

A Presentation Paper on Forms of Regional Cooperation in Micro Finance- the SDC involvement in Pakistan

by

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January 29th, 2004

This paper aims to share SDC Pakistan's various forms of cooperation in the micro-finance sector ranging from collaboration with small NGOs to donor dialogue to partnership with the State Bank of Pakistan for a conducive policy environment for MFIs. For this reason the paper will begin with a brief introduction of the SDC Country Programme mandate and the learning from its recent review. It will also introduce the MSE sector strategy. Since the purpose of the workshop is to encourage partnerships and cooperation among the microfinance providers, supporters and financiers in the South Asia region, it is hoped that SDC's highlighting of its experiences in the sector will provide valuable lessons from which participants can draw upon. These MSE sector experiences cover the last decade or so with learning from ongoing SDC programmatic interventions and framework conditions prevailing in the country.

FORMS OF REGIONAL COOPERATION

Regional cooperation is generally understood as cooperation among either states or donors or NGOs towards a particular purpose or for a specific developmental theme. However, as I understood from the PMN input provided me, this workshop is interpreting the topic as the different forms of cooperation or bilateral aid that Donors extend in the different global regions. And that is how I will be addressing it from the perspective of SDC involvement.

SDC's bilateral cooperation in Pakistan follows the traditional patterns of bilateral aid with certain innovative initiatives in the MSE sector specifically in micro finance. That is SDC extends financial assistance, technical assistance and in Pakistan an innovative project fund facility. SDC cooperates with local, national and international partners varying from NGO the private/corporate sector, public sector and state institutions like the State Bank of Pakistan

SDC cooperation with domestic and foreign partners has at the forefront the principles of trust, transparency and the ability to handle power and power differentials. Sustainability forms the overall framework for effective development assistance, requiring a joint understanding of objectives values, procedures and ways of learning.

Below are some principles that are applied to cooperation between SDC and partners:

- ◆ SDC strengthens partners' autonomy whether countries or organisations. Subsidiarity as the central criterion and for the selection and orientation of collaboration.
- ◆ Cooperation is based on holistic and systemic perspective, in collaboration with various partners.
- ◆ All forms of collaboration are aligned with the five key topics of good governance, social justice, income generation and employment, crisis prevention and management, and sustainable management of natural resources..
- ◆ Policy level and operational activities are systematically linked. In certain areas SDC will limit its work to policy level.
- ◆ Training and institutional development form the key to their empowerment;
- ◆ Support of networks facilitates the exchange of knowledge and technology;

- ◆ Using an appropriate combination of instruments, partner organisations are supported both financially and with know-how;
- ◆ The medium and long term planning of cooperation with partners is established within each Country or Regional Programme.

THE SDC CONTEXT AND TARGET GROUP (IN PAKISTAN)

In a world of increasing economic integration the success of the poverty reduction programs of developing countries depend critically on economic and financial policies of industrialized countries. As part of its cooperation for good governance, income and economic growth and empowerment for poverty alleviation as specified in the Country Programme, the MSE financial services support projects fall under the purview of such mandate.

Pakistan's socio-economic, political and institutional context for MSEs, is characterized by political uncertainty, fragmentation and weak integration in the whole economy (poor horizontal and vertical linkages) as well as, problems of access to support services. In this context, the development of the MSE sector, has remained largely unaffected by the macro-economic changes, whether negative or positive. This is the sector which is paradoxically both resilient and vulnerable. Resilient because it is easy to enter and exit the market and because MSEs are often informal they bypasses the cumbersome government restrictions that medium and large enterprises encounter. For example, having a limited asset base, an entrepreneur while susceptible to shocks such as increase in the price of tea or milk is also quite flexible in terms of changing the line of business to for instance, selling ice creams. However as MSEs graduate to larger units, their flexibility reduces and their vulnerability increases. MSE are also vulnerable because any natural calamity or the health of the entrepreneur can result in the collapse of the MSE. Also vulnerability comes in the form of state harassment in shape of taxes, limited access to formal services (e.g., credit, technology and raw materials) and victimization through adverse policy measures. The fact that MSEs largely constitute the 90%¹ informal sector where no labor laws apply and access to credit is still a privilege puts them in the poverty bracket albeit those moderate poor or vulnerable non-poor who with one shock can fall below the poverty line. This is then the context in which SDC extends its micro finance and non-financial services support through its MSE sector programme.

