Micro finance in Pakistan.

by

Khalid Saleem Cheema
MBA-2004

ACKNOWLEDGEMENTS

I would like to thank Miss Mahjabeen Cheema for providing me with her valuable insight and advice without which this thesis could not have been completed. Furthermore I would like to acknowledge the guidance provided by miss Farzana Noshab. Last but not least I am grateful to Mrs. Fauzia Janjua for becoming my advisor and being patient enough to help me out with my thesis.

ABSTRACT

More than subsidies poor need access to credit. Absence of formal employment make them non `bankable'. This forces them to borrow from local moneylenders at exorbitant interest rates. The successful implementation of the Microfinancing (Grameen Banking Model) has enabled nations around the worlds to believe that the poorest of the poor can and do stand on their own two feet and become a productive unit of the country if proper financial services are provided to them. In Pakistan, majority of the population is living below the poverty line. In order to purse the objective of becoming a developed country it is mandatory to raise the status of these people. To do this, the Pakistani government and the social sector of Pakistan is actively engaged in the proliferation of microfinance to the lowest level possible.

The thesis deals with the study of the microfinance sector in Pakistan, explaining the various facets and characteristics of this phenomenon that is currently quiet popular in the country. The study also sheds lights on the various challenges and problems faced by the participants in the microfinance sector. A comprehensive effort has been made to explain the rules and regulations pertaining to this sector. Quantitative data has been provided wherever possible to give a complete and clear picture of the current scenario of the sector. Recommendations have been provided for the purpose of increasing the outreach and effectiveness of the Microfinance Institutes currently active in the market. The entire purpose of this study is to provide a clear picture of the Microfinance Sector in Pakistan, its effectiveness, its problems and the future outlook of this important phenomenon that would enable the country to break the shackles of poverty and make its view into the realm of development and prosperity.

TABLE OF CONTENTS

CHAPTER 1- INTRODUCTION 1

1.1 Microfinance Defined 2

1.2 Clients of Microfinance 3

1.3 Millennium Development Goals (MDGs) 5

1.3.1 Eradicate Extreme Poverty And Hunger 6

1.3.2 Achieve Universal Primary Education 6

1.3.3 Promote Gender Equality And Empower Women 7

1.3.4 Combat Disease 7

1.3.5 Ensure Environmental Sustainability 7

1.3.6 Develop A Global Partnership For Development 8

1.4 Microfinance Institution (MFI) Defined 8

1.5 The Government's Role in MF 10

1.6 Role of Regulation & Supervision in Microfinance 11

1.7 Key Players In The Field Of Microfinance 12

1.7.1 Microfinance Institutions (MFIs) 12

1.7.2 Public Banks & National Development Banks 12

1.7.3 Commercial Banks 12

1.7.4 Donors 12

CHAPTER 2 MICROFINANCE IN PAKISTAN 14

2.1 **Poverty In Pakistan** **14**

2.1.1 Macroeconomic And Social Vulnerability 18

2.1.2 Income Distribution & Poverty 20

2.2 **Microfinance Sector Of Pakistan** **22**

2.2.1 The Need For Microfinance 22

2.2.2 Demand 23

2.2.3 Supply 24

2.2.4 MF Clientele of Pakistan 28

2.2.5 Recent Performance 28

2.3 Support For Non-banking Microfinance Institutes **30**

2.3.1 Direct Support For Specialized MFIs 30

2.3.2 Support Through The Banking System 32

2.4 Regulation Of Microfinance **36**

2.4.1 Regulation Of Non-Bank Microfinance Institutions 36

2.4.2 Regulation Of Banks 40

2.5 Regulatory & Promotional Initiatives Of SBP **43**

2.5.1 Separate Licensing Criteria for Establishing MFBs 44

2.5.2 Prudential Regulations For Micro Finance Banks 44

2.5.3 Mobile Banking Guidelines 44

2.5.4 NGO/ RSPs Transformation Guide Lines 45

2.5.5 Fit And Proper Criteria 46

2.6 Challenges & Problems Faced by the MF Sector **47**

2.6.1 Inadequate Access of the Poor to Services 47

2.6.2 Limited Retail Capacity 48

2.6.3 Obstacles For Microfinance Outreach To Women 49

2.6.4 Interest Rate 49

2.6.5 Absence of Risk Mitigation Measures 50

2.6.6 Financial Sustainability 50

2.6.7 Microfinance-Specific Policy Framework 51

2.6.8 Institutional Limitations 51

2.6.9 Services 52

2.6.10 Range Of Financial Services 53

2.6.11 Dearth of Microfinance Practitioners 53

CHAPTER 3: RECOMMENDATIONS **54**

CHAPTER 4: FUTURE OUTLOOK & CONCLUSION **60**

REFRENCES **62**

APPENDIX **63**

Chapter 1

INTRODUCTION

Chapter 2

MICROFINANCE IN PAKISTAN

Chapter 3

RECOMMENDATIONS

Chapter 4

FUTURE OUTLOOK & CONCLUSION

REFRENCES

APPENDIX

" Whoever has witnessed misery and famine in Africa, Asia or Brazil, realizes to what extent the citizens of these countries need support in terms of food and health services, but mostly need concrete means to break out of the developed countries' random aid system. The combination of microfinance tools and Internet is a real lifeline given to those who are hungry and want to feed themselves through the fruit of their labor. "

Jimmy Anidjar - *CEO, Oracle France*

"Sustainable access to microfinance helps alleviate poverty by generating income, creating jobs, allowing children to go to school, enabling families to obtain health care, and empowering people to make the choices that best serve their needs. Together, we can and must build inclusive financial sectors that help people improve their lives."

Kofi Annan - *UN Secretary-General*

The world's seven richest men could wipe out global poverty. Their combined wealth is more than enough to provide the basic needs of the poorest quarter of the world's people.
Yet 1.2 billion people worldwide live on less than one dollar/day adjusted to purchasing power parity (PPP) and 1 billion other people live below the poverty line of 2 dollars.80% of the world's population does not have access to credit.
Like everyone else, most poor people need and use financial services all the time. They save and borrow to take advantage of business opportunities, invest in home repairs and improvements, and meet seasonal expenses like school fees and holiday celebrations. The financial services available to the poor, however, often have serious limitations in terms of cost, risk, and convenience. Moneylenders, for example, often charge usurious interest rates on loans. Buying goods on credit is far more expensive than paying in cash. Local rotating savings and credit circles take deposits and give loans only at rigid time intervals and in strict amounts, and often result in the loss of members' money.
Beginning in the 1950s, development projects began to introduce subsidized credit programs targeted at specific communities. These subsidized schemes were rarely successful. Rural development banks suffered massive erosion of their capital base due to subsidized lending rates and poor repayment discipline and the funds did not always reach the poor, often ending up concentrated in the hands of better-off farmers.

In the 1970s, experimental programs in Bangladesh, Brazil, and a few other countries extended tiny loans to groups of poor women to investment in micro-businesses. This type of microenterprise credit was based on solidarity group lending in which every member of a group guaranteed the repayment of all members.

Through the 1980s and 1990s, microcredit programs throughout the world improved upon the original methodologies and bucked conventional wisdom about financing the poor. First, it showed that poor people, especially women, had excellent repayment rates among the better programs, rates that were better than the formal financial sectors of most developing countries. Second, the poor were willing and able to pay interest rates that allowed microfinance institutions (MFIs) to cover their costs.

These two features—high repayment and cost-recovery interest rates—permitted some MFIs to achieve long-term sustainability and reach large numbers of clients. In fact, the promise of microfinance as a strategy that combines massive outreach, far-reaching impact, and financial sustainability makes it unique among development interventions.

Today, the microfinance industry and the greater development community share the view that permanent poverty reduction requires addressing the multiple dimensions of poverty. For the international community, this means reaching specific Millennium Development Goals (MDGs) in education, women's empowerment, and health, among others. For microfinance, this means viewing microfinance as an essential element in any country's financial system.

Microfinance Defined:

“Microfinance is the supply of loans, savings, and other basic financial services to the poor.”

“Microfinance means the provision of financial services (credit, savings, insurance, etc.) to those living in poverty and excluded from the financial system.”

These people do not have an income and do not own property, and are therefore unable to provide bank guarantees and are therefore generally “forgotten” by financial institutions and banks. People living in poverty, like everyone else, need a diverse range of financial

instruments to run their businesses, build assets, stabilize consumption, and shield themselves against risks. Financial services needed by the poor include working capital loans; consumer credit, savings, pensions, insurance, and money transfer services. The poor rarely access services through the formal financial sector. They address their need for financial services through a variety of financial relationships, mostly informal. Credit is available from informal commercial and non-commercial moneylenders but usually at a very high cost to borrowers. Savings services are available through a variety of informal relationships like savings clubs, rotating savings and credit associations, and mutual insurance societies that have a tendency to be erratic and insecure.

Providers of financial services to the poor include donor-supported, non-profit non-government organizations (NGOs), cooperatives; community-based development institutions like self-help groups and credit unions; commercial and state banks; insurance and credit card companies; wire services; post offices; and other points of sale. NGOs and other non-bank financial institutions have led the way in developing workable credit methodologies for the poor and reaching out to large numbers of the poor. Throughout the 1980s and 1990s, these programs improved upon the original methodologies and bucked conventional wisdom about financing the poor. They have shown that the poor repay their loans and are willing and able to pay interest rates that cover the costs of providing the loans.

Financial services for the poor have proved to be a powerful instrument for poverty reduction that enables the poor to build assets, increase incomes, and reduce their vulnerability to economic stress. However, with nearly one billion people still lacking access to basic financial services, especially the very poor, the challenge of providing financial services to them remains. Convenient, safe, and secure deposit services are a particularly crucial need.

Clients of Microfinance:

The clients of microfinance—female heads of households, pensioners, displaced persons, retrenched workers, small farmers, and micro-entrepreneurs—fall into four poverty levels:

- Destitute
- Extreme poor
- Moderate poor

- Vulnerable non-poor

While repayment capacity, collateral availability, and data availability vary across these categories, methodologies and operational structures have been developed that meet the financial needs of these client groups in a sustainable manner.

More formal and mainstream financial services including collateral-based credit, payment services, and credit card accounts may suit the moderate poor. Financial services and delivery mechanisms for the extreme and moderate poor may utilize group structures or more flexible forms of collateral and loan analysis. Serving the destitute is more challenging (and impossible for many financial service providers), but innovative schemes have opened up pathways to economic activity and access to financial services for them.

The client group for a given financial service provider is primarily determined by its mission, institutional form, and methodology. Banks that scale down to serve the poor tend to reach only the moderate poor. Credit union clients range from the moderate poor to the vulnerable non-poor, although this varies by region and type of credit union. NGOs, informal savings and loan groups, and community savings and credit associations have a wide range of client profiles.

How Financial Services Help the Poor:

Poor people, with access to savings, credit, insurance, and other financial services, are more resilient and better able to cope with the everyday crises they face. Even the most rigorous econometric studies have proven that microfinance can smooth consumption levels and significantly reduce the need to sell assets to meet basic needs. With access to micro insurance, poor people can cope with sudden increased expenses associated with death, serious illness, and loss of assets.

Access to credit allows poor people to take advantage of economic opportunities. While increased earnings are by no means automatic, clients have overwhelmingly demonstrated that reliable sources of credit provide a fundamental basis for planning and expanding business activities. Many studies show that clients who join and stay in programs have better economic conditions than non-clients, suggesting that programs contribute to these improvements. A few studies have also shown that over a long period of time many clients do actually graduate out of poverty.

By reducing vulnerability and increasing earnings and savings, financial services allow poor households to make the transformation from "every-day survival" to "planning for the future." Households are able to send more children to school for longer periods and to make greater investments in their children's education. Increased earnings from financial services lead to better nutrition and better living conditions, which translates into a lower incidence of illness. Increased earnings also mean that clients may seek out and pay for health care services when needed, rather than go without or wait until their health seriously deteriorates.

Microfinance programs have generally targeted poor women. By providing access to financial services only through women—making women responsible for loans, ensuring repayment through women, maintaining savings accounts for women, providing insurance coverage through women—microfinance programs send a strong message to households as well as to communities. Many qualitative and quantitative studies have documented how access to financial services has improved the status of women within the family and the community. Women have become more assertive and confident. In regions where women's mobility is strictly regulated, women have become more visible and are better able to negotiate the public sphere. Women own assets, including land and housing, and play a stronger role in decision-making. In some programs that have been active over many years, there are even reports of declining levels of violence against women.

Although access to financial services opens up possibilities of improving the economic conditions of the poor, in some cases, clients can be left worse-off. Ill-advised credit can lead to too much debt. Sustainable financial services that improve the conditions of the poor depend on a clear vision of sustainability, on careful program design, on efficient operations, and very importantly, on constantly trying to understand and meet client needs.

Millennium Development Goals:

In September 2000, the member states of the United Nations unanimously adopted the Millennium Development Goals (MDGs). The MDGs commit the international community to a common vision of development one in which human development and poverty reduction have the highest priority. The objective of the MDGs is to serve as guideposts

and focus the efforts of the world community on achieving significant, measurable improvements in poor peoples lives. The goals grew out of the agreements and resolutions of various development conferences organized by the UN in the 1990s.

The relationship between microfinance and the MDGs is such that, the MDGs provide objectives for nations to curb poverty, hunger, disease, illiteracy, etc while Microfinance is the tool which is used to reach the MDGs. The MDGs also apply to Pakistan and have been set as the development targets for the country in the coming years. Some of the more common MDGs are:

Eradicate Extreme Poverty And Hunger:

The poor have physical assets—food, clothing, housing—and financial assets, such as income or savings, with which to acquire basic necessities. Access to financial services enables the poor to increase income and smooth consumption flows, and thus expand their asset base and reduce their vulnerability. Empirical evidence shows that, among the poor, those participating in microfinance programs who had access to financial services were able to improve their well-being both at the individual and household level much more than those who did not have access to financial services.

Achieve Universal Primary Education:

Increased earning and savings provide poor people with some cushion from the day-to-day struggle of earning a living. This opens up the possibility of investing in their children’s future, and in education in particular. Empirical evidence indicates that, in poor households with access to financial services, children are not only sent to school in larger numbers, but they also stay in school longer. Even where children help out in family enterprises, the poverty-induced imperative of child labor decreases, and school dropout rates are much lower in client households than in non-client households.

Promote Gender Equality And Empower Women:

Overall, the experience of microfinance programs points to strong evidence that the access to financial services and the resultant transfer of financial resources to poor women, over time, lead to women becoming more confident, more assertive, and better

able to confront systemic gender inequities. Access to finance enables poor women to become economic agents of change by increasing their income and productivity, access to markets and information, and decision-making power. However, it would be wrong to assume access to financial services automatically has a positive impact on women's welfare. In some instances, women's access to microfinance may result in increased violence within the household, leaving them with a greater loss of power. Women borrowing for a micro enterprise may end up being forced to work longer hours and lose control over financial resources and decision making to male members of the family. Neither should microfinance be seen as a substitute for dealing with key structural issues pertinent to women and poverty, such as lack of skills and education, or legislation that discriminates against women (e.g., property rights, agrarian or land reform, trade agreements).

