PMIC
Pakistan Microfinance Investment Company Limited

The Microfinance Sector in Pakistan:

PATHWAYS TO GROWTH

February 2024

Produced by:
Sakib Sherani (Independent Consultant)

Background and Acknowledgement

This report has been commissioned by Pakistan Microfinance Investment Company (PMIC) and funded by KfW vide BMZ no. 2008 70 261 and KfW Procurement no: 507812.

To better understand the growth dynamics of the microfinance sector in a selected sample of peer countries, and the potential limiting factors impacting the sector's growth in Pakistan, the Pakistan Microfinance Investment Company Limited ("PMIC") has commissioned a study, on the expansion of the microfinance sector in Pakistan, with an emphasis on providing policy recommendations.

PMIC is a national-level apex institution for microfinance providers in the country, registered with the Securities and Exchange Commission of Pakistan (SECP). It is licensed to undertake or carry out Investment Finance Services. It functions primarily as a wholesale lender to microfinance providers (MFPs) and rural support programs (RSPs) while engaging in policy advocacy related to the sector.

PMIC was established as an important pillar of the National Financial Inclusion Strategy (NFIS) 2015 formulated by the Government of Pakistan under the aegis of the State Bank of Pakistan (SBP) and was jointly created by Pakistan Poverty Alleviation Fund (PPAF), Karandaaz Pakistan and KfW Development Bank.

This report has been authored by Mr. Sakib Sherani of Macro Economic Insights (SMC-Pvt.) Ltd. Mr. Sherani has extensive public policy experience. He has been a member of several Prime Minister's Economic Advisory Councils and its equivalents since 2004. He has also served as Principal Economic Adviser to the Ministry of Finance, Government of Pakistan. In this position, he has negotiated with the IMF, been a core member of the government's economic reform team, as well as a member of the Revenue Advisory Council dealing with tax and FBR reform, and of the Panel of Economists of the Planning Commission.

Mr. Sherani has high-level experience in financial institutions, capital markets, the development sector, and not-for-profit entities. He remained on the board of the Rural Support Programmes Network (RSPN) as a director representing the Ministry of Finance from 2009 to 2011 and on the board of Pak-Arab Refinery Limited (PARCO) representing the Government of Pakistan.

The author would like to gratefully acknowledge the support and cooperation of Pakistan Microfinance Investment Company (PMIC), the Pakistan Microfinance Network (PMN), SECP, Dr Alok Misra of Microfinance Institutions Network – India (MFIN), Mr. Sanjay Sinha of M-Cril (India), Mr. Andrew C. McCartney of Asian Development Bank (ADB), Mr. Fahad Hasan from the World Bank, the heads of Khushali Microfinance Bank, National Rural Support Programme (NRSP), Habib Bank Limited (HBL) Microfinance Bank, Thardeep and Kashf Foundation for their generous time and insights.

Table of Contents

Glossary of Terms

ADB	Asian Development Bank
AKRSP	Agha Khan Rural Support Programme
AML	Anti-Money Laundering
Asomif	Association of Microfinance Institutions of Peru
BISP	Benazir Income Support Programme
BSP	Bangko Sentral ng Pilipinas
CAGR	Compound Annual Growth Rate
CAR	Capital Adequacy Ratio
CDF	Credit and Development Forum (Bangladesh)
CFT	Combating the Financing of Terrorism
CIB	Credit Information Bureau
CPI	Consumer Price Index
CY	Calendar Year
EDPYMES	Entities for the Development of the Small and Microenterprise (Peru)
FOGAPI	Guarantee Fund Foundation for Loans to Small Industries (Peru)
EMI	Electronic Money Institutions
GLP	Gross Loan Portfolio
INR	Indian Rupee
M-Cril	Micro-Credit Ratings International Ltd.
MF	Microfinance
MFBs	Microfinance Banks
MFIs	Microfinance Institutions
MFIN	Microfinance Institutions Network
MFP	Microfinance Provider
MNGO	Microfinance Non-Government Organisation
MRA	Microcredit Regulatory Authority (Bangladesh)
MSDP	Microfinance Sector Development Program
MSEs	Micro and Small Enterprises
MSMEs	Micro, Small & Medium Enterprises

MUDRA	Micro Units Development and Refinance Agency Ltd. (India)
NABARD	National Bank for Agriculture and Rural Development (India)
NBFCs	Non-Banking Finance Companies
NBMFCs	Non-Bank Micro Finance Companies
NFIS	National Financial Inclusion Strategy
NPLs	Non-Performing Loans
NRSP	National Rural Support Programme
NSFI	National Strategy for Financial Inclusion (Philippines)
PMIC	Pakistan Microfinance Investment Company Ltd.
PMN	Pakistan Microfinance Network
PPAF	Pakistan Poverty Alleviation Fund
RBI	Reserve Bank of India
RoA	Return on Assets
RSPN	Rural Support Programmes Network
SBP	State Bank of Pakistan
SBS	Superintendence of Banks, Insurers and Private Pension Funds (Peru)
SDGs	Sustainable Development Goals
SECP	Securities and Exchange Commission of Pakistan
SFBs	Small Finance Banks
SHGs	Self Help Groups
SIDBI	Small Industries Development Bank of India
Tk	(Bangladesh) Taka

Executive Summary

Key Findings

- Pakistan's Microfinance (MF) sector has come a long way from its modest organized beginnings in 2000. Over nearly 25 years, the footprint of microfinance has grown steadily despite setbacks and challenges, with the gross loan portfolio crossing a milestone of Rs 500 billion and a number of active borrowers at slightly over 9 million, in 2023.
- 46 percent of the borrowers are women, while the geographic coverage is across most of Pakistan, with microfinance operations conducted in 139 out of 170 districts of the country. 42 percent of the sector's lending is to borrowers in rural areas.
- The overall steady growth in microfinance outreach masks some years of serious setbacks to the sector and has been achieved despite strong headwinds. The sector has been beset by multiple challenges over the years. Super floods in 2010, 2011, and 2022 decimated large swathes of the country's rural economy and deeply impacted lives and livelihoods. The once-in-a-lifetime COVID-19 pandemic had a lingering adverse effect on microfinance borrowers during 2020-2021, with a significant deterioration in the quality of credit portfolios of microfinance providers (MFPs).
- In addition, the overall macroeconomic environment has been challenging virtually uninterrupted since 2008, with Pakistan experiencing a series of economic shocks that have stalled growth, reversed the decline in poverty, led to unprecedented inflation, especially food inflation, and increased the distress of many existing borrowers as well as the wider microfinance target population.
- The confluence of the above factors has meant that, notwithstanding the achievement of some impressive milestones, overall, MF outreach has remained below ambition, potential, expectation as well as target. The relative performance of the sector when compared with a selected cohort of "high achievers" such as Bangladesh, India, Peru, Bolivia, Indonesia, Philippines, and Vietnam over a similar period remains below par.
- According to the Pakistan Microfinance Network, Pakistan's "predicted" penetration of microfinance lending should be almost 41 million active borrowers, or 29 percent of the adult population (15 years+), from the current penetration of 6 percent.
- The impressive gains notwithstanding, the below-expectation performance of the microfinance sector in Pakistan has occurred despite strong policy and regulatory support and underscores numerous unresolved challenges and constraints, beyond exogenous shocks. The foremost of these pertains to the availability of financing. With a significant pre-emption of bank credit by the government, the banking sector has limited capacity or appetite to lend for development finance. The lack of depth in, and sophistication of, the country's capital markets preclude sector players from availing liquidity from the larger pool of national savings.
- A closely related constraint is that with the dominance of MFBs, the sector is viewed more through the prism of financial system stability than the achievement of development finance goals. The unintended consequence of this is that the cost base of MFBs relating to compliance and risk management (including provisioning requirements) is very high. This has nudged the sector to operate as smaller versions of commercial banks, with a loss-avoidance and profit-orientation mindset, rather than as specialized development finance institutions catering to the low-income unbanked segment of the population. There is a case for regulatory forbearance in some areas without sacrificing overall financial stability goals.
- The microfinance sector is also in need of product and delivery innovation and needs to graduate from a 'credit-only' to a 'credit-plus model. A more diversified product and services suite is required, which is currently too focused on individual/group microlending. Increased lending to micro-enterprises, microinsurance, micro-savings products, micro-pensions, Islamic finance products, use of co-lending arrangements, "factoring"/discounting accounts receivables of MSMEs, loans for low-cost housing, Agri-value chain financing, small vendor financing, green finance/lending for improving climate adaptation and resilience and enhancing the outreach of financial literacy are all currently under-served segments.
- Given the nature of microfinance and its geographic footprint, it can play an increasingly important role in improving

