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GROWTH AND PERFORMANCE OF MICROFINANCE IN PAKISTAN

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Abstract. This paper views the growth strategy adopted by the microfinance sector and its impact on performance of the microfinance institutions. To strike a balance between outreach and poverty alleviation, an intensive growth strategy would have been more cost effective at the initial stages of development. This would have reflected in improved performance, efficiency and productivity. Instead the sector adopted an extensive growth strategy which involved huge investment in physical infrastructure and rapid increase in recruitment and branch network. Thus, the credit constrained institutions had to focus more on sustainability than their primary objective of social support. The issue of sustainability would not have been as central had the sector adopted an intensive growth strategy. The six dimensions of outreach examined also indicate that the targets set were modestly attained as breadth of outreach is below the target outreach, depth of outreach is concentrated in big urban cities, scope of outreach is mostly limited to credit. The financial performance of the sector is weak, its cost per borrower is increasing and productivity ratios are low. Growth of the sector is being led by a few unsustainable institutions that are neither operationally nor financially self-sufficient. This approach has already impacted the growth of microfinance in the last few years and is likely to continue to impact the growth and performance of the sector unless more funds are injected.

I. INTRODUCTION

The roots of microfinance lie in a social mission of enhancing outreach to alleviate poverty. More recently there is a major shift in emphasis from the social objective of poverty alleviation towards the economic objective of sustainable and market based financial services. In other words, the new focus of microfinance involves trade off between outreach and efficiency Rhyne (1998). One implication of this changed focus is that microfinance

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institutions will have to be financially self-sufficient to meet the objective of enhanced outreach. Microfinance sector in Pakistan is also faced with the challenge of enhancing outreach on sustainable basis. One way to minimize the trade off is to improve efficiency and productivity through intensive growth strategy of the sector.

The target market of microfinance sector is estimated to be 25 to 30 million borrowers and government has set the outreach goal posts to at least 3 million by 2010 and moved it further to 10 million by 2015. To increase outreach the sector adopted extensive growth strategy and the overall growth rate of outreach varied from 100 percent in 2004 to a low level of 36 percent during 2005-06 and later to 52 percent in 2007. Outreach in terms of number of active borrowers increased from a low base of 240000 in 2003 to 1.27 million in 2007. Gross loan portfolio increased from Rs. 2.3 billion in 2004 to 12.7 billion in 2007, loan size also increased from Rs. 6,629 in 2004 to Rs. 10,000 in 2006 and 2007. The number of savers increased from 888000 to 1.14 million in 2007 and investment in the sector is as high as $ 400 million between 1999-2005 (Pakistan Microfinance Network, 2007).

Despite progress made over the past few years, outreach of the sector is just 40% of the target outreach of 3 million poor. Growth of the sector is largely led by a few unsustainable institutions that lack operational and financial sustainability. The financial self-sufficiency of the sector is as low as 76 percent and the average return on assets (AROA) of the sector remain negative. Instead of laying emphasis on intensive growth strategy of utilizing the existing capacity to improve productivity and efficiency and reliance on mobile offices, the sector focused on extensive expansion in terms of fixed branches and offices which led to high operating and financial costs of majority of the institutions.[1]

As a result the sector remains dependent on external support, subsidized credit and tax exemptions etc. Besides paid up capital financially majority of the institutions rely on donor funds and subsidized debt as the major source of funding. This implies future growth of the sector is conditional upon the availability of donor funds or subsidized credit, otherwise growth of the sector may slow down. Moreover, besides the issues of outreach and sustainability, the recent slow growth of GDP and high inflation may also impact the progress of the sector.

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[1]Unlike the Grameen Bank, the Khushali Bank in particular focused on expanding fixed branches rather than relying on mobile offices which could have saved on operating cost of the bank.

The purpose of this paper is to examine firstly the growth pattern of the microfinance sector and secondly its impact on performance of the microfinance institutions. In doing so the study attempts to establish a link between the growth strategy and performance of the sector. In other words, whether the existing growth strategy led to improve performance of the sector which would largely determine the extent to which the primary social objective of the sector is attained.

The plan of the paper is as such: section II of the paper gives the institutional set up of the microfinance sector, section III provides the literature review, and section IV presents the model of outreach and financial sustainability along with methodology and data source. Section V reports the main findings about the growth pattern and its impact on performance of the sector. Leading microfinance institutions, driving the overall growth of the sector, are also identified. The impact of growth pattern on four aspects of outreach, *i.e.* the breadth, depth, scope and worth of outreach, is assessed. The impact of growth on cost and length of outreach is also assessed by analyzing the operational self-sufficiency (OSS), financial self-sufficiency (FSS) and productivity of the microfinance sector. The main conclusions are mentioned in the final section of the paper.

