Shamshad Akhtar: Launch of microfinance initiatives

Speech by Dr Shamshad Akhtar, Governor of the State Bank of Pakistan, at the Launch of Microfinance Initiatives, Karachi, 19 December 2008.

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1. Approximately 30 million Pakistanis are living in poverty. Despite consensus that microfinance is an effective tool to alleviate poverty, there is a wide gap between demand and supply of financial services for the poor and marginalized segments of population. The current outreach of microfinance services, 1.8 million customers, while a significant improvement over last few years, is a mere 5% of the potential microfinance market. Where there are challenges there are also numerous opportunities for growth of microfinance businesses. SBP and the Government of Pakistan are committed to increasing outreach and facilitating the development of the microfinance sector. To kick start real action, SBP with industry developed a Microfinance Strategy which was adopted in 2007. This strategy has set growth targets of increasing the numbers of microfinance borrowers to 3 million by the end of 2010 and 10 million by 2015.

2. The microfinance outreach increased by 47% at the end of December 2007 and by 13% as of September of 2008 as the concept of commercialization or for-profit microfinance business started to permeate. NGOs and MFIs have been seeking additional sources of funding in an effort to expand their operations and distribution of services. The enabling regulatory environment promoted by the SBP has helped MFIs to create innovative partnerships with commercial banks or transform themselves into a regulated entity which allows them to accept deposits and utilize mainstream sources of capital. Pakistan has proven to be leader in the Asian region in commercialized microfinance and is the first country to introduce a comprehensive legal, regulatory, and supervisory framework for formal microfinance in Asia.

SBP initiatives for the promotion of microfinance

3. To realize the growth targets of microfinance, SBP has identified three concurrent steps the industry needs to undergo in order to fulfill set goals:

1) Sustainable cost-covering operating/business model;

2) Mobilize private domestic capital; and

3) Build human resource systems.

4. In order to develop these critical areas of the microfinance industry, SBP has undertaken several steps, which include, but not limited to:

(i) State Bank launched the Financial Inclusion Program, aimed at eliminating market failures. FIP is a £50 million program funded by the UK Department for International Development (DFID) with several initiatives aimed at improving access to financial services for poor and marginalized groups and for small enterprises in Pakistan.

(ii) State Bank has issued Branchless Banking Regulations, which is the regulatory framework to promote banking in remote areas using technology.

(iii) SBP encouraged microfinance institutions to transform into regulated entities.

(iv) SBP encouraged partnerships between the post office (PO) network and MF providers. Post Offices already manage over 4 million savings accounts, mainly small accounts below Rs 10,000, through more than 12,000 branches. There is scope for the Post Office and MF providers to join forces with the latter acting as intermediaries for funds raised by POs, especially as MF providers are constrained by limited funding.

(v) SBP is encouraging new international players including BRAC and ASA who have already started microfinance operations in Pakistan.

(vi) SBP has set up a special Micro finance focal group with an independent head and qualified staff to support these and other financial inclusion initiatives.

4. Many of these initiatives are recent and have yet to demonstrate effect vis-à-vis improved outlook for microfinance. However, the effectiveness of some of these initiatives may be improved in light of inferences drawn from microfinance industry trends. Broadly, the current outlook for microfinance remains optimistic, but we must examine emerging trends with caution.

- **First**, the industry is still young and continues to be largely dependent on donor assistance to grow, which though necessary at infancy stage is an unsustainable approach to long-term development. It is, however, critical that MFBs move toward deposit mobilization to increase funds for on-lending to achieve of the National Strategy of reaching 10 million clients by 2015.
- **Second**, cost-efficiency is especially important in the current environment of the global financial crisis where rising cost of borrowing will eventually impact cost of lending for MFIs and MFBs as they move towards commercial funding. Hopefully, the introduction of international players may encourage local organizations to develop cost efficient structures and improve the quality of available human resource.
- **Third**, resource deficiency exists for microfinance not only in the form of funding. Human resource capacity must also be strengthened to provide quality microfinance services. Capacity building will take time as human resource development will primarily have to come from organic means given the unique nature of the microfinance industry.
- **Lastly**, there are concerns over gender and regional participation will have to be critically examined and addressed in order to make microfinance's ability to fight poverty more meaningful.

New initiatives

5. Today the biggest challenge faced by microfinance is scaling up. Although microfinance operations can become successful in achieving sustainability, however, initially these cannot grow on solely deposit mobilization or retained earnings, nor can it raise capital in financial markets. In order for microfinance to play a bigger role in improving livelihood opportunities for the poor and alleviate poverty, it must be scaledup significantly and must become sustainable to be able to generate profits and mobilize deposits and capital from alternative sources. This would require a number of things including institutional strengthening and specific interventions to resolve market failures. The commercialization for greater outreach and sustainability require greater institutional building blocks which in turn require new partnerships.