Combat Disease:

Other than hunger, illness is generally the most important risk that poor people periodically face. Deaths due to illness, time taken off from work because of an illness, and health care-related expenses erode incomes and savings, often force the poor to sell assets and go into debt. Increased earnings and savings allow clients to seek out and pay for health care services when needed, rather than wait for conditions to deteriorate. In addition, many microfinance institutions actively promote health education. This may take the form of a few simple, preventive health care messages on immunization, safe drinking water, and pre-natal and post-natal care. Some programs provide credit products for water and sanitation that directly improve clients living conditions. A few programs have also taken initiatives to promote health insurance for their clients.

Ensure Environmental Sustainability:

There has been very little study of the extent of the impact of financial services for the poor on safe drinking water, sanitation, or other forms of environmental sustainability. However, there is evidence that with increased earnings the poor do invest in improved housing, water, and sanitation. Many microfinance programs provide specific loans for tube wells and for toilets. Other programs, such as SEWA in India, have creatively linked

microfinance to slum improvement projects. Such projects help build community infrastructure (tap water, toilets, drainage, and paved roads) that are paid for by community residents through loans from microfinance institutions.

Develop A Global Partnership For Development:

The last goal provides the means to achieve the other goals. Access to financial services enables the poor to fight the various dimensions of poverty and make improvements to their lives. Whether they save or borrow, evidence shows that when poor people have access to financial services, they choose to invest their loans, additional earnings, or savings in a wide range of activities and assets that benefit not only themselves but also their households. Thus access to financial services provides the poor with the means to make improvements in their lives—in other words, to achieve most of the MDGs—on their own terms, in a sustainable way. Access to credit, savings, or other financial services is only one of a series of strategies needed to reduce poverty and achieve the MDGs. Financial services need to be complemented by access to education, health care, housing, transportation, markets, and information.

Microfinance Institution (MFI) Defined:

“A microfinance institution (MFI) is an organization that provides financial services to the poor.”

This very broad definition includes a wide range of providers that vary in their legal structure, mission, methodology, and sustainability. However, all share the common characteristic of providing financial services to a clientele poorer and more vulnerable than traditional bank clients.

Historical context can help explain how specialized MFIs developed over the last few decades. Between the 1950s and 1970s, governments and donors focused on providing subsidized agricultural credit to small and marginal farmers, in hopes of raising productivity and incomes. During the 1980s, micro enterprise credit concentrated on providing loans to poor women to invest in tiny businesses, enabling them to accumulate assets and raise household income and welfare. These experiments resulted in the

emergence of nongovernmental organizations (NGOs) that provided financial services for the poor. In the 1990s, many of these institutions transformed themselves into formal financial institutions in order to access and on-lend client savings, thus enhancing their outreach. An MFI can be broadly defined as any organization—credit union, downscaled commercial bank, financial NGO, or credit cooperative—that provides financial services for the poor.

Various characteristics of MFIs are:

Formal Providers:

Formal Providers are sometimes defined as those that are subject not only to general laws but also to specific banking regulation and supervision (development banks, savings and postal banks, commercial banks, and non-bank financial intermediaries). Formal providers may also be any registered legal organizations offering any kind of financial services. Semiformal providers are registered entities subject to general and commercial laws but are not usually under bank regulation and supervision (financial NGOs, credit unions and cooperatives). Informal providers are non-registered groups such as rotating savings and credit associations (ROSCAs) and self-help groups.

Ownership Structures:

MFIs can be of almost any type imaginable. They can be government-owned, like the rural credit cooperatives in China; member-owned, like the credit unions in West Africa; socially minded shareholders, like many transformed NGOs in Latin America; and profit-maximizing shareholders, like the microfinance banks in Eastern Europe.

Focus:

Focus of some providers is exclusively on financial services to the poor. Others are focused on financial services in general, offering a wide range of financial services for different markets. Organizations providing financial services to the poor may also provide non-financial services. These services can include business-development services, like

training and technical assistance, or social services, like health and empowerment training.

Services:

Poor people need and demand the same types of financial services as everyone else. The most well known service is non-collateralized "micro-loans," delivered through a range of group-based and individual methodologies. The menu of services offered also includes others adapted to the specific needs of the poor, such as savings, insurance, and remittances. The types of services offered are limited by what is allowed by the legal structure of the provider. Non-regulated institutions are not generally allowed to provide savings or insurance.

The Government's Role in Microfinance:

Governments play a complex role in microfinance. Until recently, many governments believed that it was their responsibility to provide development finance, including direct lending to the disadvantaged. But decades of experience have shown that when governments engage in retail lending to the poor, they almost always do it badly. Short-term political gain is very tempting for politically controlled lending organizations: they disburse too quickly, and they collect too sporadically because they are unwilling to be tough on defaulters. Furthermore, good microfinance requires an agile and efficient corporate culture, which can be difficult to maintain in an organization subject to government hiring and firing policies.

More recently, many governments have recognized that they can not do a good job of lending to the poor, yet they still seek to promote such lending by setting up apex facilities that make wholesale funding available to a range of private microfinance providers. Such apexes can be useful if the country has a critical mass of solid microfinance institutions. However, they usually have not been effective in developing good institutions where few or none existed before, and they are likely to be subjected to political pressure unless their structure effectively precludes government influence.

Although governments are not usually good at lending, they play an important role in setting appropriate policies. The key things that a government can do for microfinance are to maintain macroeconomic stability and to avoid interest-rate caps that prevent MFIs from

covering their costs and operating sustainably. Beyond this, it is doubtful that the development of microfinance, at least in its earlier stages, requires a national policy framework. No such framework was present in most countries where microfinance first reached massive numbers of clients for instance, in Bangladesh, Indonesia, and Bolivia. In fact, political attention to microfinance has sometimes done more harm than good.

When microfinance providers take up voluntary deposit services, then governments need to regulate it in order to protect depositors.

Role Of Regulation And Supervision In Microfinance:

Banks are regulated to protect their depositors and to prevent risks to the financial system. Credit-only MFIs do not take deposits from the public and are too small to pose much risk for the financial system. Regulation by the financial authorities is needed for MFIs that do take deposits—for instance, savings-based financial cooperatives or credit-based MFIs that want to start taking deposits to finance their growth.

In many countries, various factions are pushing for new laws to create a special, new type of financial license that is tailor-made for deposit-taking MFIs. Such laws need to be approached with care. New licensing windows for MFIs have been most successful in countries where a critical mass of profitable credit-only MFIs existed before the opening of the window.

Drafters of new legislation typically fail to give enough attention to the practical feasibility of supervising compliance with the new regulations. In Indonesia, Ghana, and the Philippines, for example, dozens of new institutions took advantage of a newly created licensing window, but supervision proved grossly inadequate and a high proportion of them failed.

MFIs that do not take deposits do not need intensive regulation and supervision, but they do need a certain minimum regulatory structure in order to operate. In the transition economies of former socialist countries, legislation is sometimes necessary to clarify the right of NGOs and other non-bank institutions to engage in the business of lending.

In all countries, enforcement of unrealistically low interest-rate caps can make sustainable microlending impossible. MFIs need to charge interest rates that are considerably higher

than normal bank rates because the administrative costs of making small loans are high in relation to the amount lent.

Key Players In The Field Of Microfinance:

Microfinance Institutions (MFIs):

These are most often set up at the initiative of local communities and created with the support of International Cooperation Agencies and international NGOs. In France, organizations such as GRET, CIRAD or IRAM, have assisted in the creation of several MFIs. In the United States, networks such as ACCION, Opportunity International or FINCA have assisted in the creation of these MFIs, with funding coming from international cooperation organisations. In 2004, it was estimated that over EUR 80 million had been loaned to clients of these Microfinance Institutions, whilst demand is estimated to have been EUR 500 million

Public Banks And National Development Banks:

Their involvement in this sector has increased, with national public institutions often acting as a “banker” for microfinance institutions. In Mali, an Institution such as the BNDA (National Bank for Agricultural Development) finances nearly 80% of MFIs, and in Mexico Institutions such as FIRA or Financiera Rural is responsible for refinancing many MFIs. Public banks sometimes directly provide microfinance, as did BancoEstado in Chile, for example (in 2005, this was one of the first microfinance programmes in Latin America, with over 150,000 clients)

Commercial Banks:

These have been increasingly involved in this sector, on several levels. They are able to assist MFIs, either by refinancing their activities or by providing technical assistance, as is the case, for example, in India with ICICI (the country’s second major commercial bank). They can also directly develop their own Microfinance activities, as does Financial Bank in

Benin via its branch office FINADEV, and BanColombia in Colombia via MicroEmpresarios, a specialized client segment.

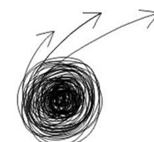
Donors:

Bilateral cooperation (USAID, AFD, KFW, DFID), multilateral cooperation (European Commission, United Nations, World Bank, Regional Development Bank): all donors are active in developing the sector and assist in its development.

POVERTY IN PAKISTAN

Pakistan is a country with a population of 146 million & an average growth rate of 2.8 % per annum. Women form 48% of the total population and 52 % are men. According to the estimates 97 million people live in rural areas whereas 49 million in the urban areas. The total labor force is estimated at 41.5 million, of which 28.1 million (67.7%) is in rural areas and 13.4 million (32.3%) in urban areas. Agriculture is the mainstay of economy with sustaining 48.4 % of the employed labor force. The other main sectoral employers are services 15.02 %, trade 13.87 and manufacturing 11.25 %. Per capita income is estimated at US$ 480.

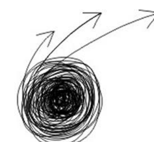
Exports in 2000-01 were estimated at US$ 8925 million or 15.7% of GDP. Exports mainly comprise of primary commodities 11 %, semi-manufactures 14% and manufactured goods 75%. The main export items are cotton, leather, rice, synthetic textiles, sports goods etc. Imports in 2000-01 were US$ 10,171 million reflecting a trade gape of US$ 1,246 million. Major imports include petroleum, machinery, edible oil, chemical and fertilizers. Persistent fiscal deficit is a major economic issue with fiscal deficit in 2000-01 estimated at 5.7 % of GDP. This led to unsustainable growth in public debt, and the current level of domestic debt rests at US$ 27 billion (PKR 1.6 trillion) and foreign debt at US$ 36 billion. The unsustainable levels of public debt and resulting debt servicing liabilities together with regional security needs leave limited fiscal space for servicing social development in Pakistan. After the relatively difficult phase for Pakistan's economy during the 90's the far reaching structural reforms initiated and accelerated in particular over the past three years have now started to pay off and Pakistan has witnessed a modest rebound in growth, its vulnerability to external shocks has reduced and its key economic fundamentals have improved. The real gross domestic product growth of 3.6% during FY 2001-02 as against 2.5% in the previous year and the growth target of 4.5% for the FY 2003 seems achievable. The current growth rates however need to be strengthened to arrest the current growth in poverty levels. Macro stabilization, governance reforms and re-profiling of external debt stock have created prospects for robust growth in future.



The Government has indicated its willingness to speed up the pace of structural reforms to meet the major challenges of

- Reducing poverty,
- Improving governance and administration,
- Improving the fiscal and balance of payments positions,
- Restoring investor confidence,
- Achieving higher growth on a sustainable basis, and
- Improving social indicators.

Economic Indicators	**2004**	**2003**	**2002**	**2001**	**2000**	**1999**
Monetary						
Inflation Rate (Changes In Consumer Prices)	**7.44%**	**2.91%**	**3.29%**	**3.15%**	**4.37%**	**4.14%**
Discount Rate	**7.50%**	**7.50%**	**7.50%**	**10.00%**	**13.00%**	**13.00%**
Financial Depth	**n/a**	**58.29%**	**54.77%**	**49.36%**	**48.07%**	**45.76%**
Output and Income						
GDP (current US$; thousands)	**n/a**	**68,815,070**	**59,234,920**	**58,765,320**	**60,932,570**	**58,605,050**
GNI per capita, Atlas method (current US$)	**600**	**470**	**420**	**420**	**450**	**460**
GDP per capita growth (annual %)	**n/a**	**3.29%**	**0.40%**	**0.11%**	**1.78%**	**1.19%**
Cost to register a business (% of GNI per capita)	**n/a**	**46.80%**	**44.40%**	**n/a**	**n/a**	**n/a**
Exchange rates and Foreign						
Exchange Rate (Local Currency per US$, End of Period)	**n/a**	**57.22**	**58.53**	**60.86**	**58.03**	**51.78**
Foreign direct investment, net inflows (% of GDP)	**n/a**	**n/a**	**1.39%**	**0.65%**	**0.51%**	**0.91%**

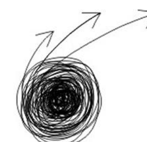


Workers' remittances, receipts (BoP, current US$; thousands)	**n/a**	**3,963,000**	**3,554,000**	**1,461,000**	**1,075,000**	**996,000**
Private capital flows, net total (DRS, current US$; thousands)	**n/a**	**n/a**	**379,300**	**228,600**	**17,800**	**120,500**
Socioeconomic Indicators						
Population, total (thousands)	**n/a**	**148,439**	**144,902**	**141,450**	**138,080**	**134,790**
Rural population (% of total population)	**n/a**	**65.88%**	**66.22%**	**66.56%**	**66.90%**	**67.16%**

*** Source: IMF/IFS (International Financial Statistics)**

The Table above provides a snapshot of Pakistan's performance during the recent years. The GDP has been increasing steadily, a good sign, and at first glance it would seem that Pakistan was heading on the road of development at a rapid phase. This is not so. Along with the rise in GDP the population of Pakistan has risen at a proportionate rate plus the inflation rate has been running rampant in the country. Although alongside growth of a country's economy an increase in inflation rate is expected but since the past 5 years inflation rate has steadily increased. Last year it was 7.44% and this year it touched the 9% mark and shows no signs of decreasing.

The table on the next page will be helpful in shedding the light on the true and pitiful picture of the prevalent poverty in Pakistan.



