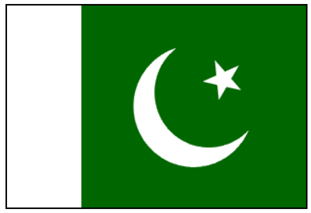

State of Microfinance in Pakistan

Prepared for

Institute of Microfinance (InM)

As part of the project on
State of Microfinance in SAARC Countries

By

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Disclaimer

Any opinions expressed and policy suggestions proposed in the document are the author's own and do not necessarily reflect the views of Institute of Microfinance (InM). The report also does not represent the official stand of the Government of the countries studied.

List of abbreviations

ADB	Asian Development Bank
AKAM	Aga Khan Agency for Microfinance
AKF	Aga Khan Foundation
AKRSP	Aga Khan Rural Support Programme
BRAC	Bangladesh Rural Advancement Committee
CGAP	Consultative Group to Assist the Poor
CLEAR	Country Level Effectiveness and Accountability Review
EC	European Commission
GTZ	Gesellschaft für Technische Zusammenarbeit
KB	Khushhali Bank
MFB	Microfinance Bank
MFI	Micro Finance Institution
NGO	Nongovernmental Organization
NRSP	National Rural Support Programme
OCT	Orangi Charitable Trust
OSS	Operational Self-Sufficiency
PAR	Portfolio at Risk
PMN	Pakistan Microfinance Network
PPAF	Pakistan Poverty Alleviation Fund
PRSP	Punjab Rural Support Program
SAARC	South Asian Association for Regional Cooperation
SBP	State Bank of Pakistan
SDC	Swiss Agency for Development and Cooperation
SECP	Securities and Exchange Commission of Pakistan
SHG	Self-Help Groups
SRSP	Sarhad Rural Support Programme
TRDP	Thardeep Rural Development Programme
UNDP	United Nations Development Programme
USAID	United States Agency for International Development
WB	World Bank
ZTBL	Zarai Taraqiati Bank Limited

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Chapter1: Introduction and Objectives

A. Overview

The Institute of Microfinance (InM) has undertaken the task of publishing reports on the state of microfinance in different regions. Each year, InM will prepare a document on the state of micro finance in different regions. In 2009, the Institute will publish a report on the State of Microfinance in the SAARC countries. This series will include seven country reports on each of the SAARC countries. This report on the state of the Microfinance Sector in Pakistan is part of this first series of reports. This report will attempt to provide an overview of the state of micro finance in Pakistan from both the demand and supply side up to the end of December 2008. The report is based on secondary information and much of the information reproduced here has been provided by the Pakistan Micro-Finance Network (PMN), the Pakistan Poverty Alleviation Fund (PPAF) and annual reports of the MFIs. The report includes an analysis of the impact on the sector based on the Gallup surveys conducted by PPAF, Kashf Foundation surveys and an overview of impact in the sector commissioned by the Pakistan Micro-Finance Network and the Asian Development Bank as well as by independent researchers.

B. Country Background

(i) Country Economic Background

Pakistan is estimated to have a population of around 160 million. The country's economy has grown at an average rate of over 7.5 percent in the last three years (2004/05 – 2006/07), thus positioning itself as one of the fastest growing economies of the Asian region.1 The key drivers of this growth have been the service sectors and industry. The revenue position of the country was strong with collection of more taxes than targeted and a sharp reduction in public and external debt burden. Workers' remittances at around $ 4.5 billion in 2007 remain one of the largest sources of external finance for the country. Real per capita GDP has grown by 4.7 percent and per capita income in current dollar terms was up by 14.2 percent, reaching USD 926 at the end of June 2006. While overall inflation rate decelerated from 9.0 percent in July 2005 to 6.2 percent in July 2006,2 the surge in food prices in Pakistan in 2008 posed a serious problem. During the last cropping season ending March 2008, prices of staple crops increased significantly from 30% for wheat to 88% for rice.3 This has the potential to drive a growing section of the population below the poverty line. Pakistan is now listed among the 40 countries that are facing food price crises. The Government maintains that given the high poverty levels in Pakistan, it is important to maintain the elevated growth rates for the medium to long-term. It recognises that if the economy is to continue growing at rates above historical norms, there is a need

[1] Economic Survey of Pakistan 2005-2006.
[2] Economic Survey of Pakistan 2005-2006.
[3] Ministry of Food Agriculture and Livestock. 2008.

to implement policies and measures to stabilise emerging macro-economic imbalances4 and improve the security situation.

(ii) Agriculture and Rural Poverty

Agriculture growth has historically played a major role in Pakistan's development and continues to be crucial for overall growth and poverty reduction. Agriculture is the mainstay of Pakistan's economy. Nearly twenty-one percent of total output (GDP) and 44.8 percent of total employment is generated in agriculture. Agriculture's contribution to gross domestic product has declined from a little over 25 per cent in 1990 to its current 21 per cent in 2007.5 However, this sector faces numerous constraints, particularly concerning access to land, water, improved agricultural inputs, credit and inadequate infrastructure. Two sectors ignored in the past in Pakistan are livestock and fisheries. These two sectors are particularly important from the poverty alleviation perspective. The livestock sector contributes about 52 percent to the agriculture GDP. While agricultural growth is considered necessary, it is no longer considered sufficient for rapid reduction of rural poverty. The majority (57 per cent) of the rural poor are from non-farm households with the poorest 40 per cent of rural households deriving only 30 per cent of their income from agriculture.6 Investment in the rural and small-town non-farm sector is considered critical for poverty reduction.

Non-availability of adequate credit has been one of the major impediments to the growth of the agriculture sector. While the crop sector contributes only 34% to the agriculture GDP, this sector accounted for 84% of the total agriculture credit in the Financial Year (FY) 2006 while the share of non-crops sector was only 16%.7 There is also considerable geographic disparity in the provision of microfinance. Province-wise credit disbursement has been very uneven over the years. Punjab's share in agricultural credit disbursement increased from 73% in FY02 to 83% in FY06 whereas the share of Sindh declined form 19% to 11% in the same period. Shares for Balochistan and AJK have also witnessed considerable decline, while North-West Frontier Province (NWFP) has maintained the same share of 5% over this period.

(iii) Overview of Rural Poverty

Nearly one-quarter of the population in Pakistan was classified as poor in October 2006. The Government estimates that 23.9 per cent of the people lived below the poverty line. Although the poverty rate is said to have declined by about 10.6 per cent from 34.46 per cent in 2008, non-income measures of welfare related to health and education are low in comparison with those of other countries in South Asia. Furthermore, the impact of the increase in international prices of major food commodities which reached their highest level in nearly 30 years at the start of 2008 has had a very negative impact on the poor. As a result of the food price inflation in Pakistan, it is believed that the poorest households are now spending more than 70% of their

[4] State Bank of Pakistan. Annual Report: Review of the Economy Volume 1: 2006-2007.

[5] State Bank of Pakistan. Annual Report: Review of the Economy Volume 1: 2006-2007.

[6] Ibid.

[7] Qureshi, Dr. Sarfraz Khan. TA 4478-PAK. National Agriculture Sector Strategy. Background Paper on Rural Finance Issues for Rapid Rural Growth. Volume 3. Asian Development Bank.

[8] Centre for Research on Poverty Reduction and Income Distribution. Pakistan

incomes on food.9 About 17 million people10 are feared to have joined the food insecure category (60 million) as a result of the recent food price inflation.11 A re-examination of the poverty situation in Pakistan is required as a result of these recent changes. The socio-economic indicators with respect to women are the lowest in the region. Pakistan's ranking in terms of Human Development Index is higher than the Gender Development Index reflecting the inequalities persisting between men and women. The rise of fundamentalism has led to additional problems for women especially in the Northern parts of the country.

[9]Crockford, Kevin. Senior Rural Development Specialist. World Bank. August 2008.

[10] The 2008 population is estimated to be 160 million, 65.9 percent of which is rural (FAO, IFAD).

[11] FAO. Pakistan: Initiative on Soaring Food Prices: August 2008.

Chapter 2: The History of Microfinance in Pakistan

A. The Informal Sector

The poor of Pakistan have generally relied on informal sources for meeting most of their credit requirements. Informal providers serve a predominantly lower income group who are perceived by the financial institutions as "un-bankable" due to their inability to comply with conventional loan collateral requirements. The informal credit market is served by a wide variety of providers including predominantly family and friends, landlords, money lenders, traders, Aartis, or commission agents. Large landlords usually provide credit to their tenants or sharecroppers for the purchase of agriculture inputs and consumption purposes. This is most common in Sindh and Southern Punjab. Aarties or commission agents favor interlinked transactions providing, for example, inputs to farmers and undertaking to sell their produce. It is difficult to properly assess the actual price of credit in these interlinked transactions. Suppliers' credit is common in established markets such as textile, and informal finance is common in the transport sector as well as in the shoemaking, dairy and livestock industries. The Agriculture Census of 2000 estimated that 65% of outstanding debt of all rural households was provided by non-institutional or informal sources. Table 1 below illustrates that in case of agriculture households, the share was 61% and for livestock holders it stood at 85%.12 A fact not fully acknowledged is that most of the funds in the informal sector are actually provided by family and friends. A Financial Markets Survey found that 82% of individuals borrowed 69 percent of the total amount of funds at very low or no interest payments with flexible repayment schedules from friends and relatives.13

Distinct advantages are offered by informal credit, as it imposes no restriction on the purpose of its use, can be provided in small amounts, is characterized by low transaction costs, high interest rates by commission agents but no interest rate when provided by friends and family and rapid disbursement of credit. Although, its share in total credit has declined, it still remains a major source of credit in rural areas. The close familiarity of borrowers with informal lenders, inability of formal institutions to reach the poor explain why there is a heavy dependency of the rural population especially farmers on the informal market. Most informal lenders have, however, limited loan portfolios and operate within a narrow area of their influence.

Table 1: Outstanding Debt by Type of Household

Type of Household	Total	Institutional	Non- Institutional	Institutional%	Non-Institutional %
All Households	845,890	299,902	545,988	35	65
Non-Agriculture Households	122,994	21,086	101,908	17	83
Agricultural Household	722,895	278,816	444,079	39	61

[12] Qureshi, Dr. Sarfraz Khan. TA 4478-PAK. National Agriculture Sector Strategy. Background Paper on Rural Finance Issues for Rapid Rural Growth. Volume 3. Asian Development Bank.

[13] Rural Financial Markets Studies: Rural Credit Study & Role of Women in the Rural Economy and the Credit Market Study. September 1998.

Livestock Holders	81,380	12,097	69,283	15	85
Farm Household-Total	641,516	266,720	374,796	42	58
Under 5 acres	181,724	29,090	152,634	16	84
5.0-12.5 acres	182,160	75,943	106,217	42	58
12.5-25.0 acres	123,676	70,085	53,591	57	43
25.0 acres and above	153,955	91,602	62,353	59	41

Source: Pakistan Agricultural Census, 2000

There is widespread use of Rotating Savings and Credit Associations at all levels in Pakistan. These are called Committees and are especially popular among women from all socio-economic backgrounds to establish private savings committees which people trust. The members of a Committee know each other well and deposit a fixed amount in a pool which is then distributed by rotation to each member on a monthly basis. This helps to meet the savings need in an informal manner in a system which enjoys a high degree of trust. The funds are generally used for a large financial outlay such as a marriage, house building, consumer durables, education, etc.

B. Early Initiatives by Government

The Government has in the past made little distinction between agriculture and micro-lending. Its focus in the past has been on providing credit to small farmers. Prior to independence, institutional credit was available to the farmers either in the form of Taccavi loans which were initiated by the Government before cooperatives and commercial banks actively came into crop and other agriculture sector loans. Taccavi loans were given from the government's treasury and disbursed through revenue departments of the provincial governments. These were disbursed to needy farmers for seeds, fertilizers, etc, by revenue agencies. Taccavi loans were also given in the case of damage to crops in floods or famine conditions. Taccavi loans carried an element of interest, and in the case of a delay in repayment, penal interest was also levied. The formal sanction and regulation of Taccavi loans was established through the Land Improvement Loans Act of 1883 (LILA) and Agriculturists Loan Act 1884 (ALA), later on replaced by West Pakistan Agriculturists Loan Act of 1958 (ALA). Under LILA, loans were disbursed for sinking of irrigation wells/tubewells, land levelling, and land reclamation and development for agricultural purposes. The contribution of these loans towards total institutional credit declined overtime with the development of new institutional sources. Delays and procedural difficulties in sanctioning and disbursement of loans rendered the system of Taccavi inefficient and ultimately these loans were discontinued in 1993-94.14

Cooperatives have been another source of credit from the formal sector. Credit cooperatives have existed in this region since their introduction in India under the Cooperative Credit Societies Act of 1904. The objective

[14] Iqbal, Muhammad, Ahmad, Munir and Abbas, Kalbe. The Impact of Institutional Credit on Agricultural Production in Pakistan. The Pakistan Development Review. Pakistan Institute of Development Economics. 2003.

was to provide loans to small farmers through their own local associations on relatively easy terms and free them from the exorbitant rates offered by moneylenders and grain merchants. .15 At the time of independence, the co-operative banks were engaged in financing commercial activities mainly and had neglected the financing of co-operative societies. To further enhance the level of rural credit and to promote the cooperative societies and cooperative movement in the country, the Government established the Federal Bank for Cooperatives (FBC) and Provincial Cooperative Banks (PCBs) in the late 1970s. This was undertaken through an Ordinance in 1976 entitled the "Establishment of Federal Bank for Co-operatives and Regulation of Co-operative Banking Ordinance" was promulgated. The Federal Bank for Cooperatives (FBC) was designed as an apex body to meet the credit needs of cooperative banks and societies. It was designed as a development bank and served as a tool for the State Bank of Pakistan to regulate the Provincial Cooperative Banks. The SBP would lend to the Federal Co-operative Bank at just 0.5 percent. The Federal Bank would keep a percentage-based fee and pass on the subsidized funds to Provincial Co-operative Banks. These would then on-lend to the Co-operative Societies established in the provinces and registered and regulated under the aegis of the Provincial Co-operative Societies Department at a profit (8 percent - 10 percent).

The FBC along with PCBs played a positive role in the development of cooperatives and extension of rural credit in the initial years. However, it could not sustain this effort despite the development of 66,000 primary societies, primarily due to misuse of subsidized funds and incapacity of FBC to effectively monitor and regulate the activities of PCBs and the Societies. The Cooperatives suffered from uneven coverage, with no presence in two thirds of the villages; lack of accountability and professional management; poor portfolio management; and weak supervisory capacity of the provincial cooperative departments. Cooperatives met with little success and have been mired in financial misappropriations due to politicization and domination by the rural elite. The Punjab Economic Research Institute (PERI) conducted an evaluation of the Cooperative Credit Programme in Punjab in August 1986. One of its main findings was that only four percent of the co-operative societies were genuine. An estimation of the Subsidy Dependence Index (SDI) which measures the percentage increase in the financial institution's average on-lending interest rate required to fully compensate for the elimination of subsidy, revealed that the Punjab Provincial Bank was heavily subsidy dependent. It would have to increase its on-lending interest rate to 25 percent instead of 14 percent to fully eliminate the subsidy in 1994-95. Provisioning for reserve requirements would have entailed an even higher increase in on lending rates.16

In the 1950s two specialized institutions namely the Agricultural Development Finance Corporation and the Agricultural Bank were established in Pakistan. These were merged to form the Agricultural Development Bank of Pakistan (ADBP) in 1961. Historically, ADBP has been used as a subsidy delivery vehicle by successive governments, lending to its clients at below market interest rates. The Bank introduced a village and client centered approach through the expansion of its supervised credit scheme by bringing credit services to the farmers through Mobile Credit Officers (MCOs). To provide access in rural areas, a country wide network of branches and MCOs was developed. ADBP also introduced services for women through female credit officers.17 There was relaxation in lending conditions which had previously been based on mortgaging land and as a result had excluded tenants, landless and women from accessing most credit lines.

The directed agricultural credit programmes of the Government proved to be subsidy dependent and ineffective in helping to achieve important goals. Instead of building a sustainable financial infrastructure,

[15] Qureshi and Shah. 1992.

[16] Report of the Committee on Rural Finance. SBP. 2002.

[17] PCR, Gujranwala Agriculture Development Project, Operations Monitoring & Evaluation Department, ADBP, October 1994.

many of the directed credit programmes undermined the development of a viable financial market. Cheap credit was ineffective in alleviating rural poverty, in stimulating agricultural investments and in spurring agricultural production. Support for these traditional directed agricultural credit efforts began to wane in the 1980s and by the end of the decade most donors and some governments sharply reduced their support for agricultural credit. In part, this decline in support was due to the unsatisfactory performance of these efforts. Critics increasingly argued that relatively few of the credit subsidies were captured by poor people and that subsidized and directed credit had a weak effect on farm production and investment. Serious and chronic loan recovery problems, dependency on outside funding, and overall costs eroded the support for these efforts. Poor performance and the lessening of donor and government support led to the collapse of many public agricultural development banks and rural (government directed) co-operatives in the 1980s.

The Agriculture Development Bank of Pakistan (ADBP) was converted into a public limited company and renamed the Zarai Taraqiati Bank Limited (ZTBL) in 2002. The ZTBL was allowed enhanced paid up capital and a clean balance sheet with a leaner structure. The restructuring included its process, system and product reengineering, with major emphasis being laid on reorientation of existing employees with specific focus on their capacity building, induction of a professional management team. ZTBL restructuring was undertaken as part of the reform agenda of the ADB-funded Rural Finance Sector Development Program. At the same time the Government liquidated the Federal Bank for Cooperatives (FBC). The Punjab Provincial Cooperative Bank is now the only scheduled cooperative bank which still has operations on the ground. The other Provincial Cooperative Banks may also be liquidated as they currently exist only on paper. At this time a host of private sector institutions were also established to enhance the accountability and transparency of the private sector institutions.

C. Micro-Finance Initiatives by NGOs

The provision of microfinance services was initiated on a small scale by several NGOs running development programmes when they realized that credit was an essential input for enhancing productivity and incomes. The Aga Khan Rural Support Programme (AKRSP) in the Northern Areas and the Orangi Pilot Programme in urban Karachi were among the first to initiate a micro-finance Programme. When AKRSP first started its operations, loans were not part of its portfolio. At this stage, savings was the only component of the AKRSP model due to its basic premise that social capital, human capital development and capital formation constituted key elements for rural development. Its strategy for capital formation was to insist that its members save during their weekly Village Organisation meetings. The savings programme generated considerable interest among both men and women and, in fact, provided the main motivation for the first women's organizations established in the Northern Areas. AKRSP's savings programme provided the first opportunity to small savers to save with the formal sector through its intermediation with the banks. The savings were deposited with commercial banks as the NGO was not allowed to take deposits.

When AKRSP first initiated its operations it had not systematically planned a credit programme for its clients. AKRSP entered the credit market when it realised that its clients needed loans for investment purposes and that the loans available from the formal sector could not be easily tapped due to cumbersome disbursement procedures and high transactions costs. AKRSP's credit chronology illustrates its dynamic nature and the inexperience of its financial mangers. AKRSP has experimented with many types of different loan products since its inception in 1982. In designing its loan products, AKRSP appears to have struggled with balancing several different motivations such as social cohesion, access to inexpensive source of funds for its clients, investment in village development and sustainability. AKRSP experimented with short and long-term loan products and individual and group loans as well as developing a village banking model. In later years, AKRSP developed a package of Village Banking which allowed the VOs and WOs to assume much of the responsibility for micro-level banking operations and laid the cornerstone for the financial autonomy which the VOs and WOs later wrested for themselves and initiated a programme of internal lending under which the members on- lent their members money from their own savings on terms and conditions determined by them. Finally AKRSP separated microfinance from its operations and transferred all its resources and staff to the First MicroFinance Bank and completely divested itself of microfinance operations. However, some of its stronger VOs and WOs continue the village banking operations on their own even today.

Table 2: AKRSP's Savings and Loan Products 1982 - 2001

Financial Product	Year introduced	Year withdrawn	Reason to withdraw	Interest rate (f) flat, (d) decl. balance
Community savings	1982			
Short term loans	1983	1999		0
Medium term loans	1984	1999		8%
Village Banking or Group loans to VOs (V/WOCP)	1989			15%
Enterprise credit loans ECP	1992			16%, raised to 24% in 1998
Corporate Credit loans	1996	1999		
Business Committee loans	2000			

The Orangi Pilot Programme which had used the improvement of sanitation in one of the urban slums in Karachi initiated a credit programme when it realised a critical need for financial services. However, OPP did not have a model either and under the guidance of Dr Akhtar Hameed Khan experimented with several different approaches. These programme continued to grow gradually and spawn other rural development initiatives across the country such as the National Rural Support Programme in Islamabad, the Punjab Rural Support Programme in Lahore and the Sarhad Rural Support programme in Peshawar. These were all patterned on the line of AKRSP. These programmes were not designed to run as sustainable programmes and were managed by Social Organizers with no experience of managing such programmes. In fact in the early years there was no estimation of how much it cost to actually deliver these credit services and the interest rates were fixed on an ad hoc basis to reflect what the programme managers felt the poor could afford to pay.

