SUNTEXT REVIEWS

SunText Review of Economics & Business
ISSN: 2766-4775

Open Access
Research Article
Volume 3:3

The Rise of Microfinance in the Middle East

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Received date: 23 July 2022; **Accepted date:** 07 August 2022; **Published date:** 18 August 2022

Citation: Abu Karsh SM (2022). The Rise of Microfinance in the Middle East. SunText Rev Econ Bus 3(3): 166.

DOI: https://doi.org/10.51737/2766-4775.2022.066

Abstract

The present study explores the rise of microfinance in the Middle East. The study investigates more regarding microfinance institutions, economic development, and direct and indirect benefits linked with microfinance institutions. The research examines how states use microfinances are to reduce poverty and support solutions that improve reconciliations. Banking institutions often treat low-income individuals and SMEs harshly. They restrict financial help, as they fear losing money loaned due to lack reliable source of income to repay the loan debt or collateral. Consequently, microfinancing institutions exploits this by offering these individuals and SMES microcredit and microloans solutions. The present study employed secondary sources for data collection aligned with the research topic and specific objectives. . The selection criteria for the secondary sources include qualitative research papers investigating if Microfinancing exists and the potential opportunities for Middle Eastern countries where access to finance and capital markets are limited. The findings suggest that Microfinancing is present in the Middle East, but significant barriers exist restricting the industry's growth. Thus, the findings underline the need to remove these barriers for the microfinancing sector to reach the same levels as other global parts, particularly developed economies. Microfinancing institutions across the Middle East are predominantly not-for-profit due to their lack of incentives to transform into for-profit organisations.

Keywords: Microfinance; Microfinancing; Middle east; Banking institutions; Microfinance industry; low-income; Financial solutions

Introduction

Global banking institutions have always put profits first before people. They consistently refuse to finance individuals and business with limited access to financial resources. Banking institutions fear profit erosion from loan defaults rather than attempting to find workable finance solutions low-income persons and SMEs. Therefore, these individuals are forced to seek financial resources from family, friends, or shylocks, who extort them with high interest rates, making it impossible for them to afford the loans. Microfinancing is an attractive solution for individuals with limited access to financial support. The microfinance sector offers people the opportunity to self-sustain with income-producing activities by giving access to borrowing, savings, and insurance activities [1]. By offering these people the opportunity to gain self-sufficiency, they can obtain basic human needs, living standards, and personal improvement through increased enthusiasm, motivation, and passion. Empirical studies focusing on the rise of microfinance in the Middle East are limited, with huge literature gaps. The majority of existing studies on the same fail to critically analyse Microfinancing in the Middle East. For example, there is a research gap on the main reasons the poor cannot develop economically, including limited access to loans and formal banking systems. Their access to acceptable collateral, assets, and legal documents are limited. Besides, commercial banks' control and monitoring of loans are less profitable; thus, unattractive to most people. Therefore, more studies are needed better to understand the microfinance institutions across the Middle East and provide people with necessary insights on the most profitable funds accessible. Consequently, the present study investigates microfinance adoption in the Middle East. The paper explores the delivery methods microfinance institutions often adopt and identifies future opportunities within the microfinance sector and how these can be applied to benefit individuals.

Methodology

The present study was a systematic review including prior primary and secondary qualitative research. The studies used focussed on microfinancing as a solution to individuals and small businesses with limited access to finance. The dependent variable in this research paper is the survival of unemployed individuals on low incomes with limited access to finance from banking institutions. The independent variable is to examine if Microfinancing is the solution that will offer these people access to finance in the Middle East. To prove that there is truth in the independent variable, a review of previous peer journals, publications, and other trusted sources will be undertaken to see how the authors have witnessed the success and rise of Microfinancing, particularly in the Middle East and the research is supported by my views and recommendations. Secondary research is undertaken to examine the future opportunities for Microfinancing and how they can benefit individuals and small business across the Middle East. This study can benefit individuals, business, policymakers, and the academic community in exploiting these opportunities to improve their understanding on microfinancing. Besides, academics can use this study to get background information on future studies comparing banking and microfinance institutions.