SDC AND THE MSE SECTOR OVERALL GOALS

The Swiss Agency for Development and Cooperation (SDC) is a part of the Ministry of Foreign Affairs of the Govt. of Switzerland. It has been extending bi-lateral cooperation to Pakistan since 1966. The Swiss Government, under its Federal Law on International Development Cooperation and Humanitarian Aid, established in early '76, declared poverty reduction as their overarching goal. This commitment to poverty reduction is reflected in a number of guidelines and policies that frame Switzerland's bilateral and multilateral cooperation. Within the central tenet of poverty reduction in SDC's bi-lateral cooperation with Pakistan, Micro Finance is recognised as the development tool for contributing to poverty alleviation.

The SDC overall goal is “ to effectively strengthen potentials and opportunities with dedicated and professional Pakistani partners in selected areas in order to improve the living conditions of disadvantaged groups of society.” The MSE sector envisions its contribution to poverty alleviation

¹ Human Development in South Asia 2003

through market-oriented employment, self-employment and income generation in a sustainable way.” Its overall goal is “to improve the profitability, competitiveness and the productivity of a better organized MSE sector with a specific focus on women entrepreneurs.”

SDC’s MSE Programme focus is on improving the quality of service delivery by various public and private institutions and systems to the benefit of the MSEs. It is led by the MSE strategy, which pursues a dual approach as it promotes demand-based financial as well as non-financial services. Accordingly, SDC co-operates with respective organizations and institutions with a view to assist them in becoming more effective, efficient and relevant:

(i) Financial services: The objective is “*to contribute to the development of an appropriate and demand-oriented financial services system providing services to MSEs with a specific focus on microfinance.*” The support aims at institutional development support to the financial non-governmental sector, for improved service provision to MSEs. Support methodologies range from re-structuring existing financial institutions to creation of new structures, geared towards catering to the capital, credit or savings requirements of MSEs.

(ii) Non-financial services: The objective is “*to enhance entrepreneurial, managerial and technical skills of the MSEs through market-based demand, with a specific focus on income generation and organization strengthening.*” This mode of support extended largely focuses on improving the access to business development services (advisory services, skills, information, resources, and linkages) by MSEs. Special focus is on skills development, through strengthening existing training providers to cater to the MSE needs. Key elements include capacity building (training, consultancy, information support) at the service provider level, networks and alliances between MSEs and their support organizations and leveraged interventions to overcome institutional and information constraints.

MSE SECTOR FORMS OF COOPERATION AT THE THREE LEVELS OF DEVELOPMENT SUPPORT

The MSE strategy while distinguishing financial services and non financial services as complementary and concurrent channels of development, extends development support at three levels i.e. the i) Macro level- contributing to a policy environment, conducive to MSE development; ii) Meso level-strengthening HID capacities at the intermediary level to provide more appropriate services to MSEs; and iii) Micro level: to enhance the productivity, profitability and competitiveness of MSEs. Although, SDC’s development thrust is often on strengthening meso level organisations with a special emphasis on service providers of both micro finance services and business development services. Recently the Mid term review of the Country Programme identified stronger links between the different levels of support , i.e. macro and meso and so on to help realise programme goals.