In the early 1990s most NGOs were running their micro-finance programmes from outright donor grants. The sector was not at a stage where it was considering loans to finance its programmes. There was little consideration given to the source of funds that would fuel future growth. None of the NGOs, apart from the Sarhad Rural Support Corporation (now SRSP) which had been given a loan from Khyber Bank as part of a donor project, was reporting any financial cost on borrowings because they did not incur any cost on this account. The year 1996 is viewed as a turning point in the history of the microfinance sector in Pakistan.18 This was the year that Kashf Foundation was initiated as the first specialized microfinance organization in the country with a grant from Grameen Foundation, AKRSP realized the need to separate it's microfinance

[18] Haq, Aban. Ed. Edited by Minerva John. Microfinance Industry Assessment: A Report on Pakistan. Pakistan Micro-Finance Network. September 2008.

operations and created a separate unit to track financial performance, and the National Rural Support Programme initiated its Urban Poverty Alleviation Programme (UPAP) in Rawalpindi to help develop a pilot programme on a sustainable pattern. Some of the NGOs decided to collaborate and form an association of microfinance providers in Pakistan in 1998, called the Microfinance Group-Pakistan, which later evolved into a formal organization in 2001 in the form of the Pakistan Microfinance Network (PMN). The establishment of PMN spurred a focus on transparency, performance reporting, capacity building and tracking progress in the microfinance sector.

At the government level, concerted efforts for the promotion of the sector began in the year 2000 when an apex funding body, the Pakistan Poverty Alleviation Fund (PPAF) was established for poverty alleviation. As an apex organization, the role of PPAF is to act as a wholesaler and intermediary of funds, while its Partner Organizations (POs) perform the actual retailing function of loaning funds and implementation of projects on the ground. PPAF provides its partner NGOs three types of facilities which consist of (i) extending lines of credit for expansion of poverty targeted micro credit programs (ii) grants for Community Physical Infrastructure (CPI) schemes and social sector services on a cost sharing basis and (iii) grants to strengthen the human and institutional capacity of POs.

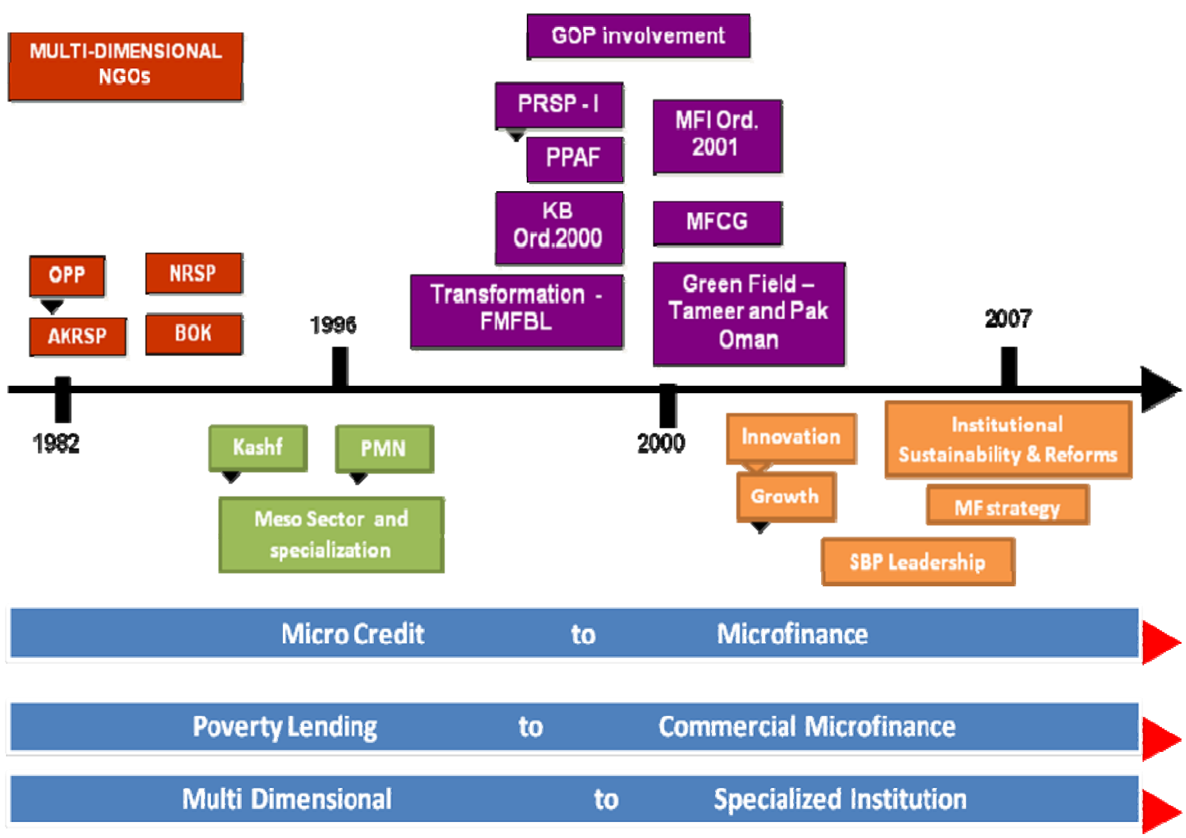
The establishment of PPAF and its financing of NGOs provided a real impetus to the growth of the sector. In the last eight years from 2000 to 2008, PPAF has established itself as one of the main players in the development sector in Pakistan. From the initiation of its activities in 2000 to the end of December 2007, PPAF had disbursed a cumulative total of US$ 457 million to 71 Partner Organizations. On a cumulative basis it has disbursed US$ 348 million for credit, US$ 75 million for community infrastructure schemes and US$ 34 million for capacity building. It has developed itself as a professional and highly credible apex institution with a strong and efficient corporate culture. It is today one of the largest social funds in the world. While its Partner Organizations may hold a wide range of views regarding PPAF, they all agree that it has been the main catalyst which has led to the exponential growth in the microfinance sector, enabled a more integrated approach to rural development and allowed a long-term perspective to social mobilisation and community empowerment. They also agree that it has transformed them from charity driven organizations dependent upon donor financing to organizations with a clear business plan for becoming sustainable development partners.

There was little conception of working towards sustainability in the micro-finance operations when PPAF first started its operations. For many years the main providers in the sector were micro-finance NGOs which started micro-finance as one of their many activities. They initiated micro-finance more as a tool for social mobilization than as a sustainable financial product. Some of the leading organizations had not properly separated out their micro-finance operations from their other operations and assigned notional costs to their micro-finance operations. The Pakistan Poverty Alleviation Fund (PPAF) was the first organization which was able to change the expectation that NGOs could only operate with grants. Prior to PPAF, none of the NGOs had ever taken loans to finance their operations. PPAF thus brought about a significant shift in the institutional mindset of these organizations. This change entailed a complete transformation in organizational culture, appraisal criteria, staffing pattern, financial management and monitoring and evaluation criteria.

The leading microfinance practitioners are all beginning to transform their microfinance programmes in Pakistan. They have all either already separated their microfinance programmes from other services or are in the process of doing so. PPAF now requires its Partner Organizations to prepare separate audited accounts for their microfinance operations.19

In 2000 the government under a separate ordinance and with financial assistance from the Asian Development Bank established the Khushali Bank for providing microfinance to un-served and underserved areas of the country. In 2001 the State Bank of Pakistan formulated the Microfinance Institutions Ordinance 2001 which opened the way for the private sector to establish microfinance banks with much lower levels of reserve requirements and equity financing. This heralded the beginning of the 'commercial' era for microfinance when microfinance was not viewed as just a 'social' service but rather a sustainable financial enterprise as well. To date, eight MFBs have been established in Pakistan (NRSP and Kashf have recently been provided microfinance banking licenses). The sector consists of a diverse range of players today. It includes development NGOs, specialized MFI, Microfinance Banks, development finance banks with microfinance operations, commercial banks also attempting to develop a range of products, post office branches with some linkages with the microfinance sector, insurance companies and private sector leasing firms with products especially designed for the microfinance sector.

Figure 1: Chronology of MFI Development in Pakistan



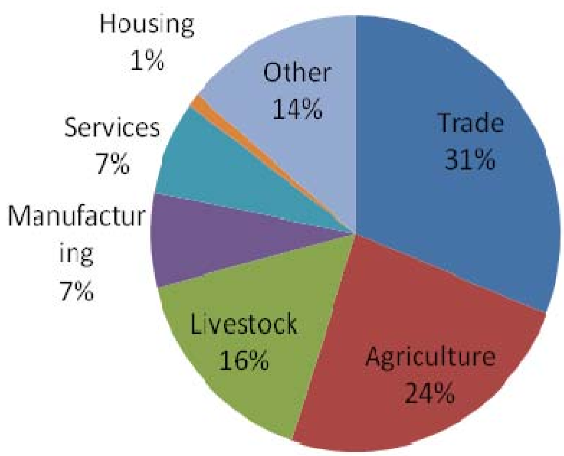
[19] PIR. PMN 2006.

Chapter 3: Products and Lending Methodologies

A. Types of Loans and Services

While the microfinance sector consists of a diverse range of institutions, the products that they offer do not vary very significantly. Mostly the sector offers a general loan or an agricultural loan of just under US$ 200 for a year. The repayments begin more or less immediately and repayments are expected to be made generally on a weekly or bi-monthly basis. The most common use of loans is for trade (31%), agriculture (24%), livestock (16%), manufacturing (7%). A few loan products like housing have recently been added by a few MFIs but still make up a small proportion of the loans. The Figure below gives the overall purpose for which the loans were being used at the end of December 2008. Despite the purpose for which the loan is taken, the loan amount and repayments are not structured to reflect their use. Thus most people who are using micro-loans are borrowing from other sources as well. Some private sector leasing companies are offering various types of equipment on lease. At one point the State Bank of Pakistan was offering technical assistance to MFIs for developing innovative financial products based on Islamic principles of financing. A few MFIs have introduced Islamic products but these have not really reached any significant scale.

Figure 2: Use of Micro-Loans in Pakistan (December 2008)



While some MFIs are very innovative in introducing new products others are satisfied with a standard one product portfolio such as the National Rural Support Programme and other RSPs. The First Micro Finance Bank has been among the innovators in the sector and has gradually developed a range of products, support services and linked up with other agencies like the Pakistan Post Office to expand the outreach of its services. FMFB offers a full range of financial products, such as deposits and loans and transfer of funds. FMFB offers current accounts, savings accounts and fixed term deposits (1 month - 2 years) with interest rates varying from 1 to 3%. Only Rs.5 is required to open a saving account. The FMFB has also introduced Bachat Committees, which enable clients to operate their own account, have a market-based return and liquidity. FMFB also proposes additional services, such as cheques operations, micro insurance (with loan and life coverage) and wire transfers and Health Insurance (spouse and children). It also offers mobile vehicles for accessibility at low cost to clients It provides different loan products, adapted to its diverse clientele, in urban and rural regions. Its financial products include the following

Business Group Loan	Solidarity group lending, Rs.5,000- 50,000, 15% annual interest rate.
Business Committee Loan	Larger solidarity groups, Rs.3,000-50,000, 12% annual interest rate.
Individual Loan	Microenterprises. Rs.5,000-100,000, 16% annual interest rate
Group Loan	Village banking methodology, rural areas, 10% annual interest rate
Urban Group Loan	Solidarity groups, 3-10 borrowers, Rs.3,000-50,000, 15% annual interest rate
House Improvement Loan	Rural areas, 5 or more borrowers in village or women organisations, Rs.1,500-50,000, 15% annual interest rate
Employee loan scheme	Low-income employees, Rs.5,000-40,000, 10% annual interest rate
Livestock Finance	Collaboration for supporting women livestock farmers in interior Sindh (Ranipur); Bank provided financial facilities, while Engro provided market access;

Kashf Foundation has also gradually expanded the range of its services. The range of its products is outlined in Box 1 below.

Box 1: Loan products offered by Kashf Foundation

General Loan	The GL is based on group collateral where a group of 25 women jointly insure each other against default. Center members have to wait for 7 days after their registration to get the first loan, while repeat clients can obtain a loan within 24 hours. The loans are advanced to female members of the household.	**Emergency Loan**	The EL has been designed to provide credit to clients during financially volatile periods. Clients use EL to pay their children's school fees, utility bills and all other unplanned petty expenditures. The EL loan is very easy and quick to access. The EL serves as a complementary loan to the GL and loans are disbursed through the same center methodology.
Home Improvement Loan	Kashf introduced the HIL in 2006, since home improvement and renovation was identified as a key priority by clients. The HIL works on the same group liability model where three to ten clients from the existing center form an HIL group and the responsibility of approval and repayment lies with the center.	**Insurance**	Kashf was one of the pioneer organizations to introduce life insurance for poor clients in order to deal with emergency periods such as the death of a bread winner. This service is provided to the client and her spouse at a minimal premium. The insurance covers all outstanding loan balances plus a small burial payout at the time of the death of either party.
Business Surmaya Loan	Clients requiring loans below Rs 500,000 cannot obtain access to formal financial sources, since such amounts are still too small for commercial banks. A quick estimate can show that the potential market for small enterprises is about 6 million with a negligible outreach to such entrepreneurs by the banking and the microfinance sector as a whole. Kashf targets fast moving small entrepreneurs through the BSL, the entire methodology of which is based on a credit scoring model. The BSL is advanced to clients with a minimum of 2 years running experience of their businesses and has no collateral requirements. Generally the loan has a minimum processing time of less than 5 days.		

The Khushali Bank products include an agriculture loan, livestock loan, asset purchase loan, working capital loan, new business loans and a micro-loan insurance scheme. Its loan products are based on a group methodology, interest rate of 29% declining with no collateral requirement but a mandatory insurance requirement. Table 3 below outlines some of the key requirements of the different types of loans offered by KB. For many years, KB did not offer deposit services. However, it has recently started offering a Khushhali Mahana Committee Account which is a non-interest bearing account and requires a minimum balance of Rs 200.

Table 3: Typical Khushali Bank Products

Product Features	**Details**
Product Name	Agriculture, Livestock, Asset Purchase, Working Capital Loan, New Business Loan
Product Type/Category (Group Based, Individual etc.)	Group Based
Product Description	Extended for managing running business for the purchase of raw material/inventory
Loan Eligibility Criteria	Age: 18 – 58 years, Maximum for repeat clients: 65 years Income: Maximum 150,000 PKR Resident for 2 years NADRA NIC Holder 2 years experience
Loan Amount	
(i) Minimum initial amount (ii) Maximum initial amount (iii) Maximum total amount	PKR 3,000 / 5,000 * PKR 10,000 / 15,000 * PKR 30,000 / 40,000*
Tenure/Repayment Options	3-12 Months Equal Monthly Installments / Bullet / Quarterly / Semiannual
Guarantors	Cross Guarantees
Collateral Insurance	None Mandatory
Rates & Fees Structure	29% (on declining balance)
Documentation Required	ILA, PG form, Cash flow, Credit scoring, Loan Contract terms and conditions, Schedule of Charges, Loan Repayment Schedule
Disbursement Tools (Draft/Cheque/Cash etc.)	Cheque / Draft / Direct Account Credit
Repeat Loans	Yes
Top Ups	Not allowed

There are a few MFIs which have their own particular philosophy of lending and offer some unique financial products. One of these is Akhuwat whose philosophy is based on the principle of Qarze-e-Hasna, i.e. helping someone in need with interest-free loans. In order to finance its operations it raises its funds through an appeal to philanthropists especially before Ramzan through special fund-raising events, appeals, awareness campaign and websites. Some volunteers also work on a marketing plan for funds mobilization. The Board also tries to identify partner organizations which can help with bringing in funds. Akhuwats loan products include a business loan in which the applicant has to come up with a viable business plan to become eligible for the loan. The Enterprise loan is also known as the family loan because during the period of appraisal and lending the entire family is involved in the process with the view to make it a family venture instead of individual effort. Among its more innovative products is what is described as a Liberation Loan which is used for the repayment of loans taken from moneylenders on interest basis. This type of loan is given to those who have borrowed money from moneylenders at very high interest rates. Akhuwat believes that this type of lending is exploitation of the poor and the needy and is resulting in increasing the poverty instead of reducing it. Akhuwat pays the principal amount in one go for the client and then the client has to pay back the amount in interest free instalments to Akhuwat. Range of this loan is up to Rs. 30,000. In addition, Akhuwat has an education loan, marriage loan, emergency loan, housing loan and a silver loan to expand existing business. The loan size and repayment period for each of these varies. Naturally the speed at which the MFI can expand its operations is slow and by the end of December 2008 it had given out only 13,000 loans.

B. Lending Methodologies

Despite the wide variety of microfinance providers in Pakistan, the lending methodology is surprisingly uniform. About 92% of the borrowers and 89% of the funds have been provided through the group lending methodology. The group lending methodology uses both the community group and the solidarity group approach. While the RSPs use the broad based village, community or women's20 organization as the group through which they provide financial services, the MFIs generally use the solidarity group lending model. Kashf Foundation, in particular, follows the Grameen Approach of solidarity group lending. The difference between the Community approach and the solidarity group approach mainly is that the community approach focuses on reducing the transaction costs of loan screening, disbursement and repayment whereas the solidarity group approach is more focused on using the group for guarantee purposes and ensuring that the social collateral become operative. While the community organization also exerts peer pressure for the return of the loan the collateral aspects of the community group are not always as well defined as the solidarity group model.

The Rural Support Programmes Lending Methodology

The RSPs use the forum of the Community Organization (CO) for delivering small loans which are given through COs to individual members for productive purposes. 21 The prime responsibility for identifying borrowers and assessing the character of the borrowers' lies with the COs. RSP staff appraises requests for credit to determine profitability of the proposed activities and assess repayment capacity of the borrowers. RSP disburses loans at the CO level and the CO is responsible for depositing the repayments with RSP mobile staff or RSP offices. Thus, the CO acts as a collector and also becomes a guarantor for the RSP loan. The forum of CO creates social pressure for the borrowers to repay RSP loans on time. NRSP also has an Urban

[20] Sununtar Setboonsarng, Ziyodullo Parpiev. Microfinance and the Millennium Development Goals in Pakistan: Impact Assessment using Propensity Score Matching Discussion Paper No: 104. ADB Institute. 18 April 2008.

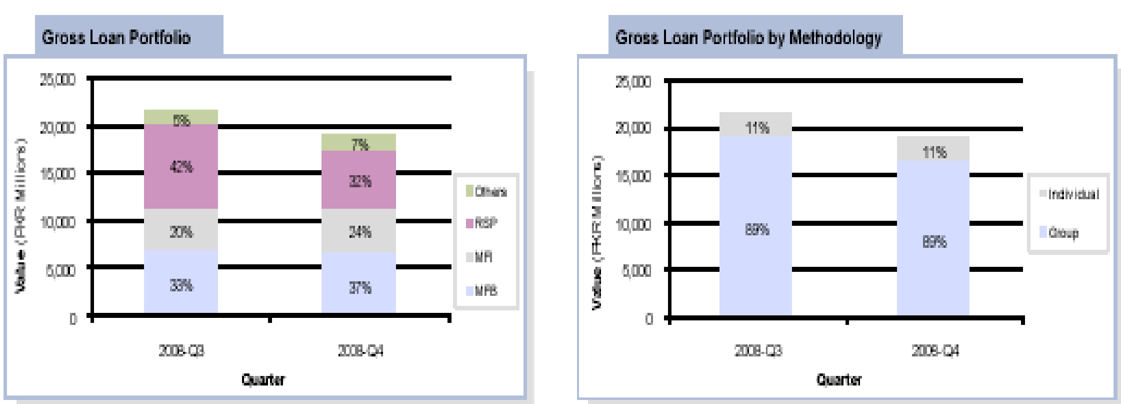
[21] Bajwa, Rashid. Committee on Rural Finance. Micro Credit Methodologies and the Role of the Rural Support Programmes in delivery of Microcredit in Pakistan. By Member (co-opted). December, 2002

Credit Programme that follows a group based; women focused approach which is different from the RSP rural credit approach. The UPAP was from the very outset designed as a sustainable programme with a careful analysis of its costs and revenues. Many of the other NGOs follow variants of this basic approach. The Thardeep Rural Development Programme (TRDP) extends microcredit to the community organizations (COs) without collateral, and on the basis of social guarantee. Micro credit is extended in the field of enterprise, livestock development, and small infrastructure development schemes, agri-input, etc. The Sungi Development Foundation (Group Lending) is based on a theme of saving first-credit later; which reflects the importance of community saving for their economic uplift. The major responsibilities of CED include support in mobilization of community savings.

Table 4: Lending Methodology of MFIs

		Lending Methodology		Peer Group[2]			
	Total	Group	Individual	MFB	MFI	RSP	Others
Number of Branches/Units							
2008-03	1,594			357	275	862	100
2008-04	1,552			366	256	820	110
Active Borrowers							
2008-03	1,871,508	1,740,230	131,278	622,960	456,939	721,682	69,927
2008-04	1,732,879	1,593,964	138,915	605,151	463,160	581,513	83,055
Gross Loan Portfolio (PKR Millions)							
2008-03	21,427	19,061	2,366	7,026	4,320	8,915	1,166
2008-04	18,752	16,622	2,130	6,801	4,594	6,084	1,274
Average Loan Balance (PKR)							
2008-03	11,449	10,953	18,025	11,278	9,455	12,353	16,674
2008-04	10,821	10,428	15,335	11,238	9,919	10,462	15,334
Number of Loans Disbursed							
2008-03	448,332	409,410	38,922	128,712	171,024	126,114	22,482
2008-04	576,943	542,025	34,918	174,979	195,882	185,107	20,975
Disbursements (PKR Millions)							
2008-03	6,509	5,519	990	1,931	2,265	1,964	349
2008-04	8,358	7,604	755	2,535	2,558	2,930	335
Average Loan Size (PKR)							
2008-03	14,518	13,480	25,428	15,000	13,243	15,572	15,535
2008-04	14,497	14,028	21,614	14,488	13,058	15,829	15,983

Figure 4: Gross Loan Portfolio by Methodology and Peer group (December 2008)



Kashf Foundation (Group-lending based on the Grameen approach)

Kashf's approach is based on targeting women from low-income communities. The women are asked to form into centers comprising of core groups of five, who then take responsibility for each others repayments. The entire centre ensures both the timely repayment of loans and provides a key resource for managing businesses and sharing information. The strategy also relies on setting up decentralized operations through a network of local branches, which are staffed by women from the local area. This ensures confidence building, trust and the ability to cater to women's economic needs on an on-going basis. Damen (Damen is Development Action for Mobilization and Emancipation) has in many based on the Kashf model of group-lending.