Defining microfinance

Microfinancing give people with a low income or unemployed the opportunity to access small finance packages in the form of small business loans using existing ethical lending practices to become self-sufficient. The people can be individuals or groups who conduct business activities as small businesses. Microfinancing consists of credit offerings through loans, savings accounts, micro-insurance, and the ability to transfer money [2].

The simplicity of microfinancing

The size of the microloans being offered by institutions can range from as little as $100 up to a maximum amount of $25,000 [3]. However, the maximum limit will vary and be set by institutions worldwide. The micro financiers will charge interest rates on the loans and state the repayment plan. Some micro financiers will require the recipient to set aside part of their income into a separate bank account. Micro financiers can access this savings account if the recipient defaults on loan repayment. If the recipient repays the loan without bankruptcy, then the money in the savings account becomes the recipient's property. Microfinancing is not just about offering small business loans. Microfinancing institutions will typically include traditional bank accounts and provide educational activities that will teach the individuals about managing cash flow and bookkeeping. Still, there needs to be more financial products and services available.

History

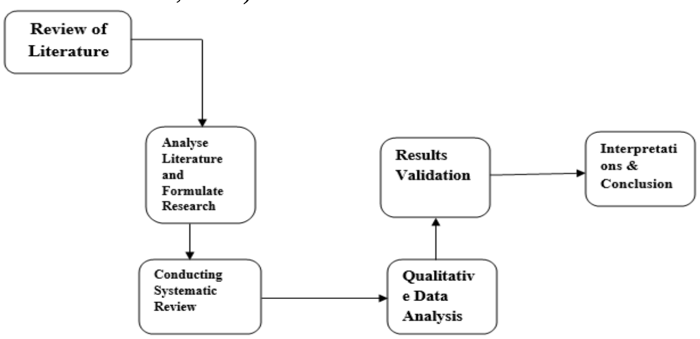
Microfinancing is not a new concept as it has been in existence since the early 18th century. History suggests that microfinance first occurred with the poor Irish citizens given direct access to micro lending through the Irish Loan Fund system to improve their basic living standards. During the 1970s, the popularity of microfinancing started to rise on a large scale with institutions such as the Grameen Bank and SKS Microfinance. SKS Microfinance was founded in India in 1998 to serve the large communities of people in India with little or no income. Its business model was simple. Rather than offering microfinance to individuals, it worked by pooling groups of five people together, which gave them the added benefit that the loan's chances were better. Due to its popularity, microfinancing has become an acceptable method for offering financing and banking activities worldwide.

Benefits of Microfinance

Microfinance is the prepared financing solution for those people who cannot access finance through traditional banks. Microfinancing provides these people with access to small business loans that will help them become self-sufficient and successful entrepreneurs. The benefits of microfinance extend beyond the direct effects of giving these people access to an alternative source of financing. People who have developed successful businesses contribute to economic growth in a small way by creating jobs, increasing trade, and taxation within their community and country. Unemployed or low-income people will usually be encouraged to deposit some income into a savings account. During uncertain economic times, these people can rely upon their savings to repay their loans and still enjoy a better quality of life. When economic times are good, these people can enjoy life and sustain a better lifestyle for their families and themselves. Access to microfinance benefits people living in harmony and removes the chance to use survival crisis tactics to access basic human needs. The survival crisis tactics can disrupt and harm communities, as evidenced in many African countries and some parts of the Middle East, such as Lebanon and Yemen. Social unrest exists because people demand democratic reforms and improvements in their basic living standards. Microfinancing institutes provide a growth platform in many economies by increasing their economies of scale (International Finance Corporation, 2018). The growth in economies of scale can lead to a significant improvement in three areas, namely (i) operational efficiency improvements, (ii) financial profitability improvement, and (iii) an increase in self-sustainability. Financial profitability improves as revenues increase and operating costs decrease for the microfinancing institutes, and as such, the institute can become more competitive in the marketplace. In countries with many microfinancing institutions, gaining a competitive advantage is critical.