II. INSTITUTIONAL SET UP IN PAKISTAN

Historically, in 1970s Agricultural Development Bank of Pakistan (ADBP) later named as Zarai Taraqiati Bank Limited (ZTBL) was established to extend subsidized rural credit to the rural farmers. Over the years both the outreach and financial performance of the bank has not remained satisfactory and is currently undergoing a restructuring process. In 1980s two microfinance institutions namely the Agha Khan Rural Support Programme (AKRSP), later graduated as First Micro Finance Bank (FMFB), and the Orangi Pilot Project (OPP) were set up with a social objective of alleviating poverty by providing credit to the poor. The services of AKRSP were focused in Northern areas and Chitral, whereas the OPP provided financial help to the urban poor of Karachi. Later on, the success of AKRSP led to the introduction of Rural Support Programs (RSPs) at the national level. These RSPs placed a strong emphasis on helping the poor through subsidized credit and other social services as part of their poverty reduction strategy. Besides these institutions, specialized and multi purpose microfinance institutions (MFIs) and NGOs also extended microfinance services to the poor segment of the population with a missionary objective.

In 1998, Pakistan Microfinance Network (PMN) was set up to represent the emerging MFIs. Later in 2000, Pakistan Poverty Alleviation Fund (PPAF) was set up as an apex organization, with the support of World Bank to provide wholesale refinancing to MFIs.[2] Currently, it refinances almost 56 percent of the micro loans to microfinance institutions that are members of PMN. PPAF Micro credit Loan Fund is Rs. 10,513 million (US $ 175.2 million), and its current outstanding portfolio to MFIs is Rs. 4,013 million (US $ 66.9 million) (CLEAR, 2007).[3] A New Bank Fund has been established worth US $ 15 million with assistance of ADB and for capacity building of newly licensed institutions at the provincial and district levels in Pakistan. Also a Microfinance Credit Guarantee Facility (MCGF) has been established with the UK Department of International Development (DFID) grant of pounds 10 million by SBP to facilitate banks and DFIs in easing the credit constraint of MFBs/MFIs to enhance outreach (SBP, 2008; IMF, 2008). In the same context, recently a Benazir Income Support Fund of Rs. 34 billion has been created as a social safety net for extending outreach to the poor segment of the population.

In 2000, the first microfinance bank, *i.e.* Khushali Bank (KB) was established as part of governments Poverty Reduction Strategy with a loan of US $ 150 million from ADB. Both the PPAF and KB were based on the same rational: that these initiatives will be instrumental in reducing poverty. In 2001, the Microfinance Ordinance was introduced and separate prudential regulations were formulated as part of microfinance initiatives.

Presently, there are three different models of microfinance services in Pakistan, *i.e.* 6 Micro Finance Banks (MFBs), 10 Micro Finance Institutions (MFIs) and 4 Rural Support Programmes (RSPs), all the three models started with small size short term group lending policy of working capital loans.[4] Some MFIs and MFBs like Tameer Bank and FMFB have diversified into

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[2]Microfinance activities are supported by *Multilateral agencies:* ADB, EC, IFAD, IFC, ILO, UNDP, World Bank, *Bilateral agencies*: AECI, DFID, JBIC, SDC, USAID, *International NGOs:* PLAN, ACTED, Save the Children US, Islamic Relief, *International Private Investors*: Citigroup, Deutsche Bank (Global Commercial Microfinance Consortium), Shore Bank Int., Aga Khan Agency for Microfinance (AKAM).

[3]The Orangi Charitable Trust (OCT)/OPP also offers financing in a limited manner to small MFIs in the provinces of Sindh and Punjab.

[4]Recent data reported by PMN (2008) show that some of the MFBs and MFIs have initiated insurance and deposit mobilization services in a limited manner.

MFIs that extend credit services include Asasah, Kashf Foundation, Orangi Pilot Project (OPP), Sindh Agricultural and Forestry Workers (SAFWCO), whereas multi purpose NGOs also provide microfinance. Other NGOs include Sungi Development Foundation, Development Action for Mobilization and Emancipation and Taraqee Foundation.

individual based large loans relative to market average loan size. However, RSPs provide multi product microfinance services including infrastructure development projects like health, education, insurance, mobilization of savings and primarily operate in rural areas.[5]

Besides the three main groups of microfinance other institutions that also provide microfinance services include, commercial banks and government owned institutions etc. Although the main product of these institutions is not microfinance, the government-owned institutions that provide microfinance services to the poor include: micro credit and saving services and subsidized credit for government's Rozgar Scheme by National Bank of Pakistan (NBP); credit and saving services by ZTBL; special microfinance services by government owned First Women's Bank, Bank of Khyber, SME Bank, financial savings and money transfer services provided through countrywide network of 7,500 branches of Pak Post Saving Banks, the seven National Saving Schemes (NSS) of Central Directorate of National Savings (CDNS) which accept deposits of about 4 million account holders and the Zakat office that provide charity funds as a social objective. Some commercial financial institutions including ORIX leasing also extend microfinance services to their poor customers (CLEAR, 2007).

III. REVIEW OF LITERATURE

A review of literature about the microfinance sector in Pakistan reveals that interest in assessing the performance of microfinance sector is relatively new and most of the studies were initially conducted to assess the impact of microfinance on poverty reduction. Majority of the studies in this area were undertaken in the decade of 2000 mostly by the microfinance institutions like Kashf, NRSP, Orangi Pilot Project and the Pakistan Poverty Alleviation Programme. A few studies and surveys were also conducted by Pakistan Institute of Development Economics, State Bank of Pakistan and the Applied Economic Research Centre.

Initially most of the studies examined growth of microfinance by developing proxy measures of outreach and repayment of loans. Such an approach is based on the assumption that if outreach in terms of number of borrowers was increasing and loan repayments were made by the borrowers then microfinance sector was performing successfully (Khandker, 1999).

