

# **Microfinance Challenges and Opportunities in Pakistan**

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## **Abstract**

The purpose of the paper is to highlight the challenges and opportunities face microfinance sector in Pakistan. Micro finance sector in Pakistan is coming to the end of its primary stage and is now in a position to take off towards significant growth. However, the successful transition is subject to strategic thinking by Micro Finance Providers (MFP). Numerous challenges are ahead of this sector like improper regulations, increasing competition, innovative and diversified products, profitability, stability, limited management capacity of micro finance institutions (MFIs) etc. On the other hand, the rapid increase in poverty in Pakistan, along with other opportunities, is paving way for the growth of this sector and offering a huge market potential for microfinance. On this basis the sector presents a lot of opportunities such as: stimulating growth of economy, women empowerment, increasing volume, accessibility and outreach, economics of scope etc.

**Keywords:** Microfinance: Challenges and Opportunities

## **1. Introduction**

Microfinance is the provision of financial services to low-income clients, including consumers and the self-employed, who traditionally lack access to banking and related services. More broadly, it is a movement whose object is “a world in which as many poor and near-poor households as possible have permanent access to an appropriate range of high quality financial services, including not just credit but also savings, insurance, and fund transfers.” Those who promote microfinance generally believe that such access will help poor people out of poverty

The vision of microfinance is quite simple to create systemic change in financial systems worldwide. Instead of the exclusive financial systems that have for decades benefited and protected the wealthy, microfinance intends that they serve the impoverished majorities, help lift them out of poverty, and make them full participants in their country's social and economic development..

The microfinance revolution began when Bangladeshi economist professor Muhammad Yunus first handed over a few dollars to an impoverished basket weaver in 1974. Since then, the movement toward microfinance. The granting of very small loans to the poorest people in the world to enable them to run small businesses that will lift them out of poverty. Has won passionate supporters across the globe. Last year, Yunus and the microfinance institution the founded, Grameen Bank, shared the Nobel Peace Prize.

It is well recognized fact that microfinance is the most suitable way to empower the poor and to increase their income generating capacity (PIPRP 2001). In Pakistan as well as at international level, the importance of microfinance as a tool to eliminate poverty is well accepted. But with this extraordinary scope this sector is facing some serious challenges as well.

The basic idea of micro-finance services is to provide the financial assistance to the poor at the time he or she needs it at the doorstep and at a very convenient condition (Waheedur Rehman 2007). Recently microfinance has got special attention not only in the academic debates but also in the area of policy making (Smailbone and Wyer 2000).

### **Key Principles of Microfinance**

1. Poor people need a variety of financial services, not just loans.
2. Microfinance is a powerful tool to fight poverty.
3. Microfinance means building financial systems that serve the poor.
4. Microfinance must pay for itself to reach large numbers of poor people.
5. Microfinance is about building permanent local financial institutions.
6. Microcredit is not the best tool for everyone or every situation.
7. Interest rate ceilings making it harder for poor people to get credit.
8. The role of government is to enable financial services, not to provide them.
9. Donor funds should complement private capital, not compete with it.
10. The key bottleneck is the shortage of strong institutions and managers.
11. Microfinance works best when it measures and discloses its performance

Microfinance can also be distinguished from charity. It is better to provide grants to families who are destitute, or so poor they are unlikely to be able to generate the cash flow required to repay a loan. This situation can occur for example, in a war zone or after a natural disaster.

Microcredit and microfinance are relatively new terms in the field of development, first coming to prominence in the 1970s, according to Robinson (2001) and Otero (1999). Prior to then, from the 1950s through to the 1970s, the provision of financial services by donors or governments was mainly in the form of subsidised rural credit programmes. These often resulted in high loan defaults, high losses and an inability to reach poor rural households (Robinson, 2001). Robinson states that the 1980s represented a turning point in the history of microfinance in that MFIs such as Grameen Bank and BRI2 began to show that they could provide small loans and savings services profitably on a large scale. They received no continuing subsidies, were commercially funded and fully sustainable, and could attain wide outreach to clients (Robinson, 2001). It was also at this time that the term “microcredit” came to prominence in development (MIX3, 2005). The difference between microcredit and the subsidised rural credit programmes of the 1950s and 1960s was that microcredit insisted on repayment, on charging interest rates that covered the cost of credit delivery and by focusing on clients who were dependent on the informal sector for credit (ibid.). It was now clear for the first time that microcredit could provide large-scale outreach profitably.