OPP (Individual Lending)

OCT supports people's initiative through providing credit to existing micro-enterprises at the bank rate of interest, without collateral (personal guarantee of 2 neighbors), of amounts ranging from Rs. 2,000 to Rs. 50,000 through simple procedures. Selection, disbursement and recovery of loan are done by OCT with the help of good borrowers.

SAFWCO (Group Lending)

A broad based NGO in Sindh specifically operates to mobilize the community groups for savings and forms male and female saving groups in the villages. It provides credit facility to the poor/vulnerable groups specially women and trains potential entrepreneurs for managerial and technical skills. The social organization section identifies the villages for credit and saving activities on the basis of their socio-economic situation. The Program Officer of the Credit section holds meetings with the COs on credit and saving policies and forms a Credit Committee to identify the poor for loans and for monitoring the credit program. Later, applications for credit are invited from the potential users through Credit Committees. They initially scrutinize the applications and recommend the applications to the Credit Section for disbursement. Members of Credit Committee, guaranteeing proper use and recovery, give the final approval for credit. The targeting, processing, disbursement, utilization and recovery procedures for credit are based on community participation, involving all members of the CO.

Micro-Finance Banks

While most banks use the individual lending model, the two largest banks, the Khushali Bank and the First Micro-Finance Bank use the group lending approach. The First Microfinance Bank uses all types of lending methodologies such as individual lending, solidarity group lending and village banking services. Its lending approach reveals its genesis as it was essentially a spin-off from the microfinance operations of AKRSP which is a major share holder in the FMFB. However, in terms of its savings products, the bank has been unable to develop a product for the small savers. Its deposits are largely made up of a few large institutional savers.

The Khushali Bank's lending approach is based on the Grameen model, i.e., it loans to community groups without collateral. The bank operates on a community-based service delivery mechanism and forms client clusters to reduce transactional costs. The Khushali Bank generally contracts an NGO for group formation and then its loan officers provide financing to these groups. An evaluation of the microfinance sector found that there was wide variation in the implementation of group lending methodology. While it was being implemented effectively in many cases in its spirit in other situations the group was being used as a convenient tool for quick disbursements and repayment. In many cases, groups existed only on paper and the borrowers themselves did not know that they belonged to a group.

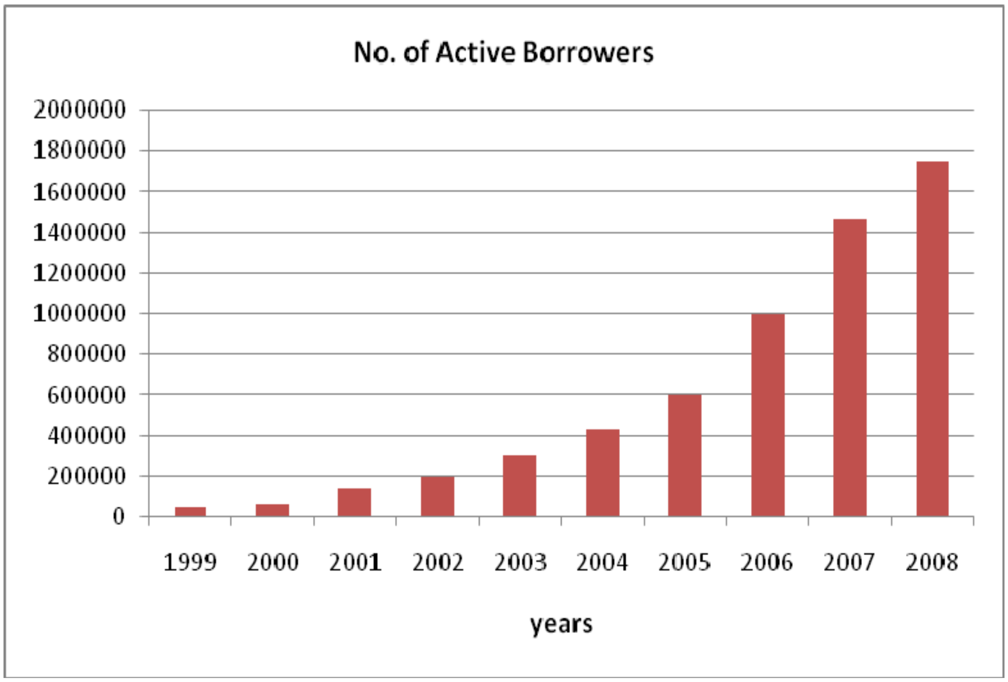
KB was established with a special mandate to target the poor. As such it has developed specific strategies to target poor households. To ensure that the loan reaches the target segment, KB has limited the loan size to about US$150, an equivalent of 36% of the per capita GDP, an amount in which wealthy people would not have interest. In practice, however, different members of the same household often borrow in tandem, rendering the small loan limit an ineffective deterrent. Khushhali Bank also uses another method of targeting: ranking poor prospective borrowers by tracking the economic status of their beneficiaries. This approach, however, is not adopted rigorously and suffers from subjectivity since participating households generally self-select themselves as poor. Moreover, the very aims of the Khushali Bank—obtaining group guarantees for repayment and maintaining a close scrutiny of monthly cash flows to determine the repayment capacity of potential clients—can potentially exclude the poor, a priori.

Chapter 4: Growth and Outreach

A. Overview

By the end of December 2008 there were 1.733 million active borrowers in Pakistan of which 47% were reported to be women.22 There were 1.743 million active savers and 2.241 insurance policy holders of various types. Thus there are more policy holders and active savers than there are active borrowers in the sector. However, while the total amount of loan outstanding was US$ 234 million, the amount of savings held by the clients was only US$ 67 million. There has been rapid growth in the sector in the last few years particularly between 2005 and 2007. Pakistan's microfinance sector was amongst one of the fastest growing globally, with an expansion of nearly 47 percent during 2007. The major growth in the sector has come as a result of donor financing of the Pakistan Poverty Alleviation Fund principally financed by the World Bank and the Khushali Bank which was established with financing from the Asian Development Bank. Figure 5 below shows the pattern of growth in the last few years. While the numbers have continued to grow the rate of growth has slowed down somewhat in the last year or so.

Figure 5: Growth in Active Borrowers in Pakistan



[22] MicroWatch Issue 10. The Pakistan Microfinance Network March 2009.

B. Growth in the Microfinance Sector in Pakistan

The Pakistan MicroFinance Network tracks growth in the sector on a quarterly basis and reports that in the last quarter of 2008 there was a dramatic downturn as microcredit growth entered into negative figures for the first time in two years. Active borrowers decreased by 7% while the Gross Loan Portfolio (GLP) of the sector fell by 12%. This decline is attributed to the financial crisis, the credit crunch; slow down in economic activity, political and economic instability in the country, lack of security and the rising Portfolio at Risk in the sector which is cautioning slow growth. The PMN reports that many MFIs have been unable to roll over-existing lines of credit. The increase in active borrowers has mostly come from smaller organizations such as BRAC, which has continued its modest growth. Organizations like the National Rural Support Programme (NRSP) and the First MicroFinance Bank (FMFB), which have been two of the largest contributors to microcredit growth, reduced their numbers in the last quarter of 2008. Despite the negative growth in the last three months, there was an increase in the overall number of borrowers last year.

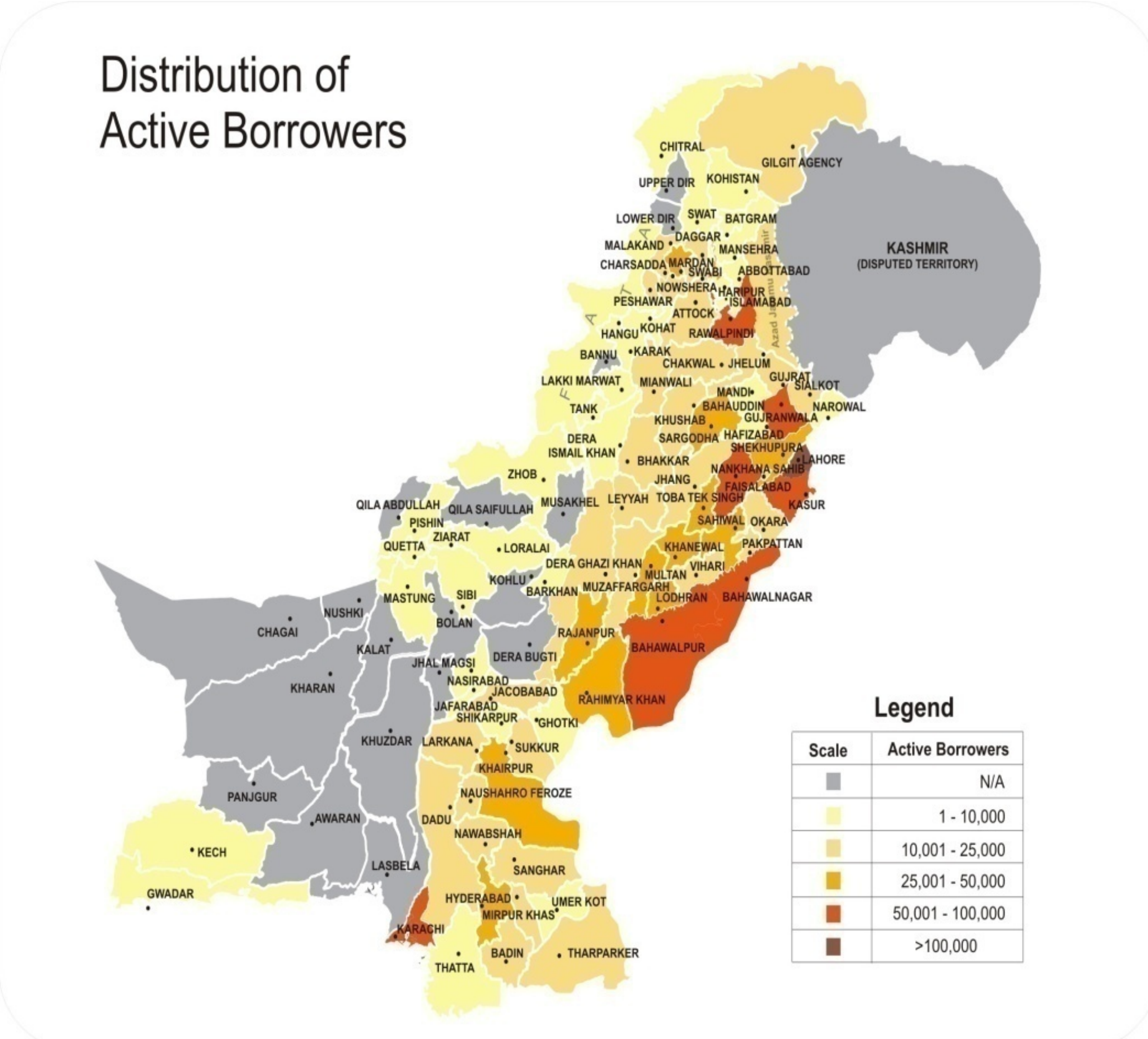
Table 5: Growth up to December 2008 in the Micro-Finance Sector

	Microcredit		Micro-Savings		Micro-Insurance	
	Active Borrowers	Value (PKR Millions)	Active Savers	Value (PKR Millions)	Policy Holders	Sum Insured (PKR Millions)
2008-Q3	1,871,508	21,427	1,857,737	4,961	2,300,289	37,824
2008-Q4	1,732,879	18,752	1,743,609	5,384	2,241,552	34,340
Increase (Net)	-138,629	-2,675	-114,128	423	-58,737	-3,485
Increase (%)	-7	-12	-6	9	-3	-9

Source. Pakistan Microfinance Network.

Although the range of financial services that an institution can offer is dependent on its legal status, most MFIs are currently providing similar products and targeting similar markets. A review of the geographic dispersion of active borrowers (Figure 6) shows that there is concentration of service provision in urban areas of Punjab and Karachi. There are large parts of the country which are underserved or un-served. Most MFIs have not provided coverage to rural areas because of the high cost of serving these areas. Pakistan has an overall population density of 206 persons per square kilometer.

Figure 6: Micro-Credit Coverage in Pakistan



* Geographical boundaries for new districts demarcated in 2004-06 have not been made available by Survey of Pakistan. The following districts are therefore, not shown on the map: Sehwan Sharif, Jamshoro (Dadu); Matyari, Tando Allahyar, Tando Muhammad Khan (Hyderabad); Shedadkot (Larkana); Mingora (Swat); Sherani (Zhob)

At the end of December 2008, the microfinance sector had 1,743,609 active savers and the total volume of savings constituted US$ 67 million. The number of savers surpassed the number of active borrowers. There are essentially two types of approaches used for generating savings in the sector. The first is intermediation which is when public deposits are used to finance an organization's loan portfolio. Only SBP-regulated MFPs (CFIs and MFBs) can accept and intermediate deposits from the general public. The second is mobilization: MFPs not regulated by SBP (MFIs, NGOs, RSPs) can neither hold nor intermediate deposits from the general public. These organizations do however mobilize savings from their members/clients to place with licensed commercial banks. The Table below outlines the total number of savers, the volume of savings and the savings balance in the sector at the end of December 2008. The figures indicate that the majority of the savers are with RSPs while the majority of the savings is with MFBs which rely on both low and high end deposits. Within the Banks the FMFB has the major share of savers. An analysis of the number and volume of savings shows that MFBs have an average balance of Pak Rs 16,594 while the RSPs have an average balance of Pak Rs 925 per account.

Summary of Micro-Savings Provision December 2008

Saving Methodology				Peer Group			
	Total	Intermediation	Mobilization	MFB	MFI	RSP	Others
No of Savers	1,743,609	227,314	1,471,167	244,173	28,269	1402,203	68,964
Value of Savings (PkR) millions	5,384	4,052	1,332	4,052	5	1,297	30
Average Savings Balance (PkR)	3088	17,825	905	16,594	174	925	429

Savings is not an area which the sector has focused upon very significantly. The Rural Support programmes which patterned their programmes on the model of AKRSP initiated savings not because it offered a service to the client but because it was in keeping with their strategy of social mobilization which dictated that capital accumulation was a key part of building social capital. As such, the savings programmes offered by the RSPs have lacked some of the key attributes of savings products which clients generally prefer such as liquidity, security, convenience. Savings were often used by the RSPS as security for group loans and as such members could not withdraw funds if there was a loan outstanding against the VO or WO. The growth in the number of savers and volume of savings is illustrated in the graphs below. This shows that savings have been more or less static with RSPs/MFIs. There appears to have been a special push to enhance savings by the RSPs/MFIs in the last one year. MFBs have shown a steady growth in both the volume and number of savers.

Figure 7: Growth in Savings of RSPs

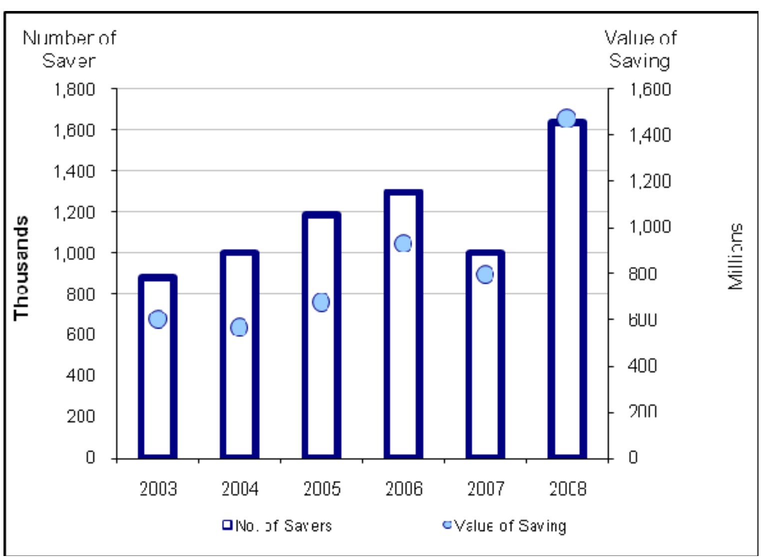
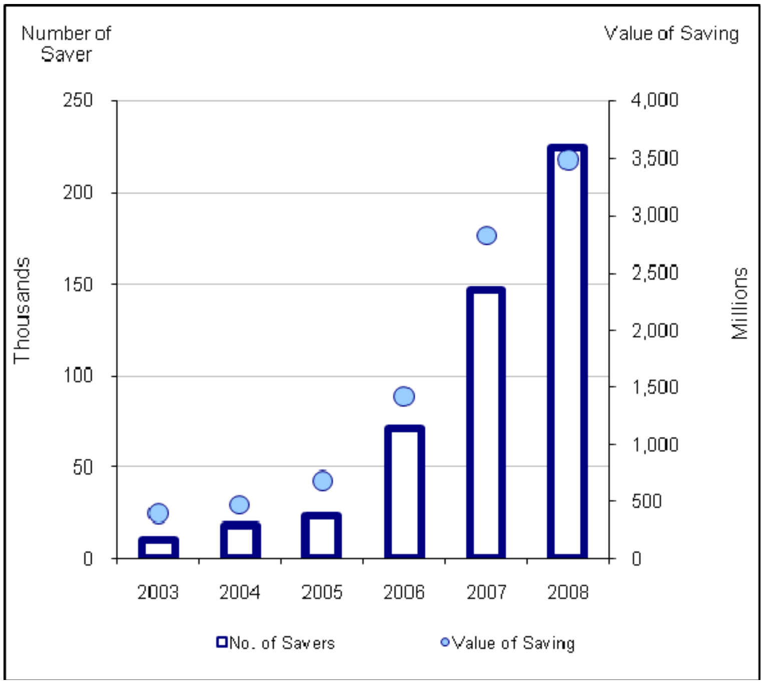


Figure 8: Growth in Savings with Micro-Finance Banks



Given the sector's credit focus in the past, developments in micro-insurance have grown rapidly due to effective negotiations by the MFIs on behalf of their clients with insurance companies. By the end of December 2008, there were approximately 2.2 million policy holders in the microfinance sector, of which 70 percent were covered by life insurance (or more precisely, credit-life) and the rest by health. Kashf Foundation has the largest number of clients with insurance (approximately 600,000), followed by National Rural Support Programme (NRSP), which offers both life and health insurance. NRSP has also partnered with Adamjee Insurance Company Ltd. to provide health insurance to its clients.23

Establishment of the First Micro Insurance Agency (FMiA), as an affiliate of the Aga Khan Agency for Microfinance (AKAM), is the first concerted effort to promote micro-insurance in the sector. FMiA is currently working with a number of MFIs such as First Micro Finance Bank (FMFB), Tameer MFB, Khushhali Bank (KB) and Kashf to develop and offer credit-life and health insurance products. It also plans to extend its product range to livestock and crop insurance in the future. At the moment, the target market for FMiA and its partners are their credit clients. The extension of stand-alone insurance products will take a few years. FMiA's back office functions are handled by New Jubilee Life Insurance Company Limited.

As in most countries, the sector is dominated by a few players in terms of market share and growth. The top 5 Microfinance providers which include the NRSP, the Khushali Bank, Kashf Foundation, the First

[23] PMN, 2008.

Microfinance Bank and the Punjab Rural Support programme have 80% of the market share in terms of active borrowers at the end of December 2008. Table 6 below gives the top providers and their market share.

Table 6: Share of Top 5 MFIs in Pakistan

	MFP	Active Borrowers (31 Dec)	Market Share (% of Active Borrowers)
1	NRSP	463,383	26.7
2	KB	366,714	21.2
3	KASHF	319,652	18.4
4	FMFBL	171,795	9.9
5	PRSP	79,378	4.6

C. Rural Support Programmes and Broad Based Development NGOs

Rural Support Programmes originated in Pakistan during the 1980s when the first RSP -the AKRSP - was established in the Northern Areas of Pakistan. In subsequent years, the RSP model based on community-organization and mobilization was replicated across the country. There are currently over 10 RSPs operating across Pakistan. The Rural Support Programmes and broad based development NGOs provide microfinance services as well as grants for community level infrastructure projects, education and health services at the village level. While some of the rural support programmes have received initial endowments from the Government such as the National Rural Support Programme, the Punjab Rural Support Programme and the Sindh Rural Support programme and are therefore known as Government-sponsored Non-Governmental Organizations (GoNGOs) most others have received no support from the Government but rely almost exclusively on donor support such as the Sarhad Rural Support Programme, the Balochistan Rural Support Programme and the Thardeep Rural Development Programme. A few other organizations are also included in this category such as the Development Action for Mobilization and Emancipation (DAMEN), Sungi Development Foundation and Centre for Women Cooperative Development (CWCD). International NGOs have also entered the sector, with Bangladesh Rural

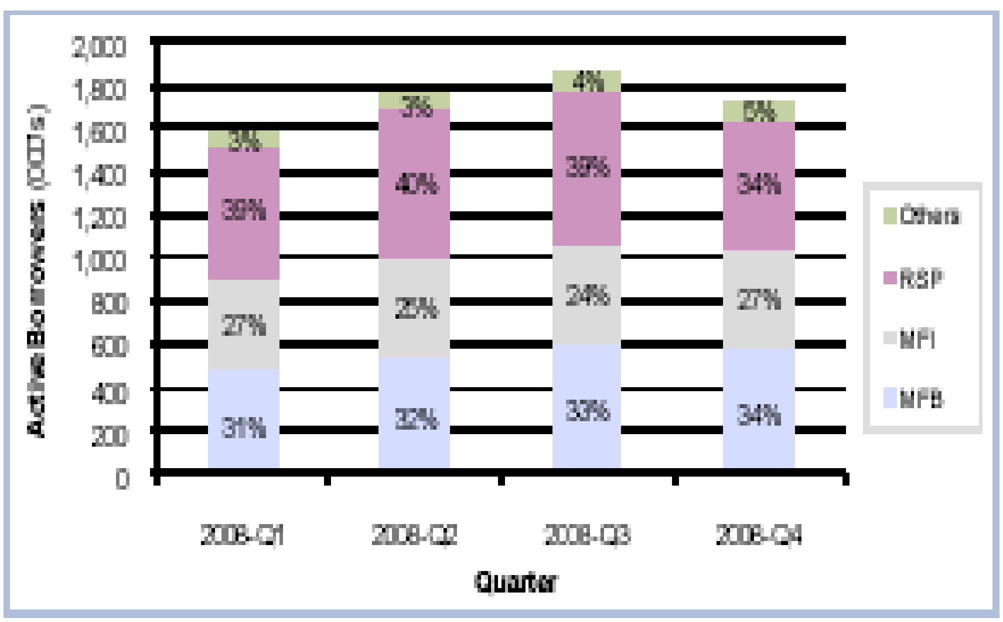
Advancement Committee (BRAC) beginning operations in 2007 and ASA expected to start its operations soon in Pakistan. Table 7 below provides some basic details about some of the leading RSPs and other NGOs.