FACTS OF POVERTY

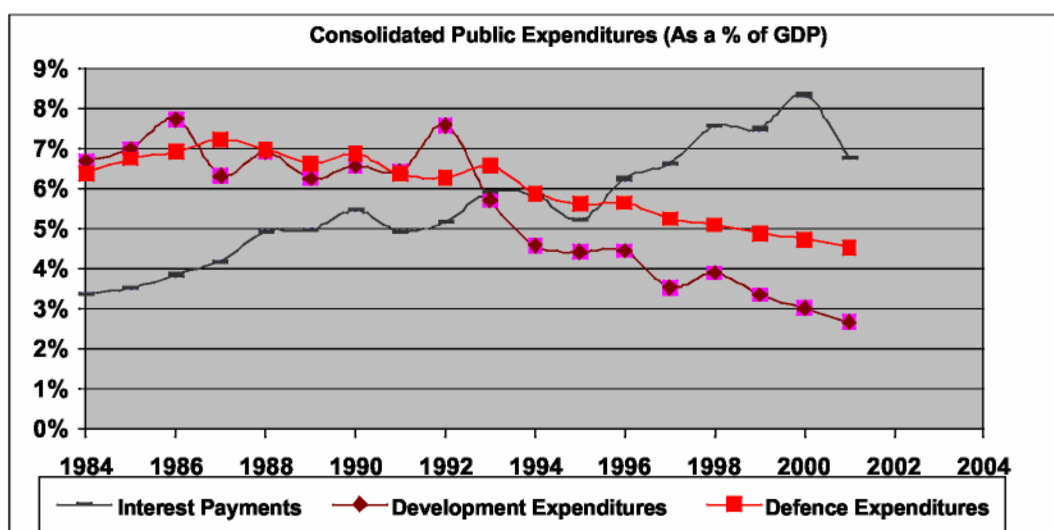
An analysis of poverty by socio-economic groups, focusing on key demographic and economic characteristics, reveals the following facts of poverty in Pakistan:

1. Poverty in Pakistan has remained fairly stable during the 1990s, from 29.3% in 1993-94 to 32.2% in 1998-99.
2 Poverty is considerably higher in rural as compared to urban areas. According to calculations by FBS based on PIHS data poverty headcount in 1998-99 was 36.3% and 22.4% for rural and urban areas of Pakistan, respectively. Poverty incidences vary significantly between provinces. NWFP has the highest rural as well as urban poverty followed by Punjab. Balochistan data for 1998-99 shows relatively low poverty; however, poverty in Balochistan is as high as in NWFP as in other years [2].

   Poverty is strongly related to lack of basic needs, especially education and cultivable land
4. The poor have a higher dependency ratio, as households with a large number of children, and single earning member, are more likely to be poor. On average the poor have almost five household members less than 18 years of age, while the number for the non-poor is three. Average number of births by a poor woman (married and of age 15-49) is almost five, compared to four for a non-poor woman.
5. More than one third of the poor households are headed by aged persons who are dependent on transfer incomes, such as pensions and other forms of social support.
6. Education is the most important factor that distinguishes the poor from the non-poor. The percentage of literate household heads is 27 in poor households while for non-poor households it is 52.
7. The poor are also characterized by relatively low access to health related infrastructure, like sanitation. While 76% of the poor live in households with no toilet with flush, compared to 53% of the non-poor. The poor are also less likely to have access to electricity and gas – 60% and 10% of the poor live in households with electricity and gas connections, compared to 75% and 24% of the non-poor, respectively.
8. Relatively poor communities also seem to have less access to health facilities and immunization coverage. 45% of the children in poor households aged one to five years have been fully immunized as against 58% in non-poor households.
9. Poverty is (relatively) higher when head of the households are unskilled agricultural workers, engaged in services, transport, production, and sales occupation.
10. The non-poor own 0.84 acres of cultivable land per capita, while the poor own only 0.27 acres per capita. In addition the poor are less able to diversify their agricultural production and are thus more susceptible to economic shocks.

Macroeconomic And Social Vulnerability:

Over the recent decades economic growth in Pakistan has followed a downward trend with real GDP growth falling from over 6 percent per annum in the 1980s to around 4 percent during the late 1990s. A sharp rise in interest payments on public debt and a commensurate fall in development expenditures, over the same period, lie behind this sluggish performance. This imbalance had been the result of persistent fiscal and current account deficits and failed efforts towards structural adjustment that has resulted in development spending bearing the brunt of public expenditure cuts.



Source: Economic Survey 1990-91, 1994-95, & 2000-01.

While it is true that the extent and depth of poverty measured through different approaches varies depending upon the indices used and definitions employed, however there is considerable conformity in terms of the trends they reveal. According to the latest Federal Bureau of Statistics (FBS) study, after declining in the 1980s, poverty remained fairly stable during the 1990s and broadly followed per capita GDP growth trends

Poverty during the 1990s

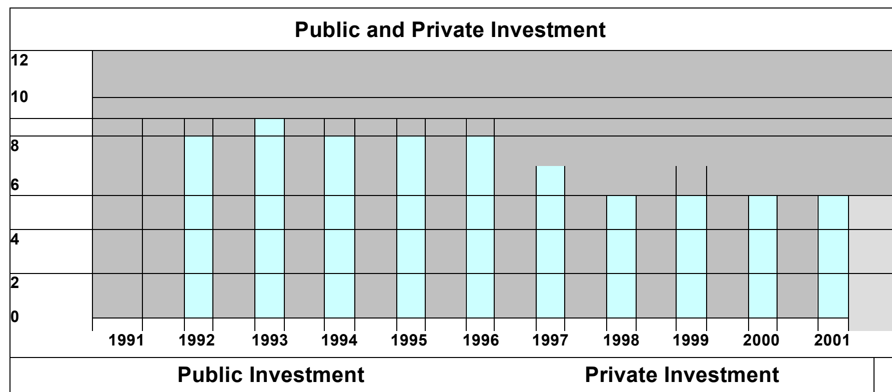
Poverty Index	1992-93 HIES	1993-94 HIES	1996-97 HIES	1998-99 PIHS
Head-count ratio	26.6	29.3	26.3	32.2
Head-count ratio	25.7	28.6	24.0	32.6
Poverty gap	4.5	5.5	4.5	6.9
Poverty gap	4.5	5.4	4.3	7.0
Severity of poverty	1.2	1.5	1.2	2.2
Severity of poverty	1.2	1.5	1.2	2.2

Source: FBS 2001; World Bank 2001.

Note: The FBS (un-shaded lines) study assesses the poverty line by using a calorie based approach while the World Bank (shaded lines) study uses the basic needs approach

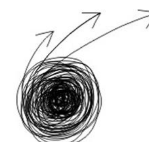
These results conform with the notion that the momentum gained in the fight against poverty, during the 1980s, was lost during the 1990s when poverty leveled off; while it rose at the end of the decade when per capita GDP growth became negligible. These results are in line with other studies, using different measurement approaches, which reveal similar behavior in terms of poverty and inequality. These trends highlight an urgent need to develop multidimensional poverty indices, which not only capture individuals' current poverty level but also their vulnerability of slipping into and out of poverty in response to shocks

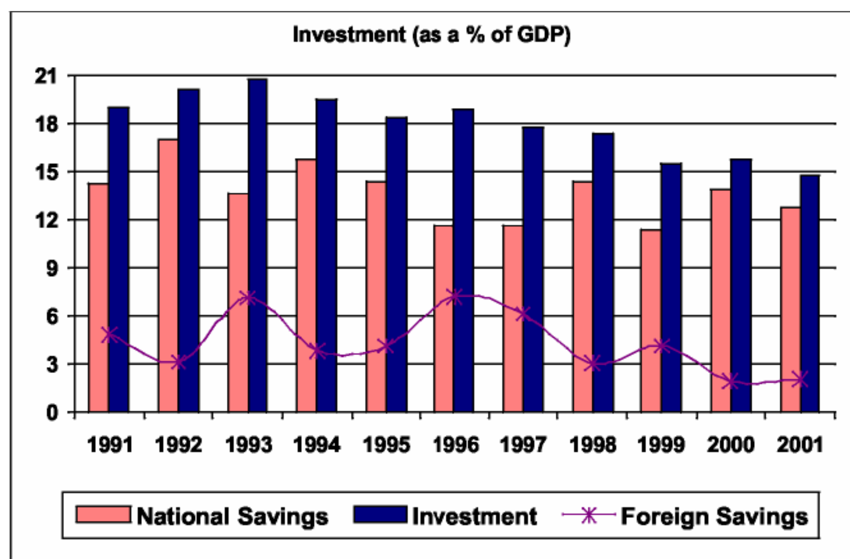
Overall investment has come down from over 20% of GDP during 1992-93 to an all time low of 14% of GDP in 2000-01. In fact, over the same period, while public investment has almost halved it has failed to crowd in private investment and in some instances has crowded out private investment, which has fallen by one forth .With the result that new employment opportunities have failed to keep pace with the needs of the rising population. In order to achieve higher investment it is therefore critical that the level of national savings, which play an important role in mitigating risks in the face of volatility, be raised.



Source: Economic Survey 2000-01.

However, the country has not been generating adequate savings to finance its (albeit lower) investment needs. Recent reductions in interest rates on domestic debt instruments (e.g. National Savings Schemes) have led to a reduction in interest payments on domestic debt, however that has lowered incentives for fresh household savings in such schemes. The meager national savings rate of 12 per cent of GDP leaves no option but to rely on external resources for financing investment





Source: Economic Survey 2000-01.

Income Distribution & Poverty:

The Government has brought the issue of poverty alleviation to the center-stage of economic policy making, to which end a strategy to reduce poverty and improve income distribution has been put in place. The strategy is based on the premise that sustained economic growth accompanied by macroeconomic stability is the most powerful mean of reducing poverty in the medium-term. Although growth is absolutely essential, focus on this alone is not sufficient, for which directed programs are required.

While poverty is multi dimensional, its most obvious manifestation is loss of household income. The cost of structural adjustment programs has been distributed unequally and has fallen largely on the poor. The share of the highest 20% households was 49.7% of the national income while, 20% of the household at the bottom of the pile were receiving only 6.2% of national income.

Based on the requirement of 2150 calories, the Government of Pakistan has adopted the official poverty line in 1998-99 as US$ 10.8 (PKR 650) per capita per month. According to the calorie based poverty definition (headcount ration), 33% people in Pakistan were below the poverty line in 1999. Poverty in Pakistan is largely a rural phenomenon as incidence of poverty in rural areas was 36.3% as against 19% for urban population. Government's overall strategy and policy measures for poverty reduction include program aimed at

reviving economic growth and social development. It has adopted a multi pronged approach to promote pro-poor economic growth and reduce poverty: this has been articulated in the Interim Poverty Reduction Strategy 2001-04, which is based on the following core principals:

- Engendering growth
- Implementing broad based governance reforms
- Improving Income generating opportunities
- Improving social sector outcomes
- Reducing vulnerability to shocks.

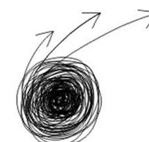
Poverty is not merely income deprivation. It is a multidimensional concept, which encompasses economic, political, and social needs that are sine qua non for a meaningful existence. The poor in Pakistan are not only deprived of financial resources, but they also lack access to basic needs such as education, health, clean drinking water, and proper sanitation. Limited access to education, health, and nutrition, undermines their capabilities, limits their ability to secure gainful employment, and results in income poverty and social exclusion; while also making them vulnerable to exogenous shocks. This cycle is further exacerbated when institutions of governance tend to exclude the most vulnerable from the decision-making process and thus feeds into poverty and human deprivation.

MICROFINANCE SECTOR OF PAKISTAN

The Need For Microfinance:

In recent years, Pakistan's relatively young and underdeveloped microfinance sector has benefited from new initiatives launched by the Pakistan government, notably, the creation of a microfinance retail bank, the Khushhali Bank and an apex organisation, the Pakistan Poverty Alleviation Fund (PPAF) set up to serve retail microfinance organisations. Growth and diversity in the sector have also been encouraged by the microfinance ordinance 2001, which resulted in the establishment of microfinance banks, such as The First Microfinance Bank, created from the transformation of the microfinance department of the Aga Khan Rural Support Program. Developed in the 1990s, other Rural Support Programs (RSPs) have had a major impact on the development of microfinance in Pakistan as they continue to represent the highest number of MFIs and the largest coverage in Pakistan. In parallel, more traditional NGOs and microfinance institutions, such as Kashf Foundation, have posted high growth in outreach, while maintaining low delinquency levels. In the banking sector, a public commercial bank specialised in serving women, the First Women's Bank is active in microfinance, while the Bank of Khyber in the North West Frontier Province (NWFP) develops new products and partnerships with NGO and RSPs in order to serve lower income populations.

- With a current GDP per capita of US$420, almost 35% of the 150 million Pakistani people live below the poverty line.
- The 1990s saw a substantial increase in poverty, with 80% of the 97 million in the rural population living with less than US$1 per day.
- 36.3% of the rural population is considered poor by Pakistan standards, while urban poverty is 22.4% (1999 data).
- Agriculture income accounts for only half the revenues of the rural population with non-farm activities and remittances providing the rest.
- The poor, and the majority of the middle class, have very little access to credit. The formal banking sector has usually avoided lending to the poor because of



supposed difficulties in collection and lack of collateral. Therefore, the poor must rely on alternative sources for funds, such as relatives or suppliers, or depend on moneylenders who charge extremely high interest rates. The poor also participate in local ROSCAS, called committees, however, tensions between net savers and net borrowers often cause fragility.

- Current microfinance providers only serve an estimated 5%, or 6.5 million, poor households needing microfinance services.
- In rural areas, access to financial services is needed mostly for agricultural, livestock and non-farm activities. In urban Pakistan, microfinance clients are mostly vendors, small traders, cottage industry workers and low-wage earners.

Demand:

The average size of loan taken by households as microfinance is about US$ 295 (PKR l6, 540) at an interest rate of 18-20 % per annum. Considering these, the estimated potential demand for micro credit is about US$ 2 billion per annum based on the number of poor households (6.6 million) or about US$ 3 billion based on half the adult poor population (10 million).

Similarly, the estimates for deposit possibilities range from US$ 225 million to US$ 350 million per annum. Based on population distribution, two thirds of this demand is considered to emanate from the rural poor. The NGO-MFIs experience reflects that depositors out-number borrowers by 2-4 times. The poor emphasize the safety and accessibility of savings facilities as many lost their savings in the past due to failures of cooperatives and finance companies.

Most of the demand for MF in rural areas is for agriculture production (50 %), livestock (25 %), and the balance for other household-based income-generating activities (IGAs). In urban areas, most of the demand is for small business and self-employed ventures. Households are extended families and the pool of labor within a family unit creates potential for a diverse range of income-earning opportunities. Demand attributes include:

- Small and frequent loans;

- Flexible terms compatible with the nature of activity;
- Preference of women, due to restricted mobility,
- Simple and speedy delivery procedures placed within the community;
- Service proximity, and
- Significant and sustained social preparation to familiarize the poor with managing IGAs.

Interest rate sensitivity is high in rural areas due to the general low level of economic activity. The apprehension of becoming indebted, particularly among women, due to failed enterprises (e.g., death of livestock, failure of business, crop failures) is widespread.