Below is a highlight of some instruments or forms of cooperation employed by SDC Pakistan for MF promotion

a. At the Micro Level:

Promote delivery of services to MSEs. This might include such services as:

- ◆ financial services, i.e. leasing, lending or savings and credit
- ◆ group training, more generic training offered to larger groups
- ◆ specific information services on, for example, market trends, and potential suppliers

b. At the Meso Level:

- ◆ Promoting networks and alliances between MSEs and with other MSE organisations such as Banks, NGOs and Self Help groups. *In Pakistan the meso level is mainly comprised of businesses themselves acting independently or in collaboration with others.*
- ◆ "Leveraged" interventions aimed at overcoming information, technology or institutional constraints impinging on MSEs. *Leveraging means having a relatively wide impact from a small input.*
- ◆ Capacity building - including training, advice and information - to enhance the role of associations and other meso-level institutions such as training centres, banks and NGOs *Associations continue to play an important role in Pakistan in lobbying with government agencies on behalf of their members and in providing social services to them. Limited support to them - mainly in the form of training - can help them to organise to perform this role more effectively.*

c. At the Macro level:

Promote cooperation/ coordination among donors with a view to:

- ◆ co-ordinating activities and encouraging learning, and
- ◆ Exchange of experiences contributing to a favourable policy environment for MF promotion

SDC PAKISTAN'S PROJECT EXPERIENCES

SDC started with micro credit programmes for its small and micro entrepreneurs (in its projects such as the Community Services Programme (CSP), Small Scale Enterprise Promotion Programme(SSEP) and also the Civil Society HID Programme (CHIP). The CSP and SSEP interventions were for capacity building and institutional support to the First Women Bank and Bank of Khyber, and networking between the financial sector agencies. The review of CSP highlighted the need for in-depth appraisal to assess the usefulness of the programme in terms of demand based financial services to the clients. Support to the Leasing to Micro and Small Enterprise (LMSE) project partnering with leasing companies like Leasing Association of Pakistan (LAP), Network Leasing (NLC) and Orix Leasing (ORIX) introduced another mode of microfinancing to the micro and small businesses. SDC's CHIP project's support to NGOs like Orangi Pilot Project (OPP), Kashf Foundation, Thardeep Rural Development Programme (TRDP) and CBOs also resulted in a number of microfinance initiatives and resultant lessons to incorporate in our programme work. SDC also worked with the State Bank of Pakistan and contributed to the Microfinance Ordinance promulgated by the Govt. of Pakistan in October 2001. Subsequently, SDC provided input for the framing of Prudential regulations and Licensing Conditions and Criteria for the Micro Finance Institutions (MFIs). This input resulted into a new partnership with the central bank, i.e. the State Bank Partnership for Micro Finance (SBPM). These experiences emphasised having a systemic approach to poverty alleviation and a flexible programme design with well defined benchmarks and monitoring framework at in order to remain simultaneously focused and responsive to the complex interplay of poverty dimensions. SDC's main contribution

has been to encourage the commercial sector to come forward and prove that micro finance can be a commercially viable business.

Learning from these projects contributed to the rationale of SDC's new Financial sector development projects including the recently established Financial Sector Strengthening Programme (FSSP) which uses the business development services (BDS) approach to build the institutional and retail capacities of players in the MF sector.

Some key learnings drawn from the above projects include:

i) Specific in the Financial Services Support to MSEs:

- ◆ Public private partnership, and private sector initiatives to innovate pro-poor savings and credit products can be successful and should be encouraged.
- ◆ Linkages between financial institutions and NGOs with core competency in social intermediation to provide financial and non-financial services to individuals, as well as to groups requires third party facilitation.
- ◆ A holistic programme development approach, whereby interventions at the macro level complement those at the meso level i.e., capacity building of Financial Institutions and their service provider market should be promoted
- ◆ Private sector leasing companies are dynamic, willing to tap new markets (MSEs) through provision of and access to term financing.
- ◆ Cooperation with the commercial banks revealed a gradual move by them towards exploring business potential offered by the small-scale industry but there is no link between the corporate banking sector and the MF sector.
- ◆ Access of the poor to institutionalised and sustainable financial services, especially for women need to be actively promoted.
- ◆ The capacity of local expertise towards the development of financial institutions needs to be strengthened.
- ◆ Except for a few, most MFIs/MFPs need support even in organisational self-assessment for training needs. (Recently from FSSP)
- ◆ The MF sector capacities are still geared towards credit only and not the rest of the financial services. (Recently from FSSP)

ii) General on Poverty Reduction and MSE Promotion:

- ◆ Small enterprises that achieve improvements in productivity and profitability often do so by becoming more efficient and cutting jobs. This reduces employment.
- ◆ Evidence indicates that loans and other financial services such as savings and money transfer services which the poor use to get through emergencies e.g. illness, and to manage their cash flow e.g. to smooth income between harvests are equally important for poverty alleviation poverty as income generation or micro-enterprise loans.
- ◆ Sustained improvement in the performance and income generating capacity of MSEs demands, flexible, long/ short term and complementary inputs at organisational as well as system level geared towards increasing their incomes and enhancing their productivity.
- ◆ Fighting poverty demands networking and coordination among a broad range of actors involved in shaping the institutional landscape

- ◆ The demonstration effect of practical, operational (micro) level programs must not be underestimated, while policy making level interventions have shown little effect

SDC MSE SECTOR NETWORKING EXPERIENCES

The MSE strategy promotes coordination and networking not just among donors but among a broad range of actors involved in shaping the institutional landscape on MSE promotion for more effective realization of common goals. Given the limited resources of the country, the space required, for enhancing incomes and fighting poverty has to be filled by varied actors. Recently SDC has re-activated a MSE Donor dialogue focusing on Micro Finance Donor Coordination. This is so far an informal set up but if donor presence and commitment continues then maybe collectively some of the real issues faced by MFIs, such as of equity financing, institutional capacities for accessing capital markets, etc. can be resolved.

Networking offers smaller donors (like SDC) a platform to exchange, disseminate best practices (those at a district or regional level), and explore possibilities of replication and scaling up. In order to be successful in our common aims, bundling of experiences of different donors is required, so as to demonstrate its influence on the policy environment , offering greater potential for imitation by bigger players.

In this context, recognition of experiences facilitated by SDC and its partners, by other players and in the same context replication and scaling up has remained a major challenge. Modest interventions have been more effective but with limited, recognition and influence on the policy environment. To address the complex and multi-dimension poverty issue, especially through micro finance the need for interventions to fight poverty to be put together and networked has become more pronounced.

A SDC COOPERATION IN PAKISTAN

Money and its use is a cultural thing and in SDC's target area of NWFP more so than in most places, it is tradition and cultural norms that dictate choices that people have and eventually make. Among the various forms of "Islamic" financing, *leasing* is the most popular with the low-income groups. This group and the "economically active" poor who can meet their consumption needs yet are vulnerable to external shocks that may push them below the poverty line, are the main clients of leasing and other micro finance services. Often bypassed by the public and private sector institutions this group of MSEs include the small farmers, and home based producers. Furthermore, they are most susceptible to the rising unemployment and increasing incidence of poverty in the country, especially in NWFP.

The LMSE Project

1. Phase number and period: Phase 3, from October 2003 to September 2007
2. Budget amount present phase: CHF 3,025,000 out of this CHF 2,125,000 is Financial Assistance (Loan) and CHF 750,000 is Technical Assistance (Grant)

3. Partner organisation(s): The Leasing Association of Pakistan, (LAP); Network Leasing Corporation, (NLC); Orix Leasing Pakistan, (OLP); Crescent Leasing Corporation Limited, (CresLease); Al-Zamin Modaraba, (Al-Zamin) **Indirect** partners at the macro level are the federal Government of Pakistan. The government of NWFP will be informed about the development of leasing to MSE.

4. Project description:

The LMSE project started in 1996 with the Network Leasing Corporation in Phase 1. In Phase 2, the partnership included two new partners, OLP and LAP. In Phase 3, due to the demand for LMSE, SDC Pakistan has an additional two new partners, making a total of five. Since the first phase LMSE has provided access to lease finance to over 4000 poor households/micro-entrepreneurs and disbursed a total cumulative amount of Rs. 40 million (i.e. approx. CHF. 1 mio) for productive assets. End of phase evaluations, (both of Phase 1 and 2), show that this intervention has positively affected the sense of self worth, income, education opportunities for children and health of the women and children in the peri-urban areas of Karachi and NWFP, especially. Based on the success of earlier phases a third phase was recommended for consolidating learning and experiences.