The 1990s “saw accelerated growth in the number of microfinance institutions created and an increased emphasis on reaching scale” (Robinson, 2001, p.54). Dichter (1999, p.12) refers to the 1990s as “the microfinance decade”. Microfinance had now turned into an industry according to Robinson (2001). Along with the growth in microcredit institutions, attention changed from just the provision of credit to the poor (microcredit), to the provision of other financial services such as savings and pensions (microfinance) when it became clear that the poor had a demand for these other services (MIX, 2005).

After brief discussion and reviewing the literature of microfinance in next step we discuss ,the brief sketch of Pakistan micro finance in Pakistan in section no. 2. In section 3 and 4 we discuss the opportunities and challenges faces microfinance sector. In section 5 we draw the conclusion of our study.

## **2. Evolution of Microfinance in Pakistan – A Brief Sketch**

The beginning of the modern microfinance movement can be traced back to 1982 with the establishment of Orangi Pilot Project in Karachi and the Aga Khan Rural Support Programme (AKRSP) by two different NGOs.

AKRSP spawned the rural support movement that accounts for approximately 70% of NGO outreach in microfinance and includes some of the largest providers in the country. (*World Bank Report on 'Performance and Transparency: A survey of microfinance in South Asia' Page No. 67*).

It was only in the 1990s that a variety of other NGOs began to offer microfinance services. In 1996 Kashf Foundation was established and became the first of only two Pakistani NGOs to exclusively provide microfinance services.

In the wake of government's policies to alleviate poverty during the Musharraf regime, microfinance was selected as the key objective to help curb the menace of poverty. This motive of the government resulted in the establishment of Pakistan Poverty Alleviation Fund (PPAF) in 2000 in coordination with World Bank, while establishing a microfinance bank namely Khushhali Bank simultaneously. Microfinance institutions have since been diversifying their product-offering by exploring new areas which include enterprise loans, housing finance, personal loans and deposits, leasing, insurance and remittance services.

According to the Khushhali Bank's Annual Report for the year 2007, the investors are now beginning to see microfinance as an emerging investment opportunity and by one estimate the funding to microfinance will rise significantly by the year 2015 pre-dominantly from the private sector. (*Khushhali Bank Annual Report 2007 – Page No. 4*).

Tremendous developments have been made in the microfinance sector so far. Government initiatives deserve greater appreciation which caused number of clients to increase from just 100,000 in 2001 to 1.4 million in 2007 (*Khushhali Bank Annual Report 2007 – Page No. 4*).

At present following microfinance institutions are operating in Pakistan:

#### **Micro Finance Banks**

- Kashf Microfinance Bank
- Khushhali Bank
- Network Microfinance Bank Limited (NMBL)
- Pak-Oman Microfinance Bank Limited (POMFB)
- Rozgar Microfinance Bank Limited
- Tameer Microfinance Bank Limited
- The First Micro Finance Bank Limited (FMFB)

#### **Micro Finance Institutions**

- Akhuwat
- Asasah
- Community Support Concern
- Development Action for Mobilization and Emancipation
- Kashf Foundation
- Orangi Pilot Project
- Sindh Agricultural and Forestry Workers Cooperative Organization

#### **Rural Support Programmes**

- Lachi Poverty Reduction Project
- National Rural Support Programme
- Punjab Rural support Programme
- Sarhad Rural Support Programme
- Thardeep Rural Development Programme