Supply:

Microfinance services are provided by informal, semi-formal and formal sources and institutions.

Informal Sector:

The Informal sector accounts for approximately 83% of the credit supply and are provided by moneylenders, shopkeepers, traders, middlemen, family and friends for consumption and production purposes. Every village has at least one informal committee that collects regular savings and offers loans to members in a similar management arrangement to RoSCAs (Rotating Savings and Credit Associations). Compared to the other sources of microfinancing, common interest rates in informal sources are much higher, ranging from 50% to 120% per annum. Three principal informal sources of credit are (i) commercial creditors linked with marketing intermediaries, commission agents, village traders, and shopkeepers; (ii) land-based credit arrangement extended by landlords to farmers for inputs and to meet consumption needs; and (iii) socially based arrangements of friends and family (the most numerous). Money lending as a specialized occupation is not significant and gradually declining, Informal sources, both in rural and urban areas, mainly supply short-term credit at terms that reflect the weak bargaining power of the poor, particularly for land-based credit arrangements. Every village has one or more informal committees that collect regular savings and make loans to members. These operate like

rotating savings and credit organizations. Informal credit based on reciprocity and social obligations mainly fund urgent consumption needs without any interest charges. However, these are intermittent and tend to be less than US$ 18 (PKR 1,000).

Semi-formal Sector:

NGOs and participatory organizations such as Rural Support Programs (RSP) have been the primary promoters of microfinance services in Pakistan. The number of registered NGOs is estimated at 12,000 to 20,000, two thirds of which are in urban areas in inverse relation to population and poverty distribution. Most rural NGOs are single community or village-based groups registered as community-based organizations. Of the 100 that seem to supply some Microfinance, only half have outreach beyond the immediate community. The eleven members of the Microfinance Group are considered to have substantive interest in Microfinance and are mostly funded by aid agencies. The NGOs providing MF can be broadly classified into two categories:

- Multi sectoral NGO's engaged in composite services: education, health, infrastructure, and community development. These NGOs offer micro credit as a minor program component.
- There are few NGO's with Microfinance as core activity.

NGOs deliver MF services through group-based methodology, more commonly known as the Grameen Bank model with adaptations to suit the local context. The prevalent MF delivery model includes (i) Community Organizations (CO) formation; (ii) social preparation for the poor, including skills training; (iii) regular meeting of COs; (iv) savings mobilization and loan disbursement after the approval of a majority of members; and (v) peer pressure to ensure proper credit behavior. Loans between US$ 45-1,250 (PKR 2,520 - 70,000) are given for terms ranging from 3 months to 2 years, and repayments are usually monthly or quarterly. Incentives for repayments are common. Individual loans are also provided in some cases. Pricing of loans is in terms of markup over the principal at 18-20%. This is above the Central Bank markup charges, but below the transaction cost and expenses incurred for social intermediation. Some NGOs charge up to 48%. Most

NGOs are unable to meet their costs, and use grant support to bridge their income gap. Loan repayments are reportedly high (90 to 97% of demand) in most cases.

The Government established Pakistan Poverty Alleviation Fund (PPAF) in 1997, with an endowment of PKR 500 million (US$ 9 million), as an apex institution to help the poor. PPAF plans to provide MF services primarily through NGOs to an estimated 200,000 households over the next 4 years. The World Bank is sponsoring PPAF with a US$ 90 million loan. Outreach as of June 2002 was around US$ 15 million (PKR 894 million) to over 65,000 borrowers.

Rural Support Programmes (RSPs) are multi-functional as they provide a range of services and aim to achieve provincial and national coverage. These participatory bodies operate in urban or rural areas, sometimes in both, focusing anywhere from one village to the entire nation. The Rural Support Programs in Pakistan consist of the National Rural Support Programme (NRSP), the largest, Balochistan Rural Support Programme, Sarhad Rural Support Programme (SRSP) and the Aga Khan Rural Support Programme (AKRSP). Originally seen as a group of government-assisted NGOs with a mandate to promote rural development, they now see themselves as something between a government body and an NGO. NRSP has the largest member base in Pakistan, with approximately 293,000 members gathered in Community Organizations (COs). Some NGOs, like Kashf Foundation and the Orangi Pilot Project, now specialize in microfinance and have reached a substantial and growing number of clients.

Formal Sector:

There are 21 domestic scheduled banks, of which 2 are state-owned, around 18 foreign banks, 4 specialized banks, 4 DFIs, 16 private investment banks and a number of leasing companies. Only a few of them are attempting to develop sustainable and substantive Microfinance programs. Two commercial banks, the Bank of Khyber and the First Women Bank, provide microfinance services to low-income clients, directly through their branches, or as wholesale funds to partner MFIs. The microfinance specific ordinances promulgated in 2000 and 2001 by BSP allowed for the establishment of two specialized microfinance institutions, the Khushhali Bank, a retail microfinance bank jointly owned by public and private banks, and The First Microfinance Bank Limited, established from the transformation of the microfinance activities of the Aga Khan Rural Support Programme.

Orix Leasing and Network Leasing are two leasing companies involved in microfinance by providing leasing products to low-income clients. Some leasing companies strive to increase their share in the microfinance market by proposing other financial products, and potentially to set up their own microfinance banks. Network leasing has already been granted a license to set up a microfinance bank, which was due to start operations in July 2004. The new institution, called Network-MFB, will start at the district level, with plans to become a national institution.

The Agricultural Development Bank of Pakistan (ADBP) provides two thirds of the agricultural credit available in the country through its 49 regional offices, 349 branch offices, and mobile credit offices. During 1998/99, ADBP disbursed US$ 535 million (PKR 30 billion) to 451,992 borrowers or 9% of the total 5.1 million farmers. Lending is collateral based. ADBP does not cater to the poor except under special programs. Of the 0.953 million landless farmers, 19,576 or 2% received loans. Interest rates for loans to individuals are set at 14-16% per annum.

Commercial Banks (CBs) have not expanded into MF on any scale except for experiments by the Bank of Khyber, Bank of Punjab, First Women's Bank, Habib Bank, Muslim Commercial Bank, and National Bank of Pakistan. CBs have generally regarded MF as a social obligation to be cross-subsidized by commercial operations.

Pakistan also has a rating agency, JCR-VIS, which has initiated ratings of NGOs and specialized microfinance organizations, such as The First Microfinance Bank. NGOs are rated on a corporate governance scale while the full credit rating of MFIs applies only to institutions regulated by BSP. They are described as ‘microfinance banks’ and can mobilize commercial sources of funds.

If the supply of MF services were adequate, the MF sector would be the largest sector of the financial system in terms of clientele base. Overall, the MF market is underdeveloped with an institutional outreach estimated at 200,000 borrowers (60,000 NGOs, 140,000 CBs and DFIs) for micro credit loans. This is about 3% of poor households. The CBs hold about 417,000 savings accounts deposited by NGOs on behalf of their members. A few private sector leasing company has initiated a leasing service to provide assets for hire to poor households. Insurance to mitigate the risks for the poor does not exist. Training skills for social intermediation, though developed by NGO’s, is grossly under funded & under capacity.

Microfinance Clientele OF Pakistan:

Pakistan's population is estimated at 146 million. Nearly two thirds of the population lives in rural areas. The number of poor is estimated at 47 million (33% of the population) in 6.6 million households. Of the poor, 33 million, representing 4.7 million households live in rural areas. All poor households are potential clients for both financial and non-financial services. Government considers half the adult poor population (nearly 10 million) as potential MF clients. Among this client base, women bear a disproportionately high share of the burden of poverty due to (I) low social status, (ii) lesser endowments of land and productive assets, (iii) limited access to economic opportunities and social services, and (iv) restricted mobility. Women are poorer, less healthy, and less educated than men. These differences are more pronounced in rural areas. Even though economically active, the contribution of women is inadequately documented, understood, and appreciated.

In urban areas, the poor include vendors, small traders, and laborers in the service, transport, and small industry sectors. The four categories of primary rural occupations are: landowners, sharecropper-tenants, rural artisans, and landless laborers. Sharecropper-tenants are among the poorest. Bonded labor is common amongst this group. Artisans, the traditional service providers to the rural community (e.g., blacksmiths, carpenters, weavers, barbers, tailors) are mostly poor. Landless laborers are among the poorest of the poor. 52% of rural income is generated outside agriculture. Reliance on secondary occupations is increasing as agriculture can no longer meet the income needs of the growing rural population and subsistence agriculture cannot absorb the labor surplus. These occupations include paid employment, investments in small businesses, diversification into related occupations where possible (i.e., blacksmiths who undertake all forms of metal work), employment outside the community, and migration to urban areas (estimated at 1.3% per annum).However, because of limited education and skills, sharecroppers and landless laborers have fewer options other than to provide domestic services, and make and sell handicrafts and toys.

Recent Performance:

Institutional MF is a recent development in Pakistan and, therefore, has a very limited outreach. However, the poverty reduction potential of MF is now widely recognized at the policy-making level and among the development community. In the economic and social context of Pakistan, MF is understood to comprise financial services, particularly savings and credit, for the poor with a significant degree of social intermediation. This involves improving the social condition of the poor who have been largely excluded from access to financial and social services, and includes community mobilization, skills development, risk mitigation, and access to basic infrastructure. Initial savings of up to US$ 35 (PKR 2,000) and a first time loan of about US$ 295 (PKR l6,540) are generally considered as MF.

Policies and guidelines governing the financial system and the framework of the Government's poverty reduction strategy influence the MF sector. The environment for MF has improved with the recognition that MF is critical to poverty reduction and NGOs can be effective development partners to enhance the quality of service through participatory community-based approaches. NGOs can attain legal status, and are eligible to receive resources from government-funded projects. The table below shows the increase in the outreach of the MFIs starting form year 1999 to Jun 2004. It is clear that the growth in outreach has been steady and the trend is on the rise.

1999 2000 2001 2002 2003 Jun’04

SUPPORT FOR NON-BANK MICROFINANCE INSTITUTES

The major portion of the Mf sector is composed of NGOs, Specialized MFIs and non-bank MFIs. One of the most crucial question that comes to mind when we are dealing with the sustainability of a non-bank and specialized MFI is that from where would they get their funding from. As mentioned earlier, NGOs and Non-Bank MFIs are legally bound not to accept deposits. Where would these institutes find the support for the purpose of generating necessary funds to finance the poor? The following points would be helpful enough to answer this query.

Direct Support For Specialized Microfinance Institutions:

Existing Schemes By Donor Agencies:

There is currently very little direct support for MFIs from either the government or donor agencies. There has been no systematic attempt by the government to increase access of the poor to microfinance, whether through specialist MFIs or some other avenue. What little government support there has been for microfinance has been largely incidental, rather than the result of any coherent policy framework. And while there has been some support from donor agencies for microfinance, this has been primarily in the form of small-scale projects to support NGOs through seed capital or revolving funds.

The World Bank microenterprise project has been operating since 1993. One component of the project, funded through a grant of NLG4.8 million ($3 million) from the government of the Netherlands, provides grants for seed capital and institutional strengthening for NGOs engaged in microfinance. Grants for seed capital have been provided to four NGOs, namely Orangi Pilot Project, AKRSP, Balochistan Rural Support Program and Basic Urban Services for Katchi Abadis (BUSTI). A fifth NGO was provided with some funds, but was suspended from

the project due to poor performance. The project was intended to provide funds for on-lending to poor borrowers, although there was no specific means test for identifying borrowers. All funds have now been disbursed and the World Bank commented that the project was very successful, with all four NGOs achieving very high repayment rates on loans to final borrowers.

A second, larger component was provided to leasing companies for financing leases to cottage industries, defined as those with less than ten employees (leasing is a popular technique in Islamic banking). The lessee makes a down payment of around 10 per cent, and monthly payments incorporating both principal and mark-up. At the end of the repayment period, the lessee acquires the goods. The project is not directed at poverty alleviation, and it is understood that it does not generally reach poor borrowers. Swiss Development Cooperation has also funded a leasing project.

The International Labor Organization operates two programs that include a microfinance element. One project, funded by the government of the Netherlands, provides grants for revolving funds to groups of 10 to 25 women in the North West Frontier Province and reaches around 5,000 women. The other project, funded by the government of Japan, provides grants for revolving funds to groups of between 25 and 100 members throughout Pakistan, and reaches around 2,000 men and women. These revolving funds are used for projects at the group level, rather than being on lent to individual borrowers.

Poverty Alleviation Fund:

While there is very little direct support for microfinance at present, the government and the World Bank are developing a major new initiative for providing support to MFIs, in the form of the Pakistan Poverty Alleviation Fund. It is understood that the government will provide an initial grant of $100 million to establish the fund, while the World Bank will provide a loan of a further $100 million. The fund will be set up as a joint stock company under the Companies Ordinance of 1984. The government will choose the board of directors, but it is

intended that it will include representatives from the private sector and the NGO community.

The fund will not lend directly to individual borrowers but will operate as a second tier microfinance institution, lending to NGOs and possibly other community-based organizations for on lending to self-help groups or final borrowers. While the policy on mark-ups has not yet been determined, it is envisaged that it would lend to NGOs at slightly concessional rates, and that NGOs would charge full commercial rates to final borrowers. Detailed criteria for the selection of partner NGOs have not yet been developed, but it is understood that the main criteria will include a good governance record, transparency, a strong tradition of accountability and results-oriented arrangements. It is intended that the fund will be available to support a variety of models of microfinance. It is not yet clear whether there will be a specific means test for final borrowers, and if so, how this will be determined.

The proposed establishment of the fund is a very positive development. Similar institutions have been successful in a number of other countries in the region, most particularly Bangladesh but also India, the Philippines, Sri Lanka and Thailand. Experience from these countries suggests that the fund is likely to be most successful if it adopts a number of the following principles.

Support Through The Banking System:

Directed Credit Schemes:

The State Bank of Pakistan administers a scheme requiring some banks to lend a certain proportion of their loans to agriculture. The scheme applies to the three old state-owned commercial banks; the two privatized commercial banks, the Agricultural Development Bank and the cooperative banks.

There is a complex procedure for determining the allocations for individual banks. First, the government develops an annual credit plan for the economy as a whole, specifying the maximum loans outstanding for the banking system. It then estimates the requirements for agriculture that are expected to come from the

formal financial system. The two figures are not directly comparable, because the overall credit plan is expressed in outstanding whereas the allocation for agriculture is expressed in disbursements. This annual requirement for disbursements to agriculture is then allocated to individual banks depending on a range of criteria, including area of operations, deposit ratios, and the particular bank's own plans and projections. For instance, in 1996–97 the global allocation for agriculture was Rs26 billion ($740 million), of which around Rs10 billion ($285 million) was allocated to the commercial banks, around Rs12 billion ($340 million) to the Agricultural Development Bank, and around Rs4 billion ($115 million) to the cooperative banks. In the case of commercial banks, it is understood that the requirements mean that around 5 per cent of the value of loans outstanding are to agriculture.

