

Future Vision

Microfinance in Yemen



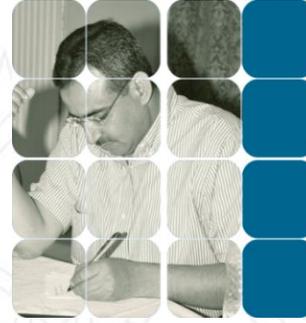
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Table of Contents

About the Author	03
Introduction	05
Banking Sector in Yemen	07
Social Safety Net in Yemen.....	12
Small and Micro Enterprises Sector.....	15
The Relation Between the Banking Sector and SMEs Enterprises Sector.....	17
Non-Financial Services for Small Enterprises'	18
Microfinance	20
Microfinance in Yemen.....	21
Strategic Requirements for Microfinance Industry Development	23
Sectors' Roles Towards Implementing the Vision	34
Conclusion	37

About the Author:



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Al-Lai is currently one of the local and regional consultants in the field of economic development, aimed at fighting poverty and unemployment, thanks to his effective contribution towards creating organizational and legislative frameworks and mechanisms, which contributed to the development of Small Enterprises sector in general and Microfinance in particular. He played an effective role in drafting the Small and Micro Enterprise Development Strategy and National Microfinance Strategy, and in issuing the Law of Microfinance Banks in 2009, which resulted in positive momentum in the Microfinance sector, represented by the establishment of Yemen Microfinance Network and foundation of many Microfinance banks in Yemen.

Mohammed al-Lai led the founding team of the first Microfinance bank in the Arab Region (Al-Amal Microfinance Bank), which started its business in early 2009. He participated in many financial and economic conferences and symposiums in Yemen and other world countries, and presented many working papers and gave different presentations on mechanisms of economic empowerment for the poor in general, and youth and women in particular. As part of its continuing contributions, he drafted this paper [vision] which attempted to highlight many issues of importance to the Banking sector in general and the Microfinance sector in particular. This paper aims to shift efforts of the government and the banking sector towards expanding and developing the Microfinance sector as one of the important mechanisms for improving the economic and social conditions of the community by focusing on the poor and limited-income people, particularly those living in rural areas. The paper suggested guaranteeing means and mechanisms on the legislative and economic levels.

Previous Posts Held by the Author:

- Deputy Governor for Banking Supervision Sector in the Central Bank of Yemen.
- Head of Small & Micro Enterprise Development Unit in SFD.

Current Posts:

- The Founding Executive Director of Al-Amal Microfinance Bank.
- Chairman of the Board of Directors of Yemen Microfinance Network.
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Introduction

Yemen is one of the poorest countries in the world, and its poverty and unemployment rates increase dramatically. In the meantime, the security and political events in the country since 2011 have played a great role in increasing such [poverty and unemployment] rates, which affects the government-run Social Safety Net (SSN) interventions. The impact of such interventions diminishes amid increasing factors, topped by the rapid population growth, high family dependency ratio, and poor outputs [less skilled graduates] in public and technical education, coupled with limited creativity, innovation and competition in the economic sector, all of which directly affect unemployment and poverty rates. Also, the country's security and economic problems undermined the government capacity to establish large projects that can create job opportunities and absorb larger numbers of the unemployed labor force.

The banking system of any world country really reflects the economic and social wellbeing in that country. The banking sector is strongly and closely correlated with the economic system, and as a result, they are affected by each other

Yemen's economic and cultural structure is one of the most intricate structures on the regional level. Yemen is the less developed state in the Middle East with a gross domestic product (GDP) of US\$650 per capita and a gross national income of US\$500 per capita, a 25.1 million-strong population, a [short] life expectancy of (59 years for men and 62 years for women). According to 2003 statistics, the country's illiteracy rate is 50%, which is very high. Moreover, Yemen is mostly a rural community and its population lives in scattered areas, which number up to more than 27,000. The national economy experiences an increasing unemployment rate, as only 5.8% of a total of 21.8 million people have jobs. National statistics estimated the unemployment rate in 2003 at 35%, which the country faces amid absence of the culture of small enterprises or self-employment, but spread of the culture of reliance on donations and aid.

Yemen's banking sector has characteristics that make it less effective in creating significant economic development in society. The most important one of its characteristics is that it is a family-centered sector, which, through the mobilization of community savings, serves existing family companies that are not able to diversify their activities and create more job opportunities, let alone that Yemen's banking sector has become an oriented sector since 1994; i.e. it is directed to cover the state's public budget deficit and bridge budget gaps in running expenditure, which make up 70% of its items. In addition, Yemen's banking sector lacks modernity and innovation in creating banking tools that ensure boosting the national economy, and gather and direct savings by a general vision, aside from individually-made decisions by owners of such savings, which is confirmed by the decrease in the percentage of people who deal with the banking sector to less than 6%.

On the contrary, the Social Safety Net and its different components suffers from many problems as a result of growing demand for its services versus its limited resources and horizons of investing its surplus funds. The increasing numbers of Social Welfare Fund (SWF) beneficiaries amid the government's limited capacity to create clear mechanisms for graduation from poverty have resulted in poor management of SWF money, and therefore such money doesn't fully go to the final beneficiary. Also, the consecutive governments' enthusiastic and unstudied reactions to any economic woes have flooded the SWF with significant numbers of controversial beneficiaries, raising questions about whether or not they are eligible for the stipends. Although we appreciate the role played by the SWF and how important it is, it should be the only pivotal role around which the government's policies revolve to alleviate poverty. From another perspective, Microfinance is considered one of the innovative tools to mitigate poverty and its impacts. Unlike other tools used to fight poverty, Microfinance is unique for its reliance on self-sustainability through refundable money. It is totally different from the other tools based on the notion that money is merely a form of grants and donations, but not refundable or repaid funds. Microfinance aims to build comprehensive local financial markets that meet the poor people's needs for financial services.

The Social Safety Net's current interventions in Yemen and the Arab Region have dealt with a poor person as being a beggar and not a destitute who may lack just training, qualification, financial culture and a source of finance in order to change from a grant seeker to a grant provider

Microfinance is important for creating new employment opportunities and conserving the existing ones, as well as reducing poverty rate in Yemen; therefore, the monetary policy reforms undertaken by the government should include necessary changes / amendments to ensure growth, sustainability and development of Microfinance in Yemen to cover those groups that don't benefit from the banking sector. On the other hand, the government should redesign the Social Safety Net's components so that they include Microfinance, given that Microfinance introduces advanced concepts for dealing with the poor, especially the productive ones. Consequently, incorporating Microfinance into the Social Safety Net would lead to diversifying and increasing the options for the poor in having access to the necessary funding for improving their living conditions.

