerical job and do not want field work as it is perceived to be harder with more social tensions), general outreach, and diversification of products.

In the interviews, private moneylending was referred to as prohibited by government and religion, but that it does exist in very small scale with very high interest for any given financing need. This is not accepted socially as it is forbidden by Islamic principles. In some areas social changes may make informal lending increase in the form of ROSCAs to the detriment of intra-family lending, as a person now may know co-workers better than more distant family members. For ROSCAs the cost of lending is zero, except for the savings requirement, which is a strong advantage and again religiously more acceptable.

Table 3 Informal advantages and disadvantages

	Perceived informal advantages			Perceived informal disadvantages		
	Accessibility	Flexibility	Low application costs	Interest rates are higher	Not large enough loans	Difficult to ask for
Agree	84.3%	71.4%	59.2%	56.8%	76.3%	44.7%
Do not agree	15.7%	28.6%	40.8%	43.2%	23.7%	55.3%

Looking at microcredit clients in table 3, 84.3% of questionnaire respondents agree that informal sources have better accessibility than the alternatives, 71.4% that these products are better adjusted to their need, and 59.2% that their application costs are lower. With regards to the disadvantages, only 56.8% agree that informal borrowing includes higher interest rates than the alternatives. This would be consistent with the low availability of moneylenders, but could also be due to the preference for interest free borrowing from family and friends. 76.3% say informal loans are not enough sometimes, which illustrates a credit ceiling problem with the informal

sector. 44.7% feel that it is emotionally difficult to ask for informal loans, which may be due to social and religious barriers or perhaps preference for the semiformal sources that clearly are available for these microcredit clients.

Table 4 Formal advantages and disadvantages

	Perceived formal advantages			Perceived formal disadvantages		
	Lower interest rates	Large enough loans	Reliability	Accessibility problems	Rigid products	Higher application costs
Agree	73%	66.7%	69.2%	63.9%	66.7%	44.7%
Do not agree	27%	33.3%	30.8%	36.1%	33.3%	55.3%

Furthermore, in table 4, 73% of respondents agree that formal sources have lower interest rates than informal sources, which could indicate that microcredit clients associate informal sources with the commercial informal lenders. 66.7% of respondents think that formal lending gives large enough loans, and 69.2% that formal funds are always available (if they can be accessed). However, 63.9% think that there are problems accessing formal loans, 66.7% think that formal sector products are rigid, and 44.7% think application costs are higher in the formal sector. The advantages of informal borrowing and disadvantages of formal borrowing are both supported, but the numbers are not that overwhelming.

Table 5 Relating to semiformal and Islamic microcredit

	Semiformal and formal similarity	Not enough Islamic microcredit
Agree	41%	64%
Do not agree	59%	36%

In table 5, 41% think that semiformal credit is similar to formal, which indicates that the formal sector is often seen as different from the MFIs. The non-profit nature of many MFIs may seem like a guarantee against usury, but even among microcredit clients who pay interest 64% think that there is not enough Islamic microcredit and that this is problematic. There is a significant relationship (with a p-value of 0.0625) between thinking that semiformal and formal sources are similar and wanting more Islamic microcredit, which could indicate that those microcredit clients who know that there are differences, i.e. those with broad knowledge about credit sources, also feel less need for more Islamic microcredit.

3.4.3 Purposes and source of microcredit

Banks care little about the purposes of loans as they secure their loans against default, but MFIs and informal lenders often ration loans for social events (Magableh 2004, p 170). Table 6 shows examples of use. Again, formal bank loans are not formal microcredits exclusively.

Table 6 Examples of use of loans

Use of formal loans	%	Use of semiformal loans	%	Use of informal loans	%
Repaying other loans	41	Initiate enterprise	63.8	Social events	40.5
Consumption	35.9	Production	51.4	Production	34.4
Production	34.6	Repaying other loans	26.1	Consumption	28.2
Initiate enterprise	33.3	Consumption	14.5	Repaying other loans	25.8
Social events	15.4	Social events	12.3	Initiate enterprise	25.4

Source: Magableh 2004, p 97ff

Thus formal or informal lending seems widely used for things other than business purposes. Social events increase the probability of requesting informal loans as well as size requested (Ibid), while decreasing the probability of applying for semiformal credit (Ibid, p 195). Informal lenders are even found to not really disburse loans for purely productive purposes (Ibid, p 164).

