FIELD BRIEF No. 7

Non-profit Microfinance Institutions Consider Commercialization

Case Study of FATEN and REEF, two Palestinian MFIs

This "FIELD Brief" is the seventh in a series produced by the Financial Integration, Economic Leveraging and Broad-Based Dissemination (FIELD)-Support Program. This brief discusses the experience of two prominent Palestinian microfinance institutions in their decision to commercialize their operations.

Managed by AED, FIELD-Support represents a consortium of leading organizations committed to advancing the state-of-the-practice of microfinance and microenterprise development through innovation, learning and exploration. FIELD Briefs support this objective by sharing what we have learned and fostering dialogue on key issues. This brief was written by Kirsten Weiss of ShoreBank International, through the Expanded and Sustained Access to Financial Services (ESAF) Associate Award. For more, visit www.microlinks.org/field.

Introduction

Today, commercialization is considered a potential key to microfinance institution (MFI) growth, and donors are recognizing the benefits of weaning MFIs off of donor funding. A palpable shift in microfinance appears to be taking place, ***away from the donor-based model of microfinance and towards the capital markets model***. But there are challenges to the MFIs involved:

1. Commercial MFIs may face additional reporting requirements: to regulatory agencies, to their boards, to their shareholders, etc.
2. When an MFI is accountable to shareholders or must repay a loan, it has to have very tight, efficient, professional operations. Donors expect accountability as well, but there's a significant difference between accountability to a grantor and accountability to someone holding your debt or to a shareholder. MFIs must learn to balance a "double bottom line" of profit and social accountability, maintaining profits and efficiencies while avoiding social mission drift.
3. Commercialization may require new software for portfolio tracking and reporting which can be very expensive.
4. The role of the CEO and governance of the MFI shifts dramatically when MFIs commercialize. The CEO is no longer the "number one" of the MFI – he or she must now report to a board. But governance also has impacts at the board level, as the board becomes responsible to shareholders. It also affects reporting, the role of internal audit, and transparency.
5. Internal controls frequently must be strengthened, with higher standards of transparency and accountability demanded by regulators, owners, and creditors.

The **Expanded and Sustained Access to Financial Services Program (ESAF)** program, funded through USAID's FIELD-Support LWA, is managed by AED with technical support from ShoreBank International (SBI) and others. ESAF supports USAID in its efforts to build a more inclusive financial sector that increases sustainable access to financial services for Palestinian households and micro, small and medium enterprises. Through a variety of interventions, ESAF is addressing weaknesses in the financial system at all levels, from banking to the financial industry to regulatory environment. In 2008 and 2009, ESAF and SBI worked with two key Palestinian microfinance institutions (MFIs): **FATEN**, one of Palestine's largest non-profit MFIs, and **Reef Finance Co.**, a rural agricultural MFI. SBI provided ongoing targeted technical assistance to the MFIs as they explored commercialization. This FIELD Brief discusses the experiences of those two MFIs.

Why commercialize?

The concept of "commercialization" is a broad one, ranging from managing an MFI in a more profitable and sustainable manner while the MFI remains non-profit, to legally structuring an MFI as a for-profit entity. One of the primary goals of ESAF is commercialization because it is perceived as a way to increase MFI sustainability and expand outreach through access to commercial debt and equity. Both are important objectives for the Palestinian microfinance sector.

The higher an MFI's "tier" (i.e. based on its size, profitability, and level of commercialization—see Figure 1. below) the greater its access to a wider variety of finance alternatives (see Table 2). In turn, access to commercial finance opens the door for MFI growth, but investors want to see profitability before investing (or lending). MFIs must therefore become sustainable (or profitable) before they can access commercial finance, and profit depends on two components: income from operations (i.e. interest income from microloans disbursed) and expenses. These factors become important when an MFI is deciding whether or not to pursue commercialization, and if yes, where to prioritize its strategic plan and internal investments: on increasing operational efficiencies, expanding its portfolio, or developing new loan products, etc.

