

## Pakistan Country Profile

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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 activities 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 and 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 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.

### Needs for Microfinance

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- 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% of the 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.

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## Microfinance sector development

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In the 1960s and 1970s, subsidized microcredit was provided in rural areas, but failed to reach the poor due to an unsustainable system, which was prone to abuse and diversion of funds to higher income groups. In the 1980s, the Aga Khan Rural Support Program (AKRSP) was established in the northern region to build community-based organizations and infrastructure, and assist in resource mobilization through credit and savings. The success of the AKRSP led to the creation of Pakistan's other RSPs, which formed the primary approach to microfinance during the 1980s and part of the 1990s. Those RSPs made a major contribution to the microfinance sector by accessing lines of credit from commercial banks to provide microcredit to low-income people living in rural areas. Similarly, the Orangi Pilot Project (OPP) developed an individual lending methodology adapted to urban slums, by targeting entrepreneurs in Karachi region. In the 1990s, learning from international best practices, NGOs specialized in microfinance started their operations, such as Kashf Foundation, Taraqee and Damen. The outreach of microfinance institutions and other rural organizations providing financial services has been limited due to a narrow institutional base, slow progress on sustainability and efficiency benchmarks.

Since 2000, the microfinance landscape in Pakistan has changed considerably. This change can be credited primarily to the government's growing interest in the microfinance sector. It was this interest that resulted in:

- The creation of the apex funding body, the Pakistan Poverty Alleviation Fund (PPAF)
- The formulation of the MFIs ordinance 2001, regulating the creation of commercial microfinance banks, such as The First MicroFinanceBank (created by the AKRSP) and the Khushhali Bank, a retail microfinance bank issued from a public-private partnership.

In the last two years, Pakistan microfinance providers have posted faster growth in terms of outreach, with 'transformed' or 'created' dedicated microfinance organizations starting to realize their full potential through a conducive regulatory environment. Other organizations are also benefiting from the dissemination of best practices and the availability of funds to finance their expansion.

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## Regulations and government initiatives

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The MFIs Ordinance 2001 was promulgated by the Government of Pakistan to support the development of the microfinance sector by introducing the concept of microfinance banks. Under this ordinance, microfinance banks created with the necessary amount of capital, can offer microfinance services, including savings deposits, to the general public. In addition, the State Bank of Pakistan (BSP) introduced additional prudential regulations related to microfinance operations. This ordinance and the relevant prudential regulations of the BSP, regulate The First MicroFinanceBank and the Khushhali Bank.

The government, with the lending support of the Asian Development Bank, also supported the creation of the Khushhali Bank. This was the first retail microfinance bank in Pakistan, owned by a group of private and public commercial banks. In addition to this project, ADB support has resulted in the establishment of several funds available to regulated microfinance banks, such as the Social Development Fund, the Community Investment Fund, a Risk Mitigation Fund and a Deposit Protection Fund.

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## Practices

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The majority of microfinance organizations operating in Pakistan, particularly RSPs, use community-based organizations as conduits for their financial services. This methodology produces the highest outreach (see PMN statistics). The largest microfinance provider is the NRSP, with national coverage. However, RSPs find it difficult to view microfinance activities as anything other than a supporting component of their larger, integrated program, resulting in difficulties to separate costs specific to microfinance.

Other organizations use the solidarity group model, adapted from the Grameen Bank to the Pakistan context, the best example being Kashf Foundation. Organizations such as this are the fastest growing providers of microfinance in Pakistan and post the best 'portfolio quality' ratios.

Finally, some organizations use a mix of individual lending and partnerships with community-based organizations. It seems that the organizations using this methodology are the most viable programs, if self-sufficiency ratios are compared.

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## Innovations

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The PPAF, a wholesale window for MFIs and the microfinance banks (Khushhali Bank and First Microfinance Bank) could be seen as innovative ventures breaking away from the traditional financing windows and vehicles in Pakistan. In addition, the State Bank of Pakistan has established a conducive legislative framework, which features the inclusion of microfinance funds as wholesale facilities and protection mechanisms for borrowers. Some microfinance providers have started to offer innovative products, such as skills training, emergency loans, and life insurance, while adopting innovative management practices in scaling up their operations or establishing partnerships between commercial bank and MFIs. Adaptations of the Grameen Bank model have been innovative and very successful, as demonstrated by the Kashf Foundation and UPAP.

The Performance Indicators report compiled by the Pakistan Microfinancing Network (PMN) provides a benchmarking tool to share best practices and standards in Pakistan, which also includes individual analysis of each member's performance.

The Swiss Agency for Development Cooperation (SDC) takes a sectoral approach to strengthening microfinance in Pakistan. The FSSP offers unique technical and financial assistance to the whole microfinance sector, with the objectives of: developing human and institutional capacity within all types of microfinance institutions; building the capacity of local expertise providers; supporting market oriented approaches and creating an enabling environment. In addition, SDC has provided support to the development of microleasing products and providers through support to Network Leasing, Orix Leasing and other leasing companies operating in Pakistan. The Leasing to Small and Micro Scale Enterprises Program (LMSE) project aims to increase earning and employment in the MSE sector in NWFP and Northern Areas through an improvement in access to leasing services on a sustainable basis.

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## Providers

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

**Informal sources of finance** account 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, interest rates from informal sources are much higher, ranging from 50% to 120% per annum.

In the **semi-formal sector**, NGOs and participatory organizations such as Rural Support Programs (RSP) have been the primary promoters of microfinance services in Pakistan. 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 Program (NRSP), the largest, Balochistan Rural Support Program, Sarhad Rural Support Program (SRSP) and the Aga Khan Rural Support Program (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.

In the **formal sector**, 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 MicroFinanceBank Limited, established from the transformation of the microfinance activities of the Aga Khan Rural Support Program. 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.

Pakistan also has a rating agency, JCR-VIS, which has initiated ratings of NGOs and specialized microfinance organizations, such as The First MicroFinanceBank. 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.

## Sources

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