Banking Sector in Yemen

Yemen's banking sector involves eight local commercial banks (running a network of 215 branches), four local Islamic banks (running a network of 63 branches) and another fourteen branches of foreign banks. Recently, other banks providing Microfinance services like Al-Amal Microfinance Bank (AMB) and Al-Kuraimi Bank have been established.

Table (1): The Structure of Yemen's Banking Sector.

Commercial	Yemeni Banks		Foreign Commercial Banks	Branches	
	Branches	Islamic			Branches
Yemen Bank for Reconstruction & Development	46	Shamil Bank of Yemen & Bahrain	16	Arab Bank	9
National Bank of Yemen	27	Sheba Islamic Bank	18	United Bank	3
Cooperative & Agricultural Credit Bank	80	Tadhamon Islamic Bank	23	Rafidain Bank	1
Housing Bank	1	Islamic Bank of Yemen for Finance & Investment	6	Qatar National Bank	1
International Bank of Yemen	21	Al-Amal Microfinance Bank	18		
Yemen Kuwait Bank	16	Al-Kuraimi Islamic Bank	78		
Yemen Commercial Bank	22				
Yemen Gulf Bank	2				
Total	215		159		14

According to the latest Central Bank of Yemen Report issued in May 2014, the volume of deposits in commercial banks in local currency totals one trillion, three hundred seventy nine billion and three hundred, seventy four million Riyals (YR 1, 379,374,000,000).

On the other hand, the volume of deposits in foreign currency totals eight hundred five billion and eight hundred seventy one million Riyals (YR 805, 871,000,000). All such savings go towards participation in treasury bills or funding other sectors. Also, the external public debt is worth seven billion, three hundred seventeen million, and eight thousand US dollars (US\$7,317,008,000). Notably, bank branches concentrate mostly in urban areas, particularly in the cities of Sana'a, Taiz, Aden, Hodeida and Ibb. It appears there is complete absence of banks in rural areas, except for some provincial capitals despite the fact that Yemen's rural population is much larger. This represents one of the great challenges to the banking sector.

Due to the limited spread of the banking sector in the third world countries, including Yemen, and its primary concentration in main cities, but very limited presence in rural areas where the number of small and micro enterprise owners [entrepreneurs] is larger and where the poverty rate is higher, this banking sector [in the third world countries], concentrates primarily on the rich groups in those communities, which are very limited. The sector's services rarely cover the middle class or poor groups of population, which contradicts the structure of the pyramid of businesses in those communities that mainly depend on small and micro enterprises that widely spread and diverse across rural and urban areas.

Having a look at the structure of Yemen's banking sector, it is noted there is a limitedness or absence of specialized banks in the different fields of agricultural, livestock, fishery, industrial and SME development, as well as in the development of exports. Yemen's banks concentrate on the commercial sector only, or to be fair on one part of the commercial sector which is imports; i.e. it doesn't cover exports as well. As a result, the role of those banks goes toward collecting foreign currency to cover importing appropriations, and this increases the demand and competition for the acquisition of hard currency, particularly the US dollar, of which price goes high in the local market due to its limited sources. Another

Yemen's banking sector is poor in the provision of financial services, and its financial centers are reliant on investments in government bonds, which, in some banks, account for 75% of their financial center. The remaining portions diversify into private sector investments through funding, loans and credits granted to different business sectors. Although this portion is a bit higher in Islamic Banks, it doesn't in all circumstances exceed 35% of the financial center of the best banks granting loans. Moreover, 21% of those loans and credits are in fact default loans.

factor is the limited capacity of the productive sectors to bring in this currency [USD] due to scarcity of investments and exports, depletion of the income from tourism and a drop in expatriate's remittances.

Amid the shift of banks for the safe investment of family and individual savings in buying government bonds, the policy of government demand for such bonds hinders some banks from investing the total portfolio of their clients' savings and capitals in such bonds. Although the treasury bills is an important tool of the financial policy to pay for state budget deficit, this policy, in our opinion and as viewed by many economic experts, is not the proper tool to cover the exacerbating deficit in the state's public budget because the public debt has exceeded US\$20 billion. Moreover, such budget deficit is the result of a rise in the government's running expenses and not in its capital and investment expenditure, which is why this amount [public debt] is expected to increase from one year to another. Consequently, safe investment in its entirety doesn't realize any form of development, but rather results in a rise in public spending, as well as a rise in the numbers of local currency (YR) banknotes issued, which exceeded in May 2014 the amount of YR 807 billion as a result of the rise in public debt and covering the state budget deficit from public savings and treasury bills. Although this tool / approach has some advantages, it involves many disadvantages and negatives. One of the most important negatives is the government's reliance on them [public savings and treasury bills] as the easiest tool to cover budget deficit, when compared with what economic and financial polices the government should follow to cover the deficit from less costly sources like boosting production of the different economic sectors, SME lending and promoting tourism and expatriate's remittances.

Despite all the financial needs endured by the different development sectors in Yemen, the country's banks appear to have strong liquidity positions, but scarce investment opportunities.

The portion invested by banks in the indebtedness of the different productive sectors, which doesn't exceed 30% of the volume of loans and credits of Yemen's banking sector, primarily concentrates on the commercial sector by funding 65% of the imports from those loans and credits. In the meantime, the loans granted to the sectors of industry and agriculture don't exceed 11% and 2.3% respectively (May 2014 figures). These percentages reflect the general characteristic of Yemen's banking sector as being a oriented sector, shifting towards covering the needs of imports and not needs the productivity-based economic development. Moreover, about 21% of the loans and credits granted by banks are bad debts and are difficult to collect. This percentage is high, compared to the counterpart percentage in other countries, which doesn't exceed 9% at the maximum. This high percentage has a very big and negative impact on the banks' credit policy and their capacity to diversify and engage in riskier economic sectors like agriculture and fisheries, as well as another negative impact on the reputation of the overall banking sector in Yemen among savers, whether individuals or companies.

The limitedness of banking services provided by the banking sector in Yemen completely contravenes the most important feature it is characterized by before banking sectors in developing countries, particularly as Yemen's banking sector is characterized by a strong

liquidity position. The individual and company savings in Yemen's banking sector have amounted up to US\$10 billion, but given its limited investment opportunities, this could represent money glut for the sector.

The money glut Yemeni banks suffer is not symptomatic of the capacity of those banks to bring in savings by diversifying their financial products. It is rather symptomatic of a lack of capacity to invest these monies and the limited availability of investment opportunities, which are restricted to treasury bills and funding imports. In our opinion, Yemeni banks will suffer liquidity excess in local currency in the case of diversifying the sources of funding the state budget deficit, and their not being reliant on treasury bills only, particularly if credit risks remain high. In this assessment, we take into consideration that such monies managed by Yemen's banking sector come from only 6% of the total population. In the meantime, the majority of Yemenis are still beyond the attention of the banking sector. Therefore, the government is in an urgent need to reduce credit risks, which the country's banking sector suffer, by reforming the judicature, promoting electronic commerce, building a credit bureau system that covers all financial service providers in the formal and informal sectors, diversifying investment opportunities by offering incentives to the banking sector to play a role in the process of production and exports, and concentrating on promising sectors that are more able to absorb the increasing numbers of labor force like industry, agriculture, and small and micro enterprises.