#### **Others**

- BRAC

- Centre for women Cooperative Development
- Jinnah Welfare Society
- Narowal Rural Development Programme
- Organization for Participatory Development
- Rural Community Development Society
- Save the Poor
- Sindh Rural Support Program
- Sungi Development Foundation
- Swabi Women’s Welfare Society
- Taraqee Foundation
- Bank of Khyber
- CRX Leasing Pakistan Limited

Source: Microwatch - Issue No. 11 Quarter (Jan-Mar 2009), Page No. 16

Following exhibits would give a somewhat clear picture of microfinance sector as to outreach, gender participation ratio, peer group share and number of employees each peer group is outsourced:

### Microfinance Outreach

Exhibit-1 gives a comprehensive and updated overview of the current microfinance outreach in Pakistan:

**Exhibit-1:**

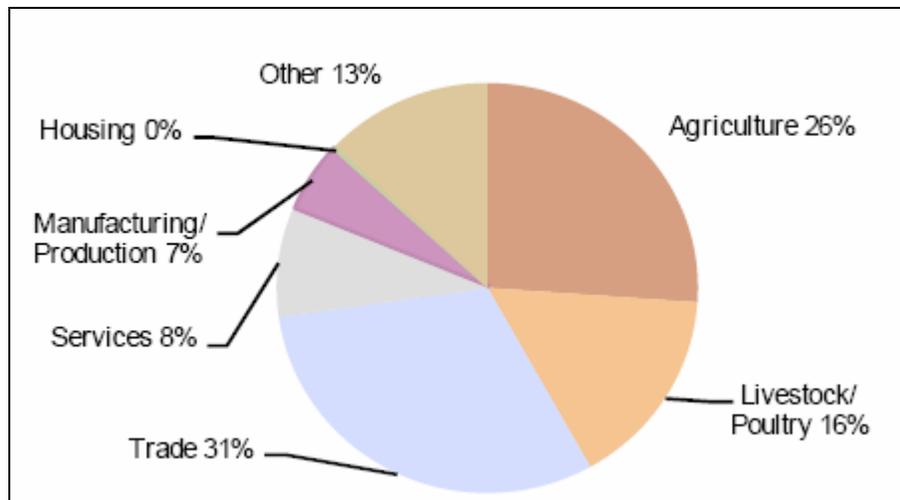
Province	Offices		Microcredit		Micro-Savings		Micro-insurance		Potential Micro-fin Market	Penetration Rate (%)
	Fixed	Mobile	Active Borrowers	Gross Loan Portfolio (PKR)	Active Savers	Value of Savings (PKR)	Policy Holders	Sum Insured (PKR)		
Balochistan	22	-	15,832	109,542,837	47,685	17,454,507	15,973	137,813,054	1,656,762	0.96
NWFP	98	2	126,692	1,116,322,751	144,311	298,677,240	132,100	2,434,214,065	4,083,817	3.10
Punjab	1,030	-	1,209,221	13,333,905,675	1,152,446	1,513,536,943	1,504,486	22,943,178,333	15,233,924	7.94
Sind	310	4	349,606	3,982,203,225	521,794	3,238,723,742	418,387	4,464,288,678	6,357,795	5.50
AJK	31	-	23,241	148,801,278	121,309	49,189,956	33,412	691,724,691	-	
FANA	15	-	20,603	489,989,681	41,959	470,655,612	20,603	489,989,681	-	
FATA	5	-	2,512	17,897,959	-	-	2,512	17,897,959	-	
ICT	13	-	3,404	53,705,481	14,270	293,929,960	1,020	52,786,393	74,750	4.55
<b>Grand Total</b>	<b>1,524</b>	<b>6</b>	<b>1,751,111</b>	<b>19,252,368,887</b>	<b>2,043,774</b>	<b>5,882,167,960</b>	<b>2,128,493</b>	<b>31,231,892,854</b>	<b>27,407,048</b>	<b>6.39</b>

