

Yaseen Anwar: Microfinance developments in Pakistan

Inaugural address by Mr Yaseen Anwar, Governor of the State Bank of Pakistan, at the 5th Pakistan Microfinance Country Forum, Karachi, 2 December 2011.

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Distinguished Speakers, Guests, Ladies and Gentlemen!

I am delighted to be invited to the 5th Pakistan Microfinance Country Forum.

Microfinance in Pakistan has made good progress but must make major breakthroughs to reach millions of underserved people who require a wide variety of financial services.

Pakistan has one of the lowest financial penetration levels in the World with 56% of the adult population totally excluded, and another 32% informally served. However, despite considerable support from the Government, donors and the State Bank of Pakistan, the microfinance sector has only been able to tap a small fraction of the potential market, with current active borrowers standing at roughly 2 million.

Now, I would like to share SBP's vision on the development of microfinance and financial inclusion in Pakistan and some of the initiatives taken by SBP. The history of microfinance is not very old in Pakistan. In fact, efforts to mainstream Microfinance into the formal financial system started in 2000 & 2001 when the Government promulgated the Microfinance Ordinance. The passage of the law allowed private sector to establish Microfinance Banks that are licensed and regulated by State Bank of Pakistan. Since then, we have witnessed the establishment of new MFBs, transformations of large MFIs, diversification of funding sources, development of inclusive financial services, emergence of alternative delivery channels, and piloting of "Microfinance – Credit Information Bureau" (MCIB). These developments are indeed a sign of growth and maturity and a direct outcome of the enabling regulatory framework and market development initiatives for microfinance. The success of microfinance in Pakistan is widely acknowledged by the international community. Our microfinance regulatory framework has been ranked globally at the top in 2010 and 2011 by the independent "the *Economic Intelligence Unit*" of UK's "The Economist" Magazine.

In developing regulations for microfinance, the State Bank has pursued a bottom-up approach along with use of strong analytical and problem solving skills and industry consultation. Since the inception of microfinance banking in Pakistan, our goal has been to determine the proportionality of a regulation before it is put in place. Hence, the regulatory approach has remained gradual and in line with the evolution of the sector. The evolution or trajectory of microfinance has so far remained positive despite the fact that many challenges arose along the way which I will cover later. Presently, nine MFBs are operating in Pakistan. All these MFBs are privately owned and reflect diversity of ownership and approaches to microfinance banking. Considering that the market has potential and the regulatory framework is supportive, the ownership in MFBs has flowed both from local and international investors including banks, development agencies, investment funds, mobile network operators, and large domestic MFIs.

One of the success stories in microfinance sector is the unique opportunity in Pakistan to utilize alternative delivery channels due to the presence of a sound and pro-growth regulatory framework, dense population, and high demand for financial services. The motivation for developing alternative channels for service delivery is twofold: firstly, there is enormous scope for expanding outreach, especially to hard-to-reach rural areas. The emerging models relying on "banking agents" will greatly extend the distribution of financial services to the poor and marginalized segments. Secondly, alternative delivery channels promise significant cost reduction to institutions. The traditional microfinance business is based on personal, one-on-one relationships. Thus, personnel expenses often account for a

significant portion of microfinance operating expenses. The use of banking agents will help to reduce the operating costs of the sector.

The recent development in mobile phone banking is highly encouraging. The expansion in the retail network of microfinance has arisen overwhelmingly from agents and mobile phone channels. Within a span of just two years, there are now almost 18,000 branchless banking outlets surpassing the 10,000 conventional bank branches. The combined daily transaction volume of the two prominent branchless banking models “Easypaisa” and “Omni” now averages over 175,000, with an average size of Rs. 3,700. As per an independent World Bank – CGAP study, the small size of the transaction indicates enhanced access to finance by the poor and the marginalized unbanked people, an important milestone for financial inclusion. The early successes of mobile banking in Pakistan are attributable to the collaborative efforts of a wide range of stakeholders, including the Government, regulatory authorities, development agencies, NADRA, telecom operators, financial institutions, and technology firms. SBP continues to work with all stakeholders, in order to support this nascent industry that is expected to be a key driver in expanding financial services to all of Pakistan. The sheer diversity of the stakeholders, many of which had not worked in businesses together, underlines the need for continued close coordination to foster a market-driven mobile banking eco-system.

I must acknowledge the important role our partner donors continue to play in facilitating this sector to develop a sound footing. I would like to especially thank the UKAid and Asian Development Bank for funding support for microfinance development. Under the programs sponsored by these donors, a number of market interventions are managed by SBP. Some of these initiatives are as follows:

The Institutional Strengthening Fund (ISF) a UK £10million grant facility launched in December 2008, is intended to strengthen institutional & human resource capacity of MFB/Is to enhance scale and sustainability of microfinance services. The ISF has thus far approved Rs. 522 million for 11 microfinance providers including top and middle tier MFBs and MFIs. Under the arrangements, the ISF will support 15 projects for investment in HR, IT, product development, Risk management systems, business plans and branchless banking development. Also, under ISF, the Pakistan Microfinance Network (PMN) was provided funding support to conduct research and develop the industry’s infrastructure such as the testing of pilot microfinance Credit Information Bureau (CIB) in Lahore. Going forward, ISF will consider how to further support important systemic areas such as upgrading CIB to the national level.