Global Statistics

The World Bank's Global Findex is quoted as saying that there are 1.7 billion adults living without formal savings or credit across the world; these people are considered financially excluded (The World Bank, 2017). Microfinancing has been a pivotal service that has been made available by many global organisations. Consequently, the latest estimates provided by the World Bank that microfinancing activities have helped over 500 million people (The World Bank, 2017) improve their lifestyles [4]. The Consultative Group to Assist the Poor (CGAP) provides a widely different estimate of 120 million people who have gained the benefit of receiving microfinancing activities. Based upon these statistics, if they are proven accurate, a large part of the global population is still not being served and needs access to Microfinancing. In 2020, the size of the global microfinance market in terms of revenue was valued at US$178.84 billion (Allied Market Research, 2021). Allied Market Research predicts that this market to grow to US$496.90 by 2030. This growth represents a growth of 10.8% (CAGR). Figure 1 demonstrates the projected revenue growth in this industry by provider type (Allied Market Research, 2021).



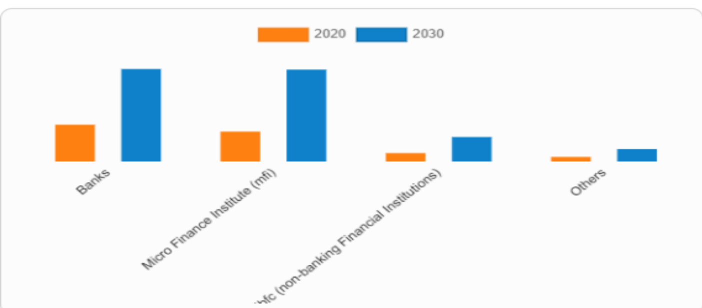


Figure 1: *Provider segmentation of the microfinance industry.*

Microfinance in the Middle East

History

Microfinancing solutions can be found in developing countries where most people fit into low or no income. Alattas and Tayachi point out that the Middle East is no exception to having unemployed or low-income people. These people have the land that contains natural resources, but they are limited with access to capital and limited mindset to help them exploit them. Microfinance steps in to help these people. There need to be more microfinancing companies in the Middle East to help these people. Many micro-financing institutions in the Middle East were unregulated. The International Finance Corporation states that in recent years, the transformations in the Middle East have involved transforming microcredit programs into registered microfinancing institutions (International Finance Corporation, 2018). The critical reasons for the high level of unregulated institutions include (i) the lack of a framework for legalities and regulations and (ii) the expected increase in the level of taxation because of regulating the industry. During the early stages of microfinancing institutions, employees had concerns about this transformation process. Their problems were twofold – (i) uncertainty about their future and (ii) their personal beliefs. Alattas and Tayachi show that Egypt was the leading country in the MENA region, with the most significant number of 14 microfinancing institutions as of 2016. These fourteen institutional providers served over 868,000 borrowers, with women accounting for 55.7% of the borrowers. Other statistics for the Egyptian economy that the authors revealed include:

- Gross loan portfolio of over US$165 million.
- The number of clients as a percentage of the number of poor people stood at 5.8%.

Based upon the research undertaken by Alattas and Tayachi, other Middle Eastern countries that had adopted Microfinancing as of 2016 included Jordan with seven microfinancing institutions and Yemen with 6 microfinancing institutions. The authors did not present statistics at this date for other larger Middle Eastern countries such as Bahrain, Saudi Arabia, United Arab Emirates, or Turkey. The statistics have not varied much since 2016. According to the Impact Finance Barometer 2021 report, the number of borrowers in the MENA was at 3% across the MENA region (Convergences, 2021). The report highlighted that the percentage of women borrowers was 59% compared to the global average of 81%. The portfolio yield was compared to other regions. The portfolio yield for MENA (18.7%) was lower than 22.3%, recorded for different areas.

