

Microfinance Challenges and Opportunities in Pakistan

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Abstract

The core purpose of this research is to explore the challenges and opportunities of microfinance sector in Pakistan. Since last decade microfinance sector rapidly has been grown in the world and particularly in Pakistan. Many challenges are in front 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 contrary, poverty rapidly increased in Pakistan, along with other opportunities, is road surface way for the growth of this sector and offering huge market possibility for microfinance. This base exhibits a lot of opportunities in this sector such as: stimulating growth of economy, women empowerment, increasing volume, accessibility, economics of scope etc

Keywords: Microfinance: Challenges and Opportunities

1. Introduction

Microfinance is comparatively an innovation in financial services for the low income groups, self employed persons which face difficulty to take an access towards banking facilities and banking services. More generally, according to oxford dictionary microfinance defines as:

“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.”

The object behind the concept of microfinance is to generate financial service for those people which are away from financial services and to help poor people to pull out from the vicious circle of poverty.

The idea behind the microfinance is very naive to generate appropriate change in financial systems all over the world. As the traditional financial system provided benefits and safety to the rich segment of the society, the main object of microfinance is to lift the poor segment of the society from the circle of poverty and able them to contribute and participate in the economic activities and development.

The microfinance campaign started when Professor Muhammad Yonus (Bangladeshi economist) first time granted a few dollars to an impecunious (basket maker) in the year of 1974. These little loans granting campaign to the poor persons able them to run their small businesses that would have helped them to come out from the poverty circle. The Grameen Bank is one of the successful examples which provides loans for the poor to uplift from the poverty. In this reorganization Professor Muhammad Yonus was awarded the noble prize in the year of 2007.

It is well documented that microfinance is the most appropriate and better corridor to empower the poor people and rise their income generating ability (Pakistan institute of poverty reduction program 2001). The significance of microfinance is increasing with the passage of time not only in

Pakistan but across the boarder as an instrument to eliminate poverty. This sector faces many problems and challenges in Pakistan as well as other underdeveloped countries because of additional scope of this sector

The thought behind the microfinance services is to provide financial help to the poor persons and people at their doorstep at very easy terms and conditions (Wahid Ur Rehman 2007). At this juncture microfinance has drawn special attention not only at the academic level but also in the area of policy designing (Smailbone and Wyer 2000).

Key Principles of Microfinance

According to the Wikipedia encyclopedia the following principles of microfinance can be defined as follow:

1. Deprived segment of the society need a diversity of financial services, not only loans
2. It is powerful instrument to fight against the poverty
3. It is a source to build financial systems may be useful to serve poor.
4. It must pay for itself to accomplish large numbers of poor people.
5. It is about building perpetual domestic financial institutions.
6. Micro credit is not the suitable instrument for everyone or in every situation.
7. Mark up ceilings making it difficult for poor people to get credit.
8. The task of government is to enable financial services, not to provide them.
9. The funds of the donor should be supported to private capital not to compete with private capital.
10. The shortage of organized institutions and managers are the main obstacles are microfinance.
11. It is performed well while it is measured and opened

The common mistakes or misconception are found among the people is that the microfinance is the modern shape of charity. But there is an apparent difference between microfinance and charity. Normally charity is given for fulfillment of needs while microfinance facilities is given to the poor to start business and generate own source of income and became economically independent

Microfinance and micro credit is firstly used in 1970 and it is an innovation in the field of finance. According to Robinson (2001)

“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”.

(Journal of International Development. Special Issue. 1996. Vol. 8, No. 2. p. 154.)

“These often resulted in high loan defaults, high loses and an inability to reach poor rural households 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”

(Journal of International Development. Special Issue. 1996. Vol. 8, No. 2. p. 154.)

According to Robinson 1980 was the important year in the history of microfinance service because in that year most of MFI (microfinance institute) and Grameen Bank came into existence and started their work in the field of microfinance and issuing small loans and savings services at the large scale.

1990 was also very important year for microfinance in this year a good number of microfinance institute came into existence ((Robinson, 2001). 1990’s is the microfinance decade in this decade

microfinance converted or turned into industry. Dichter (1999). “The development in micro credit institution, attention changed from, just the provision of credit to the poor (micro credit) to the provision of other financial services such as savings and pensions”. Robinson (2001)

After brief discussion and reviewing the literature of microfinance in next step we discuss, the brief sketch of Pakistan microfinance 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

In case of Pakistan the recent microfinance moment is started in 1982. The first microfinance institute in Pakistan is Orangi Pilot project in Karachi and then Aga Khan rural support programme (AKRSP).