6. I am pleased to announce that SBP today is launching three facilities for the support of microfinance sector to promote financial inclusion.

1) The Microfinance Credit Guarantee Facility

2) The Institutional Strengthening Fund; and

3) The Improving Access to Finance Services Fund

7. These measures are expected to ease liquidity constraints of microfinance providers in view of the tighter liquidity conditions and sudden spike in inflation which has severely affected the poor and marginalized segments of the society.

The Microfinance Credit Guarantee Facility

8. This is expected to increase the flow of credit to microfinance sector. The facility aims to incentivize banks/DFIs to channelize funds to MFBs/MFIs for on lending to low income segment of the population. The facility will provide credit guarantees of up to 40 percent of the funding provided by Banks/DFIs and aims to develop market and graduate poor borrowers to mainstream financial service providers. The facility will be established at SBP with UK Government Financial Inclusion Program grant funds equivalent of up to GBP 10 million to be used as the guarantee fund. The State Bank has issued necessary guidelines for operationalizing the facility which were finalized after due consultation with stakeholders.

9. Commercial banks are allowed options to undertake microfinance business directly and in partnership with MFIs by providing wholesale funds to them for on-lending through four different modes i.e. a) MF counters in existing branches, b) standalone MF Branches, c) establishment of independent subsidiary MFB, and d) linkage with NGO-MFI. The MCG facility is expected to help raise local currency funds for eligible MFIs/MFBs. The loans portfolio under the guarantee scheme will be administered by banks. The facility will also help build links between micro borrowers and formal financial institutions. The familiarization of the bank with the client should eventually lead to the "graduation" of the borrower. The facility shall provide partial Guarantee to minimize the perceived risk premium by covering part of the losses incurred on funds made available to MFBs/MFIs with the advantage of leveraging the guarantee fund a number of times while keeping the incentive for banks/DFIs to collect the loan. The lending of MCG facility will help these institutions to play their role in the growth of micro credit more effectively.

The Institutional Strengthening Fund

10. This Fund is designed to build capacity of the microfinance sector. The fund is expected to enhance potential for growth and create depth in outreach by improving human resource quality, service delivery and increasing service availability to potential microfinance clients. The fund is established at the State Bank under the UK Government’s Financial Inclusion Program that involved funds equivalent to Pound Sterling 10 million for institutional strengthening. The fund will provide grants for capacity building to generate on-lending resources through commercial sources, equity investments or deposit mobilization strategy through improvement in management, governance, internal controls and functions. The fund will also provide grants for employing cost reduction mechanisms for increasing outreach in rural and remote areas through product innovation, development or use of technology. In addition, the fund will provide grants for business development services to MFI clients or improving quality of services; and developing capacity for transformation of MFIs into licensed microfinance banks.

11. SBP has developed detailed guidelines, selection criteria and application format for ISF. The fund will primarily focus on institutions that are already regulated, or are in the process of seeking a license or have solid plans for restructuring in the near future. SBP regulatory oversight will ensure transparency and good governance practices, which will ultimately lead to greater investment in the microfinance industry. Moreover, ISF is capped at US$1 million per year per grantee and subject to at least 25% matching grant from the grantee. Grants may be made on an annual basis and institutions that qualify for funding in a year may also qualify for funding in another year subject to good performance and submission of another successful proposal through the approved application procedure.

Improving access to financial services

12. This component is designed to enhance capacity of the microfinance sector and promote financial literacy. The fund has been established at the State Bank with help of an endowment of USD 20 million under the ADB-supported “Improving Access to Financial Services Program – IAFSP”. The fund will provide benefits for and have positive impacts on rural and urban communities, in particular the poor & the women.

13. These benefits are quantitative and qualitative in nature and include (i) capacity building and training of financial services providers to promote expansion into rural areas; product and service innovation, including savings, remittances and Islamic financial services; adoption and integration of new technologies and applications for improving access to financial services; (ii) capacity building and training of Government and regulatory authorities to support development of an inclusive financial sector and implementation of measures under the Program; and (iii) literacy programs (financial and basic) conducted by or on behalf of financial services providers for clients and potential clients to improve access to financial services and the utilization of finance.

14. To initiate provision of grants SBP has developed detailed guidelines, selection criteria and application format for the IAFSF. The fund will initially focus on regulated institutions to ensure transparency and good governance practices to attract investment in the microfinance industry. Grants shall be provided to projects that meet the criteria for improving basic & financial literacy of current and potential microfinance consumers besides promoting utilization of cost effective means for financial service delivery and expanding outreach to rural and remote areas.

15. In conclusion, I would like to highlight that all the SBP initiatives have strong support of the industry simply because of the partnership we have with the Pakistan Micro Finance industry and network. Ultimate success of these initiatives lies with both the banking and microfinance industry and we count on their continued dedication for promotion of microfinance industry.