Turning to the microentrepreneur sample, informal lenders often ration loans for productive purposes as these loans exceed their credit ceiling (Daly 2002, p 22). This lack of capacity is one of the major problems of informal lending. Only 6% of those that are willing to borrow want to borrow for consumption, and the remaining 94% want to borrow for productive purposes (Ibid). 12% of them want to borrow to start up new businesses (Ibid). MFIs are sometimes misled when they lend for productive purposes, since borrowers use their loans for other purposes as well (Ibid), but nationally most semiformal loans are used for productive purposes.

Primary material

Table 7 Sources and purposes

	Informal sources	Semiformal sources	Formal sources
Business purposes	47.2%	50%	36.1%
Private and other purposes	52.8%	50%	63.9%

Turning to microcredit clients in table 7, 50% of semiformal, 47.2% of informal, and 36.1% of

with regards to use. A slightly higher percentage of informal loans were used for business purposes here than for productive purposes nationally, which could be due to a higher degree of business activity among microcredit clients. Otherwise the questionnaire results seem to conform.

3.4.4 Simultaneous borrowing from microcredit sectors and actors

In the national sample, having effective loans increases the probability of applying for formal and semiformal loans (Magableh 2004, p 158). Informal and semiformal lenders grant larger loans to people that have bank loans (Ibid, p 197), but banks ration those with semiformal and informal debt (Ibid, p 159). This may be because those that can secure bank loans have a better economic situation and can manage larger semiformal and informal loans. The opposite could go for those that have semiformal or informal loans and are looking for bank loans. Generally, those that have bank loans demand larger MFI and informal loans, but those that have MFI loans demand smaller bank and informal loans (Magableh 2004, p 174ff). Either way, the institutions do not seem to avoid simultaneous activity between sectors and actors.

Primary material

In the interviews, there was a unanimous belief that microcredit clients do borrow from more than one source simultaneously. The versions particularly mentioned were borrowers with multiple MFI loans and borrowers with MFI and informal loans. As the clients of MFIs are often unable to obtain bank loans, their activity in the formal sector is limited to formal microcredit providers like the Agricultural Credit Corporation. It seems likely though that anywhere there is credit rationing clients may look for additional financing. Simultaneous borrowing from different sectors and within a sector may not be all that problematic as long as there is repayment ability and a business, which usually is the source of repayment ability. The key seems to be repayment ability.

It was stated in the interviews that borrowing informally to cover first semiformal loan instalments was the case before in Jordan, when there were weekly instalments. In Jordan the income cycle depends on the end of the month, and so with monthly payments at the end of the month the problem of instalments during periods of low liquidity can often be avoided. The income cycle in Jordan was described by one of the interviewed as approximately two weeks of

having money after salaries are cashed on the 25th of each month. During the two weeks before the next salary many will buy from shops and suppliers on account, thus using informal credit to smooth consumption. Consequently, weekly instalments do not work that well in Jordan. They need to be at the end of the month to fit the income cycle. Moreover, the Jordanian economy differs from that of many South and East Asian economies in that it does not have much agriculture or assembly industry. Jordan is engaged in services and trade mostly, which provides for the income cycle explained above. Thus it seems clear that the character of the economy can affect what kind of microcredit products work best.

Simultaneous borrowing is however perceived to be problematic for some of the interviewed and perhaps rightly so. Unsustainable lending is not desirable. Therefore MFIs are working towards information-sharing, but even with, for example, a credit bureau it depends on how accurate information is, and how fast it is updated. A problem with microfinance clients is that the state of their projects can change fast. They are for instance heavily affected by a social crisis, like a child being sick and the subsequent medical expenses. Bigger projects are not affected by social issues in that way. Thus, multiple loans are a considerable increase in risk for lenders, but the availability of different sources of loans may also help in temporary emergencies.

Table 8 Simultaneous borrowing

	Simultaneous borrowing	Simultaneous borrowing for co-financing	Simultaneous borrowing for separate financing
Yes	41%	22.7%	27.5%
No	59%	77.3%	72.5%

Table 8 shows that 41% of surveyed microcredit clients admitted to having had simultaneous loans from the informal and formal or semiformal sectors at the same time. 22.7% of the sample had simultaneous loans for co-financing purposes, while 27.5% did it to finance different things. Thus, there is little doubt that simultaneous borrowing occurs. Co-financing should indicate credit rationing, while financing different things with different loans indicates some sort of other strategic behaviour of borrowers.