Rural population, youth, women and SME entrepreneurs are beyond the attention of Yemen's banking sector.

Yemen banking sector's contribution to funding SMEs in the country. Given that banks deal with less than 6% of the country's population, the most optimistic observers affirm that the number of SME entrepreneurs who deal with the banking sector doesn't 1% of the total population for many reasons, the most important of which are:

- The limited services provided by Yemen banking sector and their being un ware of the needs of SME entrepreneurs in terms of the amounts, profit and collaterals, and the timing of providing such services, coupled with the fact that this group [SME entrepreneurs] doesn't top the list of priority target groups for the banking sector.
- The overall banking sector, along with its services and requirements, serve the rich in all developed and developing societies, however different the percentage of target group may be from one country to another. Consequently, the percentages of target groups in poor communities, including our country, are much lower while women and youth remain beyond reach. Also, the presence of banks is limited to urban areas due to insufficient material resources to establish more branches and the high cost required to create a banking environment. Therefore, about 70% of Yemen population who live in rural areas doesn't have access to any banking services. If we generalized the percentage to women and youth, we would find that women, who constitute nearly 52% of the population, don't have access to financial

services, and that youth aged more than 18 years, who make up nearly 40% of the population, don't have access to any banking services. Such percentages magnify hitting the limit of financial destitution of funding necessary for the growth and reproduction of SMEs, given that SMEs make up more than 98% of Yemen business sector. However, SMEs sector doesn't have access to the necessary banking services for its growth and development in a manner making it able to absorb new labor force or retain its employed labor force.

Social Safety Net in Yemen

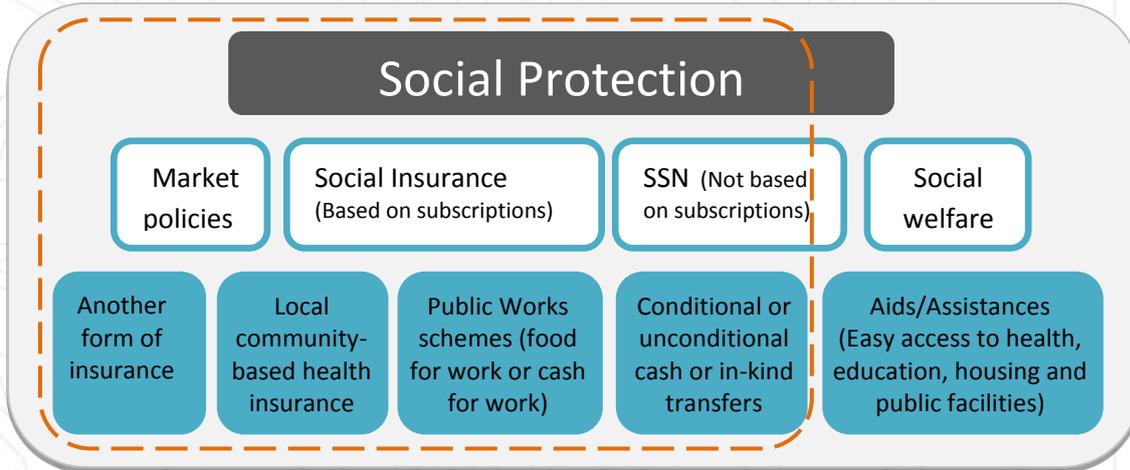
The Social Safety Net (SSN) is one of the pillars of social work with its various dimensions. The SSN concept is generally connected to economic crises and the transformations produced by economic reform programs that are symptomatic of the nature of traditional economic structures, which don't allow for adaptation to the new situations. These transformations have negative impacts on the poor groups and normally results in decreasing living conditions and increasing poverty rates, particularly as the applicable social welfare schemes aren't capable of protecting the poor themselves, let alone the new groups born to poverty. Therefore, the Yemeni Government established the SSN with the aim of reducing pressures on incomes, employment and living standards, and setting up targeted schemes to protect the poor groups through the following procedures and means:

- Schemes for direct cash assistance to poor households to bridge income gaps and attain minimum living standards (above poverty line).
- Schemes for direct (or in-kind) assistance in the form of basic commodities like food, housing, and power, and the provision of such services for lower prices than market rates.
- Schemes of lucrative enterprises, which aim to create employment opportunities for the poor and secure them direct income sources in lieu of encouraging them to receive direct cash assistance.

Having realized the impacts resulting from economic, financial and administrative reforms, the SNN was comprised of the following organizations:

- Social Welfare Fund
- Social Fund for Development
- Agricultural & Fishery Production Promotion Fund
- Public Works Project
- National Program on Family & Community Development
- Poverty Reduction & Employment Boost Program
- Insurance & Pension Scheme

Figure (1): Social Protection Framework



The SWF is the most important component of SSN in Yemen, which targets poor and destitute groups / households that have no breadwinners through quarterly cash assistance to reduce poverty among those groups.

The SWF oversees the delivery of quarterly cash assistance to the poor and needy households, of which the number of beneficiaries increased from 50,000 cases before 1996 to more than 1,500,000 cases by the end of 2012.

Table (2) Groups covered by SWF Assistance

Cases covered by temporary aid schemes	Cases covered by permanent assistance schemes
People with temporary severe disabilities	Orphans / parentless
People with temporary mild disabilities	Women without breadwinners
Households whose breadwinners are absent or missing	People with permanent severe disabilities
Households whose breadwinners are in prison	People with permanent mild disabilities
People who have come out of prison	Poor and vulnerable people

Notably, groups without income sources (widows, spinsters, divorced women, older persons) make up more than 70% of the overall cases covered, followed by groups affected by temporary loss of income (households whose breadwinners are temporary disabled or jailed) with roughly 17%. Other indigent groups with very low incomes don't exceed 8.5% of the overall cases covered.

The welfare status is the most prevalent in the SWF activity, and the number of SWF beneficiaries reaches 1,500,000 cases, making up nearly 22.6% of the population living below the miserable poverty line (WB-determined poverty line in Yemen), and only 9.6% of the population living below the absolute [extreme] poverty line. The size of continual cash assistance per person, at the minimum and maximum limits, is still low by all means. It is equivalent to less than US\$2 per person per month, which is much lower than the average international expense standard at the poverty level, set by the World Bank at US\$1 per day; i.e. US\$30 per month. This amount is also lower than some regional averages.