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[5]The four Rural Support Programmes (RSPs) include National Rural Support Programme (NRSP), Sarhad Rural Support Programme (SRSP), Punjab Rural Support Program (PRSP) and the Thar Rural Support Program (TRSP).

AKRSP, NRSP and PRSP all adopted this approach, repeat borrowers, increasing outreach and loan repayment meant successful growth of microfinance. Limitations of such an approach are that it assess breadth of outreach as the only aspect of performance and obscures other dimensions of outreach that indicate the depth, scope, worth and financial health of the sector (Schreiner, 2002). Later in 1980s, a case and impact studies approach was adopted, this approach was also biased as mostly the successful case studies were reported and repayment of loans was still used as the main indicator of performance of an individual institution or the overall sector. Such studies overestimate the benefits and underestimate costs which mask the correct picture of the actual conditions of poverty Adams (1988).

More recently there is a shift in the measurement of performance of the microfinance sector. The new and widely used approach focused on various levels of financial sustainability and dimensions of performance indicators. It is argued that financial sustainability is essential as opportunity cost in the absence of microfinance institutions may be high (Ledgerwood, 1998). Others argue that the social objective of microfinance would be undermined if microfinance is not subsidized (Khandker, 1998; Morduch, 1999). Although trade off between the social and commercial objective of microfinance is widely debated, it is quite clear that the trade off can be minimized by adopting a growth strategy which emphasizes on improving efficiency and productivity. Intensive growth strategy of microfinance sector can be cost effective and ensure the long term sustainability of the sector (Craig and Cheryl, 2006).

IV. METHODOLOGY AND DATA SOURCE

THEORETICAL MODEL OF SIX DIMENSIONS OF OUTREACH

This study is based on a theoretical model of six dimensions of outreach that are interlinked and involve a trade off (Schreiner, 2002). It explains that given the two inputs of financial and human resource the main objective of a microfinance institution is to provide a certain level of financial services at minimum cost and maximum productivity of the available human resource. It also suggests that each aspect of outreach is dependent on the other aspects of outreach. Out of the six aspects of outreach mentioned below, the first four indicators of outreach provide a good approximation of the extent and pattern of growth in terms of breadth, depth, scope and worth of outreach of an institution. The remaining two dimensions of outreach involve cost and length of outreach, *i.e.* the financial performance, efficiency and productivity of a microfinance institution.

A brief explanation of the six aspects of microfinance is given as below:

1. **Breadth of outreach**: It simply involves the number of poor people reached by an MFI and is measured as the total number of active borrowers. It can also be assessed in relation to the increase in branch network and staff hired over time.
2. **Depth of outreach**: It indicates the extent to which those excluded from the financial sector are reached by an MFI. In developing countries, poverty is found to be high in rural areas and among the women; both have limited access to the provision of financial services for several reasons. High transaction cost and risk involved in reaching the rural poor and women in developing countries has led to the concentration of microfinance services in the urban areas. Thus depth of outreach measured as ratio of active women borrowers to total borrowers and also measured as distribution of borrowers in rural and urban areas would indicate the extent to which MFIs deal with the very poor segment of the population.
3. **Scope of outreach**: It involves the diversity of financial services offered by an MFI, *i.e.* it explains whether it is a one product institution or has the capacity to offer diverse products to its customers. Scope is measured as the total number of depositors holding savings accounts and ratio of women savers to total savers.
4. **Worth or value of financial service**: The terms and conditions of microfinance affect both the borrowers and the sustainability of an MFI. Worth of microfinance increases if the terms and conditions of a loan in terms of, size, duration, frequency of loan installment payments, collateral requirements, interest rate, fees etc suit the needs of the borrowers. Worth of outreach is therefore measured as average loan size prevailing in the market.
5. **Cost of outreach or operational self-sufficiency**: An MFI is operationally self-sufficient if it generates enough revenue to meet its operating expense, otherwise it lacks operational self-sufficiency and will have to either reduce its operational cost or increase its return on assets. Operational self-sufficiency is measured as a ratio of financial revenue to financial expense.[6]

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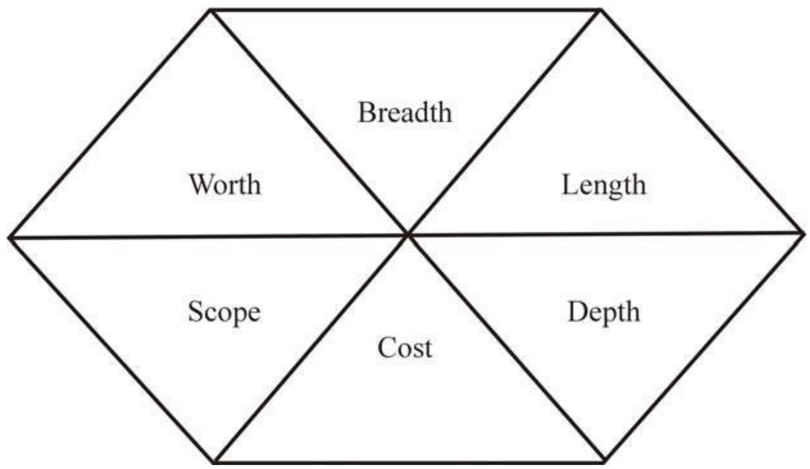
[6]Operational self-sufficiency is measured as a ratio of financial revenue to financial expense: (total interest, fees and commission on loan portfolio + financial revenue from other financial assets + other revenue from financial services like insurance or transfer services or sale of passbooks and credit cards etc.) / (financial expense + net loan loss provision expense + operating expense).

