

Microfinance in the Financial Sector

In This Document

- **Commercial Banks in Microfinance**
- **Linkages Microfinance-Financial Sector**
- **Commercialisation of Microfinance Institutions**

Commercial Banks in Microfinance

Despite half of commercial bank (CB) branches being located in rural areas, commercial banking involvement in the Pakistani Microfinance sector remains underdeveloped. The rural credit-to-deposit ratio is estimated at 12.5% and rural credit is only 6% of the total CB credit disbursements. The microfinance sector is still considered highly risky and unprofitable. Banks mention a lack of collateral amongst potential clients and high establishments and operational costs as primary reasons to avoid the sector. CBs tend to focus on mobilising rural savings for lending, mostly in the seven major cities, where returns on business ventures are significantly higher than in rural areas. Commercial banks have generally regarded microfinance as a social obligation, cross-subsidized by commercial operations.

However, two commercial banks have significant involvement in the microfinance industry, the Bank of Khyber and the First Women Bank Ltd. In the North West Frontier Province (NWFP), the Bank of Khyber has established a separate microfinance unit providing financial services to low-income population, through wholesale partnerships with Rural Support Programs, NGOs and CBOs. The First Women Bank Ltd is a public bank with a mandate to improve the socio-economic status of women in urban and rural areas. It aims to serve the dual objectives of a viable commercial bank and a development finance institution. FWBL provides financial services as well as business development services such as computer literacy and legal matters. FWBL has collaborated with different donors in bringing financial services to disadvantaged groups of women.

The SME Bank is a Development Financial Institution (DFI) specialized in the Small and Medium Enterprises sector. At present the bank is under restructuring, supported by the Asian Development Bank, to strengthen its capacity and realign its focus on the SME sector. As of December 2003, more than 2,300 SMEs had been financed by the SME Bank.

In addition, in the 1990s, the National Bank of Pakistan, another commercial bank, operated a microfinance program targeting women. Other commercial banks have also experimented with microfinance project or components, such as the Bank of Punjab and Habib Bank.

Linkages Microfinance-Financial Sector

The Swiss Agency for Development Cooperation (SDC) recognizes that establishing linkages between financial institutions and NGOs requires third party facilitation. SDC has collaborated with commercial banks and microleasing companies and encouraged them to enter the microfinance market or develop their existing activities. Some private entities have seen the business potential of serving the micro and small enterprise sector. In addition, through the FSSP, SDC has also promoted capacity building in the commercial financial sector and encouraged cooperation between MFIs and regulated financial institutions.

Kashf Foundation has entered into a partnership with a private insurance company in providing life insurance product that covers the client and the primary breadwinner. SRSP collaborates with the Bank of Khyber, which lends to SRSP clients for loans above the regular loan size ceiling.

Finally, major microfinance institutions have obtained credit lines from commercial banks, such as FWBL or Habib Bank. The Bank of Khyber has also extended credit to NGOs based on receivables.

Khushhali Bank has entered into a partnership with the Muslim Commercial Bank (MCB), enabling its clients to have access to its products through the MCB network.

Commercialisation of Microfinance Institutions

The Khushhali Bank operates as the benchmark representative of the banking and microfinance sectors' cooperation. Operating as a microfinance bank itself it lends directly to low-income clients and also to microfinance practitioners operating throughout Pakistan. It draws its funds and its profitable lending practices from the equity and technical assistance provided by the Asia Development Bank, the State Bank of Pakistan and a series of state and private commercial banks from Pakistan. The Khushhali Bank was established with US\$30 million subscribed by 16 commercial banks, 14 from the private sector (including two foreign banks) and two state-owned banks.

The First Microfinance Bank Ltd. (FMBL) is an example of a successful transformation of a microfinance program managed by NGO/non-profit entity into a viable, licensed microfinance institution able to accept deposits from the general public. FMBL builds on the twenty years experience in microfinance accumulated by the Aga Khan Rural Support Program, while benefiting from capital injected by the Aga Khan Foundation Development Fund and the International Finance Corporation. FMBL has achieved a A1+ rating by JCR-VIS Credit Rating Company Ltd.

Sources

- *Challenges and prospects, microfinance in Pakistan. Working Paper.* Khushhali Bank;
- *Report on proposed loans for the rural finance sector development program.* Asian Development Bank.