The Microfinance Credit Guarantee Facility (MCGF) a £10 million guarantee facility, was launched by SBP in December 2008, to mobilize wholesale commercial funding for microfinance providers through partial guarantees to commercial banks. The facility has thus far mobilized commercial funding of Rs. 3,225/- million for four microfinance providers for onward lending to around 200,000 new micro borrowers. Going forward, the facility will aim to raise commercial debt from non bank sources, diversifying sources of commercial capital for microfinance providers. The facility will be instrumental in mainstreaming microfinance providers and resolve some of its funding constraints on a permanent basis.

Similarly, the Financial Innovation Challenge Fund (FICF), a £10million innovation grant facility, was launched by SBP in May 2011, to provide grants to foster innovation and test new markets, lower cost of delivery, enable systems and procedures to be more efficient and provide new ways of meeting the larger demand for financial services. The first FICF challenge round was held on Financially Inclusive Government to Persons (G2P) Payments. Banks, public sector institutions, Microfinance institutions, government agencies, pension funds, and academic institutions were invited to apply for the promotion of financial inclusive G2P payments through bank accounts at branchless banking outlets and also provide other financial services to the G2P payments beneficiaries. A number of applications have been

received from these institutions which are now being evaluated for the first round of G2P payments Challenge.

Financial literacy has assumed greater importance in recent years and is now considered an important systemic area for promoting financial inclusion and ultimately financial stability. Both developed and developing countries, therefore, are focusing on programs for financial literacy/education.

SBP has started a pilot Financial Literacy Program (FLP) with the private sector as an implementing partner. The Program is the first ever initiative to promote financial literacy among the general public at the national level. The dissemination will be made through TV channels, regional Radio, print media and mobile network operators. In addition, field training and street theatres will also be used to target beneficiaries. The program will impart knowledge about basic financial concepts such as budgeting, savings, investments, debt management, financial products and branchless banking. The pilot phase will target about 50,000 beneficiaries with emphasis on low income strata. After completion of the pilot, an impact assessment of the pilot will be conducted and based on the results and recommendation the program will be scaled to the national level.

Although these early successes in microfinance industry are laudable, they have yet to create a major dent in the widespread financial exclusion. Currently, microcredit is reaching only 2 million borrowers whereas the size of the target market is estimated to be 25 to 30 million. While this high level of financial exclusion is somewhat disappointing, it does highlight the frontier of opportunities and bodes well for development of the microfinance industry to become a major participant within the overall financial sector while serving the millions of underserved and unbanked people. I, therefore, urge all stakeholders to step up their efforts in their area.

As we know, Pakistan has unfortunately faced an increased occurrence of natural calamities. In 2010 and 2011, floods and rains destroyed lives, properties, and businesses, particularly of those living in rural and peri-urban areas. The poor have also been adversely affected by volatility in food prices and fuel costs. Increased power outage has been another major concern. Furthermore, the current global financial turmoil may in the long run adversely affect the flow in funding from the global financial markets. This state of affairs poses a number of challenges for the microfinance sector. I will highlight some of these and try to offer general solutions.

The first and foremost challenge is organizational development. Every institution must determine and pursue this goal by having in place appropriate governance structures, management teams, business policies & plans, risk management practices, product development & innovation and use of appropriate technologies. Quality Human Resource is a prerequisite for achieving this goal.

The second challenge is funding avenues for microfinance service providers. It is a proven fact that in order to have a financially sustainable model, MFBs should assign more emphasis on savings mobilization and develop strategies and the infrastructure to mobilize deposits.

Thirdly, MFBs need to improve the quality of growth through promoting inclusive financial services with up-scaling credit operations. Lending operations must extend to different economic and geographic segments. SBP will issue regulatory guidelines to MFBs for up-scaling of loans, and develop a reporting structure to assess the geographic distribution of microfinance growth. Donor funding can support product development, capacity building, and market surveys.

Fourthly, institutions must assign equal importance to consumer protection and awareness. SBP will also review and strengthen its regulatory and supervisory processes to ensure protection of microfinance clients' rights.

In the new Microfinance Strategic framework 2011–15, SBP has laid out a detailed strategy to promote sustainable growth of the sector. The strategy's effectiveness and success hinges on growth dynamism fundamentally coming from microfinance operators themselves. The role of SBP is to develop the banking infrastructure, encourage the use of successful global practices, and provide the regulatory and supervisory mechanism to enable MFBs to develop viable business models.

To sum up, I would like to reaffirm the need for microfinance development for fostering a pro-poor and sustainable development in Pakistan. Microfinance has come of age, and the sector needs to discontinue dependence on external catalysts and focus on improving its financial and operating performance by setting targets for borrowers, savers, portfolio quality, and self-sufficiency. Considerable work still needs to be undertaken to ensure that all microfinance banks and institutions are acting responsibly. It is also important for the industry to continue to innovate, create new partnerships with the growing branchless banking networks, and to evolve and provide financial access to the unbanked.

Let me once again thank the organizers for holding important event and I wish the Conference all success.