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).

In the year of 1990 the microfinance facilities are widely spread across the country many NGOs took momentum in this sector. 1996 Kashf foundation was established which has started its work to provide microfinance facilities all over the country.

In Musharraf regime (1999 to 2008) the government firmly focused on poverty alleviation program. So in this era microfinance network increased very sharply because the government has selected microfinance as a tool to fight against poverty. For this purpose Pakistan government has established Pakistan Poverty Alleviation Fund (PPAF) with the help of World Bank in the year of 2000. Another initiative of the government in which microfinance has used as a tool of poverty alleviation by establishing Khushhali Bank which has provided and diversified the microfinance product like housing finance, personal loans, leasing, insurance and remittance services all over the country specially in the rural area of the country.

According to Khushhali Bank’s annual report published in the year of 2007, a good number of the investors have shown their interest in microfinance because the rate of return in microfinance is much higher than in conventional banking system. According to the several reports and studies risk in microfinance sector is lower and it will be dominant in private sector by the year of 2015

(Khushhali Bank’s Annual report 2007 page no. 4)

The microfinance network is increasing very sharply in Pakistan. Support of government is also the key factor to accelerate this sector in case of Pakistan. According to Khushhali bank report the number of client who availed microfinance facilities were 100,000 in 2001 which have accelerated to 1,400,000 in 2007

(Khushhali Bank’s Annual report 2007 page no. 5)

At Present following microfinance institutions are functioning in Pakistan:

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

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)

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 table would give as picture of microfinance sector progress in case of Pakistan.

Table 1:

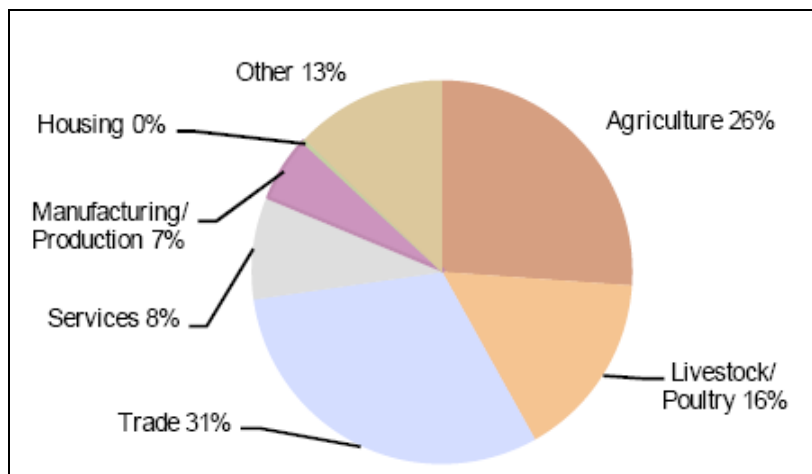
| Province | Offices | | Microcredit | | Micro-Savings | | Micro-insurance | | Potential Micro-fin Market | Penetration Rate (%) |
|--------------------|--------------|----------|------------------|----------------------------|------------------|------------------------|------------------|-----------------------|----------------------------|----------------------|
| | 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 |
| Grand Total | 1,524 | 6 | 1,751,111 | 19,252,368,887 | 2,043,774 | 5,882,167,960 | 2,128,493 | 31,231,892,854 | 27,407,048 | 6.39 |

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

As we have mentioned earlier that the network of microfinance is widely spread in Pakistan. At this moment 1.75 million people take advantage from these facilities and around Rs 19.252 billion

loans have been given to poor segment of the society. On the other hand 2.043 million savers or lender contribute Rs 5.882 billion as in the form of saving account. Potential of microfinance market exhibits that 27.407 million people are engaged in this sector in Pakistan.