Within this allocation, commercial banks are required to ensure that 50 per cent of their disbursements to agriculture are for small farmers (this requirement does not apply to the Agricultural Development Bank or the cooperative banks, although it is understood that the cooperative banks probably meet it anyway). Small farmers are defined on the basis of their landholdings, whether as owners or tenants. In more fertile areas with irrigation, small farmers are defined as those with 12.5 acres of land or less. In desert areas with irrigation, the ceiling is higher, ranging from 16 to 32 acres. In rain-fed areas, the ceilings are double those in irrigated areas.

It is unlikely that many poor farmers benefit from this allocation. It is understood that around 70 per cent of farmers fall within the definition of small farmers, and even so, some large farmers have managed to find ways of obtaining loans. Under the supervised credit scheme, the State Bank has required the banks to establish mobile banking units for reaching small borrowers, and has also provided banks with territorial jurisdiction. These measures have led to higher repayment rates on small loans than had previously been the case, with repayment rates now in the 70 to 75 per cent range.

It is understood that the State Bank has been giving preliminary consideration to extending these rules, to require all banks to allocate a part of their loan portfolio

to microfinance. Alternatively, banks may be required to reinvest a certain proportion of the resources they raise from a particular village or region back into that village or region. However, no decisions have been taken yet.

Microfinance Program of First Women Bank:

There are a number of government programs designed to provide finance for small and microenterprise development. However, the only one that appears to reach poor borrowers is a relatively small program operated by the First Women Bank, a state commercial bank established in 1989. In 1993 the Department of Women's Development provided a grant of Rs48 million ($1.4 million) to establish the program, and it is understood that it is considering a further allocation of Rs19 million ($540,000) to extend it. Under this program, the bank provides loans up to a maximum of Rs25, 000 ($712) with a mark-up of 12 per cent to women with household income of less than Rs2, 000 ($57) per month.

Loans are generally provided to individual borrowers, although in some cases borrowers organize themselves into groups and provide group guarantees. In addition, 22 NGOs are associated with the program as non-financial intermediaries, in identifying and training borrowers. The bank has also lent to five NGOs as financial intermediaries for on lending to final borrowers. In some cases, the NGOs themselves use smaller community-based organizations as non-financial intermediaries. The NGOs borrow from the bank at 13 per cent and on-lend to final borrowers at 17 to 18 per cent.

To date, the program has achieved a cumulative repayment rate of around 97 per cent. It has provided loans to around 5,040 borrowers (excluding sub-loans granted by the National Rural Support Program, a large NGO which has received a line of credit under the program). As at May 1997 there were 2,160 current borrowers, again excluding sub-loans by the National Rural Support Program. The program appears to have been quite successful, especially compared to most microfinance programs channeled through commercial banks in other countries. This may reflect the fact that First Women Bank is a relatively small

bank with a particular focus on women, and the use of NGOs as financial and non-financial intermediaries.

Other Major Programs:

The main government agency for lending to small borrowers is the Small Business Finance Corporation (SBFC), established in 1972 under the Ministry of Finance. The National Development Finance Corporation (NDFC) and some other agencies also provide loans to small and microenterprises in addition to their other activities.

The SBFC operates three main loan programs. First, its main program is to provide loans to small businesses. The maximum loan amount is Rs2 million ($57,000), with a mark-up of 15 to 18 per cent. Second, the national self-employment scheme provides loans of between Rs10,000 ($285) and Rs300,000 ($8,550) to self-employed persons, at a mark-up of 14 to 16 per cent. The average loan size is around Rs150,000 ($4,275), with very few loans at the bottom end of the range.

Third, the Youth Investment Promotion Society Scheme provides loans of between Rs10,000 ($285) and Rs200,000 ($5,700) to unemployed high school graduates aged between 18 and 35 for self-employment projects, with a mark-up of 14.5 per cent. This scheme is administered by another government agency, the Youth Investment Promotion Society, which identifies the borrowers and provides technical training. However, loans are disbursed through the SBFC. The nature of the target group means that it does not tend to reach the poor, and most loans are for considerably more than Rs10,000 ($285).

The SBFC currently has around 90,000 borrowers, and loans outstanding of around Rs12 billion ($342 million). As well as not reaching the poor, it has low recovery rates in the range of 30 to 40 per cent. Since March 1996, the SBFC has required collateral in the form of a mortgage equal to at least 50 per cent of the value of the loan, in an effort to increase repayment rates. In the past, the SBFC has been funded mainly through lines of credit from the State Bank of Pakistan, but it has not had access to such funding for the last two years, and is

relying on recycling loan repayments to maintain its lending. It is understood that the government is currently considering the future of the SBFC. Given the poor financial performance of the SBFC and the fact that it does not reach poor borrowers, it would be appropriate for the government to consider reallocating some of the its funds to the proposed Poverty Alleviation Fund.

REGULATION OF MICROFINANCE

Regulation Of Non-Bank Microfinance Institutions:

The Broad Regulatory Framework:

There are no specific provisions relating to NGOs engaged in microfinance. Hence, the regulatory framework for such NGOs is the same as for other NGOs. NGOs do not have to register in order to carry out their work. The NGO Resource Centre (1991) found that many NGOs that have chosen not to register have functioned well, achieved their objectives and gained recognition. However, registration provides a legal status and may facilitate access to financial support.

There are five main avenues for NGOs to seek registration, and all of these could apply to NGOs engaged in microfinance. First, they can register as a non-profit company under the Companies Ordinance of 1984. There are two different avenues for registration under this Ordinance. An NGO can register itself at the provincial level with the Assistant Registrar of Joint Stock Companies, or at the national level with the Corporate Law Authority.

The second avenue is to register with the Registrar of Joint Stock Companies as a society under the Societies Registration Act of 1860. Third, they can register as a cooperative society under the Cooperative Societies Act of 1925. Registration is with the provincial Registrar of Cooperative Societies. The fourth option is registration as a voluntary social welfare agency with the Directorate of Social Welfare, pursuant to the Voluntary Social Welfare Agencies Registration and Control Ordinance of 1961. Finally, they can register as a public charitable trust

under the Trust Act of 1882. This is the simplest method and entails no reporting requirements. However, it may be restrictive, as operations must be funded out of earnings and cannot be funded out of the capital of the trust.

In broad terms, the requirements for registration as a non-profit company, a society, a cooperative society or a voluntary social welfare agency are similar. A minimum number of members is required, ranging from around seven to ten. The application must include a constitution or a memorandum and articles of association providing details of the NGO — including name, address, aims and objectives, areas of operation, membership, details of the governing body, organizational structure, arrangements for meetings, and similar matters. Moreover, all of these bodies are required to prepare an annual report, maintain accounts, have the accounts audited annually, and submit these documents to the registration authority.

It was reported that the process of registration under these various Acts can be time-consuming. For instance, the NGO Resource Centre (1991) found that NGOs regarded the procedures for registration as problematic. They cited the lack of clear direction, inadequate guidelines, the time taken in getting the required documents together and the loss of time in making amendments and corrections. However, once they were registered, they generally had no problems. Clearly, it would be desirable to streamline and simplify the procedures for registration where this is possible.

In terms of the reporting requirements, different regulatory agencies enforce them differently. It is understood that the agencies regulating non-profit companies tend to enforce the requirements quite rigorously. Other agencies are less rigorous, and usually do not enforce the requirements that accounts be audited and submitted to them. Some NGOs engaged in microfinance, such as the Aga Khan Rural Support Program (AKRSP) and Kashf Foundation, have registered as non-profit companies because of the added credibility that this brings.

NGOs receiving donations from abroad are required to inform the Economic Affairs Division of the Ministry of Finance. They are required to submit an annual

report, providing details of the amount received and the usage of the funds. In practice, however, it is understood that this requirement is rarely enforced.

In 1994, the government introduced a new bill to provide for the registration and regulation of social welfare agencies, to be called the Social Welfare Agencies (Registration and Regulation) Act of 1994. The NGO movement was critical of certain aspects of this bill, and initiated discussions with the government. Following this, the bill was withdrawn and revised, and a new one was introduced in March 1996. The Pakistan NGO Forum argues that the new bill does not take account of the consultative process held during 1994–95.

One concern is that all NGOs would be required to be registered under the new bill, regardless of whether they receive public funds or not. It would also give wide powers to the registration authority, with opportunity for misuse. NGOs also consider that the reporting requirements would be onerous, particularly with respect to the use of foreign donations. Further, there would be considerable scope for NGOs to be dissolved, with inadequate right of appeal.

The bill has been tabled in the Upper House but is still pending, with its current status unclear. It is beyond the scope of this study to analyze the proposed Bill in detail. However, it is important that any legislation strike an appropriate balance between ensuring that NGOs are properly monitored and accountable to their members and third parties, while minimizing bureaucratic interference into their affairs. It is also desirable to limit the discretionary power of the regulatory authority as much as possible. Regulatory and prudential requirements should be set out clearly and transparently, with any NGO that meets these standards free to operate without restriction.

Mark-ups:

In general, there are no regulations concerning the mark-ups that NGOs involved in microfinance can charge borrowers. However, mark-ups charged by cooperatives are regulated, with a ceiling of 14% on loans from the primary societies to final borrowers. There also appears to be considerable social and political pressure on financial institutions in general, including microfinance

institutions (MFIs), to keep mark-ups low, and this may make it difficult for MFIs to operate on a sustainable basis. It would be appropriate for the government to remove the ceiling on the interest rate that cooperatives can charge, and issue a clear statement that MFIs should charge mark-ups sufficient to cover their costs.

Prudential Regulation And Supervision:

NGOs engaged in microfinance are not subject to any prudential requirements covering matters such as minimum capital, capital adequacy, reserves, liquidity or loan loss provisioning. Other than the requirements to maintain accounts and have them audited annually, there are also no financial reporting requirements.

Most commentators consider that it is not appropriate for MFIs which do not accept deposits from the general public to be subject to full prudential regulation and supervision. The question of appropriate standards for MFIs is also not as pressing in Pakistan as in some other countries, given the small number and scale of MFIs. Nevertheless, given the risks inherent in providing financial services, some standards would appear appropriate.

There is currently no second tier microfinance institution operating in Pakistan. However, it is proposed to establish the Poverty Alleviation Fund, to lend to NGOs and possibly other district-level organizations for on-lending to self-help groups and final borrowers. It will be necessary for the fund to set and enforce appropriate performance and reporting standards for the MFIs that it funds. The relatively late development of microfinance in Pakistan means that Pakistan can benefit from the experience of other countries, and establish an appropriate policy regime at an early stage in the development of the microfinance sector

Self-Regulation:

A national microfinance network has recently been established, with the Kashf Foundation taking the lead role. All of the major NGOs involved in microfinance have joined, including the Kashf Foundation, AKRSP, Sungi Development Foundation, Aga Khan Foundation, Orangi Pilot Project and Network Leasing,

and the initiative is being supported by the Asia Foundation. The network aims to promote an enabling environment for microfinance by:

- Encouraging purposeful networking among microfinance practitioners and organisations supporting microfinance
- Supporting best practice research and exchanges of information
- Promoting awareness and understanding of microfinance among policymakers and financial institutions in the private sector.

The establishment of this kind of apex body is a positive development. Over time, such a body could perform a number of important roles, including information exchange, training, research, policy dialogue with government and donor agencies, and establishing standards for self-regulation. All microfinance NGOs in Pakistan should be encouraged to play an active role in the new body.

Regulation of Banks:

Licensing And Minimum Capital Requirements:

As in most other countries, MFIs are not permitted to accept deposits from the general public. All institutions that accept deposits of money from the public for the purpose of lending or investing are required to be registered as banks under the Banking Companies Ordinance of 1962.

Unlike most other countries in South Asia, there is no network of small banks operating in the rural areas in Pakistan. Moreover, the regulatory framework precludes the establishment of small banks. The main avenue for establishing a bank is to obtain a license as a commercial bank. The minimum capital requirement is Rs500 million ($14.2 million), although it has been suggested that this may be increased to Rs1,000 million ($28.5 million). There are also some additional requirements that prevent the establishment of small banks operating at the local level. For instance, it is necessary to establish a branch in each of the four provinces of Pakistan and the disputed territory of Kashmir. It is also

necessary to be a publicly listed company with public shareholders to the extent of at least 50 per cent.

The difficulty in establishing a bank is illustrated by the experience of the Aga Khan Rural Support Program (AKRSP), which is currently seeking to establish a bank in northern Pakistan. Because of the restrictions on commercial banks, AKRSP is considering establishing an investment bank. The minimum capital requirement for investment banks is Rs100 million ($2.9 million). While successive governments have agreed in principle to AKRSP's establishing an investment bank, there have been protracted discussions and negotiations over a range of hurdles that need to be overcome. Investment banks are also not allowed to accept short-term deposits or maintain cash counters. This clearly limits the range of deposit services that any MFI established as an investment bank would be able to provide.

Given that small banks are much more likely to provide services to poor borrowers in remote locations than large banks, the restrictions on establishing banks reduce the likelihood that banks will engage in microfinance. They also make it extremely difficult for MFIs to establish banks so that they can accept deposits and offer a wider range of services. It would be appropriate for the government to establish a framework for licensing small banks, by imposing more realistic minimum capital requirements and by removing other restrictions such as the requirement to establish a branch in each province.

It should be noted that in some cases, it may be possible to establish a small bank in the form of a cooperative bank. Under the Cooperative Societies Act of 1925, the minimum capital requirement for a cooperative bank is only Rs20,000 ($570). However, the State Bank does not regulate cooperative banks. Moreover, they are generally owned and controlled by the provincial governments, and it is not clear if they would permit the establishment of new cooperative banks. Cooperative banks are subject to little prudential supervision, and generally have low credibility with the public. As such, they have difficulty in attracting deposits from the public and rely on the Federal Bank for Cooperatives for most of their

funds. Hence, even it were possible, licensing, as a cooperative bank would not provide a sound basis for a microfinance bank.

Mark-ups:

As noted above, the only regulation applying to the mark-ups charged by commercial banks is that they must charge a *minimum* of 14 % for certain loans. There is no maximum. Nevertheless, there appears to be considerable pressure on banks to keep mark-ups on small loans low, and small loans are generally charged at the minimum of 14 %. Small loans are not commercially viable at this mark-up, and are subsidized by the banks' other operations. Clearly, this situation makes it very difficult for regulated banks to engage in microfinance on a commercial basis. It would be appropriate for the government or central bank to issue a clear statement that regulated banks should set mark-ups on small loans at a level that is sufficient to cover all the costs of making such loans, and to make it clear to the banks that they should not feel under any political pressure to maintain mark-ups on small loans at artificially low levels.