Present situation

The microfinance industry has become well established in the Middle East and is expected to continue to grow in the future. The regulatory environment in most Middle Eastern countries has taken shape, which has been a critical factor in the industry's growth. The regulatory environment has set down the framework of rules, policies, and procedures that have been needed to remove the unscrupulous players. The regulatory environment has provided additional transparency and accountability amongst the micro-financial institutions. Many microfinancing businesses have changed from a not-for-profit status to for-profit companies due to the transformation across the industry and in each country in the Middle East (International Finance Corporation, 2018). Consequently, the increase in the number of for-profit companies has brought operational efficiencies across each country, plus improvements in the economies of scale. The improvement in the regulatory environment plus the growth in the number of institutions has enabled more financial products to be made available, plus rates that are more competitive and fees. The increase in the number of microfinance institutions has provided the opportunity to serve a more significant number of low-income people. For-profit microfinance institutions need to survive and survive sustainably for the long term. To serve low-income people, they are constantly in need of fresh capital. Before transforming to for-profit companies, the traditional form of funding for not-for-profit institutions was donor funding, but this is not a reliable funding source as this type of funding has become limited in recent years. Donor funding is not a sustainable form of funding. Similarly, not-for-profit institutions sought funding from other development finance institutions and commercial banks. These two types of financing approaches have limited the not-for-profit corporations' leverage capabilities as (i) the institutions had to rely upon donor funding to increase their equity and (ii) the limitations on the financial leverage ratios that were placed upon these corporations because of their legal status (International Finance Corporation, 2018). Development finance institutions and commercial banks often say that these not-for-profit organisations are too risky to lend or invest in due to the regulatory leverage limitations. Therefore, for these microfinance institutions to survive long term, they had to change their legal structure from not-for-profit to for-profit. The for-profit microfinance institutions received a better reputation than not-for-profit institutions. The for-profit microfinance institutions were able to survive longer as they could increase their financial leverage as they could raise new equity or other funding sources. The regulations in some countries across the Middle East prevent microfinance institutions from offering savings products (International Finance Corporation, 2018). Yemen and Syria are the only countries in the Middle East that allow microfinance banks and non-bank financial institutions to offer savings to low-income people. Consequently, transformation in the industry took place. In Yemen, the Al Kuraimi Islamic Microfinance Bank, previously a money exchange company, is now a microfinance bank. A similar transformation occurred in Syria, with the FMFI transforming from an NGO into a non-bank financial institution. (International Finance Corporation, 2018). The gender demographic across the Middle East is about two-thirds female who seeks assistance from microfinance institutions (Triodos Investment Management, 2018). The female gender manages a range of small size businesses. Their participation in small-scale enterprises provides a greater level of independence and improved status amongst the population, and they are favourably looked upon as economic contributors. Gender inequality still exists, with women more likely to be unemployed than men, so more women are applying for microfinance assistance. The MENA region has seen a broader impact on the political and socio-economic status with an influx of refugees due to the various civil unrests. It is reported that there are an estimated 1.5 million refugees situated in Lebanon. Lebanon's total population is 5.9 million. One in four people in Lebanon is a refugee, most of whom have arrived from Syria. A similar status of refugees can be found in Jordan. With a population of 9.9 million, Jordan is host to 1.4 million refugees, mainly from Syria. There is significant political pressure in these two countries to provide microfinance to the refugees. This political pressure arises because these refugees may not return to their home countries and decide to stay in these countries. On the other side, microfinance institutions do not wish to provide loans if they become exposed to the risk that these refugees return to their country and do not repay the loans. Research indicates that microfinancing in Palestine was needed to provide economic development and stability [5]. The authors' study examined the conceptual framework of how microfinancing institutions helped improve the direct and indirect economic development of Palestine.