climate adaptation and building climate resilience in the communities it serves.

- Enhanced digitalization and technology adoption to improve operational efficiencies and drive down costs is required in the sector, a path that most MFBs have been taking, but which NBMFCs may be hesitant to take due to the substantial upfront capital investment required.

Key Policy Recommendations

- Pakistan's financial inclusion ambitions, and its microfinance outreach goals, will be better served by imbuing a "national mission" spirit and approach. India is a prime example of the successful mainstreaming of financial inclusion and microfinance in national development goals; while increasingly entangled in electoral politics, it nevertheless offers important lessons, together with Bangladesh, on how to achieve this mainstreaming.
- Pakistan also has a similar model that it can draw a lesson from – the successful implementation of the Benazir Income Support Programme (BISP) for cash transfers to poor and vulnerable households.
- A potential pathway in the case of Pakistan is to have a cabinet-level apex committee chaired by the finance minister overseeing the implementation of a National Action Plan on Financial Inclusion. Elevating the approach to the sector will provide greater purpose and 'accountability' to financial inclusion development goals.
- Pakistan's financial inclusion goals need to be embedded in wider institutional and structural reform. No national goal or objective can be achieved in isolation. Pakistan's financial inclusion aspirations, well thought-out and clearly articulated by competent and responsive policymakers, have suffered, however, by negative externality produced by the overall environment of political and economic instability.
- The resulting "entropy" has not only affected the demand side of microfinance, in terms of its socio-economic impact on the poor and vulnerable but has also impacted adversely the "supply side" in terms of consistent and continuous demonstration of ownership at the highest levels of policymaking, or the roll-out or implementation of an economic reforms plan that would lead to greater depth in the country's capital markets, or improvements in human capital, for example. Much-needed wider reform will also free policymakers as well as the sector from the fiscal constraints that straitjacket the regulators and the sector.
- Break-through conditions in key areas of reform are often "networked" or path-dependent on other reform areas, and success in one mission-critical area provides a platform for success in several others.
- There is a case for regulatory forbearance for the microfinance sector via "special" prudential standards. Minimum capital requirements, capital adequacy standards, provisioning requirements, or loan documentation requirements are necessary tools for risk management. However, applying the same standards as commercial banks to MFBs, especially in the early growth phase of the sector, or more so when they are grappling with recapitalization challenges, may be too restrictive.
- An example is the application of Basel III enhanced risk weights for determining capital adequacy to MFBs. For a non-systemically important part of the banking sector that is on the cusp of a potential growth spurt, the application of standards that are fitter for mature, systemically important institutions appears overly conservative.
- Similarly, the introduction of IFRS 9 will increase the potential loan loss provisioning requirements of MFBs to an unfeasible extent. The implementation of IFRS 9 has been rightly deferred for the time being by SBP, but indicating an implementation timeline for MFBs simultaneous to commercial banks appears unwarranted. The latter presents greater potential systemic risks to financial sector stability than the former.
- While regulatory forbearance for microfinance institutions in key areas is yet to materialize, periodic government-mandated forbearance and moratoria for borrowers, as witnessed especially in the post-Covid pandemic period, has the potential to undermine the development of a healthy credit culture. A credit culture based on trust, honesty, and a sense of responsibility is a necessary condition for microfinance to thrive. The expansion of "nano" loans, and the high in-built tolerance of digital lenders for loan defaults, is a further threat to a viable credit culture and needs vigilance.
- The regulators of the microfinance sector in Pakistan, SBP, and SECP, have provided competent, supportive, and responsive stewardship since the sector's early days. However, while the existing model employed in Pakistan for the regulation and supervision of MFPs has worked well in the initial phase of development, it appears to be unsuited for the next phase of growth of the microfinance sector. To graduate to the next phase, Pakistan's microfinance sector requires the conversion of MFIs into deposit-taking, 'for-profit' entities with access to the capital markets. It is also likely to witness a proliferation of mobile banking/branchless banking and Fintech-enabled digital lenders, with the volume and geographic spread of lending increasing substantially.

- To be able to cater to this expected "explosive" growth, in terms of the number of institutions, volume of lending, number of active borrowers, outreach to new-to-credit borrowers, and introduction of new delivery channels, regulators will require significant dedicated resources, additional capacity, and a greater degree of coordination than before.
- To be able to better position for this challenge, it may be prudent to consider moving to a single, dedicated, and specialized apex regulator for microfinance in which both prudential as well as market conduct or non-prudential regulations are combined under one roof. This is the regulatory model that is followed in Bangladesh, India, Bolivia, Indonesia, Cambodia, and Kenya.
- While overall, the sector has client protection safeguards, enhancements are necessary, especially in the case of nano loans by digital lenders. Greater transparency and client disclosure in effective interest rates charged, the impact of hidden fees and charges, and improved monitoring of client indebtedness appear necessary.
- With Fintech-enabled digital lenders operating in the same "space" as conventional MFPs, but with relatively fewer safeguards and lighter regulatory oversight due to their difficult-to-monitor nature, there is the danger of regulatory arbitrage. Regulators need to ensure channel neutrality.
- Gaps in institutional infrastructure with regard to microfinance need to be filled for the sector to graduate to a higher plane. These pertain to the regulation of digital lenders (discussed above), the creation of a Disaster Risk Facility (see below), the introduction of a credit rating agency specific to the MF sector on the lines of M-Cril (Micro-Credit Ratings International Ltd.) in India, scaling-up PMIC by converting it to a DFI or introducing greater institutional competition in the provision of wholesale lending, deposit insurance, and the launch of a permanent, well-designed, and cost-effective credit guarantee scheme.
- Given the vulnerability to climate change of the country, and of the communities the microfinance ecosystem serves, the microfinance sector requires a liquidity safety net in the form of a Disaster Risk Facility. This is especially important as well as urgent given the frequency as well as the magnitude of climate-related events the country has experienced.
- At the meso level, the path for graduation appears to be to move the MFIs to a for-profit model (which the regulator has in its sights), allow deposit-taking by MFIs with safeguards to enhance their financial self-sufficiency, greater digitalization, and technology adoption to drive down costs, a more client need-driven product suite, expanded financial literacy programs, and greater innovation in products as well as delivery channels.