Figure 1:

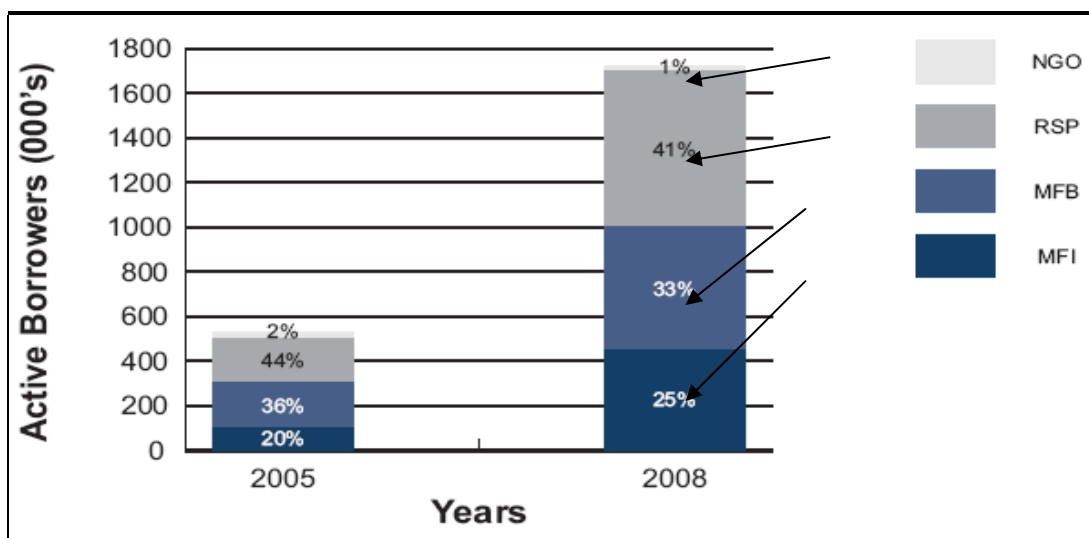


Source: Microwatch - Issue No. 11 Quarter (Jan-Mar 2009), Page No. 6

Look at the above pie chart which indicates that most of the microfinance services are available in agriculture and livestock sectors almost 42 percent of total services. This indicated major activities of microfinance are in the rural areas. We have needed to increase further share in these areas. It also indicates that only 7 percent microfinance facilities are available in manufacturing sector; further realized the share of manufacturing sector should be increased because cottage industries may be the base of industrial development in the country.

According to Economic Survey of Pakistan the microfinance industry grows by 0.5 million active borrowers to 1.7 million during the period of 2005-08 almost growth rate is 240 percent which is remarkable. At this juncture the rural support program (RSP) has a dominant share in microfinance service and it has approximately 41 percent, MFB 33 percent, MFI 25 percent and NGO 1 percent. It shown below figure 2

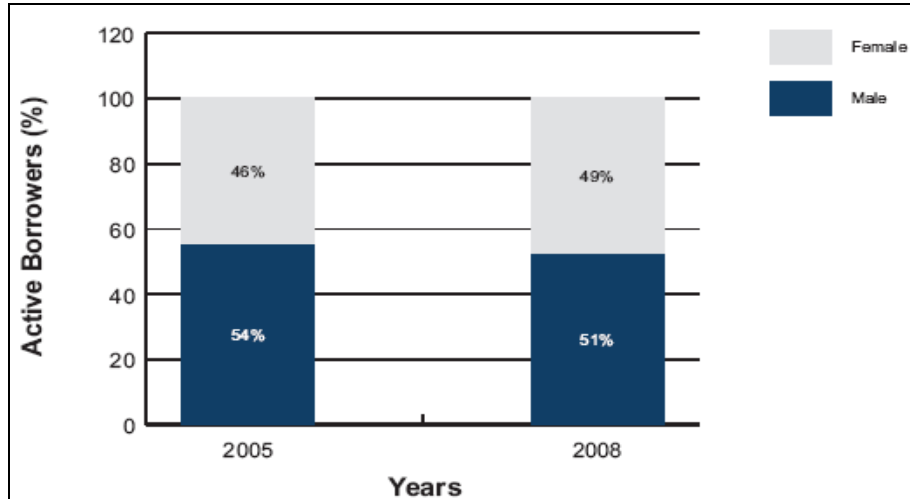
Figure 2:



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

World Bank report June 2008, the ratio of women those took advantage from microfinance services increase by 45 percent to 49 percent but this ratio is still low in case of Pakistan (as shown below figure) comparing this ratio to our neighboring countries like Bangladesh it consists of 99 percent while in India it reaches to 100 percent

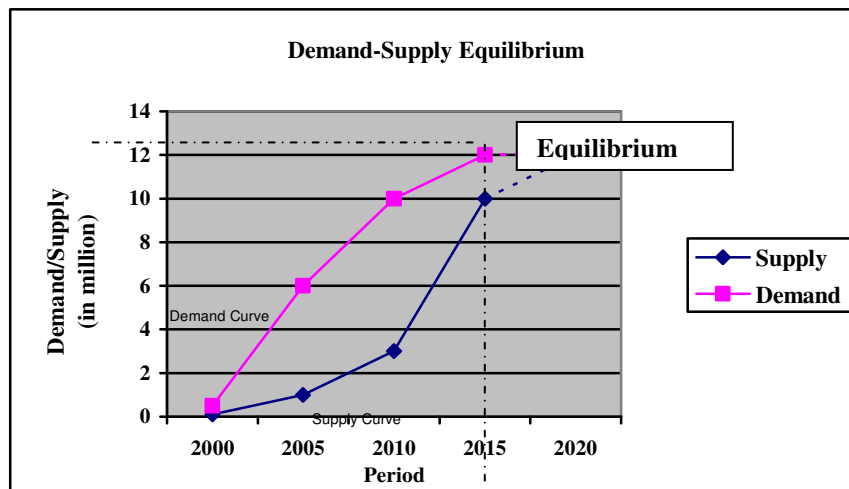
Figure 3:



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

According to State bank of Pakistan 10 years strategy paper for banking sector reforms has been suggested in which microfinance sector’s growth will be increase in coming days. According to the said report it will be reached to 3 million clients in the year of 2010 and 10 million clients in the period 2015. The estimated supply and demand will be at equilibrium to some extent in 2020 as shown in figure 4.

Figure 4:



Source: SBP, “Prudential Regulations for Microfinance Banks (MFBs),” SBP, Karachi, Pakistan (available online on the Microfinance Gateway, Washington, DC, http://www.microfinancegateway.com/files/39173_file_Prudential_Regulations_for_Microfinance_Banks_MFBs_2007_.pdf [accessed February 2009].

After the brief discourses about microfinance sketch in Pakistan we move to discuss opportunity and challenges of microfinance in Pakistan

3. Challenges

3.1 Political Interference

In Pakistan political interference is very common in all walks of life especially in rural areas. The feudal are exploiting the poor people. A major portion of agriculture loans is taken by them. The microfinance sector is also hunted by this political interference in Pakistan. So it needs a proper legislation to make the matter transparent.

3.2 Increasing Competition

After the preface of formal microfinance banks and institutions the competition has increased among these microfinance banks and institutions which can provide better services to the clients but these competitions is not so grave in formal sector of microfinance. Now client have more information about microfinance so they are demanding more facilities which improve the services in this sector as well.

3.3. Limited Management Capacity in MFIs

If we compare the MFIs, initially it is developed in the form of NGOs and then they converted them into MFI. The functioning of NGO and MFI is relatively different but the goal of both is same. Most of NGO which is converted into MFI lacking managerial capacity to run microfinance institute so it's a big challenge to microfinance sector

3.4. Innovative and Diversified Products

There are misconceptions about microfinance and people restricted it into micro credit only. Microfinance has wide ranging products which can include working capital loans, insurance, money transfers, saving loans etc. but if we saw in Pakistan most of our microfinance institutes not provided these facilities so far. So we said that their operation is very restricted. Especially low salaried person is totally ignored by this sector so far.

3.5. Stability of MFIs

If we analysis the microfinance sector it is just a by product of conventional banking system so it can say that development of microfinance institute also depend on banking sector development but at the moment the microfinance sector is sustained its own feet.

3.6. MFIs Profitability

In the initial stage of microfinance industry the MFIs generate large extent of profit but now the special condition on demand side of microfinance product. MFIs cannot be able to generate more profit. So it can reduced there profitability and their revenue is not enough to fulfill their cost of operation.