The overall goal for phase III of the LMSE Programme remains as follows:

To increase earnings and market oriented employment in the MSE sector in Pakistan on a sustainable basis.

In view of the above, the project purpose is as follows:

Enhanced access to formal medium- and long-term credit (leasing) delivery system for Micro- and Small Enterprises (MSE) in Pakistan.

Results so far in the LMSE programme have indicated both the challenges and opportunities inherent in such an intervention. “ The challenge of the programme is aiming for a development objective, which is to be achieved through working with commercial private sector partners. The specific geographical focus of NWFP and the Northern Areas adds to the challenge of the LMSE programme. However, the key advantage for success and sustainability is the fact that it is the market mechanism which has led leasing companies to cater to MSEs and not imposition by any Donor. The demand for leasing arises from awareness of MSEs and their need to grow as well as from the lack of employment opportunities in the region. The main assumption is the continued interest of the Leasing companies in the MSE market and their commitment to design newer and more innovative products. Difficulties may arise from the policy environment and taxation issues as these enterprises grow.

The strategy of the leasing companies and LAP includes co-operation with NGOs already working in micro-finance for their mutual benefit. MSEs learn to deal with micro leasing and the commercial leasing companies learn to deal with MSE financing. Furthermore, with its experiences made, it is expected that SDC's Financial Sector Strengthening Programme (FSSP) will utilize its position (as a Facilitation Unit) to introduce micro leasing with the established micro finance institutions as well as to facilitate the transfer of experiences of the different sectors to each other. It is planned that LMSE experiences will be pro-actively reflected in the national micro finance network and in the donor co-ordination group for micro finance.

The LMSE programme has made a difference and the purpose of the third phase is to establish that difference. It is expected that the cumulative effect of the earlier phases and the four-year Phase 3 will have a favourable impact on employment creation in NWFP, as well as on the living standard, productivity, and profitability of the MSEs.

WHY SUPPORT LEASING AS A MODE OF MICRO FINANCE ?

Lease finance is perhaps the most suitable financing instrument for developing MSE's; its flexibility and adaptability, its essentially non-collateralised nature, cash flow base, and marginal financing nature makes it an ideal financing tool for MSE's. Normally the MSE entrepreneurs cannot meet the banks stringent requirements regarding collateral, properly maintained and audited accounts, management structures, etc. This is where leasing makes a positive contribution as the MSE borrowers wish to obtain finance that is disbursed quickly, with little demand for documentation and under simple terms and conditions.

Advantages of leasing for MSE's:

- **No requirement for collateral:** The leasing company does not require additional security because the lessor retains ownership of the leased asset. The lessor is looking at the ability of the lessee to repay the rental from his future earnings. In case of default, the lessor will seek to repossess the asset so that it can be sold to recover the investment in the lease.
- **Leasing is term finance:** A lease is structured to have some correlation with the useful life of the leased asset. The lease term may stretch up to 70% of the estimated useful life of the asset.
- **Risk evaluation relies on alternate criteria:** The small entrepreneur invariably is unable to provide satisfactory financial data to evaluate its operations. The leasing companies have the ability to adopt alternate evaluation criteria because it places greater reliance on the MSE's future cash generation instead of collateral.
- **Leasing is a flexible form of financing:** Period of lease and rental amounts is negotiable to suit the specific needs of a lessee.
- **Documentation is simple:** It usually consists of a standard lease agreement, promissory note and an acceptance receipt evidencing that the asset has been received.
- **Tax advantages can be considerable:** In the lessee's books, the total rent payable (which is combination of principal plus profit) is expensed and is allowable for tax purposes. In case of a bank loan, only the interest portion is allowed, as tax expense although there is the additional charge of depreciation, which in leasing is available to the lessor and not the lessee. Quite often the after tax cost of leasing is lower because the principal amount being repaid in instalment is also allowed as tax expense.
- **Leasing is an Islamic mode of financing:** Leasing is a form of financing which is permissible under Islamic Law since the element of usury does not enter into it.

