

## Microfinance Sector

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**M**icrofinance sector in Pakistan comprises more than 45 institutions offering microfinance services, with around 2.8m active borrowers at end-2013 (end-2012: 2.4m). Given that vast population in the country has none or restricted access to financial services, the microfinance industry has significant potential for growth. As per estimates, target market of microfinance sector is around 27 million borrowers while as of Dec, 13, market penetration stood at 10.3% (Dec, 12: 8.6%).

*The introduction of Microfinance Institutions Ordinance, 2001 created an enabling environment for undertaking micro-finance activities in the formal sector.*

Province	Active Borrowers (Dec. '13)	Potential Micro-finance Market	Penetration Rate %
Punjab	2,032,367	15,233,924	13.3
Sindh	636,308	6,357,795	10.0
KP	84,032	4,083,817	2.1
Baloch.	20,820	1,656,762	1.3
AJK	39,006	-	-
GB	13,813	-	-
ICT	6,369	74,750	8.5
<b>Total</b>	<b>2,832,715</b>	<b>27,407,048</b>	<b>10.3</b>

While the sector posted significant growth during 2003-2008 along with increasing outreach, pace of growth decelerated during 2009-2011 attributable to delinquency crises in Punjab and subdued economic conditions. In addition to this, natural calamities in the regions where microfinance borrowers are concentrated also dented sector's growth.

There is much diversity within the sector in terms of scope and size and industry players include large institutions with nationwide presence as well as small community level organizations. Institutions offering micro-finance services may be classified into four categories: Microfinance Banks (MFBs) which are licensed and regulated by the State Bank of Pakistan (SBP); Microfinance Institutions (MFIs) which provide specialized micro-finance services and include NGOs; Rural Support Programmes (RSPs) which perform microfinance operations as part of multi-dimensional rural development programmes and other Microfinance Providers (Other MFPs) which are other organizations running microfinance operations as part of multi-dimensional service offering and may or may not be in the formal sector.

Some of the larger institutions which have achieved scale in recent years operate under the regulatory framework promulgated by the SBP. The introduction of Microfinance Institutions Ordinance, 2001 created an enabling environment for undertaking micro-finance activities in the formal sector. The sector has attracted interest from foreign investors, as evident by the varying level of direct and indirect foreign ownership of almost all MFBs operating in the country, which are 9 at present. Of these, three are directly or indirectly owned by telecom operators; over the long term, we may witness an emergence of distinct trends in case of banks operating under the telco led model.

Key statistics pertaining to loans and deposits of the sector are presented in the table below:

Rs. in billions	MFBs	Others	Total
<b>2013</b>			
Gross Loan Portfolio	29.6	22.5	52.1
Savings/Deposits	33.0	1.8	34.8
<b>2012</b>			
Gross Loan Portfolio	21.1	17.1	38.2
Savings/Deposits	23.2	1.8	25.0

Funding structure of MFBs comprises a mix of deposits and commercial borrowings, with a larger proportion of the former. Meanwhile, MFIs are largely dependent upon funding from Pakistan Poverty Alleviation Fund (PPAF) and commercial borrowings. The sector has also been the recipient of grants over time. Over the years, some market players have witnessed transition from low cost sources of funding, which had been available from world donor agencies, to market based commercial borrowings.

In December 2008, SBP introduced the Micro Credit Guarantee Facility (MCGF) which eased access to commercial sources of funding for MFBs. Credit under this facility is also available to other MFIs. Some banks have also mobilized foreign currency debt from multi-lateral organizations. Quantum of borrowings by MFBs is estimated at above Rs. 8b at end-2013.

As stated earlier, a larger part of the funding mix of MFBs comprises deposits. Greater activity on the deposit generation side has been witnessed in recent years, with total deposits held by MFBs increasing to Rs. 33b by end-2013 (2012: Rs. 23.2b). While on an aggregate basis, deposits held by MFBs are in excess of the loan portfolio, more than three-fourths of the deposits have been mobilized by three banks alone; Tameer Microfinance Bank Limited (TMBL) enjoys the largest market share, followed by The First Microfinance Bank Limited and Khushhali Bank Limited (KBL). Depositors' profiles vary across institutions; deposit mix of most banks features significant concentration. The proportion of current accounts also varies across institutions. Developing broad based access to deposits would require time. JCR-VIS considers sustainability of deposits as critical for meeting future funding requirements.