Figure 1: Tiers of Microfinance Institutions (MFIs)

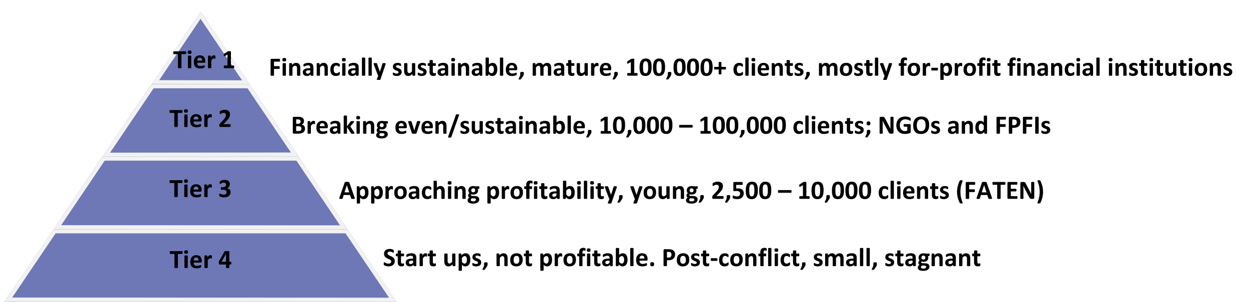

Table 1: An MFI's Tier and Access to Funding

Type of financing available	Tier 4	Tier 3	Tier 2		Tier 1	
	NGO	NGO	NGO	FPFI	NGO	FPFI
Public						
Grants	X	X	X	X	X	X
Subsidized loans	X	X	X	X	X	X
Guarantees		X	X	X	X	X

Type of financing available	Tier 4	Tier 3	Tier 2		Tier 1	
	NGO	NGO	NGO	FPFI	NGO	FPFI
Private debt						
Commercial loans			X	X	X	X
Guarantee funds			X	X	X	X
Bonds				X		X
Securitization				X		X
Commercial linkages			X	X	X	X
Private equity				X		X

Transformation to a for-profit entity is not without its trade-offs. In addition to the above-mentioned cultural change, it usually entails additional reporting to regulators and owners, a mental shift from donor dependence to market orientation, new MIS and software, changes in governance structure, and a higher level of risk management and internal controls. Commercial transformation is a tall order, and it is best to approach it one step at a time.

Case Study #1: FATEN

FATEN, one of the largest non-profit Palestinian MFIs, began operating as a financial service institution in the West Bank and Gaza in 1995. It achieved operational self-sufficiency ten years later in 2005, managing to navigate Palestine's tumultuous economic and political landscape, while introducing multiple microloan products. By November 2008, FATEN was one of the top three MFIs in Palestine, trailing behind UNRWA and highly competitive with CHF. FATEN was projected to end the calendar year with a $12 million portfolio, a fair-sized portfolio, but since its loan sizes were relatively large[1], averaging over $600, it had less than 5,000 clients. It was operationally sustainable but not financially sustainable. According to standard definitions, the MFI ranked as a Tier 3 MFI (see Figure 1. above).

In 2008, FATEN seemed a prime candidate for commercialization. It had ambitious growth targets, but would need funds to achieve them. FATEN had already identified funds to hit its 2009 target of $16 million, but beyond that it was unclear where future money would come from. The MFI did not have enough projected retained earnings to hit its growth targets, and failure to achieve them could mean lost market share and damage to its reputation if they were forced to deny larger, repeat loans, or even new loans to clients due to lack of capital.

Through ESAF, SBI consultants offered to help prepare FATEN to commercialize in order access commercial bank funds. For the purpose of accessing finance, commercialization made sense. But FATEN's organizational culture was non-profit, and the big steps SBI suggested would have to be approved by a board more familiar with the non-profit, donor-funded microfinance model. The first question was could—or even should—FATEN commercialize?

[1] Large for the world of microcredit—loan sizes were fairly average for Palestine and in particular the West Bank.

Estimates in a 2007 study by the IFC[2] placed the total number of micro-entrepreneurs in Palestine at just over 200,000 persons, and not every micro-entrepreneur would want a microloan. The same report estimated only 56% of micro-entrepreneurs in the West Bank and 57% in Gaza had a need for loans, translating to roughly 75,000 potential borrowers in the West Bank and 48,000 in Gaza[3] to be divided up amongst multiple MFIs. In a gap analysis facilitated by ESAF and SBI consultants in December 2008, managers expressed targets of a $20 million portfolio by year-end 2010, and $26 million by 2011. Given the relatively small size of the Palestinian market, Tier 1 status was probably not reasonable, but Tier 2 could be achievable. While the MFI appeared to have the human resources and institutional capacity necessary for growth, they lacked the money to fund it. FATEN would need to source additional financing; and if it chose to do so at a commercial level, the MFI would need to increase its profitability.