Regulatory environment

Microfinancing has become an essential component of expanding access to financial products which traditionally would not be offered to the unemployed or low-income people. Microfinancing has not reached its full potential due to the regulatory environment in many Middle Eastern countries. The regulatory climate or non-existence of such an environment can be a significant barrier for microfinance institutions. Triodos states that countries with little or no regulatory environment need to develop a solid legal and regulatory framework (Triodos Investment Management, 2018). In addition to the substantial legal and regulatory framework, there is a need to provide specialised support services. A robust regulatory framework coupled with technical support services will assist in making the microfinancing industry stronger in countries with little or no regulatory environment. Middle Eastern countries of Jordan and Yemen are prime examples of the regulatory environment limiting the type of financial products that microfinance institutions can offer and restrictions on their credit offering to the public. These limitations vary between the countries. In the case of Jordan, the loan cap is linked to the microfinance institution's outstanding portfolio of equity. The loan cap is based on 0.2% of the total portfolio or equity (Triodos Investment Management, 2018). The loan cap is 0.1% of the institution's equity or outstanding portfolio in Yemen. These loan cap levels can be increased by increasing its portfolio of equity. This is not always the case in other countries. Tunisia, for example, has a loan cap of 20,000 Tunisian dinars. In Egypt, the loan cap is 100,000 Egyptian pounds.

The good intention of having a regulatory environment is supposed to provide extra security to microfinance institutions. Still, the limitations that are placed can hinder the promotion of these institutions and can be deemed to be undesirable intentions. Apart from the limits mentioned, some regulations limit the amount of lending that can be done as part of their normal business activities. This limitation is a barrier that prevents microfinance institutions from upscaling their business operations. The microfinance institutions could be serving a more significant market segment where the needs are far higher than the capped loan that the banks do not serve. The limitation on lending prevents low-income people from accessing finance for education, home improvements, or even purchasing their own homes (International Finance Corporation, 2018). Microfinance institutions can bolster their presence in the marketplace where regulations exist that allow these institutions to raise equity capital and add new financial services and products. These institutions have a more significant segment of the low-income population to be able to tap into. Deposit mobilisation and other financial services can be found in the regulatory environment of countries such as Yemen and Syria. Microfinance institutions in Jordan, Palestine, and Tunisia are restricted from allowing these institutions to provide credit. This limitation in Tunisia saw the rise of microfinance institutions that changed their business structure from a not-for-profit organisation to for-profit ones. The benefit arising from this transformation to a for-profit organisation allowed these institutions to increase the size of their loan cap. The loan cap on a for-profit institution was increased to 20,000 Tunisian dinars. The loan cap was substantially less for not-for-profit organizations at 5,000 Tunisian dinars. The regulatory environment did not provide any unique benefits in Egypt if microfinance institutions changed their business structure to for-profit organisations. The regulatory environment in Egypt provided many disincentives, such as increases in fees that made operational expenses more expensive. The increase in fees made some financial products not viable to offer to the public. The Egyptian regulatory environment provided higher income tax rates, thus creating a disincentive for microfinance institutions to transform into for-profit organisations. The legislation also prevented those not-for-profit organisations could not become shareholders in other companies. This legislation prevented not-for-profit organisations from expanding their business activities (International Finance Corporation, 2018). In Palestine, as of 2019, 8 microfinance institutions were operating under different business structures, such as non-profit organisations, donor programs, non-government businesses, and cooperatives. Similar to previous studies, women's empowerment was one of the main reasons for the growth in microfinancing. The authors stated that this new trend differed from many decades ago when women were not recognised for economic development. Consequently, microfinance institutions have made some significance in providing people with basic needs and improved employment opportunities [6-13].

Barriers to Microfinance Development across the Middle East

Barriers to the development of microfinance can be classified into two labels – (i) generic barriers and (ii) country-specific barriers.