3.4.5 Outreach

An estimated 90% of microcredit demand lies in the four governorates of Amman, Zarqa, Irbid, and Aqaba⁵ (Daly 2002, p 3). The seven remaining more rural governorates therefore have less appeal for new branches from a sustainability and profitability perspective. The northern governorate of Irbid alone has the same number of estimated willing borrowers as those remaining seven governorates (Daly 2002, p 36). Interestingly, among existing microentrepreneurs a mere 8% claim to lack financial resources and the numbers are just a bit higher when looking at only rural areas (Daly 2002, p 34). However, there is a difference between lacking and having adequate financial resources.

There seems to be some relationship between wealth and preferred source of credit in the national sample as Magableh finds that owning one's place of residency makes one less likely to apply for informal loans and decreases the size of loans requested (Magableh 2004, p 202). Having an MFI close to the place of residency also positively affects the probability of applying for a semiformal loan (Ibid, p 158), which may suggest outreach problems in rural areas where the network of branches of formal and semiformal actors is less dense. In any case, as shown by for instance Campion (2002), the potential demand seems to be vastly larger than satisfied demand.

Primary material

To look into the issue of outreach the interviewed were asked specifically about the relationship between wealth and source of credit. A unanimous position said that the wealthier you are, the more likely you are to be able to acquire a semiformal or formal sector loan. Moreover, the wealthier you are, the less likely it should be that you are in need of informal borrowing. It was however pointed out that in Jordan even the poor can get funds from the more formal MFIs, but with the restriction of amounts and given that they have geographical access. If the track record becomes good, the size of future loans can increase. Some microcredit providers do not even require a business in order to grant a loan. Also, outreach is difficult to rural areas like the Tafilah governorate with 70 000 people. One branch in Amman can serve an area of 250 000 people, which is 3-4 times as much as the whole governorate of Tafilah. The population of Amman, Zarqa, and Irbid make up more than 70% of the Jordanian population and this directs MFI concentration to these areas.

⁵ See map for illustration of governorates in attachment 3.

Table 9 Outreach aspects

	Formal sector exclusion	Wealth means less informal borrowing
Yes	34.7%	40%
No	65.3%	60%

In table 9, 34.7% of microcredit clients feel excluded from formal sector borrowing according to the questionnaire, while 40% think that wealthier people borrow less from informal sources. Thus, many do not feel excluded from the formal sector and do not think that wealthier people abandon the informal sector. This may indicate that many microcredit clients in Jordan are relatively well off as they can access the formal sector (which is exemplified by commercial banks in the questionnaire), and that many feel that formal and semiformal loans are complementing, not necessarily substituting, the role of informal sector credit. These answers can be distorted by the fact that some MFIs in Jordan increase sustainability through granting larger-sized loans using the microcredit methodology, which may attract wealthier people.

3.4.6 Lending in the religious and cultural context

Religious context

Religious beliefs have a negative effect on the probability of microentrepreneurs applying for credit that does not conform to Islamic principles (Ibid, p 191f). In the national sample, Magableh finds that 83% of people that had not applied for any kind of bank loan said that Islamic beliefs were the main reasons for not applying (Magableh 2004, p 192). Of microentrepreneurs that are not willing to borrow, a rough third say that religious beliefs are the main reason (Daly 2002, 19). The number is higher in rural compared to urban areas (Ibid). Those that do not apply for credit for religious reasons are logically those that could be served if Islamic microcredit provision became more developed. For semiformal microcredit and particularly informal, religious barriers are shown to be relatively minor obstacles in the national sample (Magableh 2004, 101ff). If informal and semiformal credit are more acceptable for those that require Islamic principles to be met, informal and semiformal credit should be the more important sources of credit for these people. You can even say that informal sources of credit that do not charge interest are in fact

more or less compatible with Islamic methods (Ibid, p 164).

Logically, the ideal type of borrower is one that has a low risk of default and a high demand potential. The ideal borrowers have a characteristic relevant for sector interaction. For sustained expansion Daly recommends that MFIs target clients that also engage in informal borrowing (Daly 2002, p 6, 36). This indicates a role for informal lending also in the near future, in relation to MFI activities as well as for expansion and introduction of services that conform to religious principles.