With respect to microfinance, the RSPS and broad based NGOs are the largest peer group, accounting for 39 percent of active borrowers at the end of December 2008. However, this large share can mostly be attributed to the National Rural Support Programme (NRSP), which accounts for 80 percent of this peer group's outreach. Again, due to their multidimensional nature, the microfinance services offered by most RSPs are limited to one or two basic credit products. RSPs also mobilize savings from their members but since they are not allowed to take deposits these are deposited in commercial banks in the name of the community organizations. There is a wide variation in these organizations in terms of their financial management and sustainability. While two of these organizations are operationally self-sufficient, the others subsidize their microfinance operations from grants received through donor support or income earned from other development activities. The Punjab Rural Support programme and the Sarhad Rural Support programme have had particular problems with their microfinance programmes. As a result, PRSP has considerably slowed down its activities in the sector while SRSP and the Balochsitan Rural Support programme have conducted a complete review of their earlier programmes and have initiated new programmes with a clear assessment of costs and sustainability.

Table 7: RSPS and Broad Based Development NGOs

	NRSP	PRSP	DAMEN	CSC
Year Founded	1991	1998	1992	1989
Outreach Indicators (December 2007)				
Active Borrowers	407,641	69,361	32,627	15,525
Active Savers	760,425	333,714	-	-
Gross Loan Portfolio (Rs. Million)	4,711	552	250	114
Value of Savings (Rs. Million)	969	82	-	-
Financial Performance Indicators (2007)				
Operational Self Sufficiency (%)	101.2	65.8	108.7	85.1
Advances to Deposit ratio (%)	-1.8	-12.0	0.6	-8.3
Portfolio at Risk - at 90 days (%)	0.5	19.1	1.7	1.0
Return on Assets (%)	21.7	13.6	34.8	12.1

Figure 9: Market Share of Different Types of MFIs



D. Specialized Microfinance Institutions

Microfinance Institutions (MFIs) are non-bank microfinance providers that specialize in provision of microfinance services. Currently, five MFIs are operating in Pakistan and collectively, they reach 386,000 active borrowers. These organizations are registered with the SECP under the Companies Ordinance 1984 as non-profit associations or under the Societies Registration Act 1860, or as trusts under the Trusts Act 1882, which fall under provincial governments' jurisdiction. Given their non-bank status, they cannot 'intermediate' deposits, although some do 'mobilize' savings from their clients. With the exception of one (SAFWCO), all others originated in Punjab and most of their operations are concentrated in this province. The flagship service of these institutions is microcredit but some basic insurance services (mostly credit-life) are also provided to the credit clients. Group lending remains the dominant lending methodology but some of the MFIs, such as Kashf and Asasah who are diversifying into larger loan sizes, are beginning to deal with individual clients as well. At the end of December 2008, these MFIs had a market share of 27% in terms of active borrowers. Some like Akhuwat as explained earlier have an unusual strategy which is not to charge any interest on the loans but raise funds for operations through philanthropic contributions.

Table 8: Specialized MFIs

	Asasah	Kashf	SAFWCO	Akhuwat	OPP
Year Founded	2003	1996	1986	2001	1987
Outreach Indicators (December 2007)					
Active Borrowers	24,692	295,275	16,742	10,194	22,129
Active Savers	24,692	-	-	-	-
Gross Loan Portfolio (Rs. Million)	192	3,046	103	58	153
Value of Savings (Rs. Million)	4	-	-	-	
Financial Performance Indicators (2007)					
Operational Self Sufficiency (%)	64.7	164.0	90.4	64.8	224.7
Advances to Deposit ratio (%)	-12.8	9.3	-7.0	-11.9	12.6
Portfolio at Risk - at 90 days (%)	0.0	0.1	3.6	0.4	0.3
Return on Assets (%)	37.0	36.2	15.7	11.1	19.7

E. Microfinance Banks

Microfinance banks are relatively new players in the microfinance market in Pakistan, but have gained importance relatively quickly. All MFBs are established under the Microfinance Institutions Ordinance 2001 and are regulated by the State Bank of Pakistan. To date, six MFBs - four national level and two district level (in Karachi district) - are operating in the country and two others; Kashf Micro Finance Bank and NRSP Bank have recently obtained licenses from the SBP. The largest, in terms of market share and geographic network is the Khushali Bank (KB) 24 and the First Micro-Finance Bank which between them have 90% of the share of active clients of this peer group. Most of the banks are currently using the same group-based lending methodology as non-bank MFIs, except for Tameer MFB, which deals with individual clients and offers larger loans compared to the market average. Although banks can offer their clients services other than credit such as savings, remittance, etc, these products remain under developed, and with the exception of one or two institutions, not a lot of focus is placed on developing deposit or insurance services. The Khushali Bank which was the first bank to enter the market has had little or no incentive to develop a savings product as it was provided funds by the Asian Development Bank and commercial Banks which were required to buy its shares by the Government of Pakistan. The First Micro Finance Bank Ltd is also diversifying into products and has undertaken some innovative arrangements for extending its outreach in rural areas through partnership with Pakistan Post Office.

Table 9: Micro-Finance Banks

	KB	FMFB	TMFB	P-O MFB	NMFB	RMFB
Type of license	National	National	National	National	District (Karachi)	District (Karachi)
Year Founded	2000	2002	2005	2006	2004	2005
Outreach Indicators (December 2007)						
Active Borrowers	330,952	102,604	26,029	15,008	2,305	2,316
Active Savers	0	81,158	44,560	15,762	2,891	4,565
Gross Loan Portfolio (Rs. Million)	2,911	1,234	427	97	60	34
Value of Savings (Rs. Million)	0	2,048	649	23	90	32
Financial Performance Indicators (December 2007)						
Operational Self Sufficiency (%)	80.1	89.7	47.3	60.4	46.0	49.0
Advances to Deposit ratio (%)	-	79.2	63.1	403.2	55.0	103.9
Portfolio at Risk - at 90 days (%)	0.7	0.8	4.6	5.9	8.2	13.9
Return on Assets (%)	-9.3	-4.3	-21.4	-15.2	-17.4	-21.4
Yield on GLP - nominal (%)	21.7	27.4	28.8	24.2	28.4	27.0

[24] While this Bank was initially established under s special Ordinance it is now being brought under the purview of the main Microfinance Ordinance 2001.

F. Commercial Banks and Commercial Financial Institutions in Micro-Finance

Commercial banks in Pakistan have generally gotten into micro-finance as a result of a stipulation from the government. At one point, banks were directed to provide loans to the agriculture sector and they were given a rebate on the lending they provided. Despite the incentive, very few banks provided the requisite quota. Some banks like the Khyber Bank have established a special micro-finance department inspired more by a social welfare orientation than by a belief that micro finance was a profitable venture. Khyber Banks participation in the microfinance sector was also encouraged by donors such as the Asian Development Bank and the International Fund for Agriculture Development (IFAD) which envisioned that the credit component in their development interventions would be provided by the Bank of Khyber. However, this experience was positive only sporadically when there was committed leadership at the top. At the operational level, the Khyber Bank found that its existing staff and systems were not well suited to conducting micro-finance operations. The First Women's Bank also established a micro-finance lending operation but this lacked outreach and a true understanding and commitment. More recently, the Government has persuaded commercial banks to enter the sector through equity contributions to the Khushali Bank. However, the Government has now decided to privatise the KB and plans to offer its shares on the market.

Several interactions between the commercial sector and the micro-finance sector in Pakistan have materialized in the past due to MFIs search for funds. This has led them to forge a range of arrangements with commercial banks. Some of them have been fairly standard type of arrangements while others have been more innovative. The restriction on commercial banks in Pakistan not to provide unsecured loans above Rs 5 million has worked as a constraint in forging some of these partnerships. MFI-NGOs which have been able to provide collateral have benefited more from these arrangements. The National Rural Support Programme has pledged its government securities to secure loans from a host of commercial banks such the Habib Bank, Al-Falah Bank, Soneri Bank and First Women's Bank. Kashf and Asasah have been able to secure funds from the Muslim Commercial Bank and others, etc. However, the sector has been less entrepreneurial than in most countries in securing such arrangements.

The mainstream commercial banking sector believes that micro-finance poses excessive risk and there are no added incentives for them to enter a market when existing operations have yielded annual profits of between 60 to 100% in the last few years. However, some banks are exploring other models, such as the service company model, which reduces their direct risk exposure. The commercial sector has been enamoured with consumer lending and feels that a loan product which helps them secure loans against salaries and spread their risk offers a good path for growth. Without access to specific credit technologies for the microfinance sector, the commercial banks have been reluctant to enter the sector. As a result of the current tight liquidity conditions in the inter-bank market and rising yields on government paper and corporate debt, the commercial banks have little incentive to venture into this new area. The financial crisis is likely to further limit commercial appetite for microfinance.

The micro-finance practitioners in Pakistan have a strong view about the direct entry of commercial banks into the micro-finance sector. While micro-finance NGOs feel that commercial banks will be unable to undertake micro-finance due to their very different orientation and it is best that they stay out of the sector. In this context, the government has taken a liberalized approach and rather than pursue the old approach of directed lending for priority sectors it has issued guidelines which list the various options for commercial banks to enter into the micro-finance sector through partnerships with NGOs and through downscaling their products. In view of the current financial crisis the commercial banks entry into the microfinance sector appears somewhat unlikely.

G. Other Financial Service Providers

The first foray into microfinance by a regulated financial institution was made by a leasing company - Network Leasing Corporation (NLCL), established in 1995, specifically for providing microleasing services to small businesses throughout Pakistan. The latest annual report of NLCL shows credit lines from Deutsche Bank Microfinance Fund, Swiss Agency for Development and Cooperation (SDC), and Pakistan Poverty Alleviation Fund (PPAF). This company is now facing serious problems due to internal fraud and poor management systems. ORIX Leasing Pakistan (OLP) is a leading financial service company with an array of products. Established in 1986, OLP is a listed Pakistani leasing company sponsored by ORIX Corporation Japan - an integrated financial service company with over $50 billion assets spread over 23 countries. It has also been providing services to the micro-finance sector through arrangements with ASASAH and other intermediary MFIs.

Although not considered mainstream institutions, some public sector organizations also provide financial services to the public. Amongst these are the National Savings Organization (NSO) and Pakistan Post Savings Bank (PPSB). The NSO acts as an agent for the Ministry of Finance (MoF) and mobilizes savings through various types of deposits and savings instruments. Its products are available through its own network of 368 centers, as well as in post offices and branches of commercial banks across the country. Some of the products offered by the organization are of interest to small depositors, as the minimum deposit is now low (Rs. 100 for a savings account, Rs. 500 for some savings certificates and the special savings account). Prize Bonds sold by the NSO also come in small denominations and are relatively popular with the urban poor. Besides its core function of handling mail, Pakistan Post performs various agency functions for the government, including providing deposit services to the general public through half of the 13,000 PPSB branches. According to estimates, the PPSB holds deposits worth Rs. 56.6 billion in approximately 3.8 million accounts, of which an estimated 70 percent are below Rs. 10,000. In October 2007, Pakistan Post entered into a public-private partnership with FMFB which will allow FMFB to use 4000 of the Post's sub-offices for expanding its own microfinance operations.

H. Support Organizations

The Pakistan Microfinance Network (PMN) has provided critical support to the sector in terms of establishing industry standards, transparency, performance indicators, capacity building, research and advocacy for policy support. It is the only national level network for microfinance practitioners in the country. It emerged after the first Microcredit Summit held in 1997 as an informal effort by some practitioners, and was formally registered with the SECP as a non-profit company in 2001. Its membership currently includes 20 organizations from the various MFI peer groups who collectively account for over 95 percent of the sector. The network's vision and mission revolve around expanding access of formal financial services and supporting retail institutions in achieving this objective. Its efforts towards promoting transparency and creating an enabling environment for microfinance in Pakistan have been widely recognized. A few provincial level networks are also operating in the country but except for the Sindh Microfinance Network that was established through the efforts of the local NGOs, others have failed to move forward. Microfinance banks are also members of the Pakistan Bankers' Association (PBA), which was established in 1953 to coordinate the efforts of the banking industry in Pakistan.

The JCR-VIS Credit Rating Company is one of the two local institutions providing ratings for financial institutions in Pakistan. It is also the only company that provides ratings for MFBs and MFIs. MFBs are required to be rated annually as per SBP's requirements, but some MFIs have also had themselves rated in order to ascertain 'where they stand,' or as part of their strategies to access commercial funding in the future.

Currently, there is no credit bureau in Pakistan that covers the entire microfinance sector. The largest credit bureau is the CIB, housed in and run by the central bank, and all banks are required to submit information on all outstanding loans to the CIB. Microfinance banks are also required to report to the CIB. In addition to SBP's CIB, a few private sector credit bureaus also exist but they mainly serve the banking sector. However, efforts are underway to establish a credit bureau for the microfinance sector. Due to the strong interest of its members, PMN has begun working on setting up a pilot credit bureau in Lahore, covering all MFIs working in the district. Initially, this will house negative information only and is mostly intended to be a test run for a full fledged, country-wide CIB for the sector. In addition to the PMN, the ADB has also undertaken a feasibility study for the establishment of a CIB for the sector and their report is expected soon.

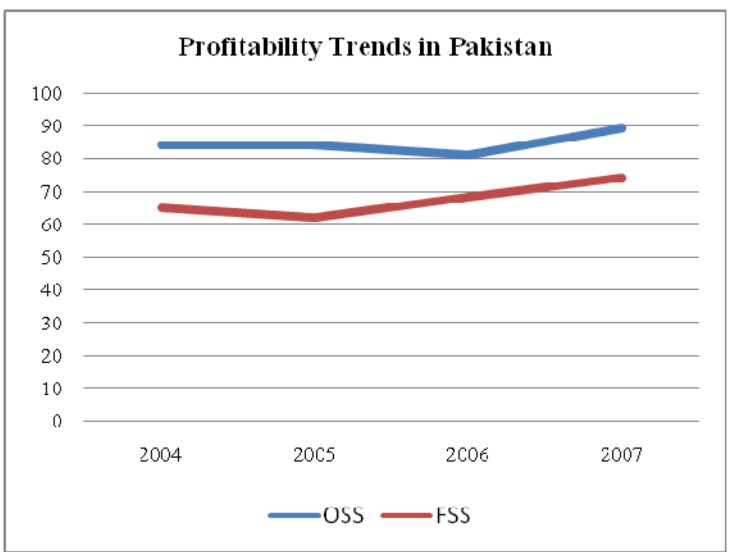
Chapter 5: Sustainability

A. Overview

Despite a sound regulatory framework for microfinance and significant injections of donor funding (estimated at close to US$ 400 million over the past five years), there is a lack of strong, sustainable institutions in Pakistan able to reach the scale necessary for significant impact.25 The number of microfinance institutions in the country is over 100 but less than 20 have portfolios of any significant size. However, the sector has come a long way in the last five years. At the start of 2000, the Pakistan Microfinance Sector was being financed by donor grants. Financial services were provided as one of the many development activities by NGO. There was no real separation of microfinance programmes or estimation of how much it was costing to run these programmes. Interest income that was being accrued would flow back into the overall budget of the organization. Until that time, microfinance was largely regarded as a social rather than a financial service. The staff managing the microfinance programmes had strong social sector skills and backgrounds, but little financial sector expertise. There was ambivalence in the attitude towards sustainability and a reluctance to charge interest rates that would cover costs.

The overall sustainability trends indicate that the sector in Pakistan has hovered at more or less the same Operational Self Sufficiency and Financial Self-Sufficiency levels due to the rapidly shifting individual MFI ratios. At the end of 2007, the sector was at 89% OSS and about 74% Financial Self-Sufficiency.

Figure 10: Profitability Trends of the Microfinance sector in Pakistan



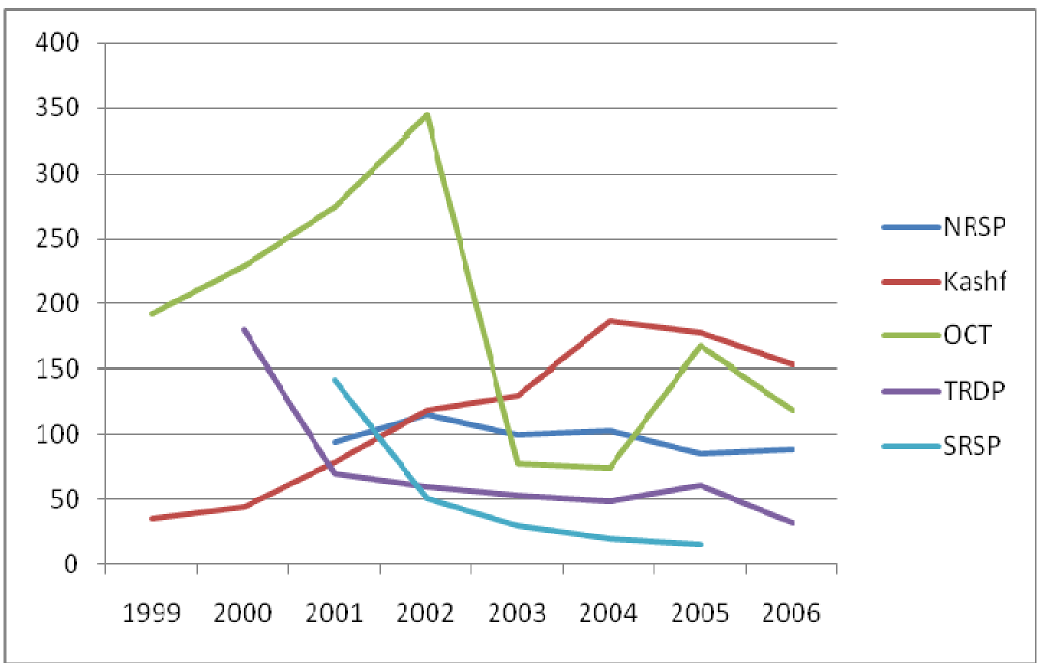
[25] CGAP Pakistan Country-Level Effectiveness and Accountability Review (CLEAR) with a Policy Diagnostic

At the end of December 2007 the PMN reported the following performance indicators for the microfinance sector in Pakistan;

26% yield on gross loan portfolio;
1.7% adjusted return on assets;
89% operational self-sufficiency;
74% financial self sufficiency;
3.1% portfolio at risk (PAR) > 30 Days;
50.7% gross loan portfolio to total assets

The Pakistan Microfinance sector has rapidly moved towards a different orientation in the last few years. From a sector which was not even fully aware of its costs of service delivery until recently, it has now emerged as a sector with a heightened consciousness about its costs and sustainability. A review of the Operational and Financial Self-Sufficiency ratios over the last few years indicates that these have fluctuated widely for some of the main MFIs. Many of the organizations were being financed by donors and interest income entailed a net inflow of funds. Some did not have a clear sense of their costs. Thus some organizations after having achieved "self-sufficiency" in their initial years have again experienced a reduction in their revenues as a result of rapid expansion. Kashf which from the outset was a specialized MFI with proper financial systems has been one of the few to track its costs and design a business plan with clear indicators regarding sustainability has steadily increased its OSS and FSS. Figure below illustrates the fluctuating self-sufficiency ratios of some of the main MFIs in Pakistan.

Figure 11: Operational Self-Sufficiency of Selected MFIs



PMN reports that the yield on the gross loan portfolio has been steadily increasing. While the yields in Pakistan are better than the average for South Asia, they are below those in other regions of the world.