In addition, a WB report on Yemen poverty assessment confirmed that the SSN and the cash transfers scheme for SWF beneficiary cases cover only 50% of those living below the poverty level. The report also indicated varying poverty rates between rural and urban areas in the different areas of Yemen, and that the number of poor people is higher in rural areas where about 70% of the population lives.

The macro policies and national agenda for reforms haven't contributed largely towards reducing poverty rates although the Yemeni government incorporated Millennium Development Goals (MDGs) into the general framework of national plans, including poverty reduction by half by 2015. However, the next period still requires more efforts focusing on providing SSN components with many development plans that will contribute to improving living conditions and reducing poverty rates in rural and urban areas.

Having a look at the results reached, it is noted that poverty still represents a real challenge to the governmental and non-governmental development plans and programs. As a result, there is a need to reformulate many of the policies and procedures followed under the SSN, including the necessity of increasing social spending as part of the state budget, rationing subsidy and shifting it towards the poorest groups, and improving the social welfare scheme tools to ensure that the poor households benefit from cash transfers, build their capacities and make them more involved in production and self-reliance. In addition, it is important to build the capacity of SSN scheme to continue implementing a package of programs aimed at alleviating poverty and reducing unemployment by strengthening and developing its components in a manner realizing the SSN scheme objectives. With this in mind, SMEs prove important as a key component of the SSN scheme.

The government should pursue development policies that target the poor in a sustainable economic manner, which doesn't deal with a poor person as being a beggar in need for assistance, but rather as a person who is able to play an effective economic and social role whenever he/she gets funding and training opportunities that help him/her to develop himself, family and community.

Small and Micro Enterprises Sector (SMEs)

The SME sector is a significant part in the process of economic development for any country because it employs a large number of the labor force in different jobs. Also, the SMEs are, for the most part, very small businesses that involve one or two persons per enterprise. The SMEs are restricted to a limited number of sectors, particularly trade and services, like retail sales, telecom centers, restaurants, handicrafts, traditional



activities and others. It is noted that entrepreneurs in this sector are unwilling to engage in new sectors even if they have sufficient capital.

SMEs depend, to a great extent, on financial sources related to their owners (or their relatives) to start up, manage and expand their enterprises. In other cases, some SME entrepreneurs borrow interest-free loans for one or two years from relatives and/or friends or through the open credit from suppliers, which is confirmed by the SMEs Baseline Survey and WB Report on Economic Development. The survey found that 89% of SME entrepreneurs depend entirely on self-owned money, 8% of them got loans from family relatives or friends and 3% had access to credits from suppliers. On the other hand, the overwhelming majority of population depends on informal arrangements to get funding for their small enterprises. I.e. people keep their money savings or sometimes buy hard currencies or gold to protect their savings. They also depend on family relatives and friends to meet their funding needs, and sometimes on credit from suppliers if available.

There are many advantages of how SMEs contribute to economic development, including:

- SMEs are considered the main source for job creation in developed and developing economies as well.
- SMEs create a potential and actual source of competition for large businesses and minimize their capacity to control prices.
- This type of enterprises contributes to developing disadvantaged areas which suffer poor development, low income levels and high unemployment rates.
- SMEs are seeds for large businesses.

- SMEs are characterized by creating good business environment, given that both employer and employees work together on realizing common interests.
- SMEs serve as a fertile field to develop innovations and serious ideas.

Therefore, the need for regular and formal financial services has become more apparent and urgent than it was before, given that the majority of traditional banks are unwilling to deal with SMEs or prefer to invest their liquidity excess in treasury bonds.

The Relation between Banking Sector and SMEs

Although Yemen banking sector is young, it has continued to play a traditional role, and hasn't expanded to serve all community groups, including the economically active poor. Moreover, the specialized banks don't have a clear strategy to play a role in promoting SMEs in the sectors of agriculture, industry or housing.

Despite the SMEs' positive role towards creating employment opportunities for more than 1.5 million citizens, the formal sector doesn't pay necessary attention to SMEs given that such enterprises may help reduce enrage among the hungry population, who are dissatisfied with their living conditions and therefore may represent a real threat to Yemen's future if it collapses.

There is an urgent need for a government intervention to provide liquidity to Microfinance banks and institutions in order for their outreach not to remain limited to urban areas.

Like commercial banks, Microfinance banks still are concentrated in urban areas, but they have made progress in rural outreach, thanks to SFD encouraging efforts.

The financial services for SMEs are pondered upon as the most important needs for the development of these enterprises. The development of countries in this field is measured against the provision of financial services that are able to develop and sustain SMEs, and probably to change them into large businesses. All the experiences imply that many SMEs worldwide have transformed into large businesses, employing thousands of labor force.

On a SFD [Social Fund for Development] initiative, Yemen's Cabinet approved in 2005 the National Strategy on SME Development with a total budget of US\$130 million, but the strategy was not implemented due to lack of necessary funding as reported by the government. However, in our opinion, the strategy was not implemented because the government was unaware of how important it is for alleviating poverty and reducing unemployment rates. Evidently, the government didn't designate a specific ministry to supervise implementation of the strategy, let alone that the government didn't allocate necessary funding to implementation of the strategy, nor did it ,at least, promote the strategy among international donors, who considered it a SFD-drafted strategy because SFD hadn't engaged donors and relevant government entities in the drafting. Additionally, some international organizations criticized the strategy for primarily focusing on the agricultural sector, and ignoring other sectors, which is why GTZ [German Agency for Technical Corporation] launched the **second phase** of the National Strategy on SME Development in cooperation with the Ministry of Industry and Trade. In our opinion, if the strategy isn't shared with the different stakeholders in the sector, if a supreme national committee wasn't established to supervise the strategy implementation and if necessary funding wasn't allocated to it, it will face the same fate of the first draft. [it will not be executed].

Non-Financial Services for SMEs Sector

The Yemeni Government is currently in an urgent need for diversifying training packages and SME training providers given that the training process hasn't yet met the needs of SME entrepreneurs. The training offered by local institutions is routine and traditional, lacks creativity and innovation and is mostly theoretical, and its practical part lacks modern technical resources to make it contemporary. Consequently, there is a huge gap between local training outputs and market needs.

The government and donor community should exert joint efforts to diversify, assess and modify SME training packages. I.e. the training, in general, and its vocational part, in particular, should be based on the needs of the labor market and the different governmental and privatized sectors through the following:

- Conducting surveys and field studies that accurately reflect labor market needs, and sharing their results with all relevant stakeholders (training centers, universities, vocational institutions in the government and private sectors] to ensure a positive response from all these groups by developing training curricula and outsourcing specialized local and international experts to provide effective SME training programs.
- Activating the role of Skills Development Fund and shifting its support, allocated to youth and unemployment reduction, towards specialized vocational training, which would feed the labor market with skilled and efficient staff.
- Developing and updating technical and vocational training programs in the government-run educational institutions in a manner matching labor market needs, given that these institutions are more able to accommodate learners in different specializations and can be developed through government subsidy.