FATEN's Road to Commercialization

For FATEN, commercial funding appeared to be a good alternative, or at least supplement, to donor funding. But to access it, FATEN would need to improve its risk management to provide a higher comfort level to investors, to gain the support of the board for acquiring commercial financing, and to actively court local and international banks. FATEN had a good reputation, but although it was sustainable, its financials were not quite up to the stringent requirements of commercial lenders. Its legal status as a non-profit and its position as a Tier 3 MFI restricted its financing options (see Table 1. above).

To increase the MFI's profitability, FATEN's strategic plan called for focusing on its line of smaller-sized loans, which had higher yields. However, while the interest rates on these loans were higher than FATEN's larger-sized loans, this plan assumed that these smaller loans were also more profitable. Having never undergone a product costing exercise, it was unclear if this assumption was correct. Therefore, the SBI consultants recommended a product costing exercise to determine how the expenses of different-sized products compared. The consultants also suggested increasing the number of borrowers per loan officer to increase efficiencies. At the time of the gap analysis by the SBI team in December 2008, the MFI averaged 159 borrowers per loan officer. The consultants felt, and FATEN management agreed, that 250 borrowers per loan officer was a rational and obtainable target (see Table 2. below).

Increasing efficiencies appeared to be a significant issue for Palestinian MFIs. Palestine's relatively small market size made the achievement of economies of scale difficult. Its MFIs also faced economic and political uncertainties unique to the Palestinian situation, all of which tended to increase costs. Gaza and the West Bank were not only separated geographically, but also working under two different governments. The Palestinian microfinance industry's comparatively high level of portfolio at risk (see Table 2. below) has resulted, largely, from the difficulties associated with the continued Israeli occupation. Added to the mix was the general uncertainty surrounding Palestine's economy—business owners became more risk-averse as uncertainty rose, and borrowing became less palatable, further shrinking the microfinance market.

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[2] International Finance Corporation (IFC). Microfinance Market Survey in the West Bank and Gaza Strip. Washington, DC. May, 2007: 16.

[3] Ibid.

The donor community had also been feeding Palestinian MFIs grants for decades, reducing the incentive for efficient, sustainable operations. Had some or a combination of these factors increased the cost of lending in Palestine, making it higher than in other parts of the Middle East (see Table 2. below)? Or was that particular comparison unfair? In several respects, Eastern Europe actually made a better benchmark for the Palestinian microfinance sector. Like Palestine, several Eastern European countries, most notably Bosnia, were dealing with the aftermath of conflict and border uncertainties, and the incomes and microloan sizes in Palestine and in Eastern Europe were a closer match, with loan sizes going well beyond $1,000. Still, even compared to Eastern Europe, Palestinian MFIs did not compare well in terms of efficiencies and costs. Could taking a more commercial approach to pricing, operations, and profitability help Palestinian MFIs bridge the gap?

Table 2: A Measure of Efficiencies[4]

Region	Cost per loan	Loans per loan officer	PAR_{30}
Palestine	$ 290	110	11.8%
Middle East and North Africa	$ 66	207	1.9%
Africa	$ 114	244	4.8%
Asia	$ 36	236	1.7%
Latin America & Caribbean	$ 146	242	3.2%
Eastern and Central Europe	$265	149	1.2%

Year One: October 2008 – September 2009

FATEN managers agreed to a proposal by the SBI/ESAF team for SBI's consultants to conduct risk management assessments and trainings, facilitate a strategic planning workshop for the Board, and arrange for study trips to a commercial MFI, Mi-Bospo, in Bosnia, and to the National Microfinance Bank (NMFB) in Jordan. The latter two were perceived by SBI consultants to be the most critical—the board was rightfully concerned about mission drift and uncertain as to whether the very real trade-offs they had experienced as a commercial entity would be worth it.

Unfortunately, the three Board members tapped for the study trip to Mi-Bospo were ultimately unable to attend, leaving FATEN's General Manager to visit the Bosnian MFI on his own. However, the Mi-Bospo trip provided some valuable lessons, according to FATEN's General Manager, Anwar Jayousi. At the time of the visit, Mi-Bospo was experiencing significant delinquencies, partially due to the banking crisis at that time but also due to uncontrolled growth. "High growth is not always good," reported Anwar, "controlled is important. This is the approach which FATEN will be taking—managed portfolio growth." Anwar also noted that although Bosnia had a higher standard of living than Palestine, the costs of lending were lower, and he took away from the trip some lessons in how to increase efficiencies.