6. **Length of outreach**: It indicates financial self-sufficiency of an MFI that guarantees the length of outreach over a longer period of time. If an MFI generates enough revenue and its reliance on external funds, tax exemptions, subsidized loans and other concessions is minimum, it is considered to be financially sustainable.[7]

FIGURE 1

The Six Dimensions of Outreach



Besides, the operating and financial sustainability, other indicators of performance reported include efficiency and productivity measures of the sector. Efficiency indicators include, nominal and real yield on gross loan portfolio, average return on assets and adjusted cost per borrower or adjusted cost per loan etc. The productivity indicators measured as a ratio of number of active borrowers to number of staff/loan officers show how efficiently the available human resource is utilized.

The above model views all the six dimensions of outreach as important, however length of outreach is the preferred objective as improvement in other aspects of outreach are conditional on financial sustainability of microfinance institutions. Average cost of an MFI is minimum once its outreach increase to approximately 12000 clients, beyond this level cost inefficiency cannot be covered through growth of an MFI (Brand, 2000;

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[7]Financial self-sufficiency is measured as a ratio of financial revenue to adjusted financial expense: (total of financial expense on liabilities and deposits + net loan loss provisioning + operating expense (total of personal expense and administrative expense + inflation adjustment).

Farrington, 2000). In practice, most MFIs adopt the policy of charging high price and interest for their product to cover cost inefficiency and fail to improve their operational and financial self-sufficiency (Brand and Gerschick, 2000).

The ratio analysis approach is used to assess the growth pattern and its impact on performance of the microfinance sector in the light of the indicators of performance outlined above. In this way the growth pattern, performance and sustainability issue of the overall microfinance sector, its three groups and the top few leading institutions of the sector is assessed. Our analysis is based on Pakistan microfinance network and State Bank of Pakistan data source for the period 2004-07. Prior to this time period data is sketchy and incomplete which cannot be used for reliable estimates and meaningful comparisons.[8]

V. MAIN FINDINGS AND RESULTS

GROWTH PATTERN AND MICROFINANCE SECTOR

The growth strategy of the microfinance sector in terms of its physical and financial infrastructure reported in Table 1 show that between 2004-07 overall growth of the micro-finance sector in terms of increase in branch network and the staff hired has been more than three fold which is faster than the growth of borrowers and loan portfolio. The total number of branches increased from 362 to 1165 branches and the staff recruited increased from 2913 to 9529 workers. The wide growth in branch network and recruitment of staff indicates that the sector adopted an extensive and quick growth strategy. A similar growth pattern is observed in case of the three set of institutions, where irrespective of their level of development and age, extensive expansion of branch network and recruitment of new staff took place during the same time.

Perhaps extensive growth strategy of the sector was led by the social objective and pressure to improve performance. It was mainly so because increase in number of borrowers and provision of financial services to more low income people was considered as the only measure of performance. A growth strategy with extensive branches and many workers/staff is not very

[8]One limitation of this study is that data availability constrains our investigation to ratio analysis. To establish a link among different dimensions of outreach outlined above appropriate econometric tools could not be applied, however most studies in the literature on microfinance are based on ratio analysis as the standard approach to assess the growth and performance of microfinance sector.

effective in enhancing outreach if its coverage is thin. Majority of the institutions of microfinance are heavily dependent on subsidized funds, opening of new branches and recruitment of new staff will impact the operational expenses of the sector particularly when productivity is low at the initial stages of growth. In fact reliance on mobile branches seems to be negligible which could have reduced operating cost of most MFIs. Moreover with a few exceptions extensive growth strategy has limited growth mostly to one product service which may expose the sector to concentration risk.

In contrast an intensive growth strategy at the initial stages of development could have provided more depth to the sector by focusing on provision of more than one product services to a large number of low income people concentrated in a particular area.

Besides the institutional composition and extensive expansion the structure of microfinance sector is found to be highly concentrated. It is dominated by top three leading microfinance institutions and each of the three groups is led by one lead player, *i.e.* the KB, NRSP and KASHF. Collectively the top three institutions have more than 60 percent of the branch network and staff registered on their pay roll.

TABLE 1

Physical Structure of Microfinance Sector 2004-07

	Personnel				Branches			
	2004	2005	2006	2007	2004	2005	2006	2007
MFBs	1376	1932	2996	3899	80	108	226	295
MFIs	507	859	1675	2374	62	81	173	259
RSPs	883	1335	2489	3214	203	339	652	600
Pakistan	2913	4526	7342	9529	362	549	1073	1165
Top 3			4474	5901			785	778

Source: PMN Annual Report.

Similarly Table 2 shows that although initially total assets of the sector increased rapidly, it is during the last two years that growth in total assets has slowed down. The asset composition of the sector reveals that the share of equity funds is not only low, its growth has also declined significantly in the last one year. Whereas the overall growth of total subsidized debt has declined but its share in total assets is over 70 percent which indicates heavy reliance on borrowings. At the same time growth in commercial liabilities has increased by more than 80 percent in the past one year which implies the sector has not generated sufficient deposits and future availability of subsidized funds is likely to be limited.