One interviewee stated that if you want to reach outside urban areas in a sustainable manner you need a sustainable Islamic microcredit product. Actually, in some credit contracts the term interest rate is not mentioned in the Arabic texts. It says instead roughly that there are costs for the loan to cover salaries, supplies and offices etc. However, Islamic microfinance is perhaps not the only way out for MFIs trying to serve all in Jordan. Again, the connection between those who think there is not enough Islamic microcredit and those who think that formal and semiformal sources of credit have similar characteristics, can indicate that those who are less informed about the differences between the sources are those that demand more Islamic microcredit. For this reason, informing about MFIs and their nature could help expand outreach as MFIs seem to become more accepted when their nature is taken into consideration. Statements in the interviews support this as well, as there seems to be less resistance towards MFIs now than when they started in the late 1990s. Either way, it is clear that religious beliefs affect the roles of the microcredit sources, probably in favour of the informal sources that seem to conform to Islamic principles better than alternatives.

Cultural context

Also, in the borrowing process *wasta* is displayed as the availability of a mediator that can guarantee loan approval referring to personal relationships. According to the national sample, the role of mediators in obtaining loans appears marginal, but they do increase the likelihood of applying for a bank loan (Magableh 2004, p 145, 170). Having a mediator further increases the likelihood of being credit rationed by banks and MFIs, which may reflect a weaker role of mediators in profit-maximising institutions (Ibid, p 170). Actually, mediators even have little effect with regards to informal lending (Ibid). Thus, the role of *wasta* may be limited here.

4 Conclusion

This last section will paint a picture of what may be seen as the key findings on Jordan with regards to the general theoretical arguments, the roles of the microcredit providers, and finally provide a few quite uncontroversial suggestions for the future.

Jordan is clearly a country in transition from having traditionally dominant informal microcredit providers to having more extensive modern semiformal and formal alternatives. Semiformal microcredit providers in Jordan admit that the application process is their biggest cost, which is a reasonable consequence of information asymmetries. To handle adverse selection while adjusting to the situation of the poor, semiformal lenders do extensive research on clients instead of requiring costly and too advanced documentation. They look at cash-flow figures instead of demanding lengthy paper work. This process is something that informal lenders probably avoid to a great extent through the traditional social bonds that provide relevant information. Moreover, a way to handle moral hazard is to try to control the use of loans, which is prevalent among MFI loans. The better the information one has, the more one knows about what loans will be used for, and this is how informal lenders can handle this issue. It is important to note the dominant social-bond character of informal lenders, and that there is a significant lack of moneylenders that separates Jordan from many other countries. Furthermore, it is apparent that while semiformal sources of microcredit seem to grow, they are generally moving away from some techniques like group lending that can tap informal information bases. This move may reflect sustainability-orientation and tough competition, but could potentially exclude those that are not in a position to obtain an individual loan.

4.1 Common topics and empirical support

One might conclude from the empirical section that most points of the common topics do find empirical support in Jordan, whether strong or weak. No theoretical issue raised in the questionnaire completely lacked any empirical support, but only a few issues had more than 80%

support. However, in the national and microentrepreneur samples informal sources of credit stood out as most important, followed by semiformal, and then formal. Interviewed microcredit providers said semiformal and informal sources are most important, and microcredit clients valued firstly semiformal, then formal, and then informal sources. When you start to diversify the population even more you find more differences, like gender, rural-urban, and formal-informal sector differences. This clearly points out that informal credit is still very relevant in Jordan despite the introduction of alternatives, and that it plays a big role for the population in general as well as for small businesses, but that the importance of its role may diminish as people gain access to semiformal or formal microcredit. The persisting dependence on informal credit can illustrate that Jordan still has some way to go before having a dominant regulated and formalized segment of the microcredit market, i.e. it can in a way illustrate shallow outreach⁶.