The creation of Khushhali Bank Ltd. (currently Khushhali Microfinance Bank Ltd.) took place under a stand-alone Ordinance. This was followed in 2001 by the promulgation of the Microfinance Institutions Ordinance under which SBP licenses as well as regulates all Microfinance Banks (MFBs). Some key milestones in the development of the microfinance sector since 2000 have been as follows:

1. INTRODUCTION

Pakistan's financial depth and inclusion indicators are chronically low, especially when compared to the region or to the peer income cohort. Total bank credit to the private sector stood at 15 percent of GDP in Pakistan as of 2021, compared to nearly 39 percent of GDP for Bangladesh, and over 50 percent of GDP in the case of India, according to data from the World Bank. The regional average for South Asia was over 46 percent of GDP, and 126 percent of GDP for the low- and middle-income countries cohort.

The percentage of the adult population (15 years+) with an account at a financial institution stood at 16 percent, amongst the lowest in South Asia.[1] The proportion of women with an account with a financial institution stood at just 11 percent. In comparison, 53 percent of the adult population in Bangladesh has an account in a financial institution. 50 percent of the rural population is now banked according to the Global Findex database, with 43 percent of the adult female population banked.

The comparable figures for India are: that 52 percent of the adult population has an account with a formal financial institution. Rural penetration is around 46 percent while 52 percent of the adult female population is banked. Similarly, in terms of outreach of microfinance, Pakistan scores poorly compared to its regional peers or its income cohort.

Despite having an organized microfinance sector with a strong policy and regulatory environment for over twenty years, Pakistan has not achieved the kind of success in financial inclusion and outreach that some other peer countries have. Within the South Asia region, Bangladesh and India have managed an impressive outreach to a significant part of their unbanked population, especially in rural areas and women, over roughly the same period with microfinance as a primary driver.

With a rapidly rising population amid a weak economic environment, Pakistan needs to find ways to reach an ever-larger share of its unbanked and financially excluded population, especially those most disadvantaged and economically marginalized, such as women, educated but unemployed youth, and those living in under-developed regions of the country. With Pakistan among the most vulnerable countries to climate change, ensuring a larger footprint of financial services to upscale climate resilience measures takes an even more urgent priority.

This report covers the following main areas:

- It provides a comprehensive overview of Pakistan's microfinance sector, its historical evolution and development, market structure, and the policy and regulatory framework.
- It evaluates the recent financial and operating performance of microfinance providers (MFPs) in Pakistan, and the impact of the macroeconomic environment on the sector's development as well as performance. It also analyses the challenges the sector faces both in terms of impact on performance as well as in terms of potential growth and development of the sector.
- It compares Pakistan's financial inclusion and microfinance outreach indicators with a select group of peer countries, including Bangladesh, India, Kenya, Peru, and the Philippines.
- It reviews and analyses regulatory and policy frameworks and case studies from a select sample of countries from around the world that have achieved notable success in microfinance expansion and its socioeconomic impact. For greater relevance, the sample of countries studied includes 2 case studies from South Asia in addition to Pakistan.
- It provides a comprehensive set of policy recommendations for the government, regulatory authorities, and other stakeholders in Pakistan to facilitate the sustainable expansion of the microfinance sector and enhance both its footprint as well as its developmental impact.
- It aims to catalyze a discourse between all the stakeholders on the issues and challenges facing the sustained as well as sustainable growth of the microfinance sector in Pakistan.

2. PAKISTAN'S MICROFINANCE SECTOR: AN OVERVIEW

With the formal origins of an organized and regulated microfinance sector dating back to the early 2000s, Pakistan has developed a diverse and competitive landscape, with various types of microfinance providers (MFPs) and delivery channels. However, the sector needs greater depth and breadth to be able to accomplish national financial inclusion, microfinance outreach, and social impact goals and ambitions.

The early genesis of the microfinance movement in Pakistan can be traced to the path-breaking efforts of the Agha Khan Rural Support Programme Pakistan (AKRSP) in the 1980s, followed by a handful of not-for-profit NGOs and RSPs in the 1990s. The

[1] According to SBP, the percentage of the population that is formally served (i.e. "banked" + "other formal") stood at 23 per cent as of 2015, with another 24 per cent of the population informally served. The percentage of the total population that was "financially served" thus stood at 47 per cent, according to the last available numbers.

formalization of the microfinance sector began in 2000 with the setting up of the country's first microfinance bank, Khushhali Bank Ltd., by the Government of Pakistan as a part of the country's Poverty Reduction Strategy and the Microfinance Sector Development Program (MSDP).

The creation of Khushhali Bank Ltd. (currently Khushhali Microfinance Bank Ltd.) took place under a stand-alone Ordinance. This was followed in 2001 by the promulgation of the Microfinance Institutions Ordinance under which SBP licenses as well as regulates all Microfinance Banks (MFBs). Some key milestones in the development of the microfinance sector since 2000 have been as follows:

Key Milestones/Timeline:

2000 Creation of Pakistan's first microfinance bank (Khushhali bank); PPAF set up.

2001 Microfinance Institutions Ordinance 2001 promulgated. Prudential regulations for MFBs announced by SBP.

2003 Non-Banking Finance Companies (Establishment & Regulation) Rules introduced by SECP.

2007 National Microfinance Strategy launched under the aegis of SBP.

2008 Branchless Banking Regulations introduced by SBP.

2011 Strategic Framework for Sustainable Microfinance Framework launched by SBP.

2015 National Financial Inclusion Strategy (NFIS) launched.

2016 Non-Bank Micro Finance Company (NBMFC) category introduced by SECP, Pakistan. Microfinance Investment Company Limited (PMIC) was formed.

2023 Line of Credit (LoC) facility launched by SBP.

a. Regulatory Structure

In recognition of the fact that microfinance providers (MFPs) in Pakistan fall into two distinct categories in terms of size of institutions, their nature (for-profit versus not-for-profit and social impact), the products they offer and the markets they serve, a tiered regulatory model with regards to the microfinance sector is followed.