Figure 12: Yield on Gross Loan Portfolio in Pakistan

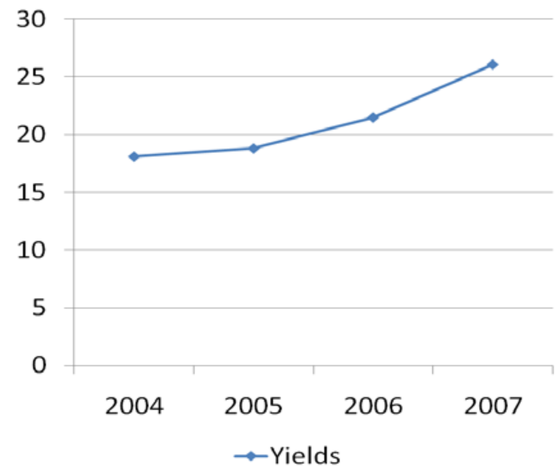
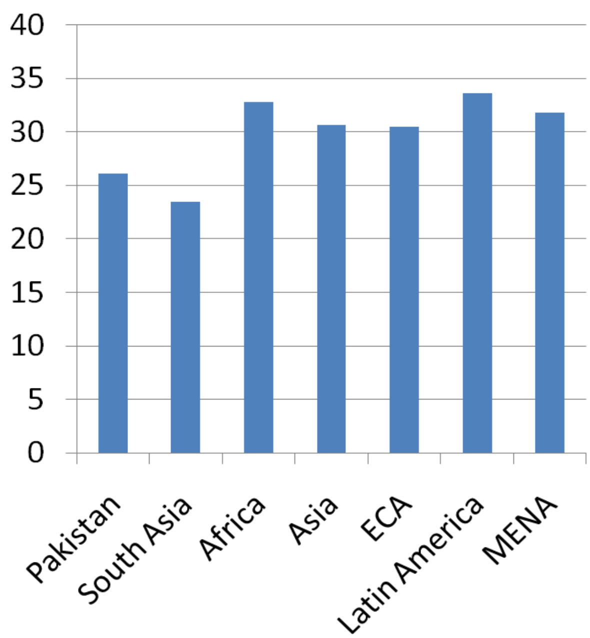


Figure 13: Comparison of Yield on Portfolio



B. Interest Rates

PPAF currently has a differentiated interest rate policy with regard to its Partner Organizations. It charges the NGOs an interest rate of 8 percent and has fixed an interest rate of 10 percent for private sector leasing companies and microfinance banks. PPAF has linked its interest rates to the inter bank rate in order to gradually move the sector towards sustainability. In its last loan with Kashf it raised the interest rate to 10.3%. As far as the interest rate policy of its partners is concerned PPAF mandates that its POs charge its clients interest rates that fully cover its costs and fix rates that are not less than the long-term deposit rates. It believes that each PO must, based on its business model, develop its own policy. However, PPAF's subsidized funds are not meant to be passed on to the client entirely. Passing on the subsidies means that institutions forgo the opportunity to become strong enough to raise commercial capital, or intermediate funds, and grow independently of donor funds. PPAF believes that subsidies can skew the credit culture because clients are not exposed to the real cost of obtaining credit. Although it may seem morally attractive to pass subsidies to clients, it actually prevents a larger number of people from accessing services in the long run, because institutions cannot expand significantly without using initial subsidies to build their own capacity. Invested well, donor subsidies can yield ongoing returns, not just a one-time resource transfer. A historical review of interest rates in the micro-finance sector shows that interest rates have moved from an average of about 3% to 30% today.

Nevertheless one of the key challenges in the sector in Pakistan is that most MFIs in Pakistan do not charge their clients interest rates that are high enough to enable them to cover their costs. A look at the average operating expenses of PMN members compared with the revenues generated from the loan portfolio (yield on portfolio) suggests that MFIs are not pricing their loans appropriately.26 On the one hand, the average operating expense ratios of the leading MFIs are basically in line with the region's overall low ratios at 22.4 percent compared with 22.8 percent for all of Asia. On the other hand, revenues generated from the loan portfolio (e.g., the yield on portfolio) are low at 18.8 percent for the leading MFIs compared with 30.7 percent in Asia on average.27 The CLEAR Report28 noted that the precondition of raising yield on portfolio for sustainability and growth of the microfinance sector in general and for individual microfinance providers has been recognized and accepted across the industry by key policy drivers at all levels. Thus it is anticipated that in the next few years the pricing structure of most of these organizations will shift towards sustainability. In fact it is already beginning to happen, with for example, the National Rural Support Programme (NRSP), the largest supplier of micro-credit in rural areas, now starting to raise its interest rates.

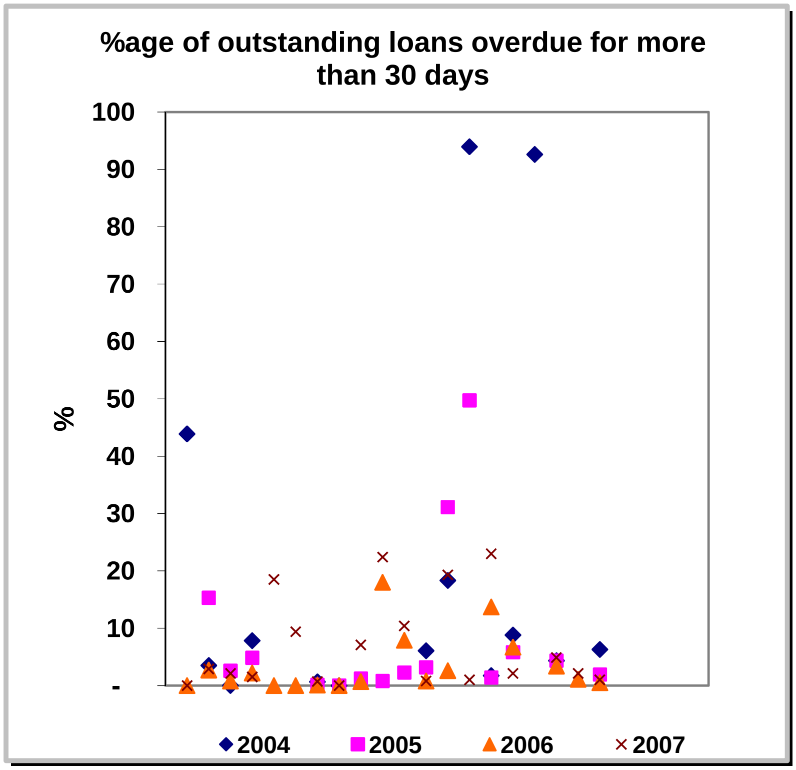
C. Portfolio at Risk

The Pakistan Microfinance Network monitors the portfolio at risk in the sector. Apart from a few outliers this has generally remained at acceptable levels in the past. In 2005 PAR was reported to be 9% for loans overdue for more than 90 days. In 2006 the PAR was 5.2% for the sector as a whole for loans overdue for more than 30 days and in 2007 it was further reduced and reported to be 3.1% for loans overdue by more than 30 days. Figure 11 below provides details of the PAR for the last few years in Pakistan. However, it is felt that these figures do not reflect the accurate PAR in the sector and that MFIs maybe under reporting on the PAR. In 2008 some organizations like Kashf are facing a serious problem with their PAR which at one point was

[26] The Pakistan Micro-Finance Network.
[27] The Pakistan Micro-Finance Network.
[28] CGAP. 2006.

reported to have reached 60% and has caused serious concerns in the sector as a whole. The reasons for this are not entirely clear but are reported to be due to political interference and client dissatisfaction. As a result the PMN has commissioned a separate study to examine the causes. A few partners of PPAF have also in the past faced problems of repayment such as the Taraqee Foundation, Network Leasing, etc. PPAF has suspended further financing to these organizations but the bad debts do not get fully reflected in the information system.

Figure 14: Portfolio at Risk



The PMN reports that there is no consistent policy for write-offs followed by MFIs in the sector. Many institutions are not writing off loans and carrying these bad assets on their books for imprudent periods. Under the existing regulatory framework for the sector, only the MFBs have a clear policy for classification of loans which is defined by the State Bank of Pakistan.

D. Client Drop Out Rate

Client drop out is an issue which has concerned MFIs and their donors in Pakistan. As a result the European Union commissioned a study29 which reviewed the issue in some depth. The study used the Schreiner Formula that calculates dropout rate as follows:

Dropout Rate (DOR)	=	1 – Retention Rate
Retention Rate (RR)	=	ACend / (ACbegin + NC)
ACend	=	Number of active clients at the end of a year
ACbegin	=	Number of active clients at the beginning of a year
NC	=	Number of new clients entering during the year

Based on Schreiner's Formula, the study found that annualized dropout rates (over a time period of a year and more) ranged from between 26.5% to 32%. While it may not be appropriate to directly compare these rates with other rates which may use different parameters to calculate the rate, the Pakistan dropout rate was fairly close to the average dropout rate of 28% reported by MFIs in Asia and well below the average global dropout rate of 48%. Table 10 below shows that the main factors for borrower dropout. Factors related to MFI policy and product design was the most commonly cited reason (63%) for drop out. Within this the product design and more specifically the cost of the loan was a significant reason for drop-outs. Idiosyncratic shocks reflecting the vulnerability to shocks of poor clients were the second main set of causes. The group lending methodology may also contribute to the dropout rate as 8% of the responses cited inactive group as a reason for drop out. A significant share of factors (about 15% in terms of equalized frequency) to borrower dropout was the lack of need to borrow again.

Where loan size was a major factor for borrower dropout, the loan amounts were considered inadequate to completely finance an income generating activity. Thus the loan was either used for non-productive purpose or the borrower had to find other source of fund to augment the loan for business or income generating purpose or when a business was being supported by inadequate capital injection, its probability of failure was increased or income generated was sufficient only to repay the loan. About 6% of respondents cited small loan size as the reason for dropping out. Problems associated with interest rates, repayment pattern and loan duration were the most commonly cited reasons for the dropout. Borrowers found interest payments high, the frequency of installments too quick, the loan period too short and penalties too high. In many cases, the loan was used to invest in an activity without immediate returns whereas the loan repayment commenced immediately after loan disbursement. This often made the client to borrow from elsewhere to meet the repayment obligation. The study maintained that its results show how little research is done by MFIs to tailor micro credit products according to the need of the borrowers. The EU study also examined the extent to which religious reasons accounted for drop-outs. On an overall basis, this factor accounted for 5% of dropouts but geographic location was a major factor in determining its significance.

[29] Research Brief on The Causes of The High Rate of Drop-Out Amongst Micro-Finance Borrowers. Civil Society Human And Institutional Development Programme (CHIP). Pakistan Financial Services Sector Reform Programme (PFSSRP). Contract Number PAK/AIDCO/2002/0382/06. December, 2005

Table 10: Causes of Client Drop-Out in Pakistan

#	Causes of Client Dropout	NGO A	NGO B	NGO C	Overall
A.	**Organizational Design and Policy**	**56**	**83**	**51**	**63**
A.1	**Loan Processing**	**1**	**8**	**10**	**6**
A.1.1	Application Procedure and Formalities	1	5	5	4
A.1.2	Selection Criteria	0	3	5	2
A.2	**Communication Strategy**	**0**	**24**	**0**	**7**
A.2.1	Communication Gap regarding cost structure	0	17	0	5
A.2.2	Information dissemination about loan availability	0	7	0	2
A.3	**Loan Product Design**	**18**	**51**	**36**	**35**
A.3.1	Small Loan Size	4	0	13	6
A.3.2	Short Loan Length	4	0	5	3
A.3.3	Repayment schedule	8	12	4	8
A.3.4	Loan too Expensive		23	14	13
A.3.5	Interest Rate is Un-Islamic	0	16	0	5
A.4	**Staff Related Causes**	**6**	**0**	**5**	**4**
A.4.1	Inadequate attention to borrowers due to lack of Competence, Workload, remuneration basis, etc.	6	0	5	4
A.5	**Group Related Causes**	**31**	**0**	**0**	**11**
A.5.1	Pushed out by Group due to Repayment Problems	2	0	0	1
A.5.2	Conflicts within the Group	6	0	0	2
A.5.3	Group became inactive	23	0	0	8
B	**Idiosyncratic Shocks**	**15**	**2**	**30**	**16**
B.1	Inability to Repay due to weak business / other reasons	9	2	12	8
B.2	Closed the business to do something else	0	0	2	1
B.3	Spent the money on crisis or celebration	2	0	10	4
B.4	Lack of ability / time to continue business	2	0	0	1
B.5	Emigration	2	0	1	1
B.6	Stopped by Family member	0	0	3	1
C	**Systemic Shocks**	**10**	**0**	**6**	**5**
C.1	Poor economic condition of the target customer	2	0	2	1
C.2	Business is seasonal	8	0	4	4
D	**Market Driven Pull Factors**	**17**	**15**	**13**	**15**
D.1	Have Enough Working Capital for Business / Have liquidity	17	15	13	15
E	**Competitive MFI Industry**	**2**	**0**	**0**	**1**
E.1	Found a better source of borrowing	2	0	0	1
Total		**100**	**100**	**100**	**100**

The study also found that staff related causes also contributed to client drop outs. However, the overall frequency of drop outs due to staff was low at 4%. The conflicts with staff usually arose due to borrower delinquency. In cases where staff misbehavior was cited, the borrower was determined not to re-join the programme. The overall over-load and pressure to meet targets appeared to compromise the quality of micro credit programmes and other development initiatives where the Social Organizer was also the Loan Officer. Client follow-up and client appraisal are generally reported to be poor and loopholes around the criteria for loan approval are shared by Loan Officers with potential borrowers to meet targets. In some MFIs the system of rewards and penalties for the credit officers revolve around portfolio target and recoveries. The loan officers get penalized financially in case of loan default. Thus, in the absence of any guidelines set by the MFIs / NGOs on how to treat borrower/clients, staffs tend to sometimes use threats to get payments, which alienate the clients.

Chapter 6: Demand for Micro-Finance Services

There is widespread belief that there is a large unmet demand for financial services, especially among the poor. Estimates of demand internationally and nationally present a wide gap in the demand and supply of micro-finance services in general and credit in particular. In Pakistan, the financial sector has grown considerably over the last few years but this expansion has not reached all segments of the population or all regions of the country. Estimations and choice of indicators to measure financial penetration vary due to data limitations and lack of international consensus on how best to quantify access, or lack thereof. World Bank (2007) uses a composite measure of access based on the percentage of adult population with access to an account with a financial intermediary. In case of Pakistan, this is estimated to be 12 percent, compared to 48 percent in India, 59 percent in Sri Lanka and 32 percent in Bangladesh. On the other hand, SBP estimates that 37 percent of adults have bank accounts. Given the realistic assumption that one individual may have more than one account, the actual percentage is likely to be lower.

In assessing credit demand in Pakistan, the Asian Development Bank's Micro-Finance Sector Development Review 30 asserted that there were 6.3 million poor households in Pakistan at the time of the assessment and all of them were potential clients for financial services and that government considered half the adult poor population (nearly 10 million) as potential micro-finance clients. The estimated potential demand for micro-credit was assessed to be about US$ 2 billion based on the need for an average loan of US$ 300 per household by all poor households or about $ 3 billion based on the estimate that half the adult poor population requires a loan at any given time. However, when these figures are juxtaposed with estimates of credit demand based on survey data, the situation that emerges is somewhat different.

The largest survey in this regard was conducted in 1998 by the Applied Economic Research Centre and this found that 76% of the households did not apply for a loan as they did not see any reason to borrow (59%) and did not like asking for a loan (17%). There was not much variation in the response by landowning pattern, tenancy pattern, and occupational group or by gender. The National Human Development Report on Poverty, Growth and Governance31 found that "70 percent of the rural households never applied for any loan. From among these, 33 percent replied that they did not need a loan and 43% did not want to pay interest for religious reasons.32 These results are quite contrary to the general contention of a widespread demand for credit. The other important aspect is that not all the people borrow concurrently. In a given year, only a certain proportion will borrow but over a longer period of time the proportion of households which borrow goes up significantly.

The Rural Financial Markets study found that 61% of the households obtained at least one loan during a five year period. Micro-Finance experts33 maintain that while most people have not applied for a loan from formal sources it does not mean that the poor do not need some emergency consumption loans during the lean

[30] Report and Recommendation of the President to the Board of Directors on the proposed Loan to the Islamic republic of Pakistan for the Micro Finance Sector Development Programme. November 2000.

[31] Poverty, Growth and Governance: The National Human development report, Pakistan, January 2003.

[32] Annexure III (i): Poverty, Growth and Governance: The National Human Development Report, Pakistan, January 2003.

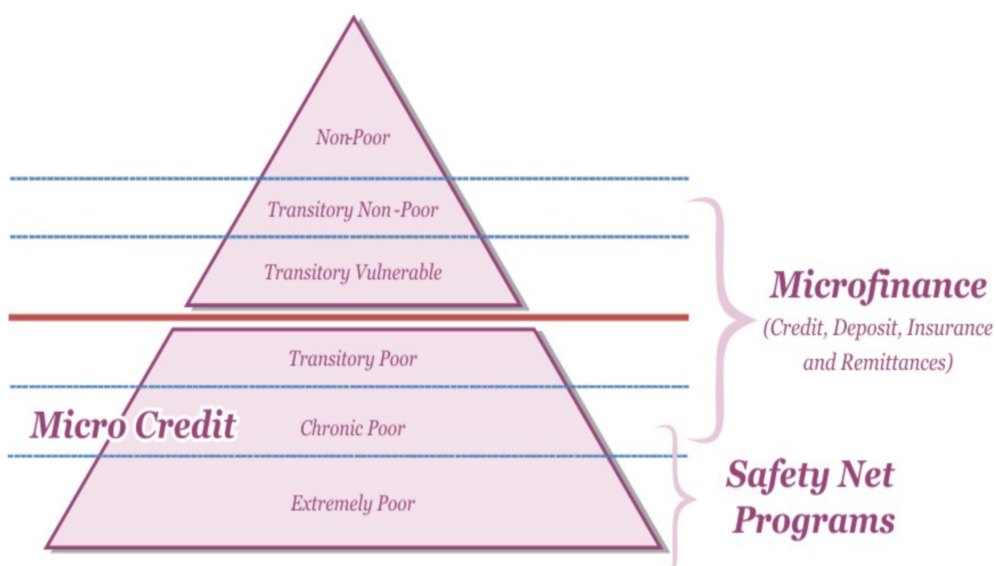
[33] S Hashemi. World Bank.

season or access to money at the beginning of the year for school fees, or money to go see a doctor or a wedding or a funeral. A "one size fits all" credit product may not be ideal for many of the poor who need different types of financial services as much as anybody else. It appears that while there may be a large unmet demand for financial-services and a demand for micro-credit, which is significantly larger than the current capacity of the MFIs to deliver, yet the large claims of an un-met demand for credit alone maybe somewhat exaggerated.

The foregoing estimates are based on data that is somewhat dated. The Pakistan Microfinance Network recently undertook an analysis of the credit demand in Pakistan. Their approach was to classify the Pakistan population into poor and non-poor categories. Within the poor, the households and population was further categorised into vulnerable, transitory poor, chronic poor and extremely poor. At the bottom of the pyramid are the extremely poor who need safety nets programme. Micro-credit is shown as an option for the chronic and transitory poor. At the middle of the pyramid the need is for microfinance programmes which include a range of financial services including savings, transfer, insurance, etc. Figure 15 provides an illustration of this graphically.

Figure 15: Niche Market for Micro Finance in Pakistan

Niche Market



Based on current data there are estimated to be 9.7 million poor households and 66.3 million poor people in Pakistan in various categories of poor (Figure 16 below). The PMN estimates that of these, 29.5 million people are potential clients of credit and about 66.3 million are potential clients of microfinance services. Based on these estimates it would appear that there is a huge unmet demand for credit in the country. Government targets at the moment are to reach 3 million people by 2010 and 10 million people by 2015. This would require a significant up-scaling of current levels of service provision and a significant increase in the volume of funds. Furthermore, survey data and client satisfaction surveys repeatedly show that in order to address client needs, the MFIs would have to increase their current loan size, extend duration of loan period, increase repayment period and reduce the frequency of payments.

Figure 17: The Potential for Microfinance

The Microfinance Potential

2004-5 HIES	Households (Millions)	Estimated Adult Population (Millions)
Non-Poor	6.4	21.7
Transitory Non-Poor	9.0	32.2
Transitory Vulnerable	4.8	17.1
Transitory Poor	3.5	12.4
Chronic Poor	1.2	4.6
Extremely Poor	0.2	0.8

Poverty Line

66.3M MF Clients

29.5M Credit Clients

There is significant divergence regarding estimates about the extent to which micro-finance actually reaches the poor. Some assert that most MFIs do not reach large numbers of very poor people. Some studies show that there are limits to the use of credit as an instrument for poverty eradication, including difficulties in identifying the poor and targeting credit to reach the poorest of the poor. Added to this is the fact that many people, especially the poorest of the poor, are usually not in a position to undertake an economic activity, partly because they lack business skills and even the motivation for business.34 The Micro-Credit Summit asserted that internationally 58 percent of the micro-clients represented the poorest. The record of MFIs in reaching the poor in Pakistan is mixed. Very few NGOs actually keep a profile of their borrowers and most follow a non-targeted approach. From a host of surveys which include some of the largest PPAF POs such as NRSP, SRSP, PRSP and Kashf it appears that at least 50% of the clients receiving loans can be classified as poor. Following the World Bank standard for defining the poor as those with an income of US $1 per day per person, Kashf assessed that 89% of its clientele spend less than $ 1 per day per head and of them 40% spend less than $ 0.55 per day per head.35

[34] PMN. Impact of MicroCredit on Poverty and Gender Equity. 2003.

[35] Poverty Assessment Study. Kashf. January 2005.

Chapter 7: Impact of Microfinance

A. Overview

One of the most broadly shared perceptions about micro-finance is that it is beneficial and therefore everyone needs and demands it. As a result, there has been very little questioning about the benefits of micro-finance and until recently, little interest in trying to measure its precise impacts.36 Both in Pakistan and elsewhere, it was assumed that if loan repayments were being made and disbursements were growing then micro-credit must be yielding benefits. Many programmes in Pakistan followed this approach. Thus many MFIs assumed that since they had repeat borrowers and expanding programmes they were a success. In order to simply reconfirm their basic perception about benefits most practitioners got in-house staff and interns to document a range of case histories of successful men and women to show how micro-credit was transforming lives. Most of the cases studies were well written and while they did demonstrate the benefits of micro-credit, they were romanticised versions of the power of credit, were generally poorly researched and the financial analysis was undertaken in a fairly superficial and uneven manner. By the late 1980s, there was a wealth of anecdotal and qualitative case study evidence to support popular perceptions regarding the positive benefits of micro-finance, but still no carefully controlled longitudinal or cross-sectional surveys of borrowers and comparable non-borrowers. 37

Interest in assessing the widespread impact of micro-credit on poverty is a relatively recent phenomenon and most of the major studies in this regard were undertaken after 2000.38 Some NGOs like OCT and Kashf have conducted regular studies to show the impact of microfinance on their clients. NRSP has also undertaken a few studies to examine how its microfinance operations change the lives of its clients. However, the most extensive national level studies have been commissioned by PPAF. The first was conducted in 2002 and covered 1800 households and a second study was conducted in 2005 with a sample of 3000 households. The ADB Institute has also examined the impact of Khushali Bank's credit programme. Some studies report particular difficulties in identifying impact. A survey on OCT was unable to quantify the gains on account of the loans. It was felt that too many variables affected business output and it was difficult to isolate the impact of the loan from other variables. While some studies report rather limited impact others show rather widespread impact. OCT's experience shows that as families of successful users of micro-credit register sustainable income increases, the impact is not confined to greater consumption or investment in the micro-enterprise. These households also show significant improvement in such social indicators as children's education, family nutrition and improved hygiene.