The provision of non-financial services is concomitant with the provision of financial services. In many countries, non-financial services are provided as part of a national strategy on SME development. Being as important as the provision of necessary funding for SME development, non-financial services play the most important role towards preparing SMEs to receive financial support, play a significant role towards SME development and make them [SMEs] more able to absorb more funds. Also, the non-financial services play the most important role towards sustaining SMEs, transforming them into large businesses and incorporating them into the banking sector.

- Creating effective mechanisms for the control and oversight of the quality of training outputs [graduates] in the government and privatized sectors, which should incorporate training criteria, monitoring and evaluation, accountability and support for those training groups.

Despite the importance of the above-said suggestions, if the training outputs are not enhanced with appropriate empowerment mechanisms to accommodate those outputs [graduates] and make use of them, they will go awry, maybe due to the following:

- The limited capacity of the labor market to employ the large numbers of graduates every year.
- The poor financial capacity of youth and graduates to initiate their own enterprises.
- The generally deteriorating economic conditions, which restrict the capacity of the private and SME sectors to accommodate new laborers, let alone they reduce the employed labor force from time to time.

Microfinance

The Microfinance sector began to provide microloans to the poor, but economically active households, with the aim of assisting these households to start up productive activities or develop their own small enterprises. Later on, the sector expanded over time to include more services (lending, savings, insurance...etc) due to the poor groups' needs for diverse financial services after it had been difficult for them to benefit from existing formal financial institutions.



Microfinance clients are normally limited-income people who cannot have access to formal financial institutions. They are usually owners of micro enterprises, who often run their own economic activities at home. In rural areas, Microfinance clients are normally small farmers or individuals who run lucrative modest enterprises like producing home-made food items or other stuff.

In cities, Microfinance activities diversely fall into shopkeepers, service providers, craftsmen, street vendors and others. Therefore, their access to formal financial institutions is directly related how much the individual income is. The poorer a person is, the fewer prospects he or she has for access to these formal institutions. On the other hand, the poorer a person is, the more costly the informal financial transactions are, and at the same time mayn't help meet the poor groups' financial needs. Consequently, the poor quit these formal institutions to become Microfinance clients.

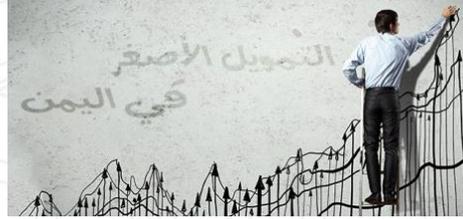
Amid increasing and diversifying Microfinance services to include savings and insurance besides lending, and growing Microfinance market, the number of clients who apply for savings, insurance and money transfer services in some communities is higher than the number of those who apply for microloans. E.g. a poor peasant may not be willing to apply for a microloan. He would prefer to find a safer way to save his money and yield in the farming season rather than consume all the money to satisfy living requirements by the day.

Microfinance in Yemen

Like most of the other Arab countries, Microfinance industry in Yemen started through the work of non-governmental organizations, which remain for a considerable time dominant over the sector. SFD played an important role in Yemen Microfinance by establishing many institutions and programs concerned with Microfinance industry in Yemen. In addition, Yemen Microfinance Network (YMN) was established with the aim of providing technical assistance and capacity building training to all MFI staff, and creating a center for exchange of information, expertise, technologies and promotional practices related to the industry.

At the end of May 2014, there were 12 MFIs providing services to more than 112,000 active borrowers and more than 400,000 savers with an active loan portfolio worth YR12,085,000. While the growth rate was relatively high, the sector's contribution, pursuant to absolute requirements, still is quite limited given that Yemen makes up only 2% of the total active borrowers in the Arab Region, and only 1% of the total active loan portfolio.

Yemen Microfinance industry still faces numerous challenges hindering expansion and outreach of the industry in a country suffering high poverty rates, which are thought to be the most important motive for outreach and expansion of MFIs' and programs' activities. This is attributable to lack of awareness about the importance of this industry for economic and social development. As result, target groups lacked adequate awareness about the culture of repayment and Microfinance policies, let alone the religious beliefs and how clients view the charges paid for the services rendered. Although the services respect for the most part the teachings of Islam, some people look unconvinced. The spread of illiteracy and insufficient legislation for MFIs are other challenges facing Microfinance Industry in Yemen. The studies confirmed that Yemen Microfinance industry still faces many difficulties in the area of institutional building due to recency of the experience. They explained that the Microfinance sector is capable of assisting the poor and needy to improve their incomes and develop their own enterprises, which would consequently minimize external shocks' impacts on them.



The Microfinance sector witnessed significant expansion and development on the level of services and targeted outreach. The sector grew by more than 200% in the number of active borrowers, and other financial services like saving, money transfer and insurance were introduced. In addition, two Microfinance banks, YMN and SME Development Agency were established.

The government's general program stressed the necessity of paying continuous attention to the poor, needy and limited-income people, supporting them and improving their living conditions. In this regard, the platform focused on the importance of expanding micro and small finance programs, establishing Microfinance banks, and encouraging banks to lend micro investors, as well as developing and improving business services offered to SMEs. However, it hasn't provided necessary strategies for the development and growth of the sector.

Amid increasing awareness about the importance of Microfinance for alleviating poverty, policymakers' attention to the industry, the possibility of donors supporting the industry through innovative initiatives (like establishing new MFIs, building NGOs capacities, promoting the outreach of banks), the Microfinance sector is currently in a more appropriate position than any time before to be pushed to move forward and develop its capacity to deliver financial services to a growing segment of SME entrepreneurs or the so called "the economically active poor" or the "the group on the brink of poverty line".

Strategic Requirements for Microfinance Industry Development

Microfinance industry in Yemen is currently in a more urgent need to be officially recognized by the Government of Yemen like other third world countries do in terms of paying special attention to the industry for being important to reach large community segments that banking sector cannot reach. Countries in East Asia, Central Europe, Africa and Latin America are examples of territories where the industry is officially recognized and supported.