Source: Microwatch - Issue No. 11 Quarter (Jan-Mar 2009), Page No. 15 (Retyped)

Number of active borrowers throughout Pakistan is 1.75 million whose gross loan portfolio constitutes Rs 19.252 billion; similarly 2.043 active savers contribute Rs 5.882 billion in saving account; likewise 2.128 million policy holders have insured an amount of Rs 31.231 billion approximately. Still there is a potential microfinance market of 27.407 million people who can be targeted as to utilize microfinance products:

Exhibit-2 projects the sector-wise distribution of active borrowers:

**Exhibit-2:**

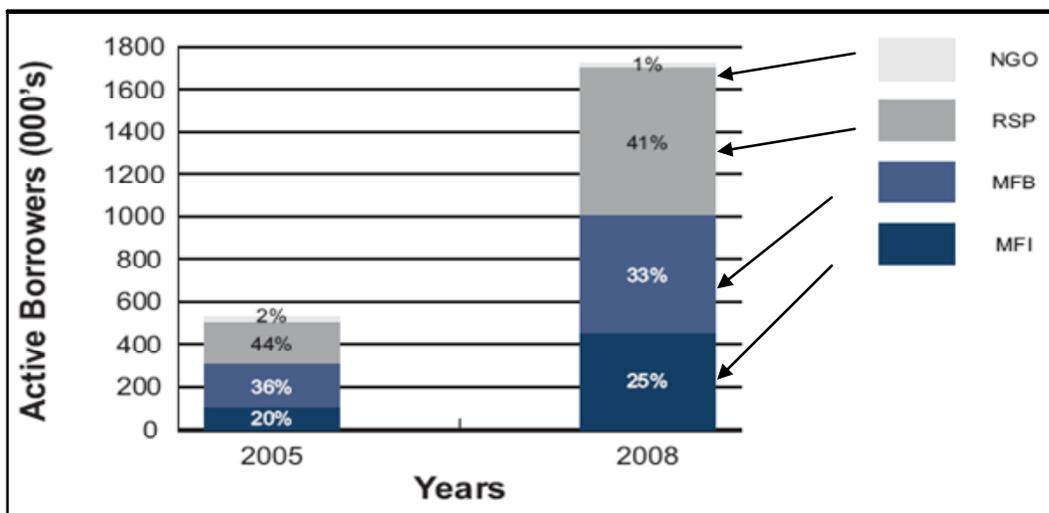


Source: Microwatch - Issue No. 11 Quarter (Jan-Mar 2009), Page No. 6

**Micro finance Outreach by peer group:**

The microfinance industry in Pakistan grew from 0.5 million active borrowers to 1.7 million during 2005-08, representing a cumulative growth rate of approximately 240%. The Rural Support Program (RSP) currently accounts for the largest proportion 41% w.r.t. outreach, followed by MFB peer group 33%, MFI 25% and NGOs 1%:

**Exhibit-3:**

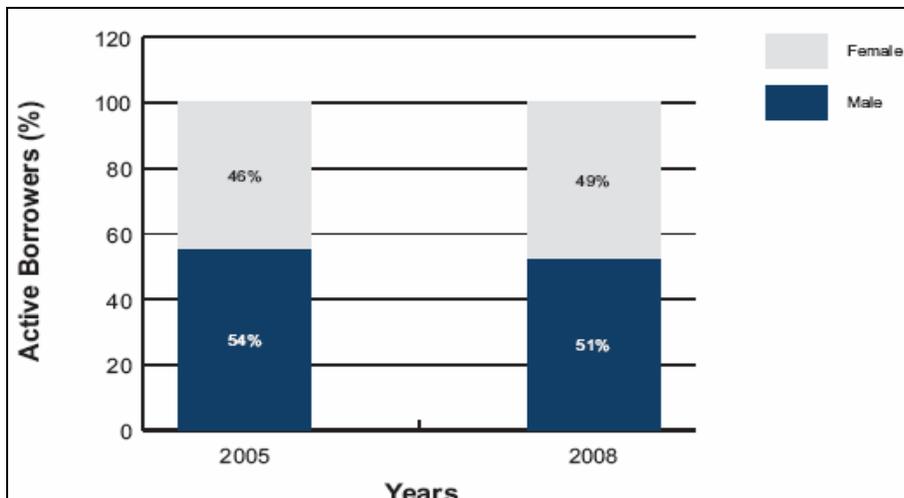


Source: Spotlight No. 05, February 2009 Page No. 3

**Proportion of Male and Female Borrowers:**

During June 2008, proportion of active women borrowers increased from 45% in 2005 to 49% of total outreach. Nonetheless, the penetration among female clients remains low compare to the numbers achieved by neighboring South Asian countries: Bangladesh 99.3% and India 100%:

**Exhibit-4:**

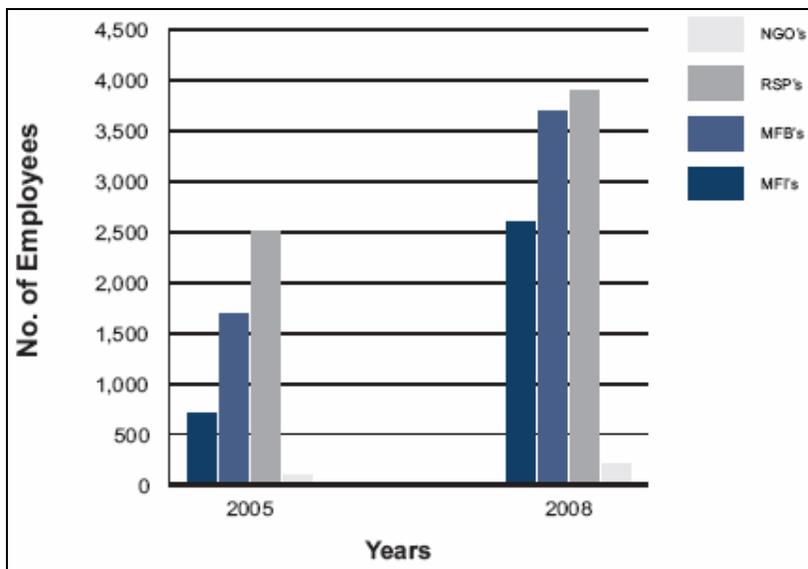


Source: Spotlight No. 05, February 2009 Page No. 5

**Total Employees by peer group:**

During 2005-2008 the number of employees in the industry increased from approximately 5,000 to more than 10,000. The largest proportion of employment i.e. 37% is accredited to RSPs as shown in Exhibit-5 below:

**Exhibit-5:**

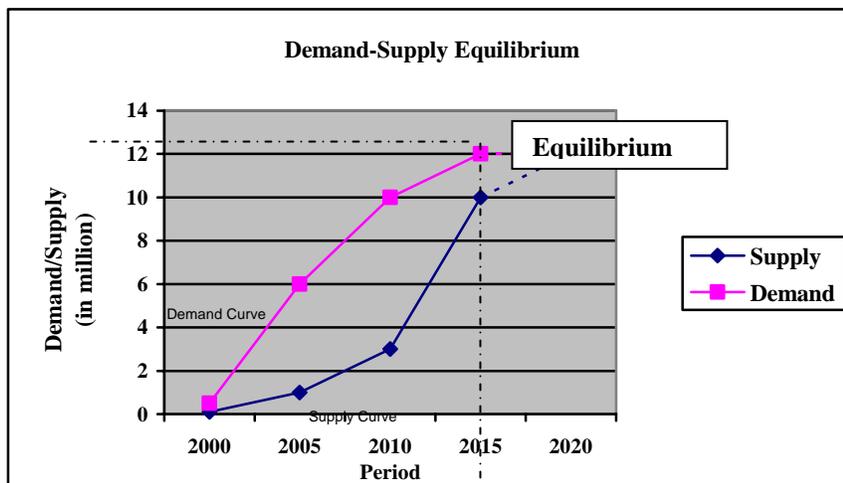


Source: Spotlight No. 05, February 2009 Page No. 11

**Microfinance Future Strategy:**

The State Bank of Pakistan’s ‘10 years Strategy Paper for the Banking Sector Reforms’ has provided a detailed articulation of measures underway for the growth of the microfinance sector and sets a target of reaching 3million clients by 2010 and 10million clients by 2015.