The leasing industry and MSE sector offer each other a source of term financing for one and new market opportunities for the other. The business of lease finance essentially requires the lessor to assess and take on the enterprise risk of the lessee and the cash flow the enterprise is expected to generate. Making micro leases, if done properly, has been found to be a profitable activity, besides benefiting the poorer sections of society and thus alleviating poverty.

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properly, is a profitable activity. It clearly benefits the poorer sections of society and thus alleviates poverty.

CONCLUSION

It is observed that in developing countries Governments start with macro reform but fail to move ahead with institutional and infrastructure improvements. As a result, detracting from the growth generated by macro reform. Thus, improvement in macroeconomic environment must be accompanied by concerted efforts in improving governance and infrastructure. Among other dimensions which are linked with governance, these include: the existing regulations and procedures, their effectiveness and transparency, and corruption associated with them. This was the case for the micro-finance and remains the case in the non-financial services for MSEs. SDC regional cooperation works inter alia to address such realities.

Despite the tremendous progress made in the last three to four years, there is still a real vacuum of financial institutions geared towards MSE financing in general and micro finance for underprivileged groups of entrepreneurs and women in particular. Some efficient examples of Micro Finance providers are the First Micro Finance Bank (FMB), Kashf, NRSP and Khushali Bank, can be quoted. However, the potential micro finance market in Pakistan is immense. Figures of more than 98% of potential clients, or some 44 million women and men, who have no access to micro finance is oft quoted. We still have a long way to go.

On a note of personal reflection, I feel we need not assess the success criteria for effective and efficient micro finance service provision in Pakistan with those of other countries-although competition is healthy- but really our success indicators should be the clients themselves. Recalling what Margaret Robinson says, the clients must be placed at the center. We must attain the standards learned from best practices, but at the end of the day the Pakistani MF providers must listen to their clients and the donors must listen to theirs, i.e. the MF providers. In this way alone can we truly facilitate MSE sector growth and contribute to poverty alleviation.

Two things I feel are still lacking among donors in this sector:

- 1) Continual and transparent sharing of experiences. That is calculating and sharing the real cost of investment in a project and what it took to make it sustainable for better replicability.
- 2) Support to institutionalized mechanisms for knowledge management in Micro Finance/MSE that will stay despite the transient donor support and the possible socio-economic and political uncertainty.

Furthermore, as we work towards coordination mechanisms for sectoral growth, we must be mindful of the three ways they typically fail: 1) they fail to take the long view, most projects are one time short fixes; 2) they fail to represent dispersed interests, those voices of those who deliver services as well as those who are provided services; 3) they fail to commit to allow assets to thrive.

We know that countries can benefit greatly from regional cooperation when the overall socio-economic conditions are similar. However, finding equitable ways to share the benefits of cooperation and deciding on resource allocations can be difficult. International organizations should use their credibility technical expertise and broader perspective, neutrality and financial resources to negotiate and press for agreements that are not feasible for countries acting alone. We all know the benefits of regional cooperation but for effective implementation of such agreements specialized institutions and mechanisms are required to put into effect provisions to deal with disputes share benefits and deal with changes in situations that require negotiations in agreements. Such an

institutional framework design can be customized; it is cheaper and cost effective. In regional cooperation, sharing problems and seeking solutions jointly also contributes to raising the level of trust among collaborators whether donors or service providers. I hope that the bold step taken by the hosts materializes into a concrete facility whereby the poor of this region can achieve their own empowerment through the support of micro finance services.

For me some open questions remain:

- ◆ How can we facilitate the development of a regional capital market for broadening investment opportunities and enabling businesses to draw finances within and across the region?
- ◆ How can we facilitate the free movement of managerial and skilled personnel and service providers?
- ◆ How can we prioritize human resource development at a regional level?

In conclusion, SDC hopes to maintain its tradition in Pakistan of being a long term donor concentrated on common interests and looking to build assets whether in terms of human capital, social, physical or financial.

References:

SDC Documents

World Bank Papers on Regional Cooperation (from the CGAP website)