In Yemen, the government official recognition of the industry should proceed according to a national strategy that guarantees re-organization and sustainability of the industry, determination of its priorities and diversification of its approaches. This process has been already applied by many countries in the above-said regions, primarily Bangladesh, India, Peru and Kosovo, and as a result, the Microfinance industry in those countries has become one of the key pillars of national economy, as well as an important and effective SSN tool. The topics of Microfinance national strategies in those countries include transforming the role of the governments from merely observers and director to facilitators and supporters for the process of establishment and outreach, as well as guarantor for sustainability and maximum community outreach of the industry. Below are some of the roles that should be played towards promoting the Microfinance industry:

Reviewing legislations related to Microfinance, primarily the Microfinance Law No. 15 of 2009 in order to promote the outreach of Microfinance banks and institutions offering Microfinance services. These amendments are essential and based on the experiences of many countries where the Microfinance industry is more developed. Below is a matrix of proposed amendments:

Table (3): Draft Amendments to Law No. 15 of 2009 Concerning Microfinance Banks

No.	Original Article	Proposed Amendment	Justifications
1	Article (6): Yemenis and non-Yemenis may establish Microfinance banks or have shares in them following approval of the Central Bank.	Yemenis and non-Yemenis may establish Microfinance banks or have shares in them following approval of the Central Bank, on condition that no single shareholder shall have 100% of the capitals of such banks.	The microfinance business involves two dimensions, one is social and the other is investment, but both dimensions rarely exist in a single investor, and the risk becomes high when a single investor controls a MFI in terms of collecting individuals' savings and how they are directed.
2	Article (7): Excluding activities contained in Islamic Banks Law, Microfinance banks are not entitled to undertake the following banking operations: <ul style="list-style-type: none"> - Receive cash deposits payable upon request through issuance of cheques. - Open letters of credit or receive bills of lading. - Operate as an agent to expand credit services. - Accept deposits and businesses relating to wills. - Possess shares in projects. 	Excluding activities contained in Islamic Banks Law, Microfinance banks are not entitled to undertake the following banking operations: <ul style="list-style-type: none"> - Open letters of credit or receive bills of lading. - Accept deposits and businesses relating to wills. 	Deleting the clause "Receive cash deposits payable upon request through issuance of cheques" for the following reasons: <ul style="list-style-type: none"> - Savings are globally considered the optimum source to fund Microfinance activities. They are also pondered upon as the most effective tool for increasing the MFIs' loan portfolio and targeting larger segments of society. - Deleting this clause would help small depositors and small capitalists to deal with MFIs and transact their accounts by cheques. Consequently, this would ensure a

sustainable funding source for MFIs.

- Consolidating the global concept by funding the poor from savings of the poor. Consequently, this would effectively contribute towards rotating savings between individuals and creating economic momentum.
- MFIs are subjected to all oversight procedures related to savers' money, and they are the same procedures displayed with senior depositors' savings from the legal reserve rate and disclosure reports...etc.
- The law allows for attracting savings, but doesn't allow for encouraging the growth and rotation of such savings via the issuance of cheques.
- MFIs and banks are subject to deposit insurance corporations, and given that they benefit most, there is no need for retaining this clause.

Deleting the clause “

Operate as an agent to expand credit services” for the following reasons:

- The Law doesn't consider Yemen's rural environment where MFIs operate, which is characterized by population dispersion, and this is why it is impossible for MFIs to establish effective presence, except through agents.
- The Law allows for inclusive financial services. Consequently, delivering such services requires acting as an agent for many international companies (Money Cram, Western Union...etc).

Deleting the Clause

"Possess shares in projects" for the following reasons:

- MFIs should rather expand their outreach and get involved in multiple and diverse projects, assisting and accompanying their activities, like founding micro-insurance companies and other institutions offering non-financial services.
- Reducing MFIs' capacities to maximize their interests, primarily used in expanding

3 **Article (8):** The paid-in capital of any Microfinance bank may not be less than (YR500,000,000) Five Hundred Million Riyals, and the Central Bank is entitled to increase this sum from time to time when required.

The paid-in capital of any Microfinance bank may not be less than 50% of the capital of an ordinary bank, and the Central Bank is entitled to increase this sum from time to time when required.

their outreach, which would not be realized if the integration of financial and non-financial services to limited-income people is ignored.

- Reducing the facilitating risks in the regulatory environment, as any decrease in the paid-in capital would encourage the transformation of financial companies interested in collecting savings into banks with full freedom to invest these savings.
- The low bank capital, provided for by the current law, is not enough to create a credit portfolio that would contribute towards reducing unemployment and poverty rates, as well as covering the high microfinance cost, particularly in the first years of operation.
- Such a low capital, amid the MFIs' dependence on loans and local and international funding, would make the obligations to equity participation ratio high,

4 **Article (10):** No Microfinance bank is entitled to grant a loan or credit facility or a financial guarantee to anyone of its shareholders, managers or staff, including members of its board of directors or their relatives up to fourth degree, or any legal entities having any form of interest or involvement therein.

Amendment to Article (10): No Microfinance bank is entitled to grant a loan or credit facility or a financial guarantee to anyone of its shareholders, managers or staff, including members of its board of directors or their relatives up to second degree, or any legal entities having any form of interest or involvement therein.

particularly as such ratio is important and serves as a guide for many international corporations and organizations investing in Microfinance.

- It is considered one of the most important challenges facing MFIs when expanding their outreach to rural areas and affected settlements, given that MFIs depend in financial service delivery on field staff, who should be selected from within local communities, as recommended by all international experiences.

1. Reviewing the NGOs Law in that it allows for establishing more MFIs. The proposal should include all the following amendments:
 - Determining the necessary capital for the establishment of MFIs, and guaranteeing capital raising from time to time pursuant to operations undertaken by these MFIs.
 - Identifying the objectives and purposes of those MFIs and ensuring monitoring and evaluating of their performance in a manner attaining those objectives and purposes.
 - Determining the necessary funding sources for the development and outreach of MFIs.
 - Identifying target groups and offering necessary incentives to those MFIs to reach inaccessible community groups that still remain beyond the reach of financial services provided by other banking institutions.
 - Designating competent oversight entities / organizations to monitor and evaluate MFIs, which is necessary to correct MFI's course of business, according to internationally recognized Microfinance oversight standards.

2. Represented by CBY and as part of its efforts to reform the country's monetary policy, the government should attempt to shift individual and company savings towards targeting the poorest productive community segment, primarily the one involved in the SME sector, which is considered the largest segment capable of producing and absorbing unemployed labor force. The following amendments could be introduced to the monetary policy after the manner of many world countries that adopt monetary policy focused on developing productive sectors. The proposed amendments include:
 - Obliging Yemen's banking sector to allocate a portion (supposedly 10% of its assets) to SME funding. This portion would ensure allocating nearly US\$1.3 billion as funds made available by banks for SME development. Banks could disburse those funds as follows:
 - Increasing lending to MFIs and banks in the form of whole loans that MFIs and banks can relend in a retailed way to SME entrepreneurs, which would consequently secure a sustainable funding source for those banks and institutions to fund their outreach plans and target large segments of SME entrepreneurs in rural and urban areas.
 - Yemeni banks should establish subsidiary companies or MFIs that ensure targeting SMEs, aside from the normal banking business. This approach is applied in many world countries including Jordan and Egypt.
 - Yemeni banks should directly lend SME entrepreneurs. This process, however, requires investment and credit decision-makers in those banks to have basic knowledge and information about how to differentiate between large loan and small loan granting requirements, as well as the target group for each type of loans.
 - Partially cutting the legal reserve from which the banks make no profit, and obliging banks to re-lending the resultant amount to MFIs with a lower interest rate in order to represent one of the MFI's sources of funding, which would bring profit to MFIs and lending banks as well.
4. The banks should adopt an incentive scheme in order to help expand the outreach of their direct and indirect lending to SME sector. The incentives may include exemptions or reduced rates of reserve on **savings** against funding and loans shifted towards SME development, and review the policy of MFI appropriations. Additionally, the CBY should accept any effort to expand the base of guarantees to cover different types, which haven't been recognized like women group guarantee, rural group guarantee and commercial guarantee because these types of guarantees are affordable for the average MF client. The Microfinance sector has proved strongly effective in retaining high repayment rates on the international level.