The microfinance sector in Pakistan operates within two distinct segments, with split regulatory jurisdiction. These segments, and the relevant regulatory framework, consisting of the following:

- Microfinance Banks (MFBs), are deposit-taking institutions regulated by SBP under the MFIs Ordinance, 2001 for licensing, minimum capital requirements, and related issues, and via Prudential Regulations for risk management.
- Non-deposit-taking Non-Bank Microfinance Companies (NBMFCs) and Rural Support Programmes (RSPs), regulated by SECP under the following framework: -
    - o Companies Ordinance, 2016.
    - o Non-Banking Finance Companies (Establishment and Regulation) Rules, 2003, as amended.[2]
    - o Non-Banking Finance Companies and Notified Entities Regulations, 2008, as amended.
- Digital lenders regulated by SECP.
- Micro Insurance Providers, regulated by SECP.

[2] SECP regulations allow for certain lending NBFCs to raise deposits subject to certain stringent conditions such as inter alia meeting minimum equity requirement, compliance with capital adequacy ratios, minimum duration of profitable operation, and listing on a stock exchange.

REGULATORY MODELS IN USE FOR MICROFINANCE

There are essentially two different types of regulatory models used for microfinance institutions (MFIs) around the world. These are:

A single apex regulator model, where a single regulatory authority is responsible for overseeing the entire microfinance industry in a country. This could either be a specialized agency created specifically for regulation and supervision of the microfinance sector, or it could be the central bank.

A second model is a tiered approach to regulation or the so-called twin peaks model. This splits the responsibility of financial regulation between two separate agencies. The first agency is responsible for prudential regulation, which involves ensuring the safety and soundness of deposit-taking financial institutions. The second agency is responsible for market conduct regulation, which involves ensuring that financial institutions treat their customers fairly and transparently.

The tiered approach model recognizes the different types of microfinance institutions, the products they offer, and the market segments they serve.

b. Industry Structure

The country's microfinance ecosystem consists of deposit-taking Microfinance Banks (MFBs), largely non-deposit taking Non-Bank Microfinance Companies (NBMFCs), split between for-profit and not-for-profit entities, microfinance operations of scheduled banks, several Investment Finance Companies (IFCs), Fintech-enabled digital lenders, Digital Banks, Credit Information Bureaus, and two regulators. It also includes two active industry associations, the Pakistan Microfinance Network, and the Rural Support Programmes Network.

As of the end of March 2023, the microfinance providers consisted of 11 MFBs and a total of 40 NBMFCs (also referred to as MFIs). The MFIs are predominantly not-for-profit NBMFCs, but also include 1 for-profit NGO, and include 9 Rural Support Programmes (RSPs) set up as Section 42 companies.

THE MICROFINANCE ECOSYSTEM IN PAKISTAN

Microfinance Providers

- MFBs
- NBMFCs (Non-Bank Microfinance Companies)
    - o For-profit NGOs
    - o Section 42 companies:
        - . RSPs
        - . Others
- Fintech-enabled NBFCs ("digital lenders")
- Commercial banks with microfinance operations
- Digital banks
- Insurance companies with Micro Insurance products
- Other (set up under Society Act 1860, Trust Act 1882, Voluntary Social Welfare Agencies

  *Registration and Control) Ordinance, 1961 or Social Welfare Ordinance, 1961).

Investment Finance Companies

Includes Pakistan Microfinance Investment Company (PMIC), a commercial wholesale lender to MFPs.

Credit Information Bureaus

- SBP CIB and e-CIB
- Private CIBs

Industry Associations

Pakistan Microfinance Network (PMN)

Rural Support Programmes Network (RSPN)

Regulators

- SBP – regulates MFBs, Digital Banks, commercial banks with MF operations, Credit Information Bureaus
- SECP – regulates NBMFCs, and NBFCs including Fintech-enabled digital lenders.

According to data from Pakistan Microfinance Network, the total number of active borrowers for the sector, as of the end of March 2023, was slightly over 9.2 million, with the Gross Loan Portfolio (GLP) amounting to Rs 509 billion. At this level, the sector's GLP was the equivalent of 0.5 percent of GDP and 1.5 percent of total credit outstanding. A comparison of the equivalent percentages for India, Bangladesh, Philippines, Peru, and Kenya is given in Table 1.

In terms of market share by segment, MFBs accounted for 66 percent of the active borrowers and 77 percent of the Gross Loan Portfolio of the sector. The five largest MFBs accounted for 79 percent of the assets of the segment, indicating a high degree of concentration in this space of the microfinance sector.
Women account for 46 percent of active borrowers, while rural clients make up 42 percent of the total borrower base. For the NBMFC segment, however, women represent 77 percent of the client base, indicating both a greater focus on, as well as success in, outreach to females. Almost 72 percent of loans outstanding are to individuals, with nearly 22 percent of lending to micro- and small enterprises (MSEs). 63 percent of the lending is unsecured in nature. Nano-loan clients account for 38 percent of the active borrowers and appear to be the fastest-growing segment.

The microfinance sector in Pakistan had 98 million micro-savers, with the total value of savings at 487.6 billion as of the end of March 2023. In terms of microinsurance, there were approximately 8.5 million policyholders, with the sum insured totaling Rs 296.3 billion.

TABLE 1. FINANCIAL INCLUSION AND MICROFINANCE INDICATORS

		Bangladesh	India	Kenya	Peru	Philippines	Pakistan
Financial Inclusion Indicators		**2021**	**2021**	**2021**	**2021**	**2021**	**2023**
Basic Info:							
Size of Adult Population (15+)	Mn	121	1,019	33	25	77	144
GDP per Capita	US$	2,688	2,389	2,099	7,126	3,499	1,597
Income Cohort		Lower MI	Lower MI	Lower MI	Upper MI	Lower MI	Lower MI
EIU Global Microscope 2020:							
Overall Financial Inclusion Rank	Rank	**=44**	**=6**	**=26**	**=1**	**=8**	**=21**
‣ Government and Policy Support		=47	6	=22	7	=15	9
‣ Products and Outlets		=34	5	=51	5	=1	17
‣ Consumer Protection		48	9	=20	=1	=17	=14
‣ Infrastructure		42	=18	17	=1	=22	=29
Percent Adult Population with:							
Financial Institution Account	%	38%	77%	51%	56%	46%	16%
Women		31%	77%	45%	51%	41%	11%
Rural		30%	77%	46%	49%	• •	12%
Mobile Money Account	%	...	...	...	...	...	...
Women		20%	5%	66%	9%	19%	3%
Rural		34%	7%	54%	9%	...	6%
Made or Received Digital Payment	%	45%	35%	78%	49%	43%	18%
Microfinance Outreach		**2023**	**2023**	**2020**	**2022**	**2022**	**Q1 2023**
No. of Active Borrowers	Mn	45.7	129.6	0.5	4.5	18.2	9.3
of which:							
Women	Mn	33	66	...	...	...	4.3
Rural	Mn	14	84	...	...	...	3.9
Micro-enterprieses	Mn	5.4	29	...	...	17	0.3
Active Borrowers as % Adult Population	%	38%	13%	2%	18%	24%	6%
Gross Loan Portfolio	US$ bn	17.9	66.7[1]	0.5	14.9	7.3[2]	1.8
Gross Loan Portfolio	% GDP	3.9	2.0[1]	0.5	6.1	1.8[2]	0.6
Share of MF in Bank Credit to Pvt. Sector	%	10%	4%	2%	13%	3.7%	

[1]Includes SHG-Bank Linkage Programme portfolio.