The generic barriers listed below apply across the global industry for microfinance.

- As many developing countries are slowly accepting microfinance as a popular alternative solution for reaching the people in need, the most significant barrier is the absence of administrative and institutional support.
- This level of support not being available further leads to another barrier associated with the lack of savings and fiscal exchange, as the previous focus had been upon the supply of loans only.
- Restrictive regulations imposed by global finance sectors.
- Some providers are not registered under the required regulations; hence, these providers will lack the experience, industry knowledge, and skills.
- Interest rates are not necessarily regulated in some countries. Access to finance by microfinance providers can be costly, with interest rates imposed upon them by banking institutions. Microfinance providers have limited purchasing power.
- Microfinance institutes in most countries across the region need to use private equity to raise capital because they cannot collect savings, like traditional microfinance banks, to fund loans.

These barriers can be lifted or reduced to a low level to ensure a more level, unrestricted playing field. An even playing field with low barriers to entry will encourage more players to enter the marketplace and be able to provide microfinancing services.

Porter's Five Forces Model

Porter's five forces include three forces from 'horizontal' competition--the threat of substitute products or services, the threat of established rivals, the threat of new entrants--and two others from 'vertical' competition--the bargaining power of suppliers and the bargaining power of customers. Figure 2 illustrates how Porter's Five Forces Model works in the microfinancing industry.

Demographics of the Middle East

Population

The Middle East comprises 17 countries, and the estimated population as of 2022 is 463,298,595 (World Population Review, 2022). The Middle East is diverse, with many ethnic groups including Arabs, Pakistanis, Sikhs, Egyptians, Jews, Filipinos, Hindus, Greeks, and Sri Lankans. The population demographics vary between each of the countries in the region. The five most and least populated countries in the area are illustrated in Table 1 (World Population Review, 2022).