The incentive scheme, which should be adopted by banks in the Microfinance sector, should exempt individual and company savings from the legal reserve percentage [portion] on their savings, which stay within the limits of the amount determined as a maximum ceiling for Deposit Guarantee Facility because those amounts are 100% guaranteed and on which an insurance charge would have been paid to the Guarantee Facility. In the event of worst possibilities, those amounts are under the law refundable by the Guarantee Facility and not by the respective bank. Exempting junior depositors from the legal reserve would contribute largely to encouraging banks to create means for the mobilization of small savings from individuals and companies. It would also reduce the cost of collecting such savings and provide new liquidity to address the most important problem facing the Microfinance sector, which is liquidity shortage. In addition to that this procedure agrees with the global principles for creating savings culture in poor communities, inculcating such savings culture in production and taking necessary funding for running their SMEs.

In addition, the proposed incentive scheme should establish linkage between the targeted interventions for reducing poverty rates implemented by the government through the SNN scheme and those implemented by international organizations in the banking sector. This procedure would be positively reflected in the quality of services provided to the poor, as well as in promoting the banking culture among the poor and targeting the poor like the rich. The procedure would also assist banks in reaching the most disadvantaged areas, providing necessary cash liquidity and reducing the administrative costs that primarily restrict banks' outreach in remote areas, coupled with the profits the banks can make from providing such services. Among these interventions is conditional cash transfers paid to the poor and the accreditation of banks as a priority tool for disbursing SWF and SSN allocations to beneficiaries.

5. Establishing a National Loan Guarantee Facility since guarantees represent the biggest obstacle to the Microfinance industry, and therefore restrict its reach to poor groups, primarily youth and women in rural areas. Consequently, the existence of a national facility grants required loans to disburse loans to those segments would contribute towards expansion of the Microfinance industry, mitigate related credit risks and reduce losses incurred by the industry as result of default loans, which is a result of the lack of credit culture among those [clients] who deal with MFIs and programs.

Microfinance industry in Yemen is recent and doesn't suffer only from clients who are incapable of providing appropriate guarantees, but also it is itself incapable of providing necessary funding to develop MF banks' loan portfolios because the banking sector is reluctant to fund MFIs and programs. Given local banks' faith in cash guarantees as a basic requirement for lending in lieu of the historic and credit

records of companies, which is adopted in more developed MF industries, we suggest that the scope of guarantees provided by Loan Guarantee Facilities include guarantees to banks to finance MFI institutions and programs against a charge paid by MFIs to the Deposit Guarantee Facility.

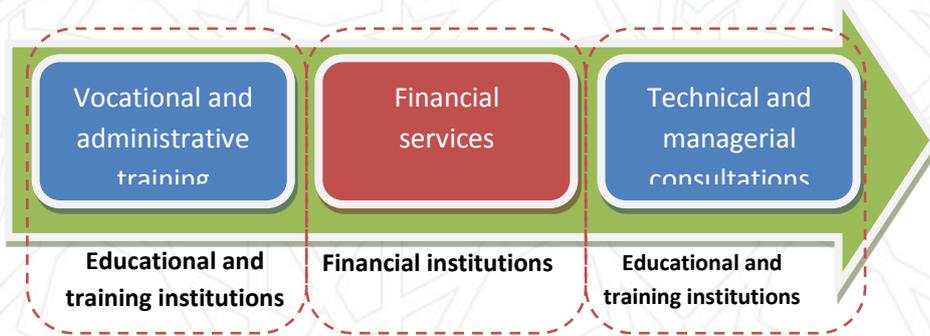
6. The Yemeni Government is currently urged to reconsider SSN components and incorporate MF and SME development as a main SSN component, particularly amid the increasing pressure / burden on SWF as a result of an increasing number of SWF beneficiaries. In the meantime, pension funds are limited to people who have attained the legal retirement age, coupled with the low amounts of money granted by SWF or pension funds, which is why the suggestion is of crucial significance. Besides, the temporary interventions undertaken by conditional cash transfer schemes are not sustainable, nor do they meet the needs of the poor. With this in mind, the government should definitely believe in the productive capacity of a poor Yemeni citizen and in assisting him/her to graduate from the poverty circle. Although the current SSN components somewhat contribute towards bridging the needs of poor households, they are at the same time incapable of meeting the growing needs of the poor due to the country's rapid population growth and high family dependency ratios. Therefore, paying attention to the Small and Micro Sector and redirecting the wasted energies of the poor towards production represent an exemplary solution to absorb the large number of [unemployed] labor force and generate decent incomes for all productive people in target households.
7. *Modifying the SSN framework to incorporate SME development.* This should primary concentrate on creating a good environment for SME development and outreach and bringing a sustainable funding source for productive persons. In this area, the SSN framework review should incorporate the following:
 - Adopting the concept of graduation [shift] from temporary aid packages to permanent funding for the establishment of small enterprises. Such "graduation concept" should be based on two main parts: training and qualifying SWF and CCT beneficiaries, who are able to work; and funding their own enterprises. Beneficiaries of both groups could be granted an initial capital, equivalent to the mount of the donation/stipend given to a beneficiary for a specific period of time, to initiate their enterprises. Afterwards, a beneficiary can be enrolled in training programs enough to earn him/her basic knowledge about starting up small enterprises, help him/her graduate and link him/her with MF banks, which would provide permanent funding to his/her enterprise. Here, the government should offer a package of incentives to graduates from SWF/CCT assistance, including exemption from taxes and administrative charges imposed on small enterprises, like it does for senior investors/businessmen. Also, the package should incorporate incentives to MF banks, including the provision of necessary funding for their development and sustainability of their services.

Such incentives could be higher when hard-to-reach groups are targeted like the case of rural finance and youth and women loans.