[2]Includes loan portfolio of cooperatives.

Sources: Global Findex Survey 2021; MIX market database; EIU Global Microscope 2020; Microcredit Regulatory Authority (Bangladesh); MFIN (India); Asomif Peru; Bangko Sentral ng Pilipinas (Philippines); Pakistan Microfinance Network.

c. Sector Performance

Despite achieving impressive milestones in microfinance outreach in its journey, the microfinance sector's financial performance has been far from steady. Since its formal, organized inception circa. 2000, the sector has encountered some major setbacks that have impacted either key players or important parts of the entire sector at different points in time.

The difficult financial and operating environment for the sector, for the MFBs, has been continuing since 2018, with a significant deterioration witnessed with the onset of the COVID-19 pandemic. The pandemic caused a major disruption in the sector dynamics, both with regard to the incomes of borrowers and the working interaction of MFPs with their client base. The effects of the pandemic on the operating and financial environment of the MF sector have persisted since 2020.

The challenging environment for MFPs has intensified since 2022. The onset of yet another balance of payments crisis caused a steep devaluation of the Rupee in 2022. This, in turn, triggered the worst, and most sustained, episode of inflation in the country's history, hurting the ability to repay many already-vulnerable borrowers. At the same time, the unprecedented hike in the policy rate by SBP to combat inflation increased sharply the sector's cost of funds.

While the sector was struggling with the fallout of these developments, Pakistan was hit by one of its worst natural disasters. A once-in-a-lifetime heat wave in early summer was followed by unprecedented precipitation causing the worst flooding in the country's history – the third major flood since 2010.

As a result of these adverse developments, loan delinquencies have risen, while operating and financial costs have expanded substantially. The infection rate of the combined loan portfolio of MFBs and NBMFCs, as measured by non-performing loans (NPLs) to total loans, rose to 4.4 percent in 2022. For MFBs, the infection rate increased to 6.7 percent of the loan portfolio as of end-2022. The portfolio-at-risk (> 30 days) for MFBs was reported to have increased to 9.5 percent by the end of March 2023. The impairment ratio for MFBs (net NPLs to capital) rose sharply in CY22 to 12.9 percent, signaling vulnerability to rising loan delinquency.

Higher provisioning requirements, the steep rise in interest expense, and the impact of inflation on administrative expense expanded the cost base of the MFPs significantly. To illustrate, the cost/income ratio of the MFBs rose sharply to 98.3 percent in CY22, from 85 percent in CY21, and 75 percent in CY18.

Therefore, the profitability of the sector has been negatively impacted. The combined return on assets (ROA) of the entire sector was negative in CY22, at (2.8) percent. For MFBs, CY22 represented the fourth consecutive year of net losses, with the number of loss-reporting institutions at 6 out of 11 comprising the MFB space. MFBs reported combined losses before taxation of Rs 21.6 billion in CY22, from a pre-tax profit of Rs 7.9 billion in CY18.

Shareholders' equity of MFBs declined significantly in CY22, to Rs 44 billion from Rs 57.2 billion in CY21. Capital adequacy was impacted in CY22 by overall losses combined with the growth in the asset base. The overall risk-weighted CAR of the MFB sector declined sharply from 18.3 percent in CY21 to 10.9 percent in CY22, well below the minimum regulatory requirement of 15 percent.

TABLE 2. PAKISTAN'S MICROFINANCE PLAYERS: FINANCIAL PERFORMANCE

	2018	2019	2020	2021	2022	CAGR 2018-22
In Billion Rs (unless stated)						
Microfinance Banks (MFBs)						
Assets	328	380	494	582	699	21%
Loans	185	207	231	278	352	17%
Gross Non-performing Loans	4.6	11.4	7.8	15.0	6.0	7%
Deposits	239	266	373	423	470	18%
Return on Assets (%)	1.7	-2.3	-1.4	-1.6	-2.7	...
Non-performing Loans Ratio (%)	2.4	5.3	3.3	5.2	5.9	...
Loans to Assets (%)	57	54	47	48	50	...
Non-Bank Microfinance Co.s (NBMFCs)						
Assets	99	113	123	147	171	15%
Loans	71	95	88	95	123	15%
Gross Non-performing loans	0	0	2	4	2	86%
Return on Assets (%)	3.0	3.7	1.7	3.0	-3.1	...
Non-performing Loans Ratio (%)	0.7	1.3	2.7	4.2	2.4	...
Loans to Assets (%)	71	84	72	65	71	...

CAGR = Compound Annual Growth Rate.
Source: Pakistan Microfinance Network 2023

3. THE MACROECONOMIC ENVIRONMENT

Since the 1990s, Pakistan's macroeconomic performance has been characterized by a secular trend of declining economic growth amid rising volatility caused by frequent boom-bust cycles. Trend economic growth has declined from over 7 per cent in the 1960s, to barely over 3 per cent in the period 1990-2022.[3]

Pakistan has also experienced multiple episodes of balance of payments stress over this period, necessitating 14 IMF programs since 1988. A relatively brief interruption to this trend was observed in the early 2000s, which helped engineer a robust decline in Pakistan's headline poverty ratio. The headline poverty rate, as measured at the national poverty line, fell steeply from over 60 percent in 2001 to less than 22 percent by 2017.

A deterioration in macroeconomic conditions since 2010, amplified by severe weather-related events in 2010, 2011, and 2022, has led to anemic economic growth overall. The effects of weak growth over this period were compounded by the substantial, and lingering, effects of the Covid-19 pandemic. In addition, the super-cycle in global commodity prices sparked by the post-pandemic recovery and reinforced by the effects of Russia's invasion of Ukraine in early 2022, has caused unprecedented inflationary pressure. Year-on-year headline CPI inflation touched 38 percent at its peak in May 2023, while food inflation averaged nearly 39 percent between July 2022 and December 2023.

As a result of these adverse developments, the trend of rapid improvement in Pakistan's headline poverty rate has reversed.

[3] As measured by the ten-year moving average of real GDP growth.

Estimates by the World Bank indicate that the poverty headcount ratio has increased to over 39 percent in FY2023, from 21 percent in FY2017. At this level, an estimated 96 million people are below the national poverty line.

To counter the sustained spike in inflation, the central bank (SBP) began an aggressive cycle of monetary tightening, increasing the policy rate to 22 percent by June 2023, from 7 percent in June 2020. With the government running fiscal deficits averaging over 7 percent since 2018, and being the largest borrower in the banking system, the steep increase in borrowing costs has put severe pressure on already-strained public finances.

Public debt has increased 152 percent between 2018 and 2023, driven largely by high-cost, shorter-tenor domestic debt. It has risen to 708 percent of total government revenue as of 2022-23, up from 531 percent in 2017-18.

The increase in interest rates in the economy, in conjunction with a larger volume of borrowing, has propelled the government's debt servicing costs by 386 percent over this period, with interest payments accounting for almost 50 percent of budget outlay in 2022-23, up from 40 percent in 2018-19. Interest payments accounted for 123 percent of net federal revenue in 2022-23, a sharp increase from 60 percent in 2017-18.