Group wise comparison indicates that asset growth of MFBs declined and was the lowest whereas the asset base of both the MFIs and RSPs grew at impressive rates of 85 percent and 52 percent respectively. However, the respective group wise asset composition during 2005-07 also shows that the share of total debt remains high and is more than 70 percent. High percentage share in the ownership of total assets as well as total debt indicate their financial dominance. Similarly, the commercial liabilities of the top three institutions have also persistently increased from 31 percent to 83 percent during 2005-07. In other words, increasing reliance on subsidized and commercial borrowings indicate that the financial structure and asset base of the sector and its three main institutions is weak to a large extent.

BREADTH, DEPTH, SCOPE AND WORTH OF OUTREACH

The four dimensions of outreach assessed include the breadth, depth, worth and scope of the sector. It is clear that during 2004-07 the overall breadth of the sector measured as total number of active borrowers increased from 0.6 million active borrowers in 2005 to 0.8 million in 2006 and further to 1.2 million in 2007, yet it remains below the target outreach of 3 million by 2010 (Appendix I). In other words, the initial growth of 100 percent during 2005-06 in breadth of outreach was followed by a decline in growth to 52 percent during 2006-07 as a backlash of expanding too fast beyond capacity (Table 3). A similar pattern of overall growth of gross loan portfolio is observed which declined from 120 percent in 2005-06 to 50 percent in 2006-07.

Group wise comparison shows, the share of MFBs in total number of active borrowers has declined from 41 percent to 34 percent during 2005-07, whereas the MFIs have gained market share from a low level of 17 percent to 33 percent and the RSPs have just managed to maintain their share of 33 percent during the same period. The breadth of outreach is also found to be highly skewed towards the top three institutions and altogether their market share is as high as 69 percent of the total active borrowers and also within their respective groups. Collectively their share has almost remained the same in total active borrowers and gross loan portfolio.

Another important dimension of performance is the depth of outreach, *i.e.* distribution of microfinance services according to gender and location.

TABLE 2

Financial Structure: % Growth and Share in Total Assets (Rs. 000)

	MFBs			MFIs			RSPs			Total			% share of Top 3		
	2005	2006	2007	2005	2006	2007	2005	2006	2007	2005	2006	2007	2005	2006	2007
TA	–	34%	10%	62%	93%	85%	39%	16%	52%	79%	31%	30%	68%	63%	63%
TE	– (35%)	37% (36%)	–10% (30%)	38% (49%)	59% (40%)	45% (32%)	–13% (25%)	36% (30%)	10% (22%)	73% (32%)	41% (35%)	5% (28%)	64% (30%)	55% (30%)	57% (25%)
TD	– (65%)	32% (64%)	21% (71%)	99% (53%)	119% (60%)	111% (68%)	74 % (75%)	9% (70%)	69% (78%)	73% (68%)	26% (65%)	43% (72%)	70% (70)	68% (70%	66% (76%)
CL	–	–23%	–21%	–	17%	269%	–24%	–10%	150%	70%	–25%	84%	31%	58%	83%

Source: PMN

TA: total assets, TE: total equity, TD: total debt, CL: commercial liabilities.

Percentages given in ( ) are the shares of total equity and debt in total assets.

Percentages without parenthesis are the growth rates of total assets, total equity, total debt and commercial liabilities.

TABLE 3

Indicators of Outreach: % Share and Growth Rate

	% share of MFBs			% share of MFIs/NGOs			% share of RSPs			% growth of Total			Share of top 3%		
	2005	2006	2007	2005	2006	2007	2005	2006	2007	2005	2006	2007	2005	2006	2007
AB	41%	39%	34%	17%	26%	33%	34%	33%	32%	100%	36%	52%	69%	55%	69%
WB	29%	37%	14%	33%	45%	58%	28%	16%	27%	90%	58%	47%	73%	70%	71%
GLP	41%	42%	35%	18%	25%	32%	30%	31%	32%	120%	48%	50%	68%	67%	71%
S	2.6%	5.2%	13%	5.8%	9.7%	26%	88%	83%	62%	19%	12%	–16%	50%	56%	84%
WS	0.93%	1.4%	4%	167%	25%	58%	78%	72%	38%	21%	21%	– 6%	55%	61%	91%
SA	50%	60%	78%	0.006%	0.007%	0.006%	48%	38%	21%	94%	73%	53%	36%	32%	22%

Source: PMN annual report

AB: number of active borrowers, WB: number of women borrowers, GLP: gross loan portfolio in Rs (000), S: number of savers, WS: Women savers, SA: total savings in Rs.

Table 3 shows the overall growth of women borrowers has slowed down from 90 percent to 47 percent between 2005-07 and the overall ratio of women borrowers to total borrowers is also low. Table 4 and 5 reports data about depth of outreach, it is shown that women borrowers are 50 percent of the total borrowers relative to 85 percent women borrowers reported in South Asia PMN (2005). Among the three groups MFIs have shown more depth and 88 percent of their clients are women, however Kashf a leading institution focusing exclusively on women borrowers during 2003-04, has more recently recorded a persistent decline in their share of women borrowers. MFBs recorded the lowest market share in extending credit to the poor women and compared to KB, FMFB has been more sensitive to the needs of the women borrowers. Although the RSPs have managed to keep a significant market share of women borrowers its share has not remained stable over the years, the ratio of women borrowers to total borrowers in case of NRSP has almost doubled between 2004-07.