Prudential Regulation And Supervision:

Commercial banks are required to maintain capital equal to at least 7.5 %of total time and demand liabilities, a cash reserve of 5 %of deposits, and liquidity of 30 %of deposits, including the cash reserve. Under the loan loss provisioning requirements, banks are required to maintain a provision of 2 %for other assets especially mentioned, 25 %for sub-standard loans, 50 %for doubtful loans, and 100 % for loss loans. Commercial banks are required to provide weekly position reports to the State Bank, as well as fortnightly, monthly, quarterly and annual reports on various aspects of their operations. The requirements listed above would not appear to impose any undue burdens on banks engaged in microfinance.

However, there are two major restrictions of a prudential nature that make it extremely difficult for banks to establish linkages with NGOs or self-help groups.

Among the countries included in this study these restrictions are unique to Pakistan, with no comparable restrictions in any other country.

First, banks are only permitted to make unsecured loans up to Rs100, 000 ($2,800). This limit was raised from Rs50, 000 ($1,400) in 1996, and even then only for loans of less than three years for trade, commerce or business. For other loans, the clean limit is Rs25, 000 ($700). For all loans above these limits, the State Bank requires that the loan be fully collateralized. While loans to individual borrowers of above Rs100, 000 ($2,800) could not be considered microfinance; this rule greatly restricts the scope for banks to lend to NGOs, village organizations or self-help groups for on-lending to poor borrowers.

Second, other than individuals, banks are only allowed to lend to structured bodies that meet certain conditions. For instance, structured bodies are required to maintain audited accounts, and are subject to regulations concerning debt-equity ratios and other matters. This makes it very difficult for banks to lend to relatively informal group structures, such as village organizations and self-help groups.

AKRSP is holding discussions with the State Bank to amend these rules or to exempt loans to NGOs and village organisations from these requirements. Nevertheless, as they stand, these restrictions are clearly a major barrier to banks establishing linkages with NGOs and self-help groups of the poor, and it would be appropriate to remove them.

Regulatory And Promotional Initiatives Of State Bank Pakistan:

The paradigm shift in Micro financing from supply-led, interventionist policies toward more liberal market-oriented approaches has led to growing emphasis on provision of conducive environment by the governments and regulatory authorities rather than intervening directly in the allocation of financial resources. Since Government of Pakistan has identified micro finance as one of its major tools to eradicate poverty, State bank of Pakistan has been in consonance with the government to establish a responsive regulatory framework that allows and encourages the provision of financial services to the poor through variety of

institutions, unregulated NGO-MFIs, RSPs etc and formal Micro finance Banks. The crucial policy initiatives of SBP, since the inception of formal micro finance sector, are summarized as follows:

Separate Licensing Criteria for Establishing Micro Finance Banks:

The formal launch of Micro finance banking, with the establishment of Khushhali Bank reinforced the government's policy stance that encouraged private sector entry into banking with the poor. The prospective creation of a micro finance banking industry thus called for revised supervisory role of SBP now entrusted with the supervision of the nascent sector. The regulatory authority, on the outset, aptly recognized the need for separately defining a set of parameters qualifying the new entrants for establishing a micro finance bank and thus formulated separate licensing criteria for Micro Finance Banks. The criteria enumerated the credentials of Board members and senior management team and the documents such as feasibility study and business plan to be submitted for establishing a MFB. In addition to the licensing criteria, State Bank of Pakistan has also formulated a separate branch licensing policy to assist balanced growth of branches of MFBs.

Prudential Regulations For Micro Finance Banks:

State Bank of Pakistan, appreciating the evolving nature and characteristics of micro finance in Pakistan, has framed separate prudential regulations for micro finance banks in consultation with stakeholders. The Regulations interalia prescribe standards for different areas of operations of MFBs including capital adequacy ratio, maximum loan size, credit and operational risk and KYC etc. and they have been designed cautiously to allow flexibility and innovation while ensuring effective regulatory and supervisory oversight.

Mobile Banking Guidelines:

The inherent structure of micro finance is quite different from that of traditional banking. The diverse demographic features of the target clients of micro finance banks demand different regulatory environment enabling MFBs to effectively penetrate the target market. Mobile banking has been one of the strategies to reach out to the potential clientele that are restricted by their terrain. However, such means to expand outreach, if ill planned and ill executed can negatively affect the banks profitability. State Bank of Pakistan has issued mobile banking guidelines to facilitate MFBs in their mobile banking operations and also to ensure that MFBs have put in place necessary systems to mitigate the risks inherent in mobile banking operations.

NGO/ RSPs /Cooperatives Transformation Guide Lines:

While tailoring a suitable regulatory environment for the MFBs, the informal sector marked by NGOs has been given due consideration by State Bank of Pakistan. The regulatory authority has been well cognizant of the vicissitudes of the informal sector and acknowledges the constraints that hinder the transformation of Micro finance institutions into micro finance banks. Therefore, in an effort to facilitate the transformation process, State bank of Pakistan has issued NGOs/RSPs/Cooperatives Transformation guidelines.

The guidelines define and discuss various aspects of the transformation and prescribe minimum requirements to be completed for the transformation. They discuss in detail the transformation process, the costs and benefits of transformation, the pre-requisites of transformation and require the NGO-MFIs to take the transformation decision based on an independent institutional assessment and clear understanding of the transformation objectives. The NGO-MFIs/RSPs/Cooperatives may apply additional processes to assess their capacity to transform and ensure a smooth transition from informal, non-profit and unregulated financial institution to a formal, for profit and regulated financial institution for the poor. The guidelines will not only facilitate NGO-MFIs in the transformation process, but would also enable SBP to have an independent

assessment of institutional capacity of NGO-MFIs approaching it for the purpose of transformation.

Fit And Proper Criteria:

The Fit and Proper Criteria for Board Members and President/Chief Executive of Micro finance Banks ensures that the Board Members and President/Chief Executive are not only persons of established integrity and track record but also have necessary capacity, qualification and experience to effectively undertake their respective responsibilities and functions in order to lead and steer the MFB as a socially conscious, pro poor and commercially viable financial institution.

Challenges And Problems Faced by the Microfinance Sector Of Pakistan:

Pakistan though a late entrant in micro finance arena has created a well recognizable niche on the international micro finance scenario. The Government in its effort to develop a pro-poor financial system having a significant poverty reduction impact has identified micro finance as a major poverty eradication tool. In pursuance of creating an enabling environment for the sector to flourish, the government in consonance with state bank of Pakistan has taken numerous steps over the past three years.

Earlier, potential suppliers have avoided entry into Micro finance sector, as it had been perceived as high risk and unprofitable area in Pakistan. Investments to enhance the supply of MF services, both from private and public sectors have been minimal due to the perception of a limited market. However, with the governments increased interest in the sector, the once non-existent realm has sprung to life and has been transformed into a rapidly developing field.

However, despite making fast progress on many fronts during last couple of years, the micro finance sector in Pakistan is still plagued with numerous problems. The limited resource base and inadequate retail capacity of MFIs has chiefly led to lack of continuity and quality of micro finance services A considerable proportion of the economically active poor still lack sustainable access to micro finance. The challenge is to address the constraints that exclude people from full participation in the financial sector, therefore the following issues need to be gauged and dealt with gravity

Inadequate Access of the Poor to Services:

Inadequate access to productive resources and social services has resulted in low indicators of well-being and lack of employment opportunities. This situation is compounded in rural areas where access is even more difficult due to inadequate or complete lack of basic infrastructure. Low skill level and absence

of support for human resource development for the poor prevents them from diversifying their household income. Government interventions have not yielded the desired impact due to inadequate emphasis on community-based participatory approaches. Resource availability relative to the requirements for the social sectors is low. Much of the investment required is for public services where private sector investments are unlikely. Without these services, MF will have less than the intended impact.

Limited Retail Capacity:

The government's policy and investment initiatives are aimed at substantially increasing the outreach of microfinance services in the medium to long term. The outreach expansion however could not so far match pace with developments on regulatory and policy front and remained modest. The position is largely attributable to limited capacity available in the country to retail the services.The existing client base of 262,340 borrowers of the unregulated sector, if compared with potential target market of approximately 6.5 million households leaves huge potential for the micro finance sector for provision of their services.

There are a number of donor initiatives for building retail capacity like Financial Sector Strengthening Program (FSSP) of SDC, DFID & Aga Khan Foundation interventions to build capacity of PMN and its members, USAID and European Union financial sector initiatives to increase access of poor to financial services etc, which need to be coordinated to increase their productivity and effectiveness and achieve a visible improvement in the country's MF retail capacity. PPAF and PMN, whose one of the mandates is to build capacity of grass roots NGO-MFIs, may take lead and coordinate different institutional building initiatives and interventions of national and international donors.

The existing regulated microfinance banks being in their initial years of operations and few in number are gradually building their capacity and network to achieve sustained rise in the outreach levels. The growing private sector interest to establish MFBs to cater to the financial services needs of micro and small enterprises, a few transformations expected over next 2-3 years and steadily

improving capacity of the existing players would result into substantial improvement in the retail capacity in the regulated MF sector.

Obstacles For Microfinance Outreach To Women:

Social intermediation costs to enhance women's access to MF are significantly higher in Pakistan as constraints on mobility, social interaction, and skills development must be addressed on a sustained basis. Although returns from social intermediation in terms of social capital and demonstrative effects are high, investments are limited due to high cost. Consequently, the gender orientation of organizations, products, and delivery mechanisms is insufficient to enhance outreach to women. Inadequate social preparation adversely affects group cohesion, the quality of loan portfolio, and ultimately the sustainability of MF operations.

Interest Rate:

The government and policy makers, since recent past has demonstrated strong commitment and resolve to help develop and grow MF sector through sector friendly policies and different investment initiatives. However, there have been frequent debates and demands, particularly from public representatives regarding relatively high interest rates in MF sector and the need to bring them at par with the normal market rates has been considered imperative.

The concessional finance schemes introduced in the past to ensure flow of adequate funding to the poor as well as under-developed areas/sectors have been a total failure resulting in limited outreach to the targeted groups/ areas, acute repayment problems, weakening of financial institutions and most importantly non-development of financial markets for such sectors. The concessional and directed credit schemes after remaining darling of donors and governments till early 90s have been discontinued in most parts of the world and replaced by Financial System Approach (FSA). The FSA assumes that poor generate sufficient surpluses from their business activities and can save and pay

market rates on the loans etc. The exceptional growth of microfinance during last two decades and its fast growing acceptability as a viable business proposition provides sufficient evidence in favor of the assumptions.

Similar is the basic premise of our MF policy, which envisages that the MFIs would price their products & services based on full cost recovery principle, which is critical for ensuring development of a self-sustainable MF sector. Further, the contrasting differences in the cost structure and credit risk profiles of Commercial Banks and MFIs needs to be kept in view while comparing their lending rates to have a real understanding of the

Absence of Risk Mitigation Measures:

The disadvantages of the poor households include lack of access to financial services, unfair terms of participation in the local economy, and vulnerability to economic and physical downturns. Poor households forego potentially viable technologies, production choices and income opportunities due to risk aversion. Mechanism's to mitigate such risks are not available. In addition poor have no means to secure the safety of their savings, unless deposited with Commercial banks, to which poor have little access.

Financial Sustainability:

The micro finance institutions working in the informal sector in Pakistan are mostly reliant on funding from international donors. The advent of the micro finance banks on Pakistan's micro finance scenario has been a recent development. Earlier, the concept thrived on the NGOs working in the informal sector, which have been reliant on funding from international donors. A number of micro finance institutions have been showing their financial efficiency, which hinges upon the borrowing cost of on-lending funds being highly subsidized by donors. Therefore, in order to maintain their capacity holdings, the MFIs need to generate sufficient revenue to meet its operating costs, including the cost of administering loans, mobilizing and training groups, mobilizing funds for on-

lending, and covering bad debts. In order to expand operations, micro finance institutions may increase the variety of their funding sources.

Microfinance-Specific Policy Framework:

In the early stages of MF sector development, a conducive policy environment is required to encourage innovations and to allow a diverse set of institutions to provide a range of services, particularly savings, in a supervised and regulated environment. The required policy attributes include (i) promotion of institutions that can target the poor with adequate gender emphasis, (ii) acceptance of individuals as well as groups of individuals for MF transactions, (iii) mechanisms to ensure that social intermediation precedes and accompanies MF services, (iv) significant investments in social intermediation, (v) pro-poor financial innovations such as measures to mitigate risks faced by the poor, (vi) realizing public-private sector synergy, (vii) autonomy in pricing and client selection, (viii) measures to integrate MF with the financial system and (ix) proactive role of the Central Bank in developing the MF sector.

Institutional Limitations:

The financial reforms in Pakistan have put in place a policy framework for efficient financial intermediation that enables institutions to concentrate on their core competencies. For the CBs and DFIs, this core competency is serving the upper and middle segments of the market. While the banking system has responded positively to the reform initiatives, an efficient and financially sound system, barring select institutions, has yet to emerge. The high level of nonperforming loans attributed to slack industrial activity is widespread. Some institutions have capital adequacy below the prescribed 8% of risk-weighted assets. Competitive pressures for product differentiation and cost reduction are increasing. Smaller institutions are not able to invest in new technology and a branch network to access low cost retail deposits to gain competitive advantage. The banking system is becoming concentrated in a few large institutions.

MF is unlikely to become a significant part of CBs' portfolios. Operating procedures of CBs are incompatible with the requirements of banking with the poor, and thus their services and delivery mechanisms have excluded the poor. Women have been virtually excluded from institutional credit. In addition, CBs are undergoing reforms that include closing loss-making branches (mostly located in rural areas), downsizing, re-capitalizing and implementing measures to recover and write-off non-performing loans. The CB's priorities therefore are restructuring and reorganization. Slow transformation of DFIs into efficient financial intermediaries due to their overt political considerations in business decisions and persistent poor governance, underlines constraints to change and undermines the development of the rural financial system. For these reasons, MF has been perceived as high risk and unprofitable in Pakistan. Consequently, potential suppliers have avoided entry into MF.

NGOs have small credit operations with limited MF specialization. NGOs do not have the trained staff, financial systems, and, until recently, have not seen the necessity of following successful practices and procedures. Even among the members of the MF Group, most have yet to achieve financial viability. Inadequate investment in social intermediation also effects portfolio quality.

Services:

Delivery of financial services to the poor, particularly in rural areas is constrained by low population density in some provinces, inadequate communication services, small loans, and low household savings that increase transaction costs. Seasonally of the agriculture business cycle, the main occupation for poor households, and the high probability of risks add to the problems of providing MF services to the rural poor. In addition, while security of savings is a prime concern for rural households, secure savings facilities are not accessible. CBs find it costly to cater to small depositors. Savings through NGO intermediaries, deposited with CBs, are generally compulsory and do not necessarily provide the maximum return to the depositor. NGOs cannot deploy such savings as micro credit.