As a result, the government is the largest borrower in the banking system, crowding out the private sector from bank credit. In 2022-23, out of the total credit issued by commercial banks, the government (including the public sector) borrowed 97 percent.

This level of "crowding out" of the non-government sector is likely to intensify in the current fiscal year and possibly next, given the unfavorable debt servicing dynamic.

The high level of government bank borrowing each year for the past several years, to finance large recurring fiscal deficits, has led to fears of a "sovereign-bank nexus" developing. This refers to a situation where a country's weak fiscal position locks the banking system in a downward spiral due to the increasing stress placed on the banking system's balance sheet emanating from the government's growing deficit financing needs. Ultimately, this can lead to the complete crowding out of non-government borrowers from the banking system, or, worse, to bank failures and the need for recapitalization. Either way, the process of financial intermediation and the flow of credit in the economy is disrupted with serious, persistent

4. MICROFINANCE IN THE CONTEXT OF SELECT PEER COUNTRIES: KEY LESSONS

The microfinance "model" has been adopted by countries around the world as an important subset of financial inclusion policies to combat poverty. In 2018, an estimated 140 million borrowers benefited from micro-loans, with the global gross loan portfolio of the sector reaching an estimated US$ 124 billion. 80 percent of the borrowers were women, and 65 percent were from rural areas.

A variety of countries have witnessed very high penetration rates of microfinance in the targeted populations. India, Bangladesh, Vietnam, Indonesia, Cambodia, and the Philippines are counted among some of the largest and most vibrant microfinance markets, along with Bolivia and Peru in South America, and Kenya in Africa. South Asia has the largest number of microcredit borrowers, an estimated 85.6 million, with 89 percent estimated to be women.

Brief profiles of four country success stories in Asia and Latin America with regard to financial inclusion and microfinance penetration are presented below.

(1) India

India has made impressive strides over the past few decades in its financial inclusion ambition. 77 percent of the population now has an account with a formal financial institution, with similar percentages for women and the rural population with accounts.

In terms of outreach to microfinance, India has the world's largest population of unique microfinance borrowers at 66 million people. Total active borrowers/accounts were 129.6 million as of March 31, 2023, according to data from MFIN, while the Gross Loan Portfolio (GLP) of the sector was INR 5,473 billion, or nearly US$ 67 billion at the relevant exchange rate. The GLP amounted to around 2 percent of India's GDP and 4 percent of total bank credit outstanding for the period.

The sector has recorded exponential growth in the past decade. In 2012, the number of active borrowers stood at 26.6 million (source: MIX Market), while the MF sector's GLP stood at INR 172.6 billion. These numbers indicate an expansion of 5 times in the number of active borrowers or a CAGR of 15 percent over this period. The sector's GLP has increased 32 times over this period, at a CAGR of 37 percent.

[4]India has two separate streams for microfinance; each is reported separately. In addition to MFIs, the National Rural Livelihood Mission (NRLM) contributes significantly to the microfinance sector through its SHG Bank Linkage Programme (SBLP). The numbers presented here are the combined total for both, as reported by MFIN in India Microfinance Review FY 2022-23.

KEY FEATURES OF INDIA'S NATIONAL STRATEGY AND APPROACH

- A history of clearly articulated national goals with regard to financial inclusion, with a focus on the inclusion of women, farmers, and credit to MSMEs.they offer, and the market segments they serve.
- The overall goal of financial inclusion has been successfully mainstreamed into national development, poverty reduction, women empowerment goals, and the attainment of SDGs.
- Continuous high-level ownership and commitment.
- Significant policy and regulatory support. A significant segment of the microfinance sector benefits from priority sector designation with regard to directed lending targets, as well as liquidity support from the government. The regulatory regime is responsive, with a strong consultative framework with industry.
- A web of government programs and entities for the uplift of targeted segments, such as NABARD, NRLM, SIDBI, SFB, PMJDY, PMFBY, and SBLP among others.
- A single apex regulator for the microfinance sector (Reserve Bank of India).
- An 'apex' national coordination mechanism between different stakeholders.
- India's national effort towards financial inclusion goals has been provided a substantial tailwind as a key pillar of the incumbent Centre government's electoral strategy.
- Diverse and deep ecosystem, with multiple institutional players and distinct market segments.

a. Industry Structure

India has a dynamic and vibrant microfinance industry, with a diverse number of players. As of March 31, 2023, a total of 211 institutions were operating in the microfinance sector. The sector comprises the following institutional players:

- NBFC-MFIs
- Banks
- Small Finance Banks - SFBs
- NBFCs
- Other MFIs
- SIDBI
- SHGs

The 82 NBFC-MFIs account for most lending in the microfinance space, with almost 40 percent of the sector's combined loan book attributable to them. 13 banks active in microfinance accounted for 34 percent of the microcredit portfolio outstanding, followed by the 9 Small Finance Banks (SFBs) with a share of almost 17 percent. NBFCs (69 in number) accounted for another 8.5 percent, while Other MFIs (38) accounted for the remaining 1 percent of the Gross Loan Portfolio of the microfinance sector.

b. Regulatory Model

India has a single designated regulator for all MFIs – the Reserve Bank of India (RBI). However, under The Micro Finance Institutions (Development and Regulation) Bill, 2012, RBI could delegate some regulatory powers to NABARD.

c. Government Support

The MF sector in India has benefited from continuous government support, especially from around c.2012 onwards. The increased interest and intervention of the Indian central government, and positive support to the sector, appear to be a direct consequence of the 2010 microcredit crisis in Andhra Pradesh. In a determined effort to avoid such a crisis, successive Indian governments have provided support to the MF sector via necessary legislation, an enabling environment, policy support, liquidity, and supportive institutional arrangements. Some of these measures include:

- Continuous high-level commitment and ownership to the development of the sector, and to the expansion of financial inclusion especially to unbanked women, rural areas, farmers, and MSMEs.
- Two high-level committees were formed specifically for furthering financial inclusion. The 2008 Committee on Financial Inclusion headed by Dr. C. Rangarajan, and the Committee on Comprehensive Financial Services for Small Businesses and Low-Income Households headed by Dr Nachiket Mor and constituted by the RBI in 2013/14. The reports of these committees, especially the Mor Committee report, have set clear national goals and provided strategic guidance for the long-term expansion of financial inclusion in India.

- Priority sector designation for bank credit allocation
- Setting up of the Micro Finance Development Fund managed by RBI for liquidity support via loans and refinance, or for investment in MFIs.
- The creation of Micro Units Development and Refinance Agency Ltd. (MUDRA), a wholesale lender and refinance provider to NBFC-MFIs for on-lending to micro-enterprises (MSMEs)
- Public sector-run credit guarantee mechanisms.
- India Microfinance Equity Fund (IMEF)
- Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) and National Credit Guarantee Trustee Company Ltd (NCGTC). CGTMSE was jointly set up by the Ministry of Micro, Small & Medium Enterprises (MoMSME), and SIDBI (Small Industries Development Bank of India). In addition, a dedicated Credit Guarantee Company has been set up under NABARD for agriculture and rural sector initiatives.
- Dedicated ministry at Centre for Promotion of micro, small and medium enterprises (Ministry of Micro, Small & Medium Enterprises, MoMSME)
- A web of government entities and programs for the uplift of targeted segments, such as NABARD, SIDBI, SFB, NRLM, PMJDY, PMFBY, SBLP, MUDRA and PM Vishwakarma scheme, among others.
- Launch of a National Mission on Financial Inclusion (Pradhan Mantri Jan Dhan Yojana, or PMJDY), which includes a commitment to provide access to all households to transactions accounts with a limited credit facility backed by a guarantee fund, as well as micro-insurance, pension, and other services, alongside an effort to promote financial literacy.