Moreover it is found that most of the microfinance services are concentrated geographically in the big urban cities and the distribution of services is uneven between rural and urban areas. Rural/Urban outreach given in Table 4 reveals that overall outreach of the three groups of microfinance increased in urban areas from 31% in 2005 to 39% in 2006. This shift from rural to urban outreach is primarily because the new MFBs and RSPs have set up their network in urban areas and the rural based portfolio has been reduced. It clearly implies that most of the MFBs and MFIs focus on urban borrowers of Punjab and Sind and their customers lie above the poverty line relative to Baluchistan and NWFP where poverty level is definitely high.

TABLE 4

Depth of Outreach (in %)

	MFBs			MFIs			RSPs			Total		
	05	06	07	05	06	07	05	06	07	05	06	07
WB/AB	32	49	21	88	89	88	36	26	43	44.6	52	50.6
WS/TS	12.6	10.5	13.5	100	100	100	33.5	34.3	27.7	36.9	39.7	44.4
LSRs000	9.4	10.8	10.2	9.2	9.9	9.8	8.2	9.4	10	9.3	10	10
Rural	69	60	–	29	26	–	89	85	–	69	61	–
Urban	31	40	–	71	74	–	11	15	–	31	39	–

Source: PMN annual Report, WB/AB: Women borrowers to active borrowers, WS/TS: women savers to total savers, LS: loan size.

As far as the worth of the microfinance credit is concerned, according to prudential regulations for MFBs a person is eligible for microfinance loan if his/her earning is less than tax able limit and the maximum loan limit per person has been raised from Rs. 100,000 to Rs. 150,000. Table 4 shows that the average loan size for all the 3 groups has increased during 2005-07 and was around Rs. 10,000 in 2007. However, excluding KB from the MFB group raises the average loan per person to Rs. 20,000, this indicates that the sector has moved towards larger loan size. It is quite possible that increase in loan size is the result of change in focus towards urban areas and big cities and also because of the major shift in emphasis on commercial objective rather than the social objective of the sector.

TABLE 5

Ratio of WS/TS and WB/AB of MFBs and Top Four Institutions

	WS/TS					WB/AB				
	2003	2004	2005	2006	2007	2003	2004	2005	2006	2007
KB	–	–	–	–	–	–	–	33.3	51	15.4
FMFBL	–	12.06	13.1	16.9	21.7	–	9.49	14.5	68.7	42.2
KASHF	100	100	100	100	100	100	100	99.6	98.4	95.9
NRSP	28.7	28.8	33.4	33.5	27.7	39.2	23.03	38.7	27.4	42.7

Source: PMN Annual Report.

The scope of outreach measured as the mobilization of savings by the sector given in Table 3 indicates the overall growth in savings and number of depositors has declined in the past two years and the sector is still at an early stage of development. The total savings are only one third of the gross loan portfolio and are insignificant as a percentage of national savings (Appendix II). It implies scope of out reach is limited to credit as the main product of the sector. It is noteworthy that extensive horizontal expansion pattern of microfinance institutions is normally one dimensional and the microfinance sector in Pakistan mostly focus on one product, *i.e.* provision of credit. A comparison of the three groups shows that RSPs have the highest number of active depositors, followed by MFIs and MFBs. One reason for low savings mobilization by MFBs could be the voluntary nature of their deposits in contrast to non-voluntary deposits generated by MFIs and RSPs. Among the MFBs depositors are mostly concentrated in FMFB because of its active policy to mobilize deposits followed by NMFB and RMFB. In contrast KB has a single product service and has not yet started mobilizing deposits perhaps mainly because of easy availability of subsidized funds. In case of MFIs, savings are compulsory for all the clients of Kashf. It is also noteworthy that although growth in the number of savers of the top three institutions has persistently increased yet growth in savings has declined considerably.

In sum, the growth strategy adopted by the sector lacked intensive utilization of resources which impacted the four dimensions of outreach. The sector lagged behind in achieving the overall target outreach, its outreach in rural areas has declined and was limited to few women borrowers. The depth of outreach is low and scope of diverse microfinance services is also limited to a large extent.

COST AND LENGTH OF OUTREACH

Although the four indicators of outreach reported above provide some insight about the various aspects of performance of the sector, one limitation of the above approach is that it obscures the sustainability issue of the sector. The cost and length of outreach therefore assess the financial performance and productivity to highlight the issue of operating and financial sustainability and efficiency of the sector.[9]

TABLE 6

Financial Performance of Microfinance Sector

	MFBs			MFIs			RSPs			Total		
	2005	2006	2007	2005	2006	2007	2005	2006	2007	2005	2006	2007
AROA	–8.1	–7.2	–10.6	2.5	–0.5	5.7	–6.9	–7.8	–7	–7.2	–6.7	–6.4
AROE	–20.3	–19	–33.2	4.8	–1.1	16.4	–21.8	–27.5	–29.6	–18.7	–19	–20.9
OSS	74.6	77.4	70.6	151.6	114.8	139.5	77.6	72.8	83.5	81.6	80.4	89
FSS	53.2	60.6	56.5	114.1	97.9	125	62.6	65	70.8	61	66.5	74
NY	17.9	20.6	24	27.8	27.1	35.2	17	18.5	20.4	18.8	21.3	26.1
RY	8.8	10.7	15	17.9	16.7	25.3	7.9	8.8	11.6	9.6	11.4	16.9

Source: PMN annual reports AROA: Average return on assets, AROE: Average return on equity, OSS: operating self-sufficiency, FSS: Financial self-sufficiency, NY: Nominal yield, RY: Real Yield.