Range of Financial services:

The economically active poor are not a homogeneous group and they demand varied loan products, safe savings, insurance, and other financial products. However the focus of the micro finance institutions has remained on the credit extension considering that the poor only lack seed capital for establishing a successful business. However, there may be a need for many other services along with credit to run successful and sustainable businesses. The borrowers/entrepreneurs who want to expand their business may need enterprise development trainings (EDTs) to get acquainted with the basic concepts of entrepreneurship like market survey, business feasibility and planning, personal entrepreneurial competencies (PECs), promotional skills, information of market trends and prices, and maintaining of records and preparing income and expenditure statements. Moreover, as micro finance institutions expand, so does their client base. Consequently, clients demand a larger variety of more sophisticated financial services specifically liquid and profitable deposit facilities. Therefore, MFIs/MFBs shall emphasize the development of client-responsive, flexible financial services for their clients.

Dearth of Microfinance Practitioners:

The existing micro finance market in Pakistan faces chronic shortage of micro finance experts. Though the concept of micro finance exists as early as 1970s, the development of micro finance related human resources is still treated as a novel proposition. There are only few experts who can be considered as well versed in the field of micro finance. With the growth of the sector, the need for micro finance expertise is also on the rise as the institutions can only be steered in the right direction by capable and discerning management.

RECOMMENDATIONS

Microfinance is not widespread in Pakistan. The aggregate outreach from banks and other institutional sources is less than 5 percent of the potential market of nearly 6.3 million households. The microfinance sector in Pakistan is characterized by a narrow institutional base, limited retail capacity and little, if any, financial integration. Commercial banks, in general, are neither structured nor geared to extend their microfinance exposure beyond experimental forays and development finance institutions (DFIs) do not target asset less poor. Non-government organizations (NGOs) have shown appreciation of the nature of microfinance demand emanating from the poor through effective targeting, participatory approaches, capacity building and general sensitivity. Yet, their microfinance operations are unlikely to attain financial self-sufficiency. The informal sources are the only window available for the poor. However, informal sources provide services at terms that tend to perpetuate rather than ameliorate poverty.

It is, therefore, a matter of urgent priority for the country that a pro-poor financial system is established as a critical element for combating the rising incidence of poverty.

This will be attained by:

- Creating a conducive policy environment.
- Developing appropriate financial infrastructure.
- Promoting and strengthening microfinance institutions (MFIs).
- Developing linkage with NGOs and community organizations.
- Investing in building social capital.
- Mitigating risks of poor households.
- Institutional development.

The strategy to reduce poverty and income inequality of the Government emphasizes sustained pro-poor growth based on private sector activity and investment. The anti-poverty program, among others, should include:

- Direct employment generation through small infrastructure projects.
- Introduction of social safety nets such as food support program.
- Enhanced access to basic education, health, and nutrition.
- Access to sustainable microfinance services for the poor to enhance their income earning capacity.
- These are aimed to enhance skills, access to productive resources, and social services; the key obstacles in combating poverty.

The following points will provide a guideline for the participants of the MF sector to become more effective and increase the outreach and sustainability of the organization.

Support For Intensive And Sustained Social Preparation:

As an integral part of the microfinance policy support for intensive and sustained social preparation, particularly to enhance outreach to poor women, building capacity of communities and providing access to basic infrastructure should be recognized. While this has been widely felt, investments in social and gender aspects have been inadequate and their linkages with affordable microfinance services weak. Attempts to provide these services at cost to the poor have neither helped the sustainability of MFIs nor have the intended beneficiaries been able to absorb the cost. There is, therefore, need at least in the short to medium term, to segregate social costs from financial intermediation costs so that these can be separately budgeted and provided for. Support should be provided for community organizations, skills development, and access to community

infrastructure exclusively to the poor, and especially to women, organized in communities to enable them to fully utilize microfinance services.

Establishing A Risk Mitigation Fund:

As a pro-poor innovation a Risk Mitigation Fund has to be established to reduce the risk aversion of the poor for fear of indebtedness in failed enterprises and enable the poor households to take advantage of potentially viable new techniques, production choices, and income opportunities. The Risk Mitigation Fund will assist the poor in case of loss of income generating assets due to unforeseen circumstances beyond their control. As a safety net measure a Deposit Protection Fund has been established to provide security to the savings of the poor.

Policies Regarding The Pak Poverty Alleviation Fund (PPAF):

The fund should be as independent and as free from political interference as possible. The plans to set the fund up as a joint stock company, and to include representatives from the private sector and the NGO community on the board of directors, are encouraging. Nevertheless, these measures may not be enough in themselves. Additional measures may be to enable private and NGO bodies to appoint representatives to the board directly, to provide for fixed-term appointments, and to spell out clearly the objectives of the fund while allowing the board maximum independence to meet these objectives.

It will also be necessary for the fund to set and enforce appropriate performance and reporting standards for the MFIs that it funds. This will mean striking an appropriate balance between the need to increase outreach and the need to strengthen the capabilities of existing MFIs. It would be appropriate to require all partner organizations to meet a set of minimum standards, and to increase these gradually over time. These standards should ensure a level playing field between MFIs, and should not be prescriptive as to the particular lending methodologies adopted by individual MFIs.

The fund should ensure that all MFIs to which it lends target their programs to the poor. MFIs should be required to set appropriate means tests that are transparent and readily enforceable. And it is important that the fund emphasizes the need for MFIs to become financially self-sufficient. Given the vast unmet demand for microfinance in Pakistan, the need for self-sufficiency is even more critical than in most other countries. MFIs should be free to charge mark-ups that are sufficient to cover their costs, and should be required to have realistic plans for attaining self-sufficiency.

Initiate Restructuring Of DFIs:

The Government should initiate restructuring DFIs, many of whom have a poor governance structure, high levels of non-performing loans, incapacity to raise resources, and relatively high cost of service delivery.

Streamlining The MF Policy:

The design and the financial infrastructure created to support MFB should be used as a basis to develop a framework-legal, supervisory and regulatory - to mainstream the attributes of the basic microfinance policy, through

- Definition and categorization of MFIs and their licensing procedures
- Corresponding supervision and regulation standards and systems
- Disclosure and reporting requirements

This sequencing is necessary prior to opening the sector for enhancing the supervisory capacity of SBP to protect the interests of the poor.

Switching To Demand-Driven And Financial System Approach:

It has become increasingly evident that the supply-driven microcredit approach cannot reach a wide range of potential clients. It has also become clear that there is effective demand by the poor for access to savings, with an increasing number of institutions mobilizing voluntary savings from low-income households, which in turn increases the ability of financial institutions to provide microfinance

services without a subsidy. Against this background, a financial system approach developed as a more market-based concept of microfinance, focusing on demand for financial services on the part of poor borrowers and savers, while setting the price of the services to ensure cost recovery and financing loans from locally mobilized savings and other commercial sources. The conventional perceptions of the financial sector that small financial schemes for the poor are not profitable as the costs of handling small accounts are high. This approach provides the scope for reaching a wider population of poor people while achieving institutional financial self-sufficiency.

In order to streamline operations, achieve efficiencies and profitability, the MFIs, (especially non-formal MFIs) may find these recommendations helpful.

Achieving Formalization: in order to achieve efficiency and effectiveness, it is necessary to transition from an NGO to a bank or another type of financial institution.

Creating Sustainability: microfinance is often criticized for not being sustainable. Many governments, including Pakistan's, assume that the poor need charity, welfare or subsidized credit, rather than basic financial services. In order to achieve full or near full sustainability, it is necessary to view the poor as a market. Proceeding from that premise, a financial solution is required. The Kashf Foundation was one of the first enterprises to accept this solution and require a sustainable interest rate, namely twenty percent.

Building A Replicable And Scalable Model: often microfinance is seen as a tool in a larger development management approach and is combined with heath, education, and other services. It does not receive the specialized attention that it deserves; it must be addressed independently.

Targeting Women: in order to empower women, it is essential that microcredit enterprises target women directly and transform into women-oriented organizations with primarily female loan officers.

Achieving Sound Portfolio Management: portfolio management is crucial to the success of microcredit enterprises. In Pakistan, most private sector lending institutions achieve only an eighty-seven to ninety-four percent recovery rate, compared to the international average of ninety-seven percent. This rate is insufficient to achieve sustainability; if a recovery rate of less than ninety-five percent is projected over the next five years, the lending agency would significantly undermine its asset base. In part, the existence of subsidized loan agencies allows clients to default on loans; this creates a cycle of poor credit and further indebts the poor.

FUTURE OUTLOOK – *Transition From An Informal To A Formal MF Sector*

The strong resolve and commitment of government and policy makers to promote the MF sector, institutional diversity allowed and encouraged by the MFIs policy and regulatory framework, the rising confidence and trust between policy makers and practitioners to work jointly to develop the sector and growing acceptance of microfinance as a viable business proposition exhibits a positive and bright outlook for the sector. The launch of PPAF-II in March 2004 together with increased donor funding to build capacity of MFIs would translate into substantially improved activity in the unregulated sector. The retail capacity would also receive a substantial boost in the medium term as stakeholders' consensus has started emerging to focus on this important area, which would not only result in improvement in retail capacity and rise in outreach levels but would also enable a few unregulated players to go for transformation into regulated MFBs. With growing private sector interest in establishing MFBs to extend financial services to micro enterprises, the outlook for the regulated MF sector is even better. The two newly licensed MFBs in private sector would largely focus on micro enterprises operating in urban areas of Karachi and make cash flow based lending to individuals as against largely rural dominated and group based financing by Khushhali and First Microfinance Bank. The establishment of private sector MFBs and their cash flow based lending to micro enterprises would attract further private investment in the sector besides encouraging existing MFBs to diversify their credit portfolio. The introduction of credit scoring appraisal system by one of the existing MFBs could be a step in that direction. The overall policy environment and future outlook for the sector except a few decisions like lowering of interest rate on agriculture loans by one or two public sector banks, is quite positive and bright and the sector is expected to grow substantially over 2-3 years.

CONCLUSION

Since the past decade Pakistan has gone form an Asian Tiger to a tame cat when it comes to development. The major obstacle between the country and prosperity is Poverty. The number of poor is estimated to have risen from 17.6 million in 1987/88 to 44.9 million in 1998/99.This figure alone tells the sad tale of the country. To eradicate poverty at the grassroot level Pakistan has decided to boldly go where it hadn't gone before, the Realm of Microfinance. The government has become an active advocate for disseminating microfinance throughout the company. Due to this Pakistan has, in the last 3 years, initiated a bold reform program for accelerating growth as well as a focused third generation microfinance sector development program providing a conducive policy framework and support mechanisms to encourage private investments in the sector. The State Bank of Pakistan provides for a regulatory framework allowing for the establishment of licensed MFIs, which can mobilize resources from local markets. The government through its actions has been successful in establishing a pro-poor sustainable financial services delivery network in the country and in creating an enabling environment that will attract other microfinance operators to commence their operations. It is very encouraging to see that the government has poverty reduction as an overarching objective and microfinance as one of its critical elements.

UN Year of Microcredit 2005

REFERENCES

- **Amjad, Rashid & Kemal, A. R**. 1997. Macroeconomic policies and their impact on poverty alleviation in Pakistan. Unpublished.
- **Hook, Andrew T.** 1997. *Savings in Pakistan: Practice and Policy 1981–1996*. State Bank of Pakistan, Karachi.
- **NGO Resource Centre.** 1991. *NGO Registration Study*. NGO Resource Centre, Karachi.
- **State Bank of Pakistan**. 1994. *Rural Financial Market Studies*, Phase 1. State Bank of Pakistan, Karachi.
- **State Bank of Pakistan.** 2004*. MFI Inspection Policy Guidebook*. State Bank of Pakistan, Karachi.
- **State Bank of Pakistan.** 2004.*Transformation Guidelines.* State Bank of Pakistan, Karachi.
- **World Bank.** 1995. *Pakistan: Poverty Assessment*. Report no.14397–PAK, World Bank, Washington D.C.
- **World Bank.** 1996. *The Aga Khan Rural Support Program: A Third Evaluation.* World Bank, Washington D.C.
- **Zafar, Roshaneh**. November 2002 Country paper on Pakistan, *"Microfinance in the Private Sector,*
- **Ledgerwood, Joanna**, 1998."Sustainable Banking with the Poor" in *Microfinance Handbook: An Institutional and Financial Perspective* .Washington D.C.: IBRD/The World Bank

APPENDIX

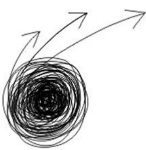
Basic Facts About Microfinance

Comprehensive impact studies have demonstrated that: (i) microfinance helps very poor households meet basic needs and protect against risks; (ii) the use of financial services by low-income households is associated with improvements in household economic welfare and enterprise stability or growth; (iii) by supporting women's economic participation, microfinance helps to empower women, thus promoting gender-equity and improving household well-being; (iv) for almost all significant impacts, the magnitude of impact is positively related to the length of time that clients have been in the programme.

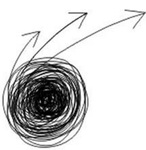
The demand for microfinance services is largely unmet. Estimates of the global demand ranges from 400 to 500 million households of which only around 30 million are reported to have access to sustainable microfinance services in 2002. Although many poor and low-income people do not yet have access to financial services, the number of customers that use microfinance, has grown between 25 and 30 percent annually over the past five years.