The depositor and borrower markets are fairly distinct for MFBs; while the borrowers of MFBs comprise individuals/enterprises which hitherto lacked access to financial services, MFBs may be striving to compete in the same domain as commercial banks for garnering deposits. While MFBs may be able to offer favorable rates compared to commercial banks, the range of ancillary services offered by MFBs may be fairly restricted in most cases.

On the credit side, the sector mostly offers short term loans to cater to varying needs of customers, such as agriculture, livestock, trade and other services; MFBs are also trying to develop expertise to offer enterprise loans to either enhance the productivity of an existing business or to startup a new business. Recently, the scope of MCGF has been extended to provide loan loss coverage to MFBs undertaking

micro-enterprise lending. Gross Loan Portfolio (GLP) of MFBs increased to Rs. 29.6b by end- 2013 (2012: Rs. 21.1b) with growth mainly led by few MFBs. The largest providers of micro-credit are KBL and TMBL, having an aggregate share of almost 60% in the GLP.

While the quantum of secured lending has increased in recent years, there is much diversity among MFBs in terms of proportion of secured versus unsecured lending. Average loan size has trended upwards; increase in average loan size<sup>1</sup> over time is expected to improve operational efficiencies. There may be a need to evaluate the sufficiency of size of loan products in meeting the financing needs of borrowers, in the back drop of persisting inflation. In case of shortfall, customers may be inclined to deal with multiple financiers or use the loan for consumption purposes.

Asset quality indicators of MFBs have remained satisfactory with PAR>30 (Portfolio At Risk > 30 days) declining to 0.7% at end-2013 (2012: 1.1%). The incidence of infection was generally lower in the outgoing year compared to the preceding year. Incremental infection in 2013 varied in the range of 0.5% to 4% for most MFBs; though it was considerably higher for one particular bank. With combined net worth in excess of Rs. 11b at end-2013, PAR>30 as a proportion of equity is considered negligible for the sector as a whole. Factors which may adversely affect asset quality indicators include natural calamities, compromised lending practices, multiple loans & inflation, among other things. A credit bureau<sup>2</sup> specific to microfinance providers (regulated and non-regulated) was rolled out in 2010 to manage multiple loans, restrict over-indebtedness and facilitate improvement in risk management practices.

There is a marked difference in the markup rates charged by the sector in comparison to conventional banks as cost of doing business for microfinance sector is considerably higher. Overheads of MFBs are estimated at around 15% for 2013; there are however some outliers with significantly higher overheads as well. While there may be some rationalization in cost structures as banks scale up their activities, high overheads are likely to persist given the small size of loans and relationship model used for lending. MFBs have been expanding their branch network<sup>3</sup> in a bid to enhance outreach.

Mark-up spreads vary considerably across the sector and are largely a function of cost of funds, with average yield on loan portfolio varying mostly in the range of 2-3%. Mark-up spreads have been reported as high as 30% by one particular institution and being around 9% on the lower end of the spectrum for another bank.

On a positive note, Operational Self Sufficiency (OSS) has improved in recent years on account of increasing loan size and introduction of cost effective service delivery channels. Going forward, profitability of the sector is expected to be driven by access to cheaper sources of funding, credit up-scaling and improvement in operational efficiencies.

For sustainable growth in the microfinance sector, continued investment in risk and control infrastructure is considered necessary to strengthen institutional framework as the size of operations increases. Information technology does and will continue to play an important role in the development of micro-finance sector. Strong banking platforms are likely to enable MFBs to increase their throughput and better manage the risk thereon. Developing HR resources through training and development is also considered essential.

Over time, the sector may also look towards broadening the scope of its activities to ancillary banking services and approval of MFBs as clearing agents may also become essential. Currently, only one MFB enjoys this status<sup>4</sup>.

*1 Under the Prudential Regulations for MFBs, maximum limit for aggregate exposure shall not exceed Rs. 150,000 for general loans and Rs. 500,000 for housing and microenterprise loans. Moreover, aggregate exposure of borrowers availing both general and microenterprise loan shall not exceed Rs. 500,000*

*2 Under the Prudential Regulation, MFBs are required to obtain credit reports from CIB if loan amount exceeds Rs. 30,000*

*3 During FY13, MFBs added 119 branches (FY12: 13 branches) to their network.*

*4 Tameer Microfinance Bank is a direct member of payment system; all other MFB's require third party services.*

### Branchless Banking<sup>5</sup>

Since the launch of the first branchless banking (BB) service in Pakistan i.e. Easy Paisa, back in 2009, the industry has exploded with inundated growth in transaction volumes.