B. Increase in Incomes

Most impact studies have examined the impact of micro-credit on incomes. In assessing the impact on income and keeping in mind the potential impact, it is important to understand that household income is derived from multiple sources particularly, in the rural areas, and a study on the clients of the RSS found that

[36] Maliha H. Hussein and Shazreh Hussain. Impact of Microfinance on Poverty and Gender Equity. Pakistan Microfinance Network. December 2003.
[37] Ibid.
[38] Ibid.

85% of the households derived their income from 3 or more sources.39 Even in urban households, it was assessed that households were not dependent only on business incomes, but due to the social and cultural factors, such as the joint family, substantial income was brought into the household due to family members working elsewhere. The OCT study40 pointed out that because of this joint family system, with collective income and expenditure patterns, with income from one head being utilised in others, it is not easy to estimate the impact of the loan on business outcomes.

The survey commissioned by the Pakistan Poverty Alleviation Fund undertook a detailed assessment of change in both personal and household incomes and found that on the whole around 41% of borrowers and 32% of non-borrowers experienced positive change in their personal income over the period under study. The difference between the two groups was found to be statistically significant. The increase in the mean income of the borrower group was proportionately higher (8%) compared to the non-borrowers (5%). However, these figures reveal a small difference which was statistically not significant. The study also found that on the whole around 44% of borrowers and 33% of non-borrowers experienced positive change in their household income over the last year. Increase in the mean income of the borrower group was (9%) compared with non-borrowers (6%). However, this difference was not found to be statistically significant. The distinction between personal and household income did not reveal differing results.

The results of the periodic assessments undertaken by Kashf show that there was a 15% increase in real income. About 73% of micro-finance clients reported an increase in income compared with only 23% of non-clients. Its surveys indicate that the average income of Kashf clients rose by 30% in one year. Its impact survey in 2004 claimed that its loans have helped a substantial number of households to rise above the poverty line, not just in absolute terms, but also compared to non-clients; ***as many as 32 percent of client households below the poverty line last year, have moved above the poverty line this year***.[41] The highest income increase was registered by clients engaged in manufacturing work and in the agricultural sector. About 62% of the respondents of a spot survey reported a sustainable increase in income after the loan while the rest reported that there had been no sustainable increase in their incomes.[42] A study[43] to assess the impact of NRSP found that generally, the income level of households in the control villages is lower than in the treatment villages. However, the differences in the household income between members and non-members or households in the treatment and control villages are not statistically significant. ***All the impact studies report small income differentials between clients and non-clients both in terms of the proportion of clients experiencing income increases and the amount of increase in household incomes***.

Some of the surveys have also attempted to assess the change in incomes from different sources. The PPAF survey undertook an analysis of change in incomes from different sources such as agriculture, livestock and enterprise. The survey found that while there was not much difference in the proportion of borrowers and non-borrowers who reported an increase in their incomes from agriculture and livestock, the change in mean income was considerably higher for the borrower group. However, the proportion of borrowers reporting a net annual increase in income from enterprise was significantly higher among the borrowers (65%) compared to non-borrowers (47%) and the difference in mean income was also considerably higher. A study on the orange Charitable Trust's clients shows that the difference between the OCT and non-OCT borrowers was

[39] Mahmood Hassan Khan. The Rural Support Programmes in Pakistan: Methods for Assessment of Cost and Impact. 2003.

[40] Akbar Zaidi. 2003.

[41] Impact Assessment of Kashf. Arjumand and Associates. DFID. December 2003.

[42] UNDP. NHDR. January 2003,

[43] Mahmud Hasan Khan.

particularly sharp at the lower end of the entrepreneur divide. The small and very small OCT borrowers seem to have somewhat better standards of living than the non-OCT borrowers. This might suggest that micro-finance worked better at the lower end of the entrepreneurial income scale.[44]

Using data from a survey of clients of Khushhali Bank in 2005, study by the ADB Institute found that the lending program contributed significantly to income generation activities such as agricultural production and, in particular, animal raising. However, the impacts on other MDGs—education, health, female empowerment, and so forth—were of limited significance. However, this survey attributed this partly to the fact that 70% of the Bank's clients in the survey went through only one loan cycle, so the impacts on other MDGs were yet to be realized.[45]

C. Return on Investments

The Study by Gallup on PPAF clients maintained that while it was quite complicated and hazardous to compute the return on investment, the researchers had roughly estimated the mean return on investment for the loans averaging around Rs 9,138 at approximately 30% per annum. In the urban context, small scale, informal enterprises have in many cases provided higher returns on capital invested than large scale or medium scale enterprises in the formal sector. OCT estimates rates of return on different enterprises as being between 8 to 30 percent. These typically include returns to both capital and labour.

D. Employment Generation

OPP-OCT's lending is exceedinly targeted toward a small number of clients it has identified as entrepreneurs and it is believed that empowering such persons will have spillover effects in the employment of those in tiers below. However, none of the studies on OCT have examined its employment generation impact. Kashf looked at this issue and found that 49% of the clients reported that an additional member of the family joined the labour force compared to 27% of non-clients who indicated having an additional economically active member compared to the previous year. The increase in employment included both men and women. The PPAF data shows that neither of the two groups, borrowers and non-borrowers made notable contribution to employment generation. Apparently, the size of their business or agricultural and livestock activity as well as the scale of loan is insufficient to make substantial contribution in this area.

E. Change in Consumption

The Rural Financial Markets study found that nearly two-thirds of the large loans were borrowed for consumption purposes.46 These were predominantly borrowed from friends, relatives and other informal

[44] Akbar Zaidi.

[45] Microfinance and the Millennium Development Goals in Pakistan: Impact Assessment using Propensity Score Matching. ADB Institute.

[46] Rural Financial Markets Studies. Rural Credit Study & Role of Women in the Rural Economy and the Credit Market Study. 1998.

sources. A comparison between borrowing and non-borrowing households reveals strikingly similar levels of household consumption expenditure between the two categories. Given the inter-temporal variation in income levels and the associated risks of crop failure, households with low income and savings potentials borrow loans as risk coverage to meet their consumption needs. Data from the survey undertaken by PIDE for the National Human Development Report found that the extremely poor whose incomes and receipts fall below the poverty line, tend to use loans and sale of assets to increase their consumption level.47 As much as 17 percent of the total consumption of the poor is financed through credit and 5 percent through the sale of land. Among 60 percent of the households, the main purpose of borrowing was consumption including ceremonies. The extremely poor use a higher proportion of the loan to finance consumption expenditure (67%) compared to the poor (58%) or the non-poor (52%). A sample survey of the beneficiaries of seven NGOS was also undertaken as part of the research for the UNDP's Human Development Report and this spot survey also found that an overwhelming proportion of the loan is being used for consumption purposes by both the poor and non-poor although less so by the non-poor.

The PPAF survey also measured change in household consumption. On the whole, around 34% of borrowers and 30% of non-borrowers experienced positive change in their overall expenditures during the study period. Change in the mean expenditure of the borrower group was proportionately higher (7%) compared to the non-borrower group (5%). Although this difference is small it is reported to be statistically significant. The PPAF survey data shows that the change in mean expenditure on overall food items is almost the same for both borrowers and non-borrowers. However, the change in key food items with high protein content was higher among borrowers.

The UNDP spot survey of NGOs found that 38% of the respondents felt they ate better now compared with 40% who felt that they ate better earlier. About 22% of the respondents reported no change. The MHK study on the RSP's found that the mean levels of expenditure were not statistically different between the member and non-member households or between households in the treatment and control villages. About 46 percent of the monthly expenditure was accounted for by food and this was quite similar in all households. However, the MHK study was not specifically on borrowers but on beneficiaries.

Interviews of OCT clients indicated that the most salient and tangible benefits of credit described by interviewees concerned food security and improved household nutrition. A majority of the interviewees described improved and increased food availability in their homes, and a greater sense of assurance about their next meal.48 Another OCT study found that while many borrowers talked about the improvement in their livelihood patterns in terms of better food intake, it is not possible to estimate any numerical value for this improvement.

The impact assessment of Kashf showed that 54% of micro-credit clients reported an improvement in their diet and nutrition compared with 3% of non-clients. Similarly, 41% of the Kashf clients reported no change against 70% of non-clients and only 5% of Kashf clients reported deterioration in diets compared with 27% of non-clients.

The evidence that is given here differs somewhat depending upon whether qualitative or quantitative methods of analysis were used. Where interviews and case studies were conducted they report a much greater increase in consumption of borrowing households. Where quantitative techniques are used for data collection and

[47] UNDP. Human Development Report. January 2003

[48] Naheed Rehman. 2003.

analysis such as in surveys including both borrowers and non-borrowers, the findings show that there is little or no difference between the consumption levels of borrowing and non-borrowing households.

F. Change in Social Sector Status and Indicators

Some of the surveys have examined expenditures on social sectors between borrowers and non-borrowers and tried to examine the extent to which micro-credit has helped people with social sector investments. The data from NRSP shows that from the borrowed capital, 11% was used to finance health and education expenditures. The NHDR/PIDE Survey shows widespread illness amongst the poor with sickness being an important factor in pushing people into poverty. The results of the spot survey of NGOs found that in terms of health status, 26% of the beneficiaries felt they had better health now while 34% reported no change and 40% reported deterioration in health status. There was a wide variation in the response of the beneficiaries of different NGOS on this score. The Kashf impact assessment looked at health care and found that 58% of clients felt that they were now able to divert more resources to health care compared with 33% of non-clients.

Most surveys have not reported on the impact of micro-credit on education expenditures or investments. Data from case studies shows that a large number of women generally claim that education of children is a high priority for them and that they borrow and save for children's education. While the impact study of Kashf reported education investment orientation of clients compared with consumption orientation of non-clients, its findings found no difference in education indicators for the control and client groups. Interestingly, the NRSP study by Mahmood Hassan Khan showed that the non-member households have spent far more on shelter and health and education than member households. However, this does not really look at micro-credit services and these members may or may not have benefited from loans.

G. Asset Accumulation

The most important assets for households in rural areas are land and livestock and in the urban areas it is the house plot. However, none of the studies looked at land ownership patterns between borrowing and non-borrowing households. The NHDR/Spot Survey of NGOs looked at land ownership between the different categories of beneficiaries to assess the economic status of the borrowing households but did not look at the impact of the loans on changes in land ownership. It appears also from the average size of loans that the loans by themselves are not sufficient to enhance the landholding pattern of the borrowers. The second most important asset in rural areas is livestock and in many urban areas it also forms an important part of the livelihood systems. Most of the RSPs provide loans for livestock and a substantial share of the loans is taken for investments in livestock. At least, 23% of the loans of NRSP were borrowed for investments in the livestock sector. However, most of the impact studies in rural areas do not report on livestock ownership.

The PPAF survey reporting on change in consumer durables reported that the increase in assets is higher among the borrowing households as compared to the non-borrowing households. On the whole, the number of borrowers who made additions to their property as well as enterprise related assets are more than the non-borrowers. But the results are mixed. The survey shows that the borrower group made more additions to the assets during the period under review compared to the control group. The asset building is more pronounced in the case of household goods and less so for financial assets or business and agricultural assets. Apparently the loan is too small to lead to building the latter type of assets. The data shows that, on average, the borrowers spent more on house repair than non-borrowers. The NRSP data showed that the member households have spent far more on purchase of assets than non-member households. The Kashf study found that 39% of clients reported housing and sanitation improvements compared with 27% of non-clients. The OCT study found that a very high proportion of borrowers take money for running finances and to buy raw material or to buy in bulk in order to realise economies of scale. Very few borrowers purchase machinery or make capital investments.

H. Impact of Micro-Credit on Women

While Most MFIs maintain that they do not discriminate against women and offer the same accessibility to women as they do to men, there is a wide divergence in the number and amount of loans that have actually been given to women. MFIs increasingly prefer to look at households as their client and do not like to distinguish between men and women. Some, like Kashf and the First Women's Bank, while targeting households give loans only through women. Others, like the Orangi Charitable Trust and Tameer Micro-Finance Bank prefer to talk about entrepreneurs and the working poor and have found it preferable to work with men. While MFIs are very particular that women should not access the loans but also use them such as Asasah, Damen etc, but others like Kashf allow the women borrowers to pass on the loan to a male relative – which most of them do.

The impact of microfinance on women's empowerment is inconclusive. Especially in the context of Pakistan where many of the MFIs admit that even when women are registered as the clients, the majority of the loans are passed on to men. While there are many case studies which show that many individual women have benefited from the loans, the overall impact of the microfinance services on women is unclear. There are studies which show both positive and negative impacts and no significant impacts. An evaluation of the impact of micro-credit on indicators of women's empowerment in the urban slums of the Lahore district of Pakistan was undertaken recently.49 This evaluation used a household level instrument that contained information on different dimensions of household decisions: child related, health, social mobility, economic and major household purchase decisions. The study explored the link between micro-credit and women's empowerment. After controlling for endogeneity in the estimation by using proxies for initial levels of empowerment, matching the controls and treated units on observable characteristics the study found no difference between the levels of empowerment of treated and control units. Participation in the micro-credit program is found to be insignificant in explaining all the outcome indicators of empowerment for the sampled households.

The impact assessment conducted by Gallup on the micro-credit clients of PPAF found that wherever the results had been disaggregated by gender, the impact reported by women was far greater than that reported by men. An analysis of the change in borrower's household income shows that while 36% of the male borrowers reported a positive change in household income as many as 61% of the women borrowers reported an increase in household income. Similarly, 34% of the men reported a positive change in personal income compared to 54% of the women who reported such an increase. **The Gallup study also reported change in personal social status by gender. This comparison found that in each case women reported a higher increase in**

[49] Salman Asim. Evaluating the Impact of Microcredit on Women's Empowerment in Pakistan. World Bank Group; Lahore School of Economics. October 20, 2008. CREB Working Paper No. 2-9

all respects compared with men. The greater impact reported by women is consistent with findings from other countries which also report a more significant impact of loans provided to women on key households indicators.

Chapter 8: Regulation

A. Evolution of Policy

The evolution and pattern of microfinance regulation in Pakistan has followed the broad contours of overall policy towards the banking sector. However, there is in official policy a lack of clear delineation between agriculture finance, micro-finance and rural finance. Thus for many years the government used agriculture finance as a kind of a catch all which was expected to include microfinance and rural finance. It is only recently that better defined boundaries have been drawn between the three types of finance. This can largely be attributed to donor financing of the microfinance sector and leadership at the State Bank of Pakistan which began to better appreciate the distinction. The policy advocacy of forums such as the Pakistan Micro-finance Network and its members has also contributed to improved understanding of the sector and its needs.

The principal source of rural finance policy in Pakistan is the State Bank of Pakistan (SBP). In September 2006 the SBP reorganized itself and for the first time created a new MicroFinance Department with financing from the Department for International development (UK). Policy pronouncements also emerge from time to time as part of donor financed projects. This is especially true in case of programmes which provide budgetary support to the Government of Pakistan and append a policy agenda as a condition for release of funds. The most significant influence has been exercised by the Asian Development Bank through its Microfinance Sector Development Programme (MSDP) and the Rural Finance Sector Development Program (RFSDP). The policy agenda appended to these projects identified the need for a policy and legal framework for the microfinance and rural finance sectors. Initiated in 2001, the Microfinance Sector Development Program (MSDP) defined a policy, legal, and institutional framework in order to facilitate microfinance service delivery. This project had three main objectives: a) to support the development of a conducive regulatory framework, which resulted in the promulgation of the Microfinance Institutions Ordinance 2001 enabling the establishment of sustainable microfinance banks; b) to facilitate the development of a microfinance bank as a public-private partnership, the Khushhali Bank; and c) to initiate the restructuring of Development Finance Institutions, mainly the Agricultural Development Bank of Pakistan, which is now called the Zarai Taraqiati Bank Ltd. In addition a series of funds, managed by the State Bank of Pakistan, were set up to support the development of microfinance outreach in Pakistan.

The trend in Pakistan as in most developing countries has moved from a directed lending approach to a more market oriented approach. However, as is clear from a review of the evolution of finance policy in Pakistan, the trend is not a move in one direction but the policy has vacillated between directed lending and allowing the market to determine the parameters. Thus in Pakistan one has seen the emergence of a hybrid approach to micro finance. There are elements in the policy which tend to favour a market led approach but given the enormous task of dealing with poverty alleviation and equity concerns, the government has always been nervous of letting the market determine the course entirely. As such, within a market led approach, many measures have been taken by Government to ensure that resources are directed to specific geographic areas, target groups and sectors of the economy. The principal means of ensuring this has been through setting up of mandatory targets for the agriculture sector, microfinance and for special geographic areas, etc.

The ambivalence of Government policy even as it opened up to private sector and transformed its own institutions is evident by its rush to create specialized modalities for delivery of credit to un-banked areas and to the un-served and under-served poor households. Clearly, the Government had identified certain gaps and weaknesses and was trying to address those and was not comfortable with leaving everything to the private sector. Thus at the same time as Government was rethinking its approach towards the financial sector and dismantling public sector participation in the delivery of formal credit, it established two special modalities to deliver microfinance services. The Khushhali Bank (KB) and the Pakistan Poverty Alleviation Fund (PPAF). What is significant about these initiatives was that they were both sponsored by donors. KB was established under financing from the Asian Development Bank and the PPAF was established with financing from the World Bank

The government promulgated the Khushhali Bank Ordinance, 2000, to establish the Khushhali Bank (KB). Keeping the experience of DFIs in view, this bank was established under the joint ownership of 16 commercial banks (three public sector, eleven private sector and two foreign banks). Its organization and operations were specifically designed to support a sustainable community-based service delivery system by utilizing the services of NGOs besides using its own branch network. After several years of operation, the Government is now in the process of privatizing Khushhali Bank as well. The main impetus for this change has also come from a revision of policy which feels that the KB would perform better if it was more performance oriented and led by the private sector. The Pakistan Poverty Alleviation Fund was established in 2001. It was modeled on the Palli Karma-Sahayak Foundation (PKSF) of Bangladesh, which functions as an apex financing institutions for MFIs. Like the PKSF, the PPAF is registered as a private, autonomous company with its own independent Board of Directors. The PPAF has been established with a clear commitment to alleviating poverty and focuses on improving the access of communities to financial services and enhancing investments in productive infrastructure projects.

Today micro-finance policy is a hybrid of the directed lending and the market oriented approach. While some of the Commercial Banks are not mandated anymore to give to agriculture sectors they are encouraged to do so. The specialized agencies like the ZTBL have been restructured but there is little indication of an improvement in its performance. The cooperative banking structure is in disarray and the Government has been unable to put an institutional infrastructure in place which will deal with the issues of providing efficient services to rural cooperatives. There are plans to transform the Punjab Provincial Cooperative Bank and the Northern Areas Cooperatives into Microfinance Banks. A Credit Union Plan was part of the ADB financed Rural Finance Sector Development Programme but nothing has come off it as yet. Under the new paradigm Government interventions primarily relate to creating conducive policies and promoting strategic initiatives with incentive programs that promote private sector role in provision of financial services.

B. Current Regulation

In Pakistan, the regulation of the sector is a relatively recent phenomenon and only applies to Micro-Finance Institutions registered as banks. The non-bank MFIs largely remain unregulated and for this reason are prohibited from providing a full range of financial services. The central bank has encouraged these institutions to transform into MFBs if they wish to offer services such as savings to their clients and other market segments. As can be seen from the above, the regulation in Pakistan is poised to support three potential sources of growth in the sector.

The Microfinance Institutions Ordinance 2001 largely provides the regulatory framework for the microfinance sector. The Ordinance defines the scope of business for a microfinance institution, the paid-up capital and liquidity requirements, licensing policies for such institutions, the basic structure of its management and administration, and SBP's powers for supervision purposes, etc. A number of amendments have been made to the Ordinance since 2001 in consultation with the sector stakeholders to make the framework more conducive and rational. The enactment of the MFI Ordinance has had positive effects on the microfinance sector in the country. It has helped re-define microfinance as a core financial sector activity with not only social implications but also commercial opportunities. Since the promulgation of the MFI Ordinance, a number of supportive regulations have also been issued by the central bank including:

Prudential Regulations for Micro Finance Banks	**2003**
Guidelines for Mobile Banking Operations	**2003**
Guidelines for NGOs Transformation	**2005**
Fit and Proper Criterion for CEOs/member of Boards of MFBs	**2005**
Prudential Regulations for Commercial Banks to undertake Micro Finance Business	**2006**
Guidelines for Commercial Banks to undertake Micro Finance Business	**2006**
Branchless Banking Regulations	**2008**

The Ordinance allows for setting up of four types of MFBs: (i) a district level MFB, licensed to operate only within the prescribed district. The minimum paid-up capital requirement to set up such a bank is Rs. 100 million; (ii) a regional level MFB, licensed to operate within five adjacent districts within the same province. The minimum paid-up capital requirement to set up such a bank is Rs. 150 million ; (iii) a provincial level MFB, licensed to operate only within the prescribed province. The minimum paid-up capital required to set up such a bank is Rs. 250 million and (iv) a national level MFB, licensed to operate anywhere in the country. The minimum paid-up capital required to set up such a bank is Rs. 500 million. Other than the difference in capital requirement, all types of banks face the same prudential regulations and can offer the same range of services to their clients.