Table 6 shows that the AROA and AROE of the sector are negative and its operational and financial self-sufficiency has slightly improved yet it remains weak despite significant increase in nominal and real yield by more

[9]A comparison of our results with an earlier study on performance of microfinance sector, reported in the Financial Stability Review State Bank of Pakistan 2006, shows that our results provide an updated information about the growth and performance of the entire microfinance sector. Whereas the SBP study is restricted mostly to the performance of the MFBs for the period 2005-06.

than 20 percent in 2007. Increase in yield arising from high interest to cover cost inefficiencies is no way to long-term financial sustainability of the sector. The overall operating expense ratio of the sector is as high as 24 percent relative to the operating expense ratio of 16 percent of South Asia. Weak operational self-sufficiency of the sector may also be due to the inefficient utilization of assets. International benchmark is that 70 percent of the total asset are allocated to loan portfolio whereas in case of Pakistan the ratio of loan portfolio to total assets indicates that only 50 percent of the total assets of the sector are invested in loan portfolio. It implies that there is still the possibility of shifting funds from idle sources to micro loans, however it seems that most of the institutions avoid the risk of non-performing loans and financial losses.

TABLE 7

Financial Sustainability Ratios of Top Four Microfinance Providers

	OSS					FSS				
	2003	2004	2005	2006	2007	2003	2004	2005	2006	2007
KB	–	–	72	75.5	76	–	–	51	56	56
FMFBL	105	105	94	113	90	77	82	65	86	80
KASHF	130	187	179	154	163	115	154	126	121	145
NRSP	73	103	85	87.6	101	67	89	75	81	92

Source: PMN Annual Reports.

Group wise data shows that the MFBs are the least sustainable and their operating expense ratio is the highest, while MFIs are the most efficient both in their operational and financial self-sufficiency (Tables 6 and 7). However, variations within the groups show that KB continues to rely heavily on subsidized funds and has failed to achieve operating and financial self-sufficiency as its operating expense remains high. FMFB the second largest MFB was operationally self-sufficient in 2006 but it lost its operating and financial self-sufficiency in 2007. Similarly within the RSPs, NRSP managed to improve only its operating self-sufficiency and has yet to achieve financial self-sufficiency and show positive AROA. In other words except for MFIs like Kashf which has shown significant improvement in AROA and operating and financial self-sufficiency, growth of the sector is mainly driven by unsustainable institutions like KB, and NRSP. This tendency implies that whatever the level of growth achieved by the sector it is not reflected in reduced cost of providing microfinance.

TABLE 8

Operating Efficiency (Weighted Average)

	MFBs			MFIs			RSPs			Total		
	2005	2006	2007	2005	2006	2007	2005	2006	2007	2005	2006	2007
AOE/AGLP	31.9	35	36.4	16.1	19.9	16.7	16.9	21.7	18.6	22.4	26.7	24.7
APE/AGLP	15.4	20	19.5	10.6	12.7	10.6	8.7	12	11	11.6	15.4	14
ACB (Rs. 000)	2.6	3.1	3.0	1.3	1.9	1.6	1.4	2.1	1.8	1.9	2.5	2.3

Source: PMN annual reports, AOE/AGLP: Adjusted operating expense to Average gross loan portfolio an indicator of efficiency of loan portfolio, APE/AGLP: Adjusted personal expense ratio to Average gross loan portfolio FR: Financial Revenue Ratio (Financial Revenue/Total assets).

Table 8 shows that despite subsidized credit cost per borrower of the sector has increased during 2005-07 and the overall cost per borrower is as high as 32.5 percent relative to cost per borrower of 18 percent in South Asia.SBP (2006) Increase in cost is largely due to increase in operating and personal expense of the sector; this has serious implications for the future growth of the sector.

TABLE 9

Productivity Indicators

	MFBs			MFIs			RSPs			Total		
	2005	2006	2007	2005	2006	2007	2005	2006	2007	2005	2006	2007
B/S	128	109	112	138	130	176	157	111	126	143	114	133
B/LO	282	244	233	178	193	307	181	140	163	150	185	221
L/S	128	109	112	271	161	212	184	111	126	239	121	142

Source: PMN annual reports B/S Borrowers per Staff. B/LO Borrowers per Loan Officer. L/O Loan per staff.

Similarly Table 9 shows the overall productivity of the sector is low relative to the productivity ratios reported in South Asia, *e.g.* staff productivity ratio of South Asia is 177 compared to the productivity ratio of 133 in Pakistan. Except for MFIs whose productivity ratio is as high as 176, both MFBs and RSPs have recorded low and declining productivity ratios of 112 and 126 during 2007 due to rapid expansion of the physical infra structure of the sector. The productivity ratios of the top three are however 152 in case of KB, 189 of Kashf and 118 of NRSP.