**Exhibit-6:**



**Data Source:** 1. Khushhali Bank Annual Report 2007 Page-4  
 2. State Bank of Pakistan’s 10 years Strategy Paper for the Banking Sector Reforms Page-14)  
 3. World Bank Report on ‘Performance and Transparency: A survey of microfinance in South Asia’ Page No.68).

The supply will approximate the demand and ultimately somewhat equilibrium may be attained by 2020 as shown in Exhibit-6 above, provided the demand remains constant.

Without prejudice to the foregoing brief sketch of Pakistan’s Microfinance Sector, following are the challenges and opportunities ahead this sector:

### 3. Challenges

#### 3.1. Improper Regulations

In the last decade this sector was not regulated, and still a lot of work has to be done. The existing regulations in many cases are not appropriate and these are undercutting the growth of this sector. It is the need of the time to liberalize the regulations and restrictions. Some rules which were made at the initial stage now have required serious reconsiderations because they become a big hurdle when the sector is in a position of take off. Moreover, it is quite necessary to reform regulatory norms which are quite complicated and have become the reasons of increasing cost, especially regulations about funds transfers, insurance and saving deposits etc. require serious attention.

#### 3.2. Increasing Competition

With the introduction of formal microfinance banks and institutions, competition among them is quite tough. Another important fact is that with the increase in awareness, clients are now demanding more services, which ultimately warrant a cost increase. It is a confront situations for MFIs. Interesting fact is that this competition is not so serious in formal segment of the sector.

#### 3.3. MFIs Profitability

In microfinance sector due to the special circumstance on demand side, MFIs cannot charge high rate of interest. It is the reason that MFIs do not consider their credit operations as a significant means to generate revenue and to cover their cost of operations. This fact minimizes their margin of profit to a large extent. So it is necessary that some concessions must be provided by the government for the healthy operation of MFIs.

### **3.4. Innovative and Diversified Products**

Microfinance is just not restricted to micro credit only. A wide range of products are included in it e.g. savings loans, insurance money transfer, services and working capital loans. Unfortunately in most of the cases MFIs have restricted themselves to just micro-credit. Expansion of the sector depends upon the fact that range of services should be increased and upto maximum number of clients. Low salaried persons are that segment of the market which is yet to be explored, with different types of financial services.

### **3.5. Stability of MFIs**

Stability of MFIs depends upon continuous development of banking sector. Microfinance in a particular context is a by-product of banking sector. Hence its stability depends upon the banking sector. But the time has come that this sector should stand on its own feet. Definitely it is a big challenge for it.

### **3.6. Limited Management Capacity in MFIs**

In fact, many MFIs are converted from NGOs to this position. The role of NGO and MFI is quite different. No doubt, both of these are working to achieve the same target but the main difference is in methodology. Most of MFIs, which are converted from NGOs, do not have sufficient managerial capacity to run this different type of institution. It is a big challenge for them to overcome this deficiency.

### **3.7. Political Interference**

In the rural areas of Pakistan role of landlords is very obvious. They openly exploit the poor people. A big proportion of loans of agriculture sector is taken by them. Microfinance sector is also negatively hunted by their negative activists. Proper legislation is required to protect this sector from their exploitation.

### **3.8. High Transaction Cost**

Another big challenge ahead this sector is high transaction cost. The volume of transactions is very small, whereas the fixed cost of those transactions is very high. It cannot vary with the size of the loan. The higher a producer's fixed costs in the proportion of his total cost, the element of risk increases in the same proportion. Moreover, if the demand for the product falls or the marginal costs increases, it becomes very difficult to adjust the cost by cutting output. This cut will reduce revenue out of which he has to pay principal amount as well as interest on the loan. This needs to be rationalized.