The First Micro-Finance Bank Limited (FMFBL), Tameer Micro-Finance Bank Limited and Pak-Oman operate at the national level, while Rozgar Micro-Finance Bank Limited (RMFBL) and Network Micro Finance Banks Limited (NMFBL) are serving at the district level. The existing regulation provides a supportive framework for the transformation of NGOs into banks. Making use of this aspect, NRSP and Kashf have applied and received their banking licenses recently.

The Micro-Finance Ordinance and the Prudential Regulations in Pakistan appear to be consistent with international practice on most aspects and seem to have embodied lessons from best practice elsewhere. The Ordinance encourages (i) transformation of NGOs into banks (ii) the establishment of micro-finance banks and (iii) encouraging downscaling of commercial bank operations and offering micro-finance services. The Ordinance has been important for encouraging the entry of private sector players into the micro-finance sector in Pakistan. While some are motivated by a profit motive others are driven more by a social welfare agenda while still others have used the regulation to enter a highly profitable banking sector through the back door. There is a need to protect the micro-finance sector from those who may have entered through the micro-finance door and then intentionally try to blur the distinction between the micro and mainstream sectors.

The regulation in the sector adds to the cost of operations and while there are benefits in terms of being allowed to generate deposits, most of the micro-finance NGOs are not at this point well poised to benefit from accepting deposits and feel therefore that regulation entails greater costs than benefits for them. Among the negative aspects which are cited as entailing greater costs is the focus on the poor, maximum loan limit, limitation on investment of surplus funds, etc. Opinion about other aspects is divided such as reserve requirements, provisioning, branch operations, opening of new branches, the limitation that micro-finance banks cannot be part of the clearing system, etc. An issue of key concern for many NGOs contemplating transformation is the tax rate. NGOs in Pakistan can apply for tax exemption status by declaring that they are either not generating any profit or investing their profit in the development work they are undertaking. This tax exemption status is granted by the Central Board of Revenue. However, upon transformation into a banking company the MFI-NGO will have to pay the same tax as all banking companies (39%) do. There is nothing in the Ordinance which grants a special tax status to micro-finance banking companies.

Some assert that the minimum capital, reserve and provisioning requirements in the regulation in Pakistan are in fact barriers to entry. However, this view is not widely shared and most compare the capital requirements with those for commercial banks in Pakistan and feel that the much lower capital requirements for the micro-finance sector has actually encouraged new entrants.

The tiered manner in which the capital requirements are structured allows micro-finance banks further flexibility in meeting these requirements depending upon the level at which they want to operate. The capital requirements stipulated in the Ordinance are much higher than that for most other countries. However, these are in keeping with the requirements of the sector and organizations which have entered the sector did not think that these requirements imposed an excessive barrier to entry.

In Pakistan, there are several other limitations on micro-finance banks which are not in the regulation but for which express permission has to be given by the State Bank. For example, micro-finance banks are not eligible to become members of the national clearing house system. This limitation restricts micro-finance bank's ability to offer demand accounts with checking facilities. This is a fairly standard restriction for micro-finance institutions operating in other countries as well. The way micro-finance banks have gotten around it is by making arrangements with other banks to be their agents. Furthermore, micro-finance banks are only allowed to undertake remittances within the country and are not allowed to engage in foreign exchange transactions. There are stringent requirements for opening new branches which inhibit the opening of costly new branches which in turn will limit the outreach to rural areas. It is argued that due to the low population densities, rural micro-finance organizations need an entirely different approach to the development of their branch infrastructure. There was a restriction on micro-finance banks to invest their surplus funds only in government securities. However, this restriction has been relaxed in the amendments announced recently.

The approach to regulation in Pakistan combines a non-interventionist financial sector policy with a strong backing for micro-finance which is encouraging new entrants into the sector and is leading to the development of a diverse set of players as well as encouraging private sector investment for the first time.50 The Micro-Finance Ordinance and the prudential regulations are regarded as providing a framework which is dynamic and can be changed subject to changes in the environment or lessons from operational experience or elsewhere. The leadership of the State Bank and the Micro-Finance Division of the State Bank has a very open minded attitude towards changes in the sector and wants to move it in direction which will make it sustainable. From a review of the sector internationally and sector specific issues in Pakistan it appears that the regulation incorporates lessons from international experience. The Practitioners in the field in Pakistan are generally satisfied with the Ordinance and the prudential regulations and have few suggestions to offer for modifying it.

The existing regulation has most features which can potentially support the sector's aspirations regarding outreach, poverty impact and sustainability. However, some additional measures have been suggested to improve operational efficiency of banks. In this regard some of the recommendations that were made by

[50] Maliha H. Hussein. Rural Finance Policy in Pakistan. PMN. September 2008

practitioners were to reduce the infrastructure requirements stipulated for bank branch offices, enhance the scope of mobile banking and consider the induction of micro-finance banks into the clearing house system. It is felt that the concept of a lending only branch should be promoted to enable the micro-finance banks to offer cost-effective services in rural areas. Currently, the excessive branch requirements inhibit delivery to rural areas and will continue to do so unless the operational costs for banks can be reduced. In addition, the current concept of mobile banking is perceived to be too limited and does not allow actual operations. It is suggested that the option of using insurance cover for field operations be used to expand the scope of mobile banking while protecting them from risk. However, while Tameer Bank pointed out that not being able to raise tier 2 capital would prove an obstacle in the future, other banks did not perceive this as a particular problem.

Like in most countries, micro-finance banks in Pakistan are not part of the clearing house system of banks and are not allowed the full spectrum of operations allowed to mainstream banks. While the State Bank insists that there is no legal bar on micro-finance banks becoming part of the system and that the volume of deposits does not currently justify the membership of micro-banks becoming a member of this system. Apart from Tameer Bank and Pak-Oman Bank this was not seen as a key obstacle and the First Micro-Finance Bank, Rozgar Bank do not see this as a major obstacle. The State Bank is considering the concept of service centers on the pattern adopted in the Philippines to allow micro-finance banks to initiate some of the operations. In any case, the State Bank of Pakistan is introducing an on-line Real Time Gross Settlement System (RGTS). Participation in the RGTS would require the banks to be part of the SWIFT and NIFT system which requires considerable financial investments and will add to the cost of the operation.

The State Bank conducts both supervision and onsite inspections. While most feel that the capacity for supervision is strong they feel less confident about onsite inspection capacity and feel that this needs to be strengthened. Furthermore, while the staff is adequate for the time being there will be a need for its capacity to grow with the sector and to develop a tiered structured for more effective supervision. International experience suggests that in many countries the supervisory agencies have not been sufficiently strengthened during the process of financial sector liberalization, even though the liberalized approach relies heavily on the existence of vigorous prudential supervision by qualified supervisors. The message from Latin America in this regard is that supervisors need to be trained to understand micro finance.51 The State Bank recognizes this need and is using donor funds to enhance its capacity. With technical assistance from the Asian Development Bank and the Swiss Development Cooperation the SBP is enhancing its capacity and many already report a significant change in staff attitude and capacity. The State Bank and the Khushhali bank have joined hands to establish a Human Development Institute to enhance the supply of skilled human resources for the micro finance sector.

The SBP is also encouraging the provision of credit to small and medium entrepreneurs through a newly set up SME Bank, to small farmers through a newly restructured Zarai Taraqiati Bank and Cooperative Banks, and to women entrepreneurs, individuals and small firms through the First Women's Bank. The SBP considers this to be the 'only durable basis through which the poor can benefit from the financial sector of the country.'52 Moreover, it also sees complementarities between MF and other elements of poverty alleviation, such as investment, infrastructure, the social services and capacity building, and feels that these should be built into the overall MF programme. The previous Governor of the Bank argued that 'income generation by the poor cannot take place only through availability of credit if there is no infrastructure, or markets for selling their produce.'

[51] Ibid.

[52] State Bank 2003.

Chapter 9: Challenges in the Sector

The principal challenge in the country is lack of security, political instability, Talibanization and the financial crisis. All these factors are already beginning to negatively affect the economic and business environment and many MFIs have already begun to revise their business plans and growth trajectories. The food price inflation in the country has also impacted some sectors although its effect on microfinance clients was not as negative as some feared.53 Many players in the sector were poised to take advantage of the growing appetite of the commercial sector for entry into the sector. Kashf had negotiated an innovative arrangement with Citibank. However, the financial crisis is likely to reduce this appetite for providing finance to the sector. The growing Talibanization and the increasing restriction on women and anything perceived as un-Islamic also poses a major threat to the sector. The fact that interest is perceived as un-Islamic and that NGOs are seen primarily as organizations which are spreading alien western values into the country and promoting participation of women in activities outside the home is also going to make it much more difficult for many of the MFIs to expand their programmes particularly in the north western part of the country. Political interference is also cited by some organizations as a negative factor as some self styled political leaders announce that now that their party is in power they have written off all loans. This posed excessive problems in the past for TRDP in Interior Sindh and is also said to be a factor in the high PAR of Kashf.

The microfinance sector in Pakistan has made significant progress in the last few years. The sector has grown rapidly, it has changed its orientation to one which is moving towards sustainability and it is operating within a policy and regulatory environment which is supportive. However, many challenges still remain. Growth has slowed down somewhat and in the current year the growth is expected to further slow down as a result of the rising Portfolio at Risk of some of the main MFIs such as Kashf Foundation which has seen a major erosion in portfolio quality partly attributed to political interference, partly to a rigid methodology and partly as a result of the economic downturn due to rising insecurity and financial crisis in the country. The projected growth in the sector is unlikely to be realised. Even with rapid growth in the past, the sector has limited outreach especially in terms of coverage and actual use of services by women. There is a huge gap between supply and demand and large parts of the country especially in rural areas are underserved or un-served. Existing services are concentrated in and around the largest urban centres.

While microfinance is advocated as a strategy for poverty alleviation, the lending methodologies and client screening systems exclude the poor from many programmes. Some MFIs suffer from pangs of consciousness about charging high interest rates to poor clients and prefer not to charge any interest rate (Akhuwat) or keep their interest rates at levels lower than those required for sustainability. There are very few programmes which have developed a strategy for the ultra poor or one of cross subsidization of poor clients. Thus there is great ambivalence in the sector about interest rate policy and targeting strategy.

The range of financial products offered by most MFIs is limited and until now most do not offer the full spectrum of services such as savings, micro-insurance and remittances. The loan amount, repayment schedule and duration of loan does not generally meet the requirements of the clients. In terms of loans, most MFIs offer only one or two loan products which generally consist of group guaranteed working capital loans. The loan amounts and repayment schedules are rarely designed to meet the actual business needs of the clients.

[53] Akbar Zaidi. PMN. November 2008.

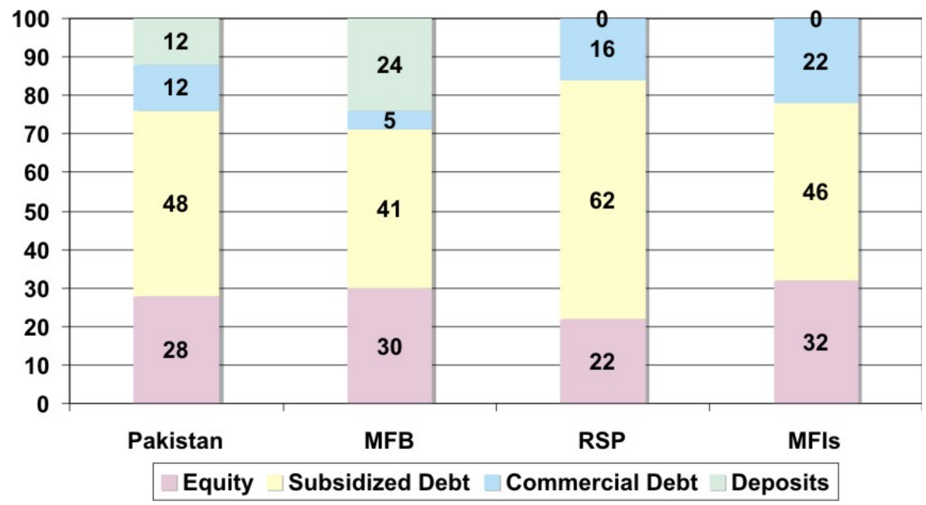
MFI staff is not well trained to help clients develop business plans or examine rates of return on different investments. The impact of the sector on poverty is questionable. While several impact studies have been undertaken these do not present any clear picture of the impact of the sector.

Sustainability is another issue in the sector. Only four MFIs had reached OSS by the end of December 2008. While the Pakistan microfinance sector has among the lowest cost of delivery its yield on portfolio is low compared to other countries. Many attribute this to interest rates which do not cover costs of delivery. This represents a real challenge to the sector as many MFIs are charging interest rates between 20% to 35%. While some of the factors are beyond the control of the microfinance practitioners such as the low population density, other cost cutting measures are well within the reach of the providers. However, this will require cost reducing strategies through use of information technology. The reduction of transactions costs have to be considered not only from the perspective of the providers of financial services but from the client perspective as well. Client satisfaction surveys and surveys which have examined dropout rate since the country reveal that many of the clients are unhappy about the lending strategies which impose high additional costs on the clients. A more recent issue which is going to present a real challenge to the sector is the high PAR of Kashf. While the NGO has indicated that this is being brought under control, the fact that there was such large scale default presents a real threat to the sector as a whole in which many organizations work at close proximity to each other and may even have duplicate clients.

The sector has been overly dependent upon donor financing and most MFIs have not been able to grow as rapidly as they expected due to lack of financing. Even when MFIs had the option to expand their financing requirements through generating deposits few have actually exercised this option. None of the MFBs have an effective savings model which can serve the dual purpose of providing their clients with a good savings product and generate funds for the institution. In the current financial crisis the sector's growth and expansion is likely to be negatively affected. An issue of growing concern is the high level of PAR in the sector which is bound to impact some of the most rapidly growing MFIs such as Kashf. The crisis which faces Kashf today has served to highlight the vulnerability that the sector faces in terms of political instability, lack of security, inappropriate lending methodologies and inadequate systems for measuring client satisfaction.

There is heavy reliance on donor financing in the sector. Despite the exponential growth in the NGOs providing micro-finance services in the last few years, the sector lags behind most countries. There are also concerns that the growth rate of the last few years may not be sustained. While the current legal framework supports the downscaling of commercial bank operations there has so far been little involvement of commercial banks in the micro-finance sector in Pakistan. While micro-finance banks can focus on deposit mobilization this option is not currently available to NGOs. There has been limited research into savings as a financial product and even banks allowed to mobilise deposits have done little to diversify their financing sources. NGOs considering transformation have little information on the extent to which they will in-fact be able to mobilise deposits and know even less about the cost of this source of financing. While some NGOs have been able to access commercial credit and innovative arrangements with commercial banks, the extent of funds they have raised through these sources is limited. PMN reports that the sector is highly underleveraged except for the RSPs which have been using subsidized debt from PPAF as their main source of funds. However, the subsidized debt form PPAF and donors still continues to finance growth.

Figure 18: Sources of Financing of MFIs



The existing regulation in Pakistan is clear and does not allow unlicensed MFIs to generate deposits. The State Bank of Pakistan feels strongly about not allowing MFI-NGOs this facility given the negative experience with agricultural cooperatives in the country. Furthermore, it is not simply a matter of changing the existing regulation. MFIs serious about mobilizing voluntary savings, require investment in infrastructure, marketing, security, controls, etc – i.e. Offering savings may actually not be a cheaper source of funds, compared to the subsidized wholesale financing they can currently tap into in Pakistan with minimum effort. Designing appropriate savings products to attract millions of poor savers require careful product design, a system of marketing, branding, infrastructure, financial management and proper liquidity arrangements. In some countries technology is also helping to address the need to reach out to the underserved areas more efficiently, with such tools as point of sale devices (Uganda, Ecuador) or cash collection machines (India). Mobilizing a significant amount of savings is not just a matter of getting a license. With the decision of NRSP and Kashf to open banks, the debate regarding permission to NGOs to accept deposits has probably become redundant.

The sector suffers from serious capacity constraints. Several donors such as the Swiss Development Cooperation, the Department for International Development (DFID-UK), USAID, the Asian Development Bank and the World Bank have been providing support for the sector and have helped to build the capacity through specially tailored programmes and institutions. The Pakistan Poverty Alleviation Fund and the Pakistan Microfinance Network have played a commendable role in helping to strengthen the sector institutions, enhance industry standards, improve transparency and performance. In the initial years many of the Governance systems were dominated by family members and friends. There is now a growing trend to replace the members of the Board with professionals and independent individuals with experience and capacity to provide real leadership.

There are many new institutions which are being created to further enhance the accountability of the sector. New initiatives are being undertaken such as the move to establish a Credit Bureau. The Pakistan Microfinance Network (PMN) has recently launched the Code of Conduct for Consumer Protection under its mandate to promote best practices and transparency in the microfinance sector. The sector is rapidly growing with intensifying competition - this can at times however, lead to undesirable practices that hurt not only the reputation but also the health of the sector. In addition, the sector's clients have low literacy and understanding of financial terms and conditions. PMN believes that it is important for microfinance practitioners to inform clients about their rights and responsibilities. There is little if any legislation on consumer rights for the financial services sector especially for non-bank service providers, PMN in collaboration with its members, has begun work to put into place measures for the protection of microfinance clients. The first initiative is the development and institutionalization of a Code of Conduct for Consumer Protection, which will be followed by the establishment of an independent complaint processing system for the sector.

Annexure

1. Outreach of MFIs
2. Performance Ratios of MFIs
3. Staffing and Branch Network

Outreach of MFIs

#	PO	Year	Active Borrowers	Female Active Borrowers	Gross Loan Portfolio (PKR '000)	No. of savers	Amount of savings (PKR '000)
1	AKHUWAT	2005	3,023	1,656	18,187	0	0
		2006	6,069	2,968	38,295	0	0
		2007	8,734	6,565	50,953	0	0
		2008	13,088	3,926	76,467	0	0
2	ASASAH	2004	4,588	3,848	23,756	4,196	930
		2005	8,492	8,492	48,677	7,163	1,499
		2006	12,512	12,512	110,281	11,884	2,481
		2007	27,711	27,711	222,451	26,609	4,810
		2008	25,129	25,129	215,125	27,000	4,910
3	BRAC	2007	NA	NA	NA	NA	NA
		2008	29,204	29,204	262,318	0	0
4	Community Support Concern	2005	NA	NA	NA	NA	NA
		2006	13,722	13,722	109,689	13,722	5,402
		2007	15,254	15,254	145,322	12,200	4,660
		2008	20,075	19,753	212,611	12,500	4,800
5	Development Action for Mobilization and Emancipation	2000	507	NA	1,777	0	0
		2001	1,756	NA	1,777	0	0
		2002	NA	NA	19,183	0	0
		2003	10,140	10,140	35,275	0	0
		2004	6,890	6,890	31,553	0	0
		2005	15,044	15,044	91,164	0	0
		2006	25,478	25,478	169,332	0	0
		2007	32,623	32,623	250,428	0	0
		2008	36,897	36,897	325,383	0	0
6	First Micro Finance Bank Ltd	2002	713	0	17,969	2,773	64,420
		2003	3,558	0	65,794	9,919	236,583
		2004	9,543	906	212,216	18,367	408,868
		2005	16,931	2,455	362,693	18,589	650,719
		2006	52,308	35,936	686,909	39,154	644,939
		2007	101,394	42,819	1,221,559	79,827	1,542,360
		2008	171,795	61,980	2,135,623	144,898	3,317,227

7	**Kashf Foundation**	1999	2,615	2,615	6,341	2,009	324
		2000	5,836	5,836	12,678	4,853	1,261
		2001	15,559	15,559	33,800	12,728	6,339
		2002	26,920	26,920	134,604	26,791	7,000
		2003	59,389	59,389	347,116	57,058	7,300
		2004	67,552	67,552	479,101	54,042	7,611
		2005	75,520	75,201	774,430	63,627	6,394
		2006	133,690	131,491	1,530,321	106,952	8,064
		2007	295,396	283,288	3,178,784	266,366	12,699
		2008	319,652	319,652	3,352,812	270,000	13,000
8	**Khushali Bank**	2003	91,532	34,416	707,465	0	0
		2004	168,105	44,716	1,397,942	0	0
		2005	227,172	75,648	1,923,245	0	0
		2006	236,917	49,989	2,147,611	0	0
		2007	283,965	43,731	2,652,921	0	0
		2008	295,423	71,291	3,396,984	0	0
9	**National Rural Support Programme**	1999	NA	NA	NA	NA	NA
		2000	NA	NA	NA	NA	NA
		2001	62,918	NA	445,464	321,961	214,420
		2002	50,190	NA	456,739	NA	NA
		2003	70,375	27,587	632,654	401,611	NA
		2004	88,401	20,362	829,408	449,721	404,210
		2005	122,157	47,328	1,206,032	549,822	476,150
		2006	190,846	52,383	1,993,573	667,079	741,620
		2007	292,456	124,996	3,244,991	830,000	992,746
		2008	463383	232340	5019740	977,836	1,047,468
10	**Orangi Charitable Trust**	1999	1,317	NA	26,767	0	0
		2000	966	NA	18,852	0	0
		2001	841	NA	21,159	0	0
		2002	NA	NA	26,217	0	0
		2003	2,481	205	34,940	0	0
		2004	3,895	180	45,086	0	0
		2005	6,986	2,420	64,027	0	0
		2006	12,002	1,848	95,806	0	0
		2007	20,987	734	143,821	0	0
		2008	22,578	900	247,584	0	0