Total number of transactions executed in 2012 stood at 120m, which in 2013 has surpassed 190m. In terms of value, transactions executed in 2013 amounted to Rs. 803b vis-à-vis Rs. 490b in 2012.

	<b>Dec-12</b>	<b>Dec-13</b>
Total Number of BB Agents	41,567	125,027
Total Number of BB Accounts	2,112,052	3,475,458
Total BB Deposits (in millions)	1,055	2,639
Total Value of Transactions (in millions)	492,282	802,697
No. of transactions (in '000s)	120,912	191,902

This growth has primarily manifested in Over the Counter (OTC) transactions which are conducted using a branchless banking agent as a facilitator. Within OTC segment, transaction volumes are driven by utility and internet bill payments. However, in terms of value, in-land remittances represent a significant portion of the transactions conducted; these include both person-to-person and person-to-account fund transfers.

Total number of BB accounts stood at 3.0m at end-9M13 (2012: 2.1m). More than 60% of these accounts were basic level 0 accounts<sup>6</sup> having low Know Your Customer (KYC) requirements and transactions limits while level 1 accounts<sup>7</sup> comprised about 34% of the total; level 1 accounts have greater KYC requirements in line with transaction limits. At end-3Q13, about 1.5m BB accounts were inactive. Moreover, the balance of deposits held in BB accounts is very limited. Till such time that the service providers are able to offer utility of balances maintained in m-wallet accounts, increasing the volume of deposits generated through the same may remain a challenge.

Total number of agents has risen sharply to 125,027 (2012: 41,567) at end-2013 with around 45% of these being shared agents. So far no major fraud cases have surfaced, lending confidence to the service infrastructure. Continued monitoring of agent activities may nevertheless be required.

As of September 2013, there were 6 players in the market, comprising service providers from both the commercial and microfinance banking sectors. These service providers are either using one-to-one (dedicated telco platform) or one-to-many business model. Market share is dominated by Easy Paisa, which enjoys a significant lead over its closest competitor, Omni. As other players also establish their foothold, market share of industry participants may continue to evolve. Rate competition has set in with the advent of new players; ability to capture greater volume of transactions will be the key to improving revenue streams from this business segment. On a positive note, increasing number of service providers is likely to create greater awareness and enhance access to financial services.

<sup>5</sup> Source: SBP's Branchless Banking Newsletter Issue 9

<sup>6</sup> Daily Limit Rs. 15,000; Monthly Limit Rs. 25,000; Annual Limit Rs. 120,000; Maximum Balance Limit Rs. 100,000

<sup>7</sup> Daily Limit Rs. 25,000; Monthly Limit Rs. 60,000; Annual Limit Rs.500,000; No maximum balance limit

Jahangir Kothari Parade (Lady Lloyd Pier)

Inspired by Her Excellency, The Honorable Lady Lloyd, this promenade pier and pavillion was constructed at a cost of 3 Lakhs and donated to the public of Karachi by Jahangir Kothari to whose genrosity and public spirit the gift is due. Foundation stone laid on January 5, 1920. Opened by Her Excellency, The Honorable Lady Lloyd on March 21, 1921.

*Dome: A roof or vault, usually hemispherical in form. Until the 19th century, domes were constructed of masonry, of wood, or of combinations of the two, frequently reinforced with iron chains around the base to counteract the outward thrust of the structure.*

*Origins: The dome seems to have developed as roofing for circular mud-brick huts in ancient Mesopotamia about 6000 years ago. In the 14th century B.C. the Mycenaean Greeks built tombs roofed with steep corbeled domes in the shape of pointed beehives (tholos tombs).*

*Otherwise, the dome was not important in ancient Greek architecture. The Romans developed the masonry dome in its purest form, culminating in a temple built by the emperor Hadrian. Set on a massive circular drum the coffered dome forms a perfect hemisphere on the interior, with a large oculus (eye) in its center to admit light.*



Jahangir Kothari  
Parade

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JV Partner in CRISL, Bangladesh  
Member Association of Credit Rating Agencies in Asia

## **KARACHI**

VIS House - 128/C, 25th lane off Khayaban-e-Ittehad  
D. H. A. Phase VII, Karachi - Pakistan

## **LAHORE**

VIS House - 61-A/1, Street # 17  
Cavalry Ground, Lahore - Pakistan

Tel: (92-21) 35311861-70 Fax: (92-21) 35311872-73  
Website: [www.jcrvis.com.pk](http://www.jcrvis.com.pk)