Other important insights concerning microfinance include:

- In the 1990s, average per capita income growth was less than 3% in 125 developing and transition countries, and was negative in 54 countries. In a further 71 countries, growth was below the 3% a year needed to double incomes in a generation.
  (*UNDP, Human Development Report, 2003*)
- At least 30 million people now have access to microfinance (*Unitus Website*)
- The existing 10,000 Microfinance Institutes (MFIs) reach only 4% of the potential market (*2001 World Bank Statistics*)
- At least 90% of eligible self-employed lack access to microcredit programs. Unmet demand is around 270,000,000 (*Unitus*)
- In Africa, women account for more than 60 per cent of the rural labour force and contribute up to 80 per cent of food production, yet receive less than 10 per cent of credit provided to farmers. (*Data Snapshots on Microfinance – The Virtual Library on Microcredit*)
- The World Bank estimates that there are now over 7000 microfinance institutions, serving some 16 million poor people in developing countries. The total cash turnover of MFIs world-wide is estimated at US$2.5 billion and the potential for new growth is outstanding.
  (*Data Snapshots on Microfinance – The Virtual Library on Microcredit*)
- There is concern that official assistance will be diverted from vital primary care aid programmes such as health, water projects and education into MFIs, owing to their popularity among donors. (*Data Snapshots on Microfinance – The Virtual Library on Microcredit*)
- Though women appear to benefit most, studies indicate that many loans awarded to and paid back by women are in fact used by men.
  (*Data Snapshots on Microfinance – The Virtual Library on Microcredit*)

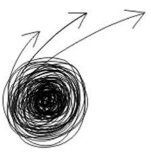


- The widely-imitated Grameen Bank in Bangladesh aims to provide credit to those in extreme poverty. Some 94 per cent of those who meet the bank's criteria and take up loans are women. Grameen borrowers keep up repayments at a rate of around 98 per cent. The Bank lends US$30 million a month to 1.8 million needy borrowers.
  (*Data Snapshots on Microfinance – The Virtual Library on Microcredit*)
- Savings are important both as a vital safety net for the poor and as a source of funding that does not rely on external sources. Many strong MFIs, notably in Africa, recycle the savings of needy clients as a principal source of loan funds for their customers.
  (*Data Snapshots on Microfinance – The Virtual Library on Microcredit*)
- The Microcredit Summit estimates that US$21.6 billion is needed to provide microfinance to 100 million of the world's poorest families. The Summit planners say it should be possible to raise US$2 billion from borrowers' savings alone. The final figure may be even higher.
  (*Data Snapshots on Microfinance – The Virtual Library on Microcredit*)
- Studies have shown that during an eight year period, among the poorest in Bangladesh with no credit service of any type, only 4 percent pulled themselves above the poverty line. But with individuals and families with credit from Grameen Bank, more than 48% rose above the poverty line. (*Data Snapshots on Microfinance – The Virtual Library on Microcredit*)
- It is estimated that, worldwide, there are 13 million microcredit borrowers, with US$ 7 billion in outstanding loans, and generating repayment rates of 97 percent. It has been growing at a rate of 30 percent annual growth.
  (*Data Snapshots on Microfinance – The Virtual Library on Microcredit*)
- Fewer than 2 per cent of poor people have access to financial services (credit or savings) from sources other than money lenders.
  (*Data Snapshots on Microfinance – The Virtual Library on Microcredit*)
- Under 10 million of the 500 million people who run micro and small enterprises have access to financial support for their businesses.
  (*Data Snapshots on Microfinance – The Virtual Library on Microcredit*)
- There is a potential demand for microcredit services from seven million borrowers.
  (*Data Snapshots on Microfinance – The Virtual Library on Microcredit*)
- There is a potential demand for microsavings services from 19 million savers.
  (*Data Snapshots on Microfinance – The Virtual Library on Microcredit*)
- The world's seven richest men could wipe out global poverty. Their combined wealth is more than enough to provide the basic needs of the poorest quarter of the world's people.
  (*Data Snapshots on Microfinance – The Virtual Library on Microcredit*)
- Studies of the impact of microcredit in more than 24 countries found dramatic improvements in household income levels. These improvements took place primarily through growth in the borrower's business, which translated into increased household income. The studies found that access to microcredit allowed the borrower to increase the number of goods or services sold and reduce the costs



of supplies and raw materials. As a result, sales increased and profits grew 25% to 40%. (*Unitus*)

- The top 5 MFIs reach almost half of the market. (*2001 World Bank Statistics*)
- Only 1% of MFIs are financially stable. (*2001 World Bank Statistics*)
- MFIs reach self-sufficiency through cost and income structures that vary by region: Asian FSS MFIs achieve a high level of profitability due to low costs. In the other regions, Eastern Europe, Latin America and Africa, MFIs face high costs and reach self-sufficiency through a combination of higher income and productivity.
(*Issabelle Barres, Microbanking Bulletin, 2002*)
- In Indonesia, borrowers increased their incomes by 12.9 percent compared to increases of 3 percent in control-group incomes. Another study on Bank Rakyat Indonesia borrowers on the island of Lombok in Indonesia reports that the average incomes of clients had increased by 112 percent and that 90 percent of households had moved out of poverty.
(*CGAP, Focus Notes. 24, Elizabeth Littlefield*)
- Microfinance programs from different regions report increasing decision-making roles of women clients. The Women's Empowerment Program in Nepal found that 68 percent of its members were making decisions on buying and selling property, sending their daughters to school, negotiating their children's marriages, and planning their family. These decisions traditionally were made by husbands. World Education, which combines education with financial services, found that women were in a stronger position to ensure female children had equal access to food, schooling, and medical care. TSPI in the Philippines reported that program participation increased the percentage of women who were principal household-fund managers from 33 percent to 51 percent. In the control group, only 31 percent of women were principal fund managers.
(*CGAP, Focus Notes. 24, Elizabeth Littlefield*)
- The number of poor people with access to microcredit schemes rose from 7.6 million in 1997 to 26.8 million in 2001—21 million of them women, enabling them to control assets, make economic decisions and assume control of their lives. According to some estimates, 5% of microfinance programme participants could lift their families out of poverty each year.
(*UNDP, Human Development Report, 2003*)
- As of December 31, 2001, 2,186 microcredit institutions reported reaching 54,904,102 clients, 26,806,014 of whom were among the poorest when they took their first loan. Nine hundred ninety- four institutions submitted a 2002 Institutional Action Plan outlining their progress. Assuming five persons per family, the 26.8 million poorest clients reached by the end of 2001 affected some 134 million family members.
(*Microcredit Summit Report 2002*)
- Over the previous two years, the growth in the number of very poor women reached has gone from 10.3 million in 1999, to 14.2 million in 2000. Now, as of 2001, 21,169,754 women have been reached. This is a 49.6 percent increase in the number of poorest women reached from December 31, 2000 to December 31, 2001. This increase represents an additional 7,016,841 poorest women reported



with microloans in the last year.
(*Microcredit Summit Report 2002*)

- Over the last five years the number of poorest clients reached has grown by 350 percent, from 7.6 million at the end of 1997 to 26.8 million at the end of 2001. (*Microcredit Summit Report 2002*)
- Data from the Micro Banking Bulletin reports that 63 of the world's top MFIs had an average rate of return, after adjusting for inflation and after taking out subsidies programs might have received, of about 2.5% of total assets. This compares favorably with returns in the commercial banking sector and gives credence to the hope of many that microfinance can be sufficiently attractive to mainstream into the retail banking sector. (*CGAP*)

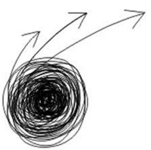
International developments in micro finance

The developments in micro finance all over the world set in motion a process of change from an activity that was entirely subsidy dependent to one that can be a viable business. By the year 2004, the MFIs and other financial institutions (OFIs) providing micro finance services expanded their outreach from a few thousand clients in the 1970s to over 10 million. The accelerated pace of micro finance activities shattered the myth that poor households cannot and do not save, and proved that savings can be successfully mobilized from poor households thus triggering a process toward broadening and deepening of rural financial markets**.** Sustainable delivery of micro finance services, on a large scale in some countries, generated positive developments in micro finance policies and practices among all stakeholders: governments, central banks, micro finance service providers, and external funding agencies.

One of the prominent developments in the realm of micro finance turned out to be the advent of micro finance institutions in the capital market beckoning towards the ascent of Micro Finance Institutions from nongovernmental organizations to commercially viable entities. The Overseas Private Investment Corporation (OPIC), a development agency of the US Treasury, guaranteed the first international bond sale, worth US$60 million bonds, to fund micro finance banks. Blue Orchard Finance is one of the two organizations issuing the bonds, which will be used to finance micro finance banks around the world. Later in August, The International Finance Corporation, provided a 34 percent partial credit guarantee to the bond issuance program of 500 million pesos (approximately$43.4 million) offered by Financiera Compartamos, a leading micro finance institution in Mexico. Such ventures in the capital market will facilitate the access of MFIs to market-based funding and will eventuallty enable them to expand their services.

BLUE BOOK ON BUILDING INCLUSIVE FINANCIAL SECTORS FOR DEVELOPMENT:

The Blue Book project is considered to be a major product of the International Year of Micro credit and a significant contribution to the follow-up of the Monterrey Consensus[1] on Financing for Development. UN DESA and UNCDF in collaboration with other concerned authorities are in the process of developing this book and carrying out the consultation for this purpose that was to be initiated in 2004 and completed during 2005. Dialogue and debate takes place around a set of key questions built around the inquiry that why *so many bankable clients are unbanked.* The consultative process aims to bring together national governments, central banks and other financial institution supervisory bodies, multilateral institutions, civil society, the private sector and stakeholders in the microfinance industry to identify and address the constraints hindering equitable access to financial services. Instead of being a negotiated "consensus" document, the process seeks to be a compelling analysis capturing the



experiences of constituencies worldwide in the effort to develop inclusive financial sectors. It is aimed to be a reference point for governments to collectively discuss strategies, and share and improve best practice in building inclusive financial sectors. Based on the global multi-stakeholder consultations, the "Blue Book" will be the synthesis of the wide range of inputs during the consultative process, giving room for the diverging perspectives from stakeholders, to maximize their ownership of the process and product.

First CGAP Financial Transparency Award CGAP announced its first Financial Transparency Award to recognize good practice and raise awareness about the good governance. It received an overwhelming response from micro finance institutions: more than 140 institutions of all types applied, from 52 different countries. The First Micro Finance Bank Limited of Pakistan MFB turned out to be one of the eleven MFIs to be awarded the Honorable Mention and five Diamond Status.

The Global Micro entrepreneurship Awards: The 2004 Global Micro entrepreneur ship awards were held in 8 countries: Afghanistan, Cambodia, Dominican Republic, Indonesia, Mexico, Mozambqiue, Pakistan and Rwanda, as well as a local contest held in New York City. The awards recognized the contribution of the global entrepreneurs to their families and community. Winners received monetary prizes and awards and had the opportunity to open 17 stock exchanges throughout the world as a reminder of their contribution to the world economy.

Major Events:

The drive to bring micro finance in the fore front gained impetus when the first Micro credit Summit held in Washington DC, USA, in 1997 launched a nine-year campaign to reach 100 million of the world's poorest families, especially the women of those families, with credit for self-employment and other financial and business services by the year 2005. Since the success of the first micro finance summit, there has been activities around the world to promote micro finance, specifically in the poverty-ridden regions of South Asia, Africa and Latin America. By the year 2004, the campaign to mainstream micro finance has gained immense momentum and has led to several high profile conferences and workshops.

Asia Pacific Region Micro credit Summit Meeting:

Asia Pacific Region Micro credit Summit Meeting was organized by PKSF, in collaboration with the Micro credit Summit Campaign**.** More than 1,200 delegates from 47 countries attended the Asia/Pacific Micro credit Summit in Dhaka, Bangladesh from February 16-19, 2004. This Summit Meeting in Dhaka not only provided inputs for program of the UN International Year of Micro credit 2005 but also turned out to be the largest regional Micro credit Summit ever with 1230 participants from 47 countries attending the meeting.

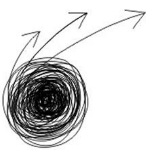
The Meeting kept in view the Millennium Development Goals, especially that of cutting absolute poverty by half by 2015 and focused on formulating strategies to achieve the ambitious goal. The core themes of the Micro credit Summit around which the plenary sessions and workshops revolved were:

*Reaching the poorest
*Reaching and empowering women
*Building financially self-sufficient institutions
* Ensuring a positive measurable impact on the lives of clients and their families.

In light of the experience of eminent organizations such as ASA, NABARD, SIDBI, and IFAD, the conference led to consensus on several major issues ranging from financial sustainability of MFIs to women empowerment. It was unanimously agreed that the major constraints to micro lending are lack of institutional capacity, conducive environment and inadequate financial infrastructure along with the paucity of capital for small and emerging MFIs. Therefore, a favorable policy environment, an appropriate financial infrastructure, increased retail level, institutional capacity and adequate investments in rural areas become imperative for micro finance development.

It was thus proposed that the lopsided growth of the sector might be avoided by:

- Reaching the poorest while building financially self-sufficient institutions,
- Integrating social services with micro credit.



- Coordinating combination of appropriate regulatory environment for micro finance with improved financial infrastructure
- Establishing a well-organized and autonomous wholesale fund that contributes to the sustainable development of the micro finance sector.
- Empowering women through provision of financial reprieve.

The Seventh Annual Conference of Micro finance institutions in C&EE and the NIS that took place on 27-29 May in Warsaw, Poland turned out to be a significant event. It achieved the feat of bringing together donor and investor representatives, industry experts, corporate world representatives as well as government official's world over specifically from Central/Eastern Europe and the Newly Independent States. The Conference workshops and plenaries covered a vast range of topics that included, MFI - bank linkages, transformation, innovations in rural micro finance, western perspective on microfinance in the East. Additionally, the discussions revolved around mergers, effective human resources management, integrating health into micro finance, strategic marketing for MFIs and managing social performance investors.

Latin America, one of the major proponents of micro finance also hosted the 7th Inter American Forum on micro enterprise. More than 1000 practitioners from all over Latin America and other regions met at the Inter-American Forum to discuss the latest best practices for the development of the micro enterprise sector.

7th International Workshop on Gender Equity & Micro Enterprise Development that took place on 28th June - 4th July 2004 in Mauritius focused on the gender inequality and their disfunctionality affecting the participation of women in micro enterprises. The objective of the workshop was the Development of gender sensitivity vis-à-vis participation of women in Micro Enterprise along with developing effective Planning process for participation of women in Micro Enterprise.

Similarly the 2nd Bi-Annual Southern African Micro Finance Summit 2004 that took place on 31 March & 1 April 2004 in Johannesburg assessed the current situation and understanding future developments in the micro finance industry in South Africa

In addition, numerous regional events such as, 7th Annual Micro enterprise Conference in Utah, Pakistan Stakeholders Workshop, Nepal Stakeholder Workshop and Mekong Stakeholder Workshop not only discussed issues of sustainability and policy environment but also deliberated on probable innovations and strategic decisions in micro finance.

The most significant of all the events is the christening of year 2005 as the International Year of Micro credit. By the end of year 2004, The United Nations launched the International Year of Micro credit in an effort to build support for

making financial services more accessible to poor and low-income people. The objective of declaring year 2005 as International Year of Micro credit is to raise public awareness about micro credit and micro finance, and promote innovative partnerships among governments, donors, international organizations, non-governmental organizations, the private sector, academia and micro finance clients. The five key objectives for the Year are designed to unite Member States, UN Agencies and Micro finance Partners in their shared interest to build sustainable and inclusive financial sectors and achieve the Millennium Development Goals (MDGs) which ranks eradication of poverty as its prime target. The objectives are to:

1. Assess and promote the contribution of micro finance and micro credit to the Millennium Development Goals;
2. Increase public awareness and understanding of micro finance and micro credit as vital parts of the development equation;
3. Promote inclusive financial sectors;
4. Support sustainable access to financial services, and
5. Encourage innovation and new partnerships by promoting and supporting strategic partnerships to build and expand the outreach and success of micro credit and micro finance

Nearly 50 countries have confirmed their participation in the year and established national committees to lead country wide and regional activities.