In addition to high-level policy support, the approach to the attainment of national financial inclusion goals and the development of the microfinance sector benefits tremendously from a focused national coordination mechanism that brings all related stakeholders under an apex umbrella headed by the finance minister (see Box).

INDIA'S NATIONAL COORDINATION MECHANISM

India launched an ambitious National Mission on Financial Inclusion ('Pradhan Mantri Jan Dhan Yojana'), which includes a commitment to access for all households to transaction accounts with a limited credit facility backed by a guarantee fund, as well as micro-insurance, pension, and other services, alongside an effort to promote financial literacy.

The National Mission sets forth an administrative structure for monitoring at (i) the Central Level, (ii) the State Level, and (iii) the District Level. Relevant members: At the Central Level, the administrative monitoring structure is composed of a Mission Head, headed by the Minister of Finance, Corporate Affairs, and Defence, including the Minister of Communications, the Minister of Rural Development, the Governor of the Reserve Bank of India (RBI), and others. In addition, a Steering Committee chaired by the Secretary for Financial Services, Government of India, and including as members high-level representatives from RBI, the National Informatics Centre (NIC), the Indian Banks' Association (IBA) and other banks, BSNL (an Indian state-owned telecommunications company), the National Bank for Agriculture and Rural Development (NABARD), and the National Payments Corporation of India (NPCI).

Operationalization: The Mission Head monitors the implementation of the National Mission on a quarterly basis, the Steering Committee monthly, and the Mission Director on a weekly/fortnightly basis.

Source: National Financial Inclusion Coordination Structures, Country Examples. World Bank Group

[41] India has two separate streams for microfinance; each is reported separately. In addition to MFIs, the National Rural Livelihood Mission (NRLM) contributes significantly to the microfinance sector through its SHG Bank Linkage Programme (SBLP). The numbers presented here are the combined total for both, as reported by MFIN in India Microfinance Review FY 2022-23.

(2) Bangladesh

As one of the pioneers of the microfinance movement, the sector has come a long way in Bangladesh. As such the country has valuable lessons on offer in terms of developing the size and scale of microfinance, as well as its scope and social impact. In fact, the Grameen Bank model has been replicated in many countries over the years.

According to the Global Findex Database 2021, 38 percent of the population now has an account with a formal financial institution, with 31 percent of the country's women and 30 percent of the rural population formally served.

In terms of outreach of microfinance, Bangladesh has the world's highest percentage of active borrowers as a percentage of the adult population, at 38 percent, compared to 13 percent for India and 6 percent for Pakistan. Total active borrowers were 45.7 million as of June 30, 2023, according to data from the Microcredit Regulatory Authority (MRA), the regulator of MFIs in Bangladesh.

The Gross Loan Portfolio (GLP) of the entire sector stood at Tk 1,935 billion, or nearly US$ 18 billion at the relevant exchange rate for the end of June 2023. The entire microfinance sector consists of MFIs, Grameen Bank, MFBs, banks, and government departments/special programs. The GLP amounted to nearly 4 percent of the country's GDP and 10 percent of total bank credit outstanding for the period.

Three standout features define Bangladesh's microfinance sector. These are 1) the near-singular focus on women; 2) the very large share of micro-enterprises in total micro-lending; and 3) the substantial portfolio of non-credit products and services such as micro-savings, micro-insurance, financial literacy programs, and "social service" programs, including relating to building climate-change resilience.

As such, it is not too surprising that the country has one of the highest shares in the world of women in active microfinance borrowers, at around 90 percent. In terms of lending by the MF sector to micro-enterprises, over 38 percent of the sector GLP is accounted for by this segment, representing 5.4 million borrowers.

Apart from the high degree of focus on serving, from the perspective of financial inclusion, the under-served segments of the population such as women and farmers, the microfinance sector has placed significant emphasis on enhancing outreach to the underserved areas of the country. This strong focus on under-developed as well as vulnerable regions of the country such as the coastal areas, hilly areas, Char, and Haor, manifests itself not just in the penetration of microfinance services in these areas but also in the accountability and transparency in statistical reporting.

Savings mobilized by all microfinance entities combined (including MFIs, Grameen Bank, MFBs/banks, and government departments/special programs) stood at Tk 902 billion, accounting for nearly 6 percent of total bank deposits. According to data from MRA, the savings of members provided 38 percent of MFIs funding for loans, with another 33 percent coming from Own Fund/Cumulative Net Surplus of MFIs. Combined, the two sources of funding impart a high level of self-sufficiency to MFIs operating in Bangladesh.

The balance in MFIs micro-insurance fund stood at Tk 43.6 billion as of end-June 2022, with over 33.2 million borrowers covered, as per data from the Credit and Development Forum (CDF).

a. Industry Structure

Bangladesh has a large number of entities in the microfinance industry, operating across the country. These MFIs include Grameen Bank, NGOs, MFI networks, government agencies, and commercial banks offering microfinance products. In addition, there is at least one wholesale lender, the government-run PKSF or Palli Karma Sahayak Foundation (Rural Employment Support Foundation).

As of June 30, 2022, a total of 520 MFIs were operating in the microfinance sector (519 MFIs + Grameen Bank), with a combined total of 24,632 branches across the country, according to data from the Credit and Development Forum. Grameen Bank accounted for almost 11 percent of the GLP of the MF sector, and, with over 6.8 million borrowers, 19 percent of the active borrowers. The top 50 MFIs, representing almost 10 percent of the total number of entities in the sector, accounted for 76 percent of the combined GLP.

Apart from Grameen Bank, the other notable MFIs operating in the microfinance space in Bangladesh include BRAC, ASA, BRDB (Bangladesh Rural Development Board), Sonali Bank, Palli Sanchay Bank, Palli Daridro Bimochon Foundation, Jatiyo Mohila Sangstha, among a handful of others. BRDB is a government body acting as a network for MFIs not included elsewhere, while Sonali Bank and Palli Sanchay Bank are nationalized commercial banks, and Jatiyo Mohila Sangstha is a government body.

a. Industry Structure

Bangladesh has a large number of entities in the microfinance industry, operating across the country. These MFIs include Grameen Bank, NGOs, MFI networks, government agencies, and commercial banks offering microfinance products. In addition, there is at least one wholesale lender, the government-run PKSF or Palli Karma Sahayak Foundation (Rural Employment Support Foundation).