TABLE 10

Productivity Ratios of the Top Three Institutions

	KB			Kashf			NRSP		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
B/S	144	132	152	144	158	189	132	104	118
B/LO	329	68	461	202	240	324	146	128	149
L/S	144	132	152	202	214	416	132	104	149

Source: PMN annual reports,B/S Borrowers per Staff. B/LO Borrowers per Loan Officer. L/O Loan per staff

Consequently the issue of trade off between outreach and sustainability could have been minimized if the sector had successfully raised its efficiency and productivity, for which the sector needs to rely on intensive utilization of their existing capacity to enhance outreach to a large number of potential borrowers. Reliance on costly extensive growth strategy is likely to adversely impact the future growth of the sector.

VI. CONCLUSION

The main conclusions drawn from the data set reported above are that although the microfinance sector adopted an extensive growth strategy and made some progress in various indicators of outreach and performance, yet the challenge of increasing the breadth, depth and scope of outreach at lower cost remains high. The operational and financial sustainability of the sector is weak and remains to be addressed. The overall cost per borrower is increasing and the productivity ratios are also low. The most likely reason for weak financial position of the sector is the inappropriate and costly growth strategy of over expansion which adversely affected the cost and productivity of the sector.

Group wise analysis suggests that MFBs are the least efficient among the three groups and MFIs have so far performed the best. However within the three groups variations in performance are observed, indicating that the overall performance of the group is weakened or strengthened by the performance of any one of the large institutions within the group. Within the

MFBs the financial instability of KB obscures the financial strength of FMFB; the performance of Kashf dominates the overall performance of the MFIs group within which not all MFIs are sustainable. Similar is the case with RSPs where the performance of NRSP masks the performance of the individual RSPs all of which are not financially self-sufficient.

In order to minimize the trade-off between the social and commercial objective of microfinance, the sector needs to concentrate less on extensive expansion and should focus more on utilizing the existing human resource and financial resources intensively. The targets set by the sector may be more simply achieved by adopting an intensive growth strategy.

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APPENDIX I

Financial Structure (Rs. 000)

	MFBs			MFIs			RSPs			Total		
	2005	2006	2007	2005	2006	2007	2005	2006	2007	2005	2006	2007
TA	7857010	10513729	11571078	1500523	2901119	5365192	3265721	3792044	5771637	13369483	17535510	22862066
TE	2764891	3797473	3414490	729433	1164923	1695691	831989	1134739	1254529	4291300	6077925	6418594
TD	5092119	6716256	8156588	790111	1736196	3669501	2433732	2657305	4517108	9078183	11457585	16443471
CL	975124	744999	581315	266806	313355	1157709	426292	381238	960879	1978819	1475376	2723484

Source: PMN

TA: total assets, TE: total equity, TD: total debt, CL: commercial liabilities

Share of Top Three Microfinance Institutions Rs. (000)

	Top three		
	2005	2006	2007
TA	9150213	11099240	14440955
TE	2748339	3346914	3673346
TD	6401874	7752226	10767599
CL	617550	819109	2272385

Source: PMN

APPENDIX II

Outreach (in Numbers), Gross Loan Portfolio and Savings in Rs. (000)

	MFBs			MFIs/NGOs			RSPs			Total		
	2005	2006	2007	2005	2006	2007	2005	2006	2007	2005	2006	2007
AB	248091	326498	435407	102889	217491	418234	208995	275638	404179	612744	835460	1267182
WB	78814	159869	89546	90694	193725	370016	76272	71269	174960	273368	434122	640868
GLP	2344414	3537832	4456259	947902	2142452	4104009	1706761	2593464	4057443	5688289	8445099	12749983
S	32482	70891	146258	70790	132558	292975	1066648	1133933	704318	1215896	1364470	1143551
WS	4101	7484	19790	70790	132558	292975	357413	389318	195235	449803	542120	508000
SA	679240	1419841	2822845	7894	15948	22,169	646941	900580	772318	1354567	2349383	3617332

Source: PMN

AB: number of active borrowers, WB: number of women borrowers, GLP: gross loan portfolio, S: number of savers, WS: Women savers, SA: total savings

Outreach of Top Three Microfinance Institutions

	KB			Kashf			NRSP			%Share of top 3		
	2005	2006	2007	2005	2006	2007	2005	2006	2007	2005	2006	2007
AB	227172	236917	283965	75520	133690	295396	122157	190846	292456	424849	492764	871817
WB	75725	120715	43817	75201	131491	283288	47328	52383	124996	198254	304589	452101
GLP	1923245	2147612	2652916	774430	1530321	3178784	1206032	1993579	3244991	3903707	5671512	9076691
S	–	–	–	63627	106952	266366	549822	667079	704318	613449	774031	970684
WS	–	–	–	63627	106952	266366	183815	223366	195235	247442	330318	461601
SA	–	–	–	6394	8064	12699	476150	741620	772318	482544	749684	785017

Source: PMN

AB: number of active borrowers, WB: number of women borrowers, GLP: gross loan portfolio, S: number of savers, WS: Women savers, SA: total savings