3.7. Improper Regulations

Microfinance is an emerging sector in Pakistan. Since it came into existence no proper legislation was made towards the said sector. At the initial stage some rules and regulation were made but these rules and regulation were not sufficient to cater the on going challenges At the moment regulatory norms are very complicated which can cause to increase the cost of operation. Especially we are focusing on the insurance and saving deposits and funds transfers.

3.8. High Transaction Cost

Microfinance sector faces transaction cost which is very significance and adversely affecting it. High transaction cost is a main obstacle to repayment of loan. Due to high transaction cost the probability of

bankruptcy increase and the demand for microfinance product fallen with the passage of time. Further its marginal cost is increase due to the default of loans. In these circumstances survival of MFIs is very difficult.

3.9. Inadequate Investment in Agriculture Development

In the agriculture sector and rural areas of Pakistan getting insufficient expenditure by government is big hurdle in the progress of microfinance. Inadequate investment in infrastructure such as roads, railways, communication is the main obstacle to the path of microfinance sector. Due to shortage of physical infrastructure it can cause to increase the cost of production and finally adversely impact on private investment activity.

3.10. Low Level of Knowledge

Shortage of human resource capital is also a hurdle to the path of economic development in all sectors of the economy. So that may cause inefficiency in MFIs. At the moment human resource capital efficacy is very low in Pakistan which is unable to run the whole mechanism smoothly

4. Opportunities

In spite of the fact that microfinance has shown very good performance in the last few years, though, the opportunities are further to grow to this sector. Following is a brief count of some these opportunities:

4.1. Poverty Alleviation

At present poverty is the most significant issue of the world as well as in Pakistan. Microfinance is the main instrument to reduce poverty. It is confirmed that poverty can be declined through microfinance. Microfinance is not only the main instrument to poverty reduction but it may be useful to diversifies income from rich segment of the society to the poor segment of the society (Chen 1992)

Source Government of Pakistan, SMEDA (Small & Medium Enterprises Development Authority), 2007, "SME Policy 2007: SME Led Growth—Creating Jobs and Reducing Poverty," Ministry of Industries and Production, Lahore, Pakistan, <http://www.smeda.org/downloads/smepolicy2007.pdf> (accessed February 2009).

4.2. Impact on Health, Social Capital and Economy

There are many positive impacts of microfinance on physical capital and social capital like health and education which may defiantly impact on economic activity and the economic development. In accordance with an estimation of 1 percent credit to women increased the probability of school enrolment increased by 1.9 percent for girls and 2.4 percent for boys (Grammen Bank). Microfinance helps to generate income and employment to poor households which help to meet their consumption pattern.

4.3. Microfinance as Development Tool

Microfinance is also useful in unexpected crises such as business risks and adverse supply shocks. Microfinance provides cushion against these shocks. It helps to give protection from crises and put them on stability different study shown that national and international crises have a little shock on it.

4.4. Opportunity for Commercial Banks

Microfinance seems new product which provides opportunity for commercial banks to boost it. According to a survey it is found that in microfinance product there are very high recovery and profitability. So commercial bank may have an opportunity to invest there funds in this sector.

4.5. Women Empowerment

Through the microfinance women can have an opportunity to their own business as we have seen in the example of Bangladesh most of the microfinance institutes preferred to provide loans to women because the recovery rate from the women is very high. So after the microfinance innovation women empowerment increased in the male dominated society

5. Conclusion

As we discussed above that microfinance services have augmented in the last few years and it was used as an instrument to alleviate poverty. Most of MFIs schemes and products preferred to provide loans and funds to women instead of men because in cases women rate of recovery is very high. On the contrary it makes the women socially and economically empowered. It is crude thought that microfinance is a magic stick which can suddenly change the economic and social scenario of the society. But no doubt it is very important tool which can be used to bring about social and economic changes gradually and durably

If we analysis microfinance as an innovation in financial services in Pakistan we can say it is still in a take off stage since 2000 .Most of the challenges of microfinance which are being faced in Pakistan has been discussed above as result of discussion we suggested a strategic policy towards the microfinance sector should be developed and design to boost and cater the challenges of future in this sector. Pakistan has a lot of opportunities in this sector. Government needs to play its vital role to accelerate this sector and provide essential facilities to minimize challenges which were discussed in this paper. Significance of this sector is to mobilize deposit in such a manner that it can play a vital role in economic development.

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