- The government should believe that the programs of graduation from donation and assistance schemes have become urgent and essential to meet the growing demand for such donations/assistance. Therefore, it should understand that Microfinance is the next step in the process of supporting the poor and directing them towards the market and self-reliance. As the social welfare and donation institutions get the necessary support and funding to finance their operations, MFIs and Banks should receive the same level of attention. Thus, the government should allocate necessary funds to MFI lending with reasonable interest rates that allow for marginal profit required to cover MFI [administrative] costs and ensure their sustainability. Also, the government should, in partnership with the international donor community, provide necessary technical assistance for building MFIs' technical and management capacities.
 - The currently applicable retirement scheme, though important it is, ignores a large segment of society which is the group of workers in the government-privatized sector. The aspect of inattention here lies in the fact that a pension lacks the purchasing power that could cope with the changing waves of inflation the national economy suffers. As a result, pensioners are vulnerable to descending to the poverty line due to their old ages, poor health conditions and increasing pressures on their pensions, let alone the waste of knowledge gained by those individuals in the pension scheme, as their skills and expertise are not employed to increase production rates in the country. Consequently, a pensioner is either waiting death or poverty. So, the government should direct and make use of such energies by encouraging their shift for SMEs and provide necessary support for this move for being essential for creating job opportunities for them and other job seekers. In this regard, MFIs represent an essential station those pensioners should go through to fund their small enterprises through financial products designed for them and under the guarantees of their pensions.
8. Bringing clear mechanisms for linking between financial and non-financial services to establish effective integration, which is essential to make use of education and training outputs [graduates] in creating new job opportunities, and promote the concept of self-employment among youth. This could be realized through the following:
- The financial institutions should develop financial programs and products targeting young graduates to provide them with the necessary capitals to start up their own enterprises and creating new job opportunities, according to simplified requirements and procedures.

- Joint coordination mechanisms should be established in a manner guaranteeing an exchange of outputs [graduates] between financial and nonfinancial institutions to ensure that graduates have access to integrated services from training, funding to consultations.

Figure (2): Exchange of outputs/graduates between educational and financial institutions



- Establishing a government-run entrepreneurship support fund, which should be concerned with increasing entrepreneurs' prospects for access to financial and nonfinancial services? Such fund should serve as an effective liaison between financial institutions, training institutions and entrepreneurs.

In addition, the SME Sector is in need for an integrated matrix of other nonfinancial services, which would contribute towards expansion and development of the sector to increase its prospects for accommodating the financial services provided, including but not limited to the following:

- Facilitating the procedures of granting permits and licenses to SMEs.
- Offering tax exemptions to SME entrepreneurs and creating a good environment for their enterprises.
- Extending specialized advisory services in the field of finance and business, particularly start-up enterprises.
- Paying attention to marketing aspect and supporting it for the purpose of developing SMEs.
- Developing and designing awareness-raising programs in all the media to promote the culture of self-employment and introducing success stories to establish these concepts.

Sectors' Roles Towards Implementing the Vision

Table (4): Details of the implementation strategy and roles of relevant entities.

Entity	Expected Role
<p>Central Bank of Yemen</p>	<ul style="list-style-type: none"> - Adopting monetary policies that ensure continuity and development of Microfinance as an important economic tool in facing poverty and unemployment. - Pursuing economic and financial policies that are capable of covering budget deficit from uncouthly sources like boosting production of the different economic sectors, SME lending, and promoting tourism and expat remittances. - Reduce credit risks, which the country's banking sector suffer, by reforming and updating the judicature, promoting electronic commerce, and building a credit bureau system that covers all financial service providers. - Reviewing/updating the legislations that ensure promoting the outreach of MF banks and institutions, and expanding their services in rural areas. - Developing an incentive scheme for MF banks. - Partially cutting the legal reserve from which the banks make no profit, and obliging banks to re-lend the resultant amount to MFIs with a lower interest rate in order to represent one of the MFI's source of funding, which would bring profit to MFIs and lending banks as well. - Establishing specialized banks in the different fields of agricultural, livestock, fishery, industrial and SME development, as well as in the development of exports

Banking Sector

- Promoting modernity and innovation in creating banking tools that ensure boosting the national economy, and gather and direct savings by a general vision, aside from individually-made decisions.
- Allocating a portion of the sector's assets to SME funding, either through direct loans or via intermediary organizations like MFIs.
- Developing financial products targeting poverty-hit communities or poorest groups in rural areas.

Non-Financial Institutions / relevant ministries and other governmental and private entities

- Modifying the SSN structure in terms of:
 - Incorporating MF and SME development as a main SSN component, considering it the next step for aid and donation schemes targeting the poor.
 - Adopting the concept of graduation from temporary aid packages to permanent funding for establishing small enterprises.
 - Steering and making use of pensioners' energies by encouraging their shift for SMEs, and providing necessary support for them.
- Reviewing the NGOs Law in that it allows for establishing more MFIs and put appropriate tools of oversight on their performance.
- Conducting surveys and field studies that accurately reflect labor market needs, and sharing their results with all stakeholders concerned with responding thereto.
- Developing and updating technical and vocational training programs in the government-run educational institutions in a manner matching labor market needs.
- Shifting the Skill Development Fund subsidy, allocated to youth and unemployment reduction, towards specialized, qualitative and unique vocational training.
- Developing an incentive package for small entrepreneurs such as exemption from taxes, custom duties and charges imposed on SME establishment.

- Developing advisory services for the SME sector and rendering them in a professional manner.
- Creating effective mechanisms for the control and oversight of the quality of training outputs [graduates]- especially vocational training outputs - in the government and privatized sectors.
- Diversifying training packages and SME training providers.
- Establishing a government-run entrepreneurship support fund that should be concerned with increasing entrepreneurs' prospects for access to financial and nonfinancial services.

Conclusion

Yemen is one of the first countries on the Arab and regional levels to recognize Microfinance in its legislative framework, which is an important step. However, recognizing the industry at the economic level has become today an urgent necessity in order for the sector to develop into an important economic tool capable of accommodating the largest economic segment, which is mostly comprised of small investors, entrepreneurs and economically active people in the informal sector.

Incorporating Microfinance into the SSN structure would largely contribute towards reaching the poor and assisting them according to economic empowerment mechanisms that transform them from job seekers into job opportunity producers / providers. Given the Microfinance sector targets all the productive age groups from youth to the elderly and pensioners, it therefore represents the most exemplary economic sanctuary when accompanied with a package of supportive non-financial services that promote the concepts of self-employment and small enterprises startup.

Although Yemen's regulatory framework approaches Microfinance as a financial sector, growth and development of this sector is the responsibility of many governmental and private groups, in addition to Central of Bank of Yemen, like the Ministry of Social Affairs & Labor, other government and private institutions and entities and the different educational and training institutions.



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