Accessibility and low application costs are likely uncontroversial advantages of informal credit, while these are often perceived to be disadvantages of formal credit. Flexibility of products is probably seen by many as an advantage of the informal sector, but by giving cash formal and semiformal sectors offer a kind of flexibility as well. Since the dominant source of informal credit seems to be family, friends, neighbours, it may not be so surprising that most informal loans were interest free and that many do not agree that interest rates are higher for informal lending in general. The informal sector also seems disadvantaged by credit ceilings, while the formal sector has reliable funds available, and some even find it difficult to ask for informal loans. The future seems to present challenges for informal credit as society changes and semiformal and formal alternatives become more acceptable and accessible, particularly since the non-commercial lenders are the preferred informal lenders. But, the current relevance of informal sources becomes more reasonable once these advantages and disadvantages are looked at.

Other than semiformal sources of microcredit being relatively often used for productive purposes, perhaps as a consequence of the semiformal clientele, there were no clear divides when it comes to sectors and purposes of loans. Informal and formal loans also finance production, but likely have a bit more flexibility when it comes to use. The topic outlined more stringent differences in purposes than what were found here.

⁶ The author is well aware of the thin, and perhaps blurry sometimes, line that separates formal credit and formal microcredit in this thesis, but does not perceive this as distorting these conclusions.

It seems fairly obvious also that simultaneous borrowing frequently occurs, and that the reason can be to co-finance projects as well as finance different things. This points to credit rationing being used by lenders and that this, at least for some people, makes them turn to other sources as well. Further, being active in the credit sector seems to spur further borrowing activity. It is also important to note that merely weak indications say that wealth should decrease informal sector borrowing, even if it is reasonable that wealth increases access to semiformal and formal funds. Knowing the importance of the informal sector credits for people in general, outreach is likely not sufficient and perhaps lack of wealth dictates that the sources of borrowing are more often informal.

4.2 Suggestions

The current roles point to three suggestions that may be able to reduce the size of the excluded segment and increase outreach of the alternatives to informal credit. These include Islamic microcredits, knowledge spread, and improved links between lenders and borrowers. Firstly, it seems obvious that managing a sustainable Islamic microcredit product would increase the number of potential microcredit clients. Regardless if this conforms to cost or profitability standards, many do resist non-Islamic financial products. In a similar vein, willingness to borrow may be increased if knowledge about the nature of microcredits is broadened via different media.

Secondly, as there are semiformal and formal credit providers in Jordan and there seem to be people that cannot reach them, the logical conclusion should be that these lenders and potential borrowers need some sort of link. Without this link the first suggestion is not very useful for those that cannot reach formal or semiformal credit sources anyway. The most usual link would be that credit providers set up new branches closer to potential borrowers, but this does not always seem economically viable, particularly in many rural areas. A suggestion that came out of discussing this problem with Dr Ihab Magableh was that of an advisor on location. This advisor would have two tasks. Firstly, he or she would provide information about possible sources of lending to those that have little knowledge of the microcredit market. Secondly, the advisor could collect applications and forward them to the designated credit institution. This may reduce the problem of lack of information about credit as well as reduce the distance between lender and borrower without the need for new branches. To organize this activity government may not be

appropriate as it has its own microfinance operations. However, there is the newly formed organisation called Microfinance Association of Jordan (MAJ). MAJ has eleven members from the microfinance community and could employ advisors to place in suitable areas. The members of MAJ will then be represented by the advisors and thereby participation is optional. If knowledge increases acceptance of interest-based credit, advisors may reduce the issue of religious barriers as well as linking borrowers and lenders. The government has initiated 132 knowledge stations in the more remote areas of Jordan to increase computer literacy and perhaps these can serve as a starting point for the deployment of a network of advisors. These are suggestions on how Jordan can continue its microcredit market development and may present practical obstacles, but they are likely not very controversial.

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Attachment 1: Template with questions for the interviews

1. What source of credit do you perceive to be the most important for the most poor, or most frequently used?
2. What do you see as the pros and cons of
 - informal credit?
 - formal credit?
 - semiformal credit?
3. Do you think the purposes of loans differ depending on source of credit?
4. Do you think people borrow from more than one source at the same time?
5. Is there a relationship between wealth and source of credit?
6. Do you think there is unsatisfied demand for Islamic microcredit?

Attachment 2: Questionnaire in English

1. What source of credit do you perceive to be the most important/helpful for your economic situation? Please mark the right alternative.
- Informal sources like family, friends, and shopkeepers.
 - Formal sources like commercial banks.
 - Semiformal sources like Microfund for Women, Tamweelcom and UNRWA.

Which source have you used most frequently the past 5 years? Please mark the right alternative.