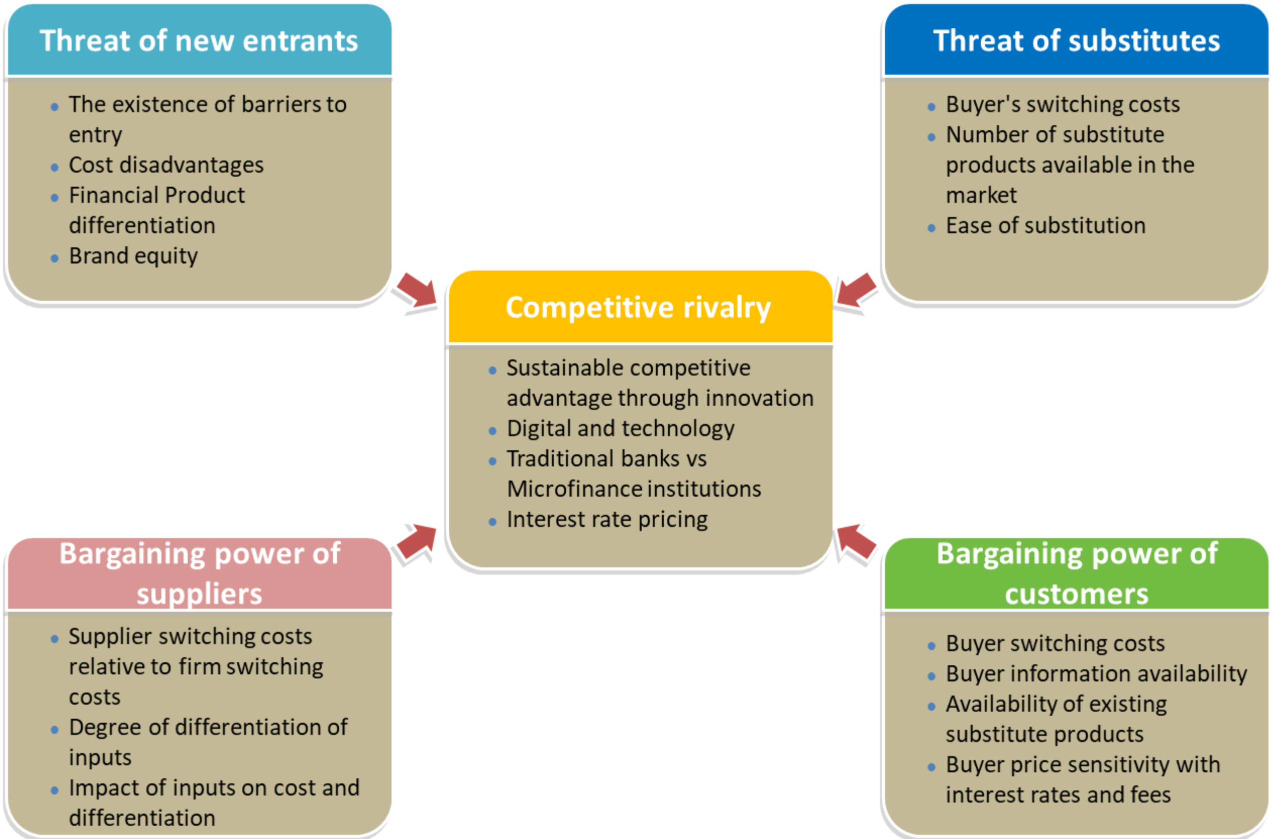


Figure 2: *Porter's Five Forces Model.*

Table 1: *Populated countries in the Middle East.*

Most Populated		Least Populated	
Country	Population	Country	Population
1. Egypt	106 million	6. Cyprus	1 million
2. Iran	86 million	7. Bahrain	2 million
3. Turkey	85 million	8. Qatar	2 million
4. Iraq	42 million	9. Kuwait	4 million
5. Saudi Arabia	35 million	10. Oman	5 million

Unemployment

Unemployment remains a concern across the MENA region. According to World Bank data, the total unemployment level across the region in 2020 was 10.5% as a percentage of the entire labour force (The World Bank, 2022). The unemployment % increase from the previous year was due to the impact of Covid-19 and the enforced lockdowns that took place in these countries. The growth of unemployment adds pressure to those people already living on low or no incomes. Delving deeper into this unemployment %, 26.94% of the total youth labour force aged 15 to 24 years were unemployed (The World Bank, 2022). Youth unemployment across the region was extremely high. The World Bank report that youth unemployment is at a staggering 30% which is one of the highest rates across the world (The World Bank, 2022). The youth unemployment rate is high due to their countries' weak economies. The, fragile economies are not strong enough to provide employment or pensions to the youth. Consequently, social unrest occurs. Enter microfinance institutions into these countries with weak economies. Typically, the barriers to entry are low due to the low or non-existing regulatory environments. Microfinance institutions have developed special training programs to help the youth become more knowledgeable. The institutions have designed special loan packages specifically for the child.

Market needs for microfinancing

Microfinance will always be an essential need because it provides resources and access to capital to the financially underserved, such as those who cannot get bank accounts, lines of credit, or loans from traditional banking institutions. Microfinance helps economically underserved people to invest in themselves and their businesses. One of the ways that individuals can support inclusive entrepreneurship is through microfinance. Microfinance institutions offer financial services, business development services, and small loans to those entrepreneurs who find it challenging to access finance. There may be many causes why low-income entrepreneurs cannot access finance. Perhaps, they may have a bad credit history, do not have the capital, or cannot provide the security needed to obtain a loan. The low-income entrepreneurs present too much risk to traditional banking institutions in the mainstream financial markets.