The visit to the NMFB in Jordan had very different outcomes. The topics covered in this visit focused on growth through access to commercial finance—an important issue for FATEN's Board. Commercial finance was a cornerstone of NMFB's strategy, which was based on choosing

[4] Note: The annual cost per borrower for Palestine is a 2008 figure based on data reported to the Palestinian Network for Small and Microfinance. The regional benchmarks are for year 2007 as reported in "The MicroBanking Bulletin" of the MIX (Microfinance Information Exchange).

commercial loans over donor funding. Fortunately, most of FATEN's Board members were able to attend this crucial discussion, though the members of the Board from Gaza were unable to participate due to travel restrictions.

July 2009 was the first month in which FATEN also showed financial sustainability—a stricter definition than operational sustainability, and one that takes inflation and the cost of finance into account. By year end, managers were also closing in on a key efficiency target: borrowers per loan officer had increased from 159 to 216, a 73% increase. More importantly, in 2009 FATEN began taking steps to access commercial funding. However, in meetings with SBI consultants, the Board expressed discomfort with perceived shifts in FATEN's direction: FATEN was a non-profit and they were wary that further commercialization would expose the MFI to the threat of mission drift.

Year Two: October 2009 – September 2010

As FATEN began to go through the commercial underwriting process, its managers realized the need to address some costing and strategic issues to make them more attractive to potential lenders. Were the products priced for profitability or were the margins too thin? Was their business plan realistic? FATEN worked with the ESAF/SBI team to develop a technical assistance plan more focused on prepping the MFI to access commercial finance.

The Year Two work plan for FATEN, therefore, included:

- **Strategic and business planning**: Near the end of 2009, SBI consultants facilitated a business planning exercise, with a three-year financial projections plan which included raising $7 million from a variety of sources including debt, microfinance investment vehicles, and savings, newly allowed under the regulation of the Palestinian Monetary Authority (PMA). The plan was slated for Board review in early 2010.
- **Product costing/pricing exercise:** ESAF/SBI consultants will work with FATEN management to gather financial and operational data for each loan product, and analyze the cost per product. The aim of this activity is to determine the true cost for the various loans FATEN offers and, in turn, assist with loan portfolio allocation and pricing decisions.
- **Communications strategy**: FATEN may recruit a senior manager to lead all public relations and communications activities. Depending on the successful candidate's skills and experience, SBI would provide training and mentoring to help this individual create and implement an effective communications strategy for all FATEN stakeholders and future investors.
- **Branch manager and auditor training**: While FATEN's strategic focus remains on micro business loans under $5,000, a significant number of loans would continue to be made to small businesses. In order to ensure the continued quality of the loan portfolio, branch managers and loan officers would receive training on the analysis of small business loan applications. SBI would also offer modules to Branch Managers on employee supervision, in order to increase the effectiveness of supervising loan officers.
- **Savings mobilization planning**: In expectation of the PMA authorization for MFIs to mobilize savings, FATEN would require careful assessment as to whether savings mobilization made sense for the MFI and planning if FATEN decided to move forward. Deposit taking would not be without risks and would require a number of physical and operational changes. SBI would provide assistance to identify gaps between FATEN's current operations and FATEN as a

potentially deposit-taking institution. The output of the technical assistance would be a plan for implementing the necessary organizational changes and building staff capacity.

Conclusion

Year Two of technical assistance got off to a strong start. By the end of 2009, managers were closing in on a key efficiency target: borrowers per loan officer had increased from 159 to 216, a 73% increase. FATEN had also negotiated a $500,000 loan with Triple Jump and another $500,000 credit line from Quds Bank. The balance sheet was looking promising (see Table 3. below) and FATEN appeared to be closing in on its aggressive growth targets. 2010 will be a critical year for FATEN. The Board review of FATEN's new business plan and addressing the need to attract additional funding—possibly from commercial sources and/or through FATEN converting into a for-profit entity—will be key.