- Informal sources like family, friends, and shopkeepers.
- Formal sources like commercial banks.
- Semiformal sources like Microfund for Women, Tamweelcom and UNRWA.

How many times have you borrowed from each source the past 5 years?

- _____ times from informal sources like family, friends, and shopkeepers.
- _____ times from formal sources like commercial banks.
- _____ times from semi-formal sources like Microfund for Women, Tamweelcom and UNRWA.

2. If you have experience of this, would you agree that the benefits of informal borrowing include:
- better accessibility than alternatives Yes No
 - better adjusted products to your need Yes No
 - lower application costs than alternatives Yes No

If you have experience of this, would you agree that the disadvantages of informal borrowing include:

- higher interest rate than other alternatives Yes No
- the size of the loan is not enough sometimes Yes No
- it is emotionally difficult to ask for it Yes No

If you have experience of this, would you agree that the benefits of formal borrowing include:

- lower interest rate than informal credit Yes No
- it gives loans that are large enough Yes No
- funds that are always available Yes No

If you have experience of this, would you agree that the disadvantages of formal borrowing include:

- problems of accessibility Yes No
- very rigid products Yes No
- higher application costs Yes No

Would you agree that semi-formal microcredit like that from Microfund for Women, Tamweelcom and UNRWA fills an important function, and has characteristics that are

similar to formal microcredit like that from commercial banks?

Yes No

Do you feel that there is not enough Islamic microcredit and that this is an obstacle for you and the people around you?

Yes No

3. What was the purpose of your latest informal loan?

For private consumption For business Other

What was the purpose of your latest formal loan?

For private consumption For business Other

What was the purpose of your latest semi-formal loan?

For private consumption For business Other

4. Have you had loans from informal sources (like family, friends, and shopkeepers) and formal sources (like commercial banks) or semi-formal sources (like Microfund for Women and Tamweelcom) at the same time?

Yes No

If yes to question 4, was this in order to co-finance a project, like lending from a family member to pay the first instalments on a bank loan?

Yes No

If yes to question 4, was this in order to be able to finance different things, like one loan to buy furniture and one loan to invest in inventories?

Yes No

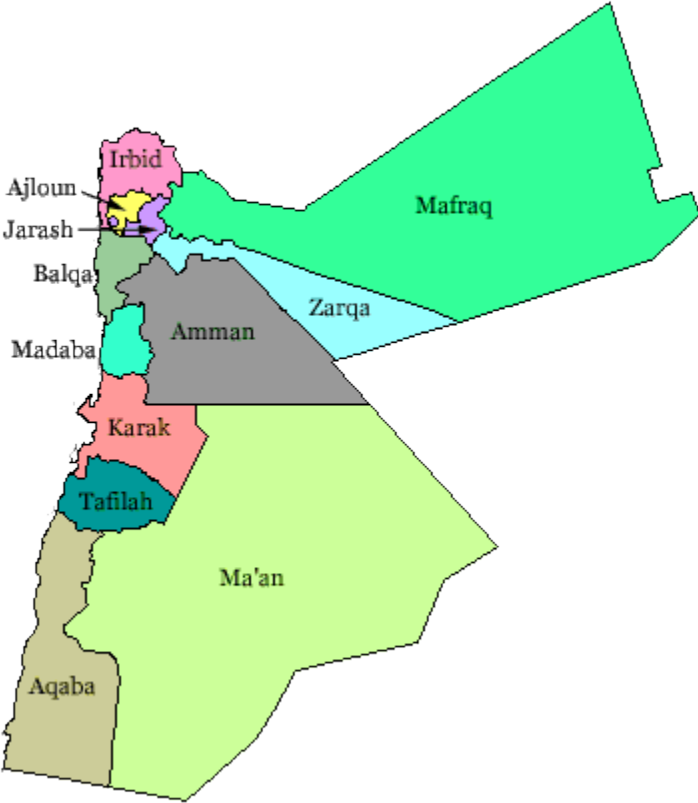
5. Do you feel excluded from formal sector borrowing, like borrowing from commercial banks?

Yes No

Do you think richer people are less likely to borrow informally, like from family, friends or shopkeepers?

Yes No

Attachment 3: Map of Jordan



Source: Wikipedia (available at: http://en.wikipedia.org/wiki/Image:Jordan_geohive.gif)