11	**Orix Leasing Pakistan Limited**	2004	2,280	1,988	50,030	0	0
		2005	4,004	3,054	74,585	0	0
		2006	3,630	2,998	73,778	0	0
		2007	8,900	6,283	127,112	0	0
		2008	15,445	13,660	190,209	0	0
12	**Pak Oman Micro Finance Bank Ltd**	2006	10,418	1,813	85,292	0	0
		2007	14,397	1181	93,493	12,249	14,638
		2008	15,702	2,834	137,945	20,099	24,019
13	**Punjab Rural Support Programme**	2002	54,299	NA	402,613	164,372	120,630
		2003	60,464	19,348	408,279	180,070	NA
		2004	54,555	19,487	351,372	224,543	50,770
		2005	47,855	15,800	198,590	203,690	47,951
		2006	41,860	6,006	260,389	270,000	51,840
		2007	67,285	35,186	427,608	188,255	61,974
		2008	79378	31752	702291	188,255	61,974
14	**Sindh Agricultural and Forestry Workers' CoordinatingOrganization**	1999	669	NA	1,892	852	168
		2000	642	NA	1,841	887	203
		2001	455	NA	1,954	1,253	202
		2002	2,027	NA	7,238	1,993	255
		2003	2,973	1,240	11,433	3,703	NA
		2004	3,569	1,761	16,822	4,500	366
		2005	8,880	2,925	42,645	-	-
		2006	14,018	5,706	88,729	NA	NA
		2007	17,529	3,841	112,250	-	-
		2008	20097	9108	164165	0	0
15	**Sarhad Rural Support Programme**	1999	1,267	NA	48,090	94,727	38,200
		2000	2,174	NA	56,360	105,279	46,050
		2001	8,354	NA	69,577	104,840	47,290
		2002	NA	NA	54,128	135,526	51,760
		2003	6,389	2,112	43,759	151,500	NA
		2004	5,077	313	29,286	162,453	64,000
		2005	6,703	3,379	13,928	179,078	67,520
		2006	NA	NA	NA	NA	NA
		2007	7,174	4,382	42,920	-	-
		2008	8991	4200	52751	0	0

16	**Tameer MicrofinanceBank Ltd**	2006	20,038	822	526,097	24,434	375,171
		2007	31,011	978	408,807	44,525	101,102
		2008	43,816	8,471	908,221	76,133	641,665
17	**Thardeep Rural DevelopementProgramme**	2000	956	NA	5,199	15,892	6,342
		2001	2,607	NA	14,649	24,616	10,980
		2002	NA	NA	26,725	44,104	18,741
		2003	5,488	1,480	38,392	56,041	NA
		2004	8,421	5,773	73,534	22,281	3,905
		2005	32,280	9,765	288,212	134,058	55,320
		2006	42,932	12,880	339,502	196,854	107,120
		2007	37,264	10,396	341,924	-	-
		2008	29761	15031	309212	236,112	187,812

Performance Ratios of MFIs

#	PO	Year	Portfolio at Risk	Loan Loss Reserve	Total Assets	Total Equity	Operational Self Sufficiency	Financial Self Sufficiency	Return on Assets	Return on Equity
1	**AKHUWAT**	2005	144	136	21,241	20,552	88.15%	NA	-1.51%	-1.54%
		2006	251	291	48,946	48,061	73.13%	NA	-3.64%	-3.72%
		2007	3,922	N/A	63,831	62,872	NA	NA	NA	NA
		2008	NA	NA	NA	NA	NA	NA	NA	NA
2	**ASASAH**	2004	NA	475	31,974	(3,571)	72.11%	72.11%	-8.65%	-83.50%
		2005	NA	974	57,603	(8,267)	69.90%	69.90%	-13.40%	-101.80%
		2006	NA	NA	224,332	(15,283)	57.00%	57.00%	-15.10%	-179.70%
		2007	NA	NA	323,417	(13,325)	66.15%	NA	-11.96%	-228.77%
		2008	NA	NA	NA	NA	NA	NA	NA	NA
3	**BRAC**	2006	NA	NA	NA	NA	NA	NA	NA	NA
		2007	NA	NA	NA	NA	NA	NA	NA	NA
		2008	NA	NA	NA	NA	NA	NA	NA	NA
4	**Community Support Concern**	2005	NA	NA	NA	NA	NA	NA	NA	NA
		2006	1,207	2194	134,847	34,592	46.40%	46.00%	-24.90%	-108.00%
		2007	3,086	3822	242,598	40,036	87.35%	NA	NA	NA
		2008	NA	NA	NA	NA	NA	NA	NA	NA
5	**Development Action for Mobilization and Emancipation**	2000	58	92	NA	NA	35.90%	33.00%	19.50%	NA
		2001	38	237	NA	NA	54.10%	46.90%	5.80%	NA
		2002	633	362	NA	NA	92.50%	77.90%	24.60%	NA
		2003	1,675	419	42 ,234	9,959	94.10%	93.22%	-1.73%	-9.86%
		2004	2,784	1425	47,776	14,930	86.78%	80.63%	-6.20%	-22.41%
		2005	3,515	917	127,030	19,021	85.00%	82.80%	-5.50%	-28.50%
		2006	11,306	6890	242,779	25,140	83.00%	82.00%	-5.40%	-46.40%
		2007	5,187	7788	349,993	40,036	108.69%		2.10%	19.14%
		2008	NA	NA	NA	NA	NA	NA	NA	NA

6	**First Micro Finance Bank Ltd**	2002	0	359	872,369	738,485	NA	NA	NA	NA
		2003	1836	1678	1,188,730	725,321	103.99%	NA	0.03%	0.05%
		2004	4611	4987	1,164,809	678,519	74.19%	NA	-2.31%	-3.87%
		2005	9321	8959	1,452,141	688,197	91.12%	NA	-0.95%	-1.82%
		2006	5495	12708	1,680,188	718,784	113.42%	NA	0.97%	2.15%
		2007	25,102	27974	2,807,162	680,964	90.43%	NA	-1.87%	-6.03%
		2008	NA	NA	NA	NA	NA	NA	NA	NA
7	**Kashf Foundation**	1999	18	155	NA	NA	35.20%	32.60%	26.30%	NA
		2000	85	380	NA	NA	44.20%	41.00%	24.50%	NA
		2001	545	238	NA	NA	79.10%	49.10%	11.80%	NA
		2002	303	303	NA	NA	119.40%	85.40%	16.50%	NA
		2003	472	199	774,466	315,915	130.07%	115.09%	2.18%	4.09%
		2004	3,139	11927	822,333	508,023	186.97%	154.81%	7.06%	13.68%
		2005	1,053	16072	1,246,663	606,935	178.90%	126.30%	4.10%	7.70%
		2006	789	30904	2,004,010	944,608	154.40%	121.60%	3.90%	8.20%
		2007	23,051	97907	4,064,008	1,426,500	164.10%	118.00%	11.55%	29.67%
		2008	NA	NA	NA	NA	NA	NA	NA	NA
8	**Khushali Bank**	2003	55465	35585	3,235,271	1,769,591	62.07%	NA	NA	NA
		2004	89328	68499	4,508,245	1,739,322	52.98%	NA	-4.92%	-10.80%
		2005	92893	75584	6,163,521	1,880,478	72.18%	NA	-3.70%	-11.35%
		2006	46603	65073	6,847,472	1,751,535	76.89%	NA	-3.29%	-12.26%
		2007	40059	56507	6,703,280	1,812,443	79.70%	NA	-3.86%	-14.67%
		2008	NA	NA	NA	NA	NA	NA	NA	NA
9	**National Rural Support Programme**	1999	NA	NA	NA	NA	NA	NA	NA	NA
		2000	NA	NA	NA	NA	NA	NA	NA	NA
		2001	115,387	63395	NA	NA	94.00%	83.60%	16.20%	NA
		2002	75,539	70614	NA	NA	116.40%	106.50%	13.70%	NA
		2003	48,028	36987	976,983	312,336	100.78%	93.82%	-0.92%	-3.00%
		2004	50,379	72909	1,292,173	406,827	102.74%	89.90%	-1.54%	-4.85%
		2005	12,765	74647	1,724,827	245,724	85.30%	75.80%	-4.40%	-21.00%
		2006	16,284	78019	2,247,756	529,707	87.60%	81.90%	-3.90%	-20.10%
		2007	25,372	83072	3,673,667	434,403	101.18%	NA	0.24%	1.66%
		2008	NA	NA	NA	NA	NA	NA	NA	NA
10	**Orangi Charitable Trust**	1999	333	1500	NA	NA	192.30%	108.00%	14.80%	NA
		2000	952	1500	NA	NA	229.50%	161.50%	21.80%	NA
		2001	2,967	3281	NA	NA	275.80%	181.30%	15.90%	NA
		2002	1,807	1732	NA	NA	345.80%	198.30%	19.40%	NA
		2003	1,031	371	66,398	59,784	77.38%	55.35%	-5.10%	-5.38%
		2004	2,841	2362	80,047	60,803	74.73%	60.69%	-6.22%	-7.55%
		2005	1,227	NA	111,925	75,561	168.00%	117.10%	2.90%	4.10%
		2006	478	NA	138,046	108,405	118.60%	87.00%	-2.60%	-3.50%
		2007	1,393	NA	182,523	120,711	NA	NA	NA	NA
		2008	NA	NA	NA	NA	NA	NA	NA	NA
11	**Orix Leasing Pakistan Limited**	2004	1,754	765	49,265	49,265	158.60%	108.09%	1.00%	1.00%
		2005	824	999	73,586	1,017	106.00%	76.60%	-5.70%	-13.90%
		2006	2,002	2018	71,760	3,115	108.10%	107.30%	1.10%	39.70%
		2007	3635	2199	126,784	27,018	121.46%	NA	3.63%	23.98%
		2008	NA	NA	NA	NA	NA	NA	NA	NA

12	**Pak Oman Micro Finance Bank Ltd**	2006	0	1279	493,188	488,766	67.42%	NA	NA	NA
		2007	8,834	5628	495,587	463,554	60.44%	NA	-7.70%	-8.07%
		2008	NA	NA	NA	NA	NA	NA	NA	NA
13	**Punjab Rural Support Programme**	2002	58,744	51430	NA	NA	90.90%	82.20%	15.10%	NA
		2003	76,905	59140	982,122	644,221	105.27 %	90.09%	-1.53%	-2.00%
		2004	64,374	67141	934,080	545,441	89.49%	69.73%	-4.28%	-6.90%
		2005	4,462	2491	1,159,627	582,450	71.80%	48.10%	-9.70%	-18.00%
		2006	6,874	76324	1,193,006	665,665	74.00%	55.10%	-7.40%	-13.80%
		2007	82,645	45797	1,720,541	908,182	65.75%	NA	-4.36%	-8.07%
		2008						NA	NA	NA
14	**Sindh Agricultural and Forestry Workers' Coordinating Organization**	1999	22	0	NA	NA	101.00 %	NA	NA	NA
		2000	37	0	NA	NA	41.40%	32.20%	5.80%	NA
		2001	298	0	NA	NA	6.00%	5.90%	13.80%	NA
		2002	608	412	NA	NA	44.10%	43.70%	27.20%	NA
		2003	743	485	21 ,420	5,067	38.48%	37.99%	-26.74%	-98.02%
		2004	732	708	20,828	6,898	58.30%	56.76%	-16.53%	-54.35%
		2005	1,324	784	63,088	15,628	59.30%	59.90%	-18.20%	-67.90%
		2006	3,043	1711	108,159	19,399	62.10%	58.40%	-12.30%	-60.00%
		2007	5,516	1628	138,822	33,128	80.89%	NA	NA	NA
		2008	NA	NA	NA	NA	NA	NA	NA	NA
15	**Sarhad Rural Support Programme**	1999	1,270	548	NA	NA	155.40 %	120.20%	16.10%	NA
		2000	5,889	2054	NA	NA	180.30 %	142.60%	12.90%	NA
		2001	18,004	4919	NA	NA	142.00 %	104.20%	9.90%	NA
		2002	32,285	29910	NA	NA	51.20%	47.80%	13.30%	NA
		2003	31,253	27781	62,774	(6,375)	28.96%	28.96%	-25.33%	0.00%
		2004	27,517	26796	19,786	(22,672)	20.01%	20.01%	-25.19%	-71.59%
		2005	-	6054	39,194	(26,106)	15.40%	15.40%	-29.50%	-35.70%
		2006	NA	NA	NA	NA	NA	NA	NA	NA
		2007	436	NA	67,946	13,613	NA	NA	NA	NA
		2008	NA	NA	NA	NA	NA	NA	NA	NA
16	**Tameer Microfinance Bank Ltd**	2006	0	7891	1,268,606	530,343	52.80%	NA	NA	NA
		2007	75,803	4877068	1,255,222	301,510	46.31%	NA	-19.10%	-57.85%
		2008	NA	NA	NA	NA	NA	NA	NA	NA
17	**Thardeep Rural development Programme**	2000	498	0	NA	NA	139.40 %	64.70%	4.80%	NA
		2001	940	0	NA	NA	70.00%	57.00%	NA	NA
		2002	986	929	NA	NA	59.80%	55.60%	10.90%	NA
		2003	1,041	1033	52,756	14,024	52.85%	52.14%	-10.68%	-39.00%
		2004	1,277	1001	96,635	29,654	49.47%	48.24%	-12.55%	-42.93%
		2005	2,398	1078	342,073	29,921	60.90%	53.10%	-7.20%	-52.90%
		2006	46,505	34428	351,282	(60,633)	31.50%	30.40%	-32.10%	344.70%
		2007	78,260	0	309,482	(101,668)	40.00%	NA	-30.34%	123.67%
		2008	NA	NA	NA	NA	NA	NA	NA	NA

Staffing and Branch Network

#	PO	Year	Number of Branches	Number of Staff	No. of clients per staff member	No. of loans per loan officer
1	**AKHUWAT**	2005	6	32	94	101
		2006	10	58	36	53
		2007	15	70	124	143
		2008	19	80	163	163
2	**ASASAH**	2004	-	46	100	176
		2005	8	95	89	142
		2006	28	345	36	66
		2007	33	280	98	157
		2008	23	226	111	111
3	**BRAC**					
		2007				
		2008	40	386	76	76
4	**Community Support Concern**	2005	NA		NA	NA
		2006	9	72	154	237
		2007	11	101	151	311
		2008	12	145	138	138
5	**Development Action for Mobilization and Emancipation**	2000				
		2001				
		2002	NA	NA	NA	
		2003	9	NA	169	307
		2004	9	73	96	199
		2005	17	114	132	231
		2006	25	195	131	170
		2007	25	198	164	330
		2008	24	185	199	199
6	**First Micro Finance Bank Ltd**	2002	NA	96	7	NA
		2003	NA	123	29	NA
		2004	28	150	64	102
		2005	NA	177	96	NA
		2006	NA	527	99	NA
		2007	92	1045	97	156
		2008	157	649	265	265

7	**Kashf Foundation**	1999				114
		2000				265
		2001				389
		2002		175	169	
		2003	37	262	227	510
		2004	39	326	207	502
		2005	41	396	144	431
		2006	85	847	158	325
		2007	159	1,567	188	416
		2008	154	1,527	209	NA
8	**Khushali Bank**	2003	NA	791	116	NA
		2004	NA	1171	144	NA
		2005	NA	1576	144	-
		2006	NA	1791	132	NA
		2007	120	1865	152	461
		2008	128	999	367	
9	**National Rural Support Programme**	1999	NA	NA	NA	NA
		2000	NA	NA	NA	NA
		2001	NA	NA	NA	333
		2002	NA	456	NA	NA
		2003	106	483	146	158
		2004	161	519	170	177
		2005	222	925	132	146
		2006	581	1836	104	128
		2007	499	2469	118	149
		2008	695	4164	111	NA
10	**Orangi Charitable Trust**	1999	NA	NA		263
		2000	NA	NA		88
		2001	NA	NA		140
		2002	NA	NA		
		2003	1	27	113	226
		2004	1		144	354
		2005	1	32	218	437
		2006	2	30	400	857
		2007	2	43	488	1,399
		2008	6	68	415	NA
11	**Orix Leasing Pakistan Limited**	2004	5	9	228	461
		2005	5	13	308	470
		2006	6	20	182	363
		2007	6	37	241	NA
		2008	7	48	321	NA

12	**Pak Oman Micro Finance Bank Ltd**	2006	NA	115	91	NA
		2007	16	201	71	206
		2008	16	99	158	
13	**Punjab Rural Support Programme**	2002	NA	NA	NA	NA
		2003	27	0	192	268
		2004	27	315	173	241
		2005	68	308	155	212
		2006	21		77	105
		2007	27	551	122	169
		2008	27	551	122	NA
14	**Sindh Agricultural and Forestry Workers' Coordinating Organization**	1999	NA	NA	NA	223
		2000	NA	NA	NA	161
		2001	NA	NA	NA	114
		2002	NA	NA	NA	NA
		2003	4	18	165	270
		2004	8	35	102	255
		2005	8	63	141	317
		2006	14	110	127	319
		2007	14	115	152	373
		2008	18	152	132	NA
15	**Sarhad Rural Support Programme**	1999	NA	NA	NA	36
		2000	NA	NA	NA	70
		2001	NA	NA	NA	178
		2002	NA	NA	NA	NA
		2003	25	59	108	118
		2004	6	29	175	188
		2005	11	37	181	353
		2006	NA		NA	NA
		2007	14	63	113	359
		2008	10	50	179.00%	NA
16	**Tameer Microfinance Bank Ltd**	2006		426	47	NA
		2007	41	658	47	67
		2008	60	962	47	NA
17	**Thardeep Rural Development Programme**	2000	NA	NA		239
		2001	NA	NA		372
		2002	NA	NA		
		2003	9	20	274	343
		2004	9	20	421	526
		2005	38	65	497	587
		2006	50	107	401	537
		2007	60	131	284	396
		2008	56	203	146	NA

Appendix Table

December 2008 Figures in (US $)

Name of MFI	Number of branches	Staff	Number of borrowers		Loan outstanding (US$)	Loan overdue (US$)	Member savings (US$)*	Public deposits (US$)
			Male	Female				
AKHUWAT	19	80	9,162	3,926	971,010	-	-	
ASASAH	30	233	0	23,730	2,866,895	-	68,292	
BRAC	40	386	0	29,204	3,331,022	-	-	
Community Support Concern	13	80	9,357	8,075	2,336,838	47,175	-	
Development Action for Mobilization and Emancipation	25	200	0	36,897	4,131,848	32,254	-	
First Micro Finance Bank Ltd	159	1575	106,211	61,980	26,811,467	343,048		41,964,978
Kashf Foundation	154	1527	0	319,652	42,575,390	-	-	
Khushali Bank	135	2008	281,843	31,008	39,280,457	871,911		230,717
National Rural Support Programme	537	3045	333,750	232,113	93,389,803	696,063	-	
Orix Leasing Pakistan Limited	9	52	4,463	10,714	1,987,276	35,035	-	
Pak Oman Micro Finance Bank Ltd	16	152	12,868	2,834	1,590,362	95,759		302,971
Punjab Rural Support Programme	27	460	33,429	40,743	8,299,581	344,686	-	
Sindh Agricultural and Forestry Workers' Coordinating Organization	18	143	11,438	6,605	1,798,121	42,679	-	
Sarhad Rural Support Programme	11	64	5,273	5,574	913,841	17,105	-	
Tameer MicrofinanceBank Ltd	27	865	35,320	8,471	11,515,581	152,737		8,120,952
Thardeep Rural Development Programme	61	184	24,748	6,003	4,014,463	298,362	-	

- Pakistan MFIs are not allowed to keep member savings. As such this figure represents the funds which are deposited by the clients in commercial banks.

December 2008

Name of MFI	Number of branches	Staff	Number of borrowers		Loan outstanding (Rs)	Loan overdue (Rs)	Member savings (Rs)*	Public deposits (Rs)
			Male	Female				
AKHUWAT	19	80	9,162	3,926	76,467,000	-	-	
ASASAH	30	233	0	23,730	225,768,000	-	5,378,000	
BRAC	40	386	0	29,204	262,318,000	-	-	
Community Support Concern	13	80	9,357	8,075	184,026,000	3,715,000	-	
Development Action for Mobilization and Emancipation	25	200	0	36,897	325,383,000	2,540,000	-	
First Micro Finance Bank Ltd	159	1575	106,211	61,980	2,111,403,000	27,015,000		3,304,742,000
Kashf Foundation	154	1527	0	319,652	3,352,812,000	-	-	
Khushali Bank	135	2008	281,843	31,008	3,093,336,000	68,663,000		18,169,000
National Rural Support Programme	537	3045	333,750	232,113	7,354,447,000	54,815,000	-	
Orix Leasing Pakistan Limited	9	52	4,463	10,714	156,498,000	2,759,000	-	
Pak Oman Micro Finance Bank Ltd	16	152	12,868	2,834	125,241,000	7,541,000		23,859,000
Punjab Rural Support Programme	27	460	33,429	40,743	653,592,000	27,144,000	-	
Sindh Agricultural and Forestry Workers' Coordinating Organization	18	143	11,438	6,605	141,602,000	3,361,000	-	
Sarhad Rural Support Programme	11	64	5,273	5,574	71,965,000	1,347,000	-	
Tameer MicrofinanceBank Ltd	27	865	35,320	8,471	906,852,000	12,028,000		639,525,000
Thardeep Rural Development Programme	61	184	24,748	6,003	316,139,000	23,496,000	-	

- Pakistan MFIs are not allowed to keep member savings. As such this figure represents the funds which are deposited by the clients in commercial banks.