Table 3: FATEN's Balance Sheet

	2008	2009	2010 - Forecast
Assets (USD)			
Portfolio outstanding	$10,449,569	$14,269,069	$17,460,526
Other assets	5,044,660	3,041,815	1,849,159
Total assets	15,494,229	17,310,884	19,309,685
Liabilities (USD)			
Concessional loans	1,207,000	2,024,956	1,844,085
Commercial loans	0	0	876,667
Other	1,859,387	2,445,374	2,545,374
Total liabilities	3,066,387	4,470,330	5,286,126

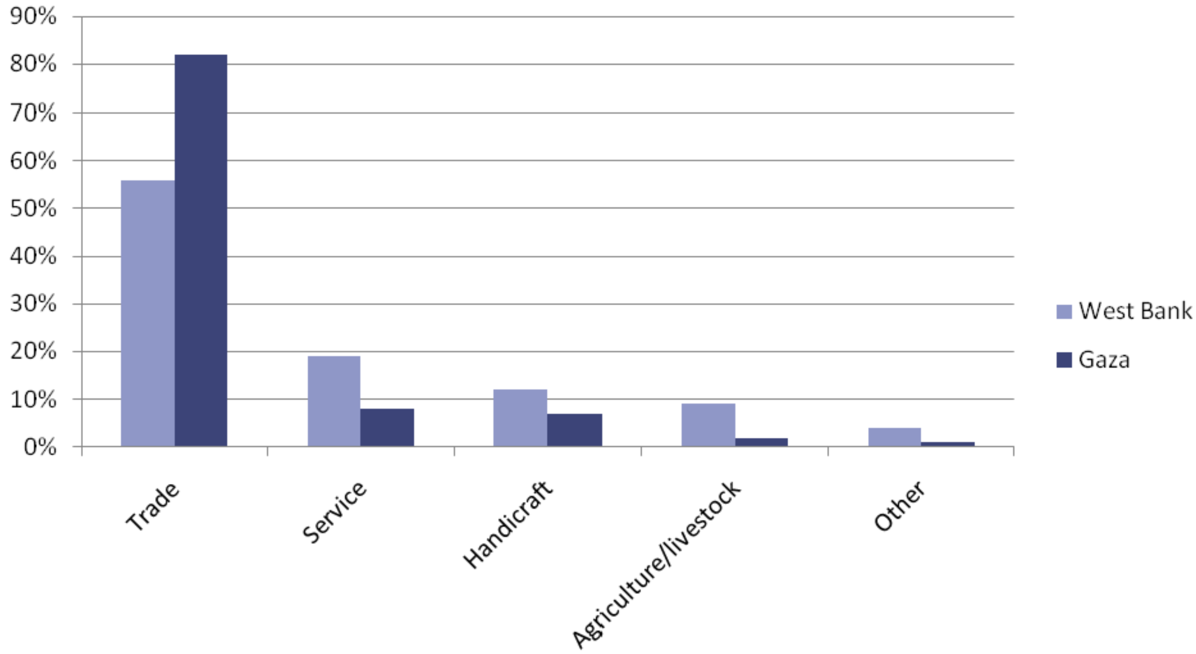
Case Study #2: Reef Finance Co.

Reef Finance Co. registered as a non-profit entity in June 2007. Its mission was to provide financial services to Palestine's rural areas, and its single-minded focus on rural and agricultural lending set it apart from other Palestinian financial institutions, as did its use of Islamic finance. This orientation toward agriculture was a natural outgrowth of its founding organization and largest stakeholder, PARC, the Palestinian Agricultural Relief Committee. PARC was founded 25 years ago by a group of Palestinian agronomists, responding to the deterioration in agricultural extension programs in the West Bank by offering expert agricultural advice to marginalized farmers in the area. This voluntary effort gained momentum and the movement quickly transformed into a non-profit entity dedicated to promoting sustainable rural development in Palestine.

The Palestinian Farmers Union (PFU) is also a stakeholder in Reef. Founded in 1993 and structured as a national umbrella organization, the PFU organizes and builds the capacity of farming cooperatives to enable them to better defend their rights. The Dutch government was the key donor, having granted Reef $2.3 million for loan capital. Reef was the only financial institution in Palestine focused on agricultural lending, approximately 90% of their portfolio. Though its agricultural portfolio added a new dimension of risk to Reef, it provided access to an otherwise neglected market. The focus on agriculture challenged Reef in another way: the potential market size. A study by the IFC in 2007 indicated that agriculture represented 9% of economic activity in the West Bank and only 2% in Gaza[5] (see Figure 2. below).