### **3.9. Policy Environment**

A general improvement in the policy environment for financial sector programs can be observed throughout the history of Pakistan, particularly in the last two to three decades. But in case of microfinance the situation is reverse. In this field many times the government becomes the competitor of private sector and gives tough time to it. In other words there is no any policy coordination in this section.

### **3.10. Inadequate investment in Agriculture Development**

Inadequate investment by government in agriculture sector and for the rural development is a big constraint in the way of microfinance promotion. Insufficient investment in physical infrastructure is a big problem in the development of microfinance sector because non-availability of infrastructure automatically increases the cost of doing business and ultimately discourages private investment.

### **3.11. Low Level of Knowledge**

The working and efficiency of banking sector as well as MFIs largely depends upon the quality of human resources, operating system procedure and practice and the level of knowledge of the person who are responsible to run that system. Unfortunately, existing human resource has a very low knowledge level which is quite insufficient to run this mechanism smoothly. It is another big challenge for the MFIs in Pakistan.

## **4. Opportunities**

Notwithstanding the fact that microfinance has shown significant growth in the last twenty years or so, however, the opportunities are still there for this sector to grow further. Following is a brief count of some these opportunities:

### **4.1. Poverty Alleviation**

Poverty is one of the major problems of the world at this juncture. Of course, Pakistan is not an exception to it. It is proven that poverty can be reduced from microfinance (Adams 2000). It is also admitted that role of microfinance is not just restricted to poverty alleviation but it also diversifies income carrying sources, builds assets and improves the status of women (Chen 1992). It has a positive impact on income and assets levels (Greetha 2006).

### **4.2. Impact on Health, Social Capital and Economy**

Microfinance has a significant impact on health and social capital and ultimately on economy. According to an estimate an increase of 1% on Grameen Bank (Bangladesh) credit to women increased the probability of school enrolment by 1.9% for girls and 2.4% for boys.

Microfinance generates income, and employment follows other than from agriculture, with the result of that it helps to smooth consumption and labour supply.

### **4.3. Microfinance as Development Tool**

The availability of microfinance or such type of services acts as a buffer against any unexpected emergencies, business risks and temporary slumps. It helps the poor to uplift them from just subsistence level and bring into the position of stability. In this way it becomes an important tool for economic development of the country.

### **4.4. Opportunity for Commercial Banks**

Microfinance as a new field provides a good opportunity for commercial banks. Very high rate of recovery and probability of higher profit gives a good opportunity to commercial banks for investment of their funds.

### **4.5. Women Empowerment.**

It is a positive outcome of microfinance that poor women now have access to financial services through Microfinance Institutions (MFIs), NGOS and other Nonbank Financial Institutions (NBFIs). Interesting and important point is that vast majority of them have excellent repayment records. By this way more effective utilization of resources becomes possible which ultimately plays a positive role in the economic development of the economy.

## **5. Conclusion**

Microfinance services for the poor are now widely promoted as a key strategy for poverty reduction. Many microfinance programmes have increasingly targeted women in response to experience of excellent repayment rates. However micro-finance is no magic bullet. Badly designed micro-finance programmes (even if financially sustainable and female-targeted) may have very limited impact on poverty. Credit programmes may not enable people to increase incomes but may accelerate a downward spiral of indebtedness. Female targeting may not benefit women but merely shift the burden of household debt and/or household thrift onto women.

Microfinance is comparatively a new branch of finance and in Pakistan it is almost at the stage of take off. Since 2000, this has observed rapid growth and performed tremendously as a market player. However, challenges are still there in the way ahead, which need to be faced with strategies policies. Besides, there are opportunities too which can be availed if government is keen to provide level playing field to the private sector market players in this area.

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