Future Opportunities

The financial inclusion of microfinance institutions in the Middle East is slight. It is reported that only 18% of the population has accounts with banking institutions. Most of these people are women (13/18 of the population). The problems have already been discussed above that outline why this % participation is low in this region. Microfinancing provides an excellent opportunity to be extended in this region and thus reach a greater targeted group. The regulatory environment needs to be introduced into those countries that do not have an environment or tightened further to provide extra security, transparency, and accountability. There needs to be more clarity and access to information, ensuring that the targeted group is aware of accessing microfinance services and products. Microfinance institutions can be motivated by introducing additional financial products such as payments, transfers, remittances, and savings accounts. The microfinance institutions can proceed further by introducing advanced technology such as POS, mobile banking, and ATMs, provided the backend of the infrastructure exists to support this technology. Offering such financial products and services can be a dominant driver in encouraging microfinance institutions to transform into for-profit organisations. The additional financial products and services can increase the client base by tapping into new markets, increasing revenue stream opportunities, improving customer loan repayments, and improving customer satisfaction. Individuals accessing these financial products and services can improve their lives and make financial independence sustainable. Alattas & Tayachi announced that a survey was recently conducted showing that the worldwide microfinance industry has the potential to grow at a rate of 16.61% (Compound Annual Growth Rate). One of the key drivers likely to influence this potential growth is the small and medium enterprises in the MENA region sitting in the untapped financial sector. Small and medium enterprises are the backbone of global economies. These enterprises are flexible, robust, enthusiastic, and can become a hub for innovation, technologies, and ideas. These small and medium enterprises must be allowed to thrive to boost economic development, particularly in weaker economies. Small and medium enterprises are job creators, particularly in the weaker economies. They provide financial growth and stability to the economy. The boost in economic development will grow gross domestic product and provide greater financial security. The growth in economic development will lead to an increase in socio-economic welfare, thus improving the lifestyles of everyone in a sustainable manner. Microfinancing platforms that will reach potential customers in outer regions and communities. Online financing will continue to witness significant growth in future years due to the increased usage of smartphones and internet users.

Conclusion

To summarise, the present study has explored the rise of microfinance in the Middle East. The paper's objective is to explore microfinance, specifically its existence and potential opportunities they offer for the Middle East countries that face limited access to finance and capital markets. The microfinance sector exists in the Middle East; however, its growth has been restricted in the past by the non-existence or lack of regulations existing in different countries coupled with access to the capital market. The paper incorporates secondary data sources, critically analysing past qualitative research studies to assess the existence of microfinancing corporations and the openings they create for Middle East countries. The present study findings indicate that microfinancing is present in the region; however, significant barriers exist that restrict the growth and expansion of the sector. These barriers should be eliminated and adopt new strategies commonly employed in other regions for the region's microfinancing industry to thrive. Research findings outline one of the main barriers as changes in the regulatory environment, including the significant transformation of not-for-profit organisations to for-profit organisations. Microfinance institutions offer more financial products, including savings accounts. The next important step that the microfinance institutions should take is introducing more technically advanced financial products such as POS, ATMs, online banking, and other solutions to low-income individuals and small businesses. Data collection for the present study was based on secondary data sources. One of its key strengths is providing adequate information and empirical findings from similar past studies. Besides, official statistics were valuable for comparisons as they dated back several decades. At the practical level, many public documents and official statistics regarding the rise of microfinance in the Middle East were freely available. Nonetheless, using secondary data sources presented several limitations; for example, some official statistics mirrored power biases, limiting the study's findings. Additionally, other restrictions include some documents lacking authenticity by missing some vital information. As earlier not, substantial literature gaps exist on the rise of microfinance in the Middle East. For example, future studies should explore promotion strategies of the microfinance industry in the Middle East and North Africa (MENA) region. Such studies should explore legal and practical guidance offered via microfinancing initiatives and how they encourage the regional exchange and experience in financial inclusion and microfinance, providing policymakers with a better comprehension of the industry, potential concerns, and solutions. Future studies should also focus on specific countries in the Middle East and compare the performance of various microfinance institutions in the region.

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