When the ESAF/SBI team first encountered Reef in October 2008, Reef only had 73 borrowers. The question for Reef was would there be enough demand in the agricultural sector alone over the long term? The SBI team was also concerned about subsidies to borrowers—a typical characteristic of agricultural lending. Reef's interest rates appeared low to the SBI consultants; the institution charged a flat 7-9% per annum—a low rate in the world of microcredit, though not for agricultural finance.

Figure 2: Economic Activities by Sector



Given its relative size and youth, Reef management's decision to submit an application for commercialization assistance under the ESAF program at first surprised SBI. But the financial institution needed money to grow, and had been actively seeking both debt and equity financing. Reef had had success attracting both, though management realized that their access to equity financing was limited by their current status as a non-profit company. Reef's upper management team further realized that in order to grow they would need to end their dependence on donor funding and attract commercial capital. However, Reef's Board was not convinced. After discussions with the SBI consultants, Reef's management team said they would request technical assistance for a feasibility study about commercialization, as well as for strategic planning work to inform Reef's Board about the possibilities of commercialization and to determine if it was appropriate.

Year One: October 2008 – September 2009

In April 2009, SBI kicked off its assistance to Reef with a Board planning and training session. The purpose was to educate Board members about commercialization—defining it, discussing its

[5] International Finance Corporation (IFC). Microfinance Market Survey in the West Bank and Gaza Strip. Washington, DC. May, 2007: 30-59.

advantages and disadvantages, and methods for accessing commercial finance. During the session, the Board initially expressed confusion about the meaning of commercialization and its implications for Reef as an financial institution with a focus on agricultural lending. By the end of the workshop and preparatory meetings, participating Board members seemed to understand how commercialization might fit with Reef's mission, and how commercialization might be necessary for Reef to achieve its long-term objectives.

The workshop participants were generally supportive toward moving forward on commercialization—including attracting commercial financing and to a lesser degree, to transforming to a for-profit institution that could attract equity investment. Management was committed to continuing their discussions with local and international banks for loans, and had high hopes for recent ESAF efforts to open an EU Guarantee Facility to MFIs, seeing it as an opportunity to leverage local capital markets. Though not all Board members attended the ESAF/SBI workshop, participants broadly supported the commercialization agenda, particularly attracting commercial finance. It was enough to move forward in the pursuit of commercial loans for Reef, but transformation to a commercial entity would need more time and consensus building.

"It was a new idea for the founders," said Reef's general manager, Mohammad S. Abu Dalo. "It's a beginning, but we need more workshops targeting the board."

Still, Reef's management got approval from the Board to move forward and at least try to access commercial lending. They began loan negotiations with four local and several international banks. Most of their negotiations with the local banks did not materialize into approved loans for a variety of reasons, such as REEF's short track record as a financial institution, a conflict of interest[6], and the lack of a loan guarantee (CHF/OPIC ultimately declined to act as a guarantor for Reef[7]). However, the Egyptian Land Bank approved a $200,000 loan to Reef. With its reputation bolstered by ESAF/SBI's support, Reef pursued negotiations for a $300,000 loan from Triple Jump.

Reef managers understood that it was one thing to apply for a loan—quite another for a bank to approve it. Reef identified weak internal controls as a barrier to both accessing commercial finance and to attaining profitable growth, and requested technical assistance from ESAF in this area. This was an important intervention for Reef, aimed at providing a level of financial assurance to its existing and potential stakeholders. Under the ESAF auspices, SBI consultants conducted a comprehensive review of Reef's internal control environment, policies and procedures in the summer of 2009. Major findings and recommendations had to do with governance, board involvement with Reef and risk management.

"Janine[8] was a great help for us," said Reef's general manager, Mohammad S. Abu Dalo. "The things she pointed out were helpful and we have implemented the recommendations she put in her report."

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[6] A Reef board member was the general manager for one of the banks approached for a loan.
[7] The lack of a loan guarantee from CHF/OPIC was particularly frustrating for Reef managers. The CHF/OPIC program was reluctant to guarantee bank loans for any MFIs in Palestine, though Reef's short history most likely counted against it.
[8] Janine McGregor is an SBI consultant and a specialist in audits of financial institutions.

Another issue was an accounting challenge— converting Reef's grant income to equity in order to create a balance sheet that was understandable to commercial lenders. The grant Reef had received from the Dutch government, for example, was being treated as accumulated income on financial statements, making income appear artificially high. It would need to be converted into donated equity, with clear provisions for custodial protection of these assets and possible representation of the Dutch on the Board, as Reef approached more commercial investors for financing.

As Reef continued to grow, it began attracting the attention of the donor community ambitious to support the agricultural sector. Several donors also admitted that the ESAF/SBI work with Reef had raised their interest as well. The SBI/Reef team, however, warned the donors[9] about the perils of "dumping" too much free money on the young institution, advocating for gradual disbursal of funding. Both Reef management and SBI consultants felt that excessive donor funding at this stage would have an adverse affect on Reef in the long term. Reef's managers recognized the honey trap of donor dependency and, with the assistance of SBI/ESAF consultants, worked with donors to accept only non-conditional donor loans, while taking care to maintain strong asset/liability ratios.

Year Two: October 2009 – September 2010

In spite of continuing board concerns, Reef had taken impressive steps to access commercial financing and improve its internal controls. ESAF/SBI took the risk to work with a young finance company and it seemed to have paid off; Reef was serious about commercialization in some form, was inundated with offers of donor assistance, and had hit a growth spurt. In October 2008, the total outstanding portfolio equaled $835,747 and Reef had less than 100 borrowers. One year later, in October 2009, it totaled $2.5 million, with nearly 600 borrowers. Increased technical assistance in project Year Two was clearly warranted.

The Year Two plans included:

- **Commercial finance**: ESAF/SBI would build on the commercialization work with the Reef board and host a study trip for the board members to a commercially oriented, agriculturally-focused FI abroad. Additionally, KFW and CHF were pursuing loan guarantee funds for MFIs, which Reef would try to obtain. Reef needed money to grow and commercialization was considered one way forward in that regard.
- **Product costing/pricing**: Concerns persisted about Reef's interest rate of 7-9% flat per annum. Was it a profitable pricing strategy or a borrower subsidy? An SBI advisor would work with Reef's finance and credit teams to adapt a simple methodology for product costing (allocation-based costing) and train Reef's team on that costing methodology and tools.
- **Risk management and internal audit**: The lack of risk management strategy had been identified as a major weakness in Reef's internal controls. SBI consultants would design a risk management strategy to mitigate these risks. Reef managers had expressed a commitment to hiring an internal auditor in 2010, a key role for the design and implementation of a risk management strategy. SBI would help Reef to establish the internal audit unit, develop its first year audit plan, and train the new internal auditor.
- **Marketing**: Reef lacked a comprehensive marketing strategy, a weakness typical to most financial institutions. SBI would help design a marketing strategy to ensure that Reef selected the right mix of products, distribution channels and promotion to reach target borrowers.

[9] SBI met with the European Union, the Spanish cooperation agency, Dutch government donors, and IFAD.

- **MIS strengthening**: To support Reef's decentralized operations approach and to facilitate the work of loan officers, Reef planned to further invest in its IT and its management information systems (MIS) infrastructure. This would include more efficient software, improved hardware for loan officers working in rural areas, and a network that could connect the loan officers with the centralized data center. The ESAF project would work with Reef directly on hardware procurement. In Year Two, SBI would assess the MIS/IT needs for Reef and guide the MIS implementation.
- **Loan officer training**: SBI would conduct a needs assessment for credit officers and design a training program to bridge the gaps identified, particularly in the areas of credit, sales, and financial management.

Conclusion

By the end of 2009, Reef had made significant strides towards commercialization, managing to attract commercial debt in spite of its non-profit status. Though Reef had become a favorite of the Palestine's donor society, it faced significant challenges. It had reached its growth phase, with all the attendant operational risks of expanding its portfolio beyond its institutional capacities. The portfolio remained almost entirely agricultural—should Palestine's agricultural sector take a blow, Reef would be vulnerable. And the temptation of free donor money could still derail their move toward commercial finance, particularly since financing Reef's growth remains a critical issue. Could these challenges derail Reef's forward progress? How far would the financial institution go along the path to commercialization?

Discussion questions:

- Can or should Reef diversify its agricultural portfolio?
- How does Reef's pricing affect its ability to attract commercial funding?
- What are Reef's main motivations for commercializing?
- Should Reef become a for-profit company, or is it enough to simply perform as one?
- What are the advantages/disadvantages of debt versus equity financing?