As of June 30, 2022, a total of 520 MFIs were operating in the microfinance sector (519 MFIs + Grameen Bank), with a combined total of 24,632 branches across the country, according to data from the Credit and Development Forum. Grameen Bank accounted for almost 11 percent of the GLP of the MF sector, and, with over 6.8 million borrowers, 19 percent of the active borrowers. The top 50 MFIs, representing almost 10 percent of the total number of entities in the sector, accounted for 76 percent of the combined GLP.

Apart from Grameen Bank, the other notable MFIs operating in the microfinance space in Bangladesh include BRAC, ASA, BRDB (Bangladesh Rural Development Board), Sonali Bank, Palli Sanchay Bank, Palli Daridro Bimochon Foundation, Jatiyo Mohila Sangstha, among a handful of others. BRDB is a government body acting as a network for MFIs not included elsewhere, while Sonali Bank and Palli Sanchay Bank are nationalized commercial banks, and Jatiyo Mohila Sangstha is a government body.

b. Regulatory Model

Like India, Bangladesh also has a single designated regulator for all MFIs – the Microcredit Regulatory Authority (MRA).

c. Government Support

The MF sector in Bangladesh has received significant direct as well as indirect public policy support, it has been argued (see Box below). The two most visible forms of this support have come from the availability of wholesale funding for MFIs from the designated apex organization, the parastatal PKSF, or the Palli Karma Sahayak Foundation. PKSF on-lends donor grants and assistance to MFIs, accounting for around 6.5 percent of the sector's funding needs in 2022-23, as per data from the MRA.

The second source of public sector support is international – the availability of substantial amounts of donor funding for the microfinance sector in Bangladesh.

EXPLAINING BANGLADESH'S SUCCESS IN MICROFINANCE
In Why Has Microfinance Been a Policy Success in Bangladesh (and beyond)? David Hulme and Karen Moore posit some answers. The following has been adapted from their paper for the Global Poverty Research Group (citation below).
A combination of public action, social energy, action research, a strong public service motivation instead of a purely commercial or profit orientation, the central role of public and civil society organizations as well as NGOs, visionary leadership at the helm of the microfinance 'movement', and generous donor funding appear to be leading factors that explain the success of microfinance in Bangladesh.
Some of the additional key factors touched upon in their paper include:
Innovation, design, and specification: the targeting of women, group lending model, charging market interest rates, compulsory savings, incentivizing loan repayment via sequentially higher loan sizes, the introduction of innovative products meeting client needs such as flexible loans, voluntary savings, micro-pensions, and mobile money, etc.
Learning and adaptation: starting from pilot projects, learning, adapting, and successfully up-scaling via 'standardization'.
Organizational strength + human resource availability
Substantial donor funding and the continuation of wholesale lending via an 'apex' parastatal organization, PKSF, or Palli Karma Sahayak Foundation.
Country-specific factors: industry leadership coming from a generation that witnessed first-hand the formational events of the 1970s (the country's war of independence, devastation caused by cyclones, mass poverty, and deprivation), the appointment of the head of PKSF as central bank governor, etc. has given momentum to the attainment of financial inclusion.
Finally, the capturing of the global public imagination by Dr. Muhammad Yunus and Grameen Bank has sparked the microfinance movement that has drawn public support as well as donor funds towards the sector.
"The spark of social entrepreneurship that Yunus set off has literally energized scores of other leading Bangladeshi social activists and thousands of others to try to get microfinancial and other services to poor people. The diffusion process has moved into the public sector through PKSF and, with the appointment of the Director of PKSF as governor of the central bank, this social energy seems set to sweep into the financial sector more widely."

Source: Adapted from Why Has Microfinance Been a Policy Success in Bangladesh (and Beyond)? Hulme, David; Moore, Karen. 2006

(3) Philippines

The Philippines is recognized as one of the leaders in the development of microfinance. Microfinance was adopted by the government as a tool for poverty alleviation in the 1990s. Since then, the sector has grown from a few Microfinance NGOs (MNGOs) to a diverse ecosystem consisting of over 2,900 microfinance providers, including MNGOs, rural banks, thrift banks, and cooperatives. [5]

In terms of outreach of microfinance, the total number of borrowers stood at slightly over 8.5 million as of end-December 2022, according to the Q4 2022 Financial Inclusion Dashboard of Bangko Sentral ng Pilipinas (BSP), the Philippines central bank.

Active borrowers as a percentage of the adult population were 11 percent, compared to 13 percent for India, 6 percent for Pakistan, and 30 percent in the case of Bangladesh. The Gross Loan Portfolio (GLP) of the sector stood at PHP 81 billion, or around US$ 1.4 billion at the relevant exchange rate for the end of December 2022. The GLP amounted to nearly 0.4 percent of the country's GDP, and slightly over 0.8 percent of total bank credit outstanding to the private sector for the period.

Despite government efforts and policy support, however, the outcomes with regard to microfinance outreach as well as overall financial inclusion in the Philippines remain somewhat underwhelming. According to the Global Findex Database 2021, 46 percent of the adult population had an account with a financial institution, with 41 percent of the country's women formally served. Data for financial access of the rural population is not available.

Similarly, microfinance outreach indicators suggest that a substantial portion of the target population remains under or un-served, especially the non-urban population and the agriculture and fisheries sectors. Two structural impediments that appear to be instrumental in holding back microfinance outreach in the Philippines include the delayed full implementation of the Philippine Identification System (PhilSys), and the low level of financial literacy in the country (2 percent of surveyed adults could answer all financial literacy questions), despite near-universal adult literacy (96 percent).

a. Industry Structure

The Philippines microfinance industry has a large number of providers. According to data from BSP, as of the end of December 2022, a total of 2,948 institutions were operating in the microfinance sector. The sector comprises the following regulated institutional players:

- Banks
- Microfinance NGOs (MNGOs)
- Credit cooperatives.

Microfinance and microfinance-oriented banks are rural or thrift banks that aim to reach the low-income sector, with at least 50% of their gross loan portfolios consisting of microfinance loans, as per their vision and mission statements.

In addition to these three broad categories or types, other Financial Service Providers (FSPs) that act as regulated lenders in the Philippines consist of "Other NBFIs", which include credit granting entities other than MNGOs, and supervised by BSP, and "financing and lending companies" regulated by the Securities and Exchange Commission. Data on microfinance lending for the Philippines does not include these two categories.

With the passage of the Islamic Banking Act, several specialized entities within the categories above cater to the Shariah-compliant segment of the microfinance sector.
According to the Q4 2022 Financial Inclusion Dashboard of BSP, as of end-December 2022, there were 2,783 credit cooperatives in the Philippines, with 9.7 million member depositors and accounting for 75 percent of the gross loan portfolio for the entire microfinance sector in the country. 27 accredited MNGOs accounted for 18 percent of the combined loan book of the sector, while 138 microfinance banks accounted for 7 percent.

a. Industry Structure

Several legislations and regulations underpin the operation of the microfinance sector in the Philippines. The Agriculture and Fisheries Modernization Act and the Social Reform and Poverty Alleviation Act, both enacted in 1997 and Executive Order No. 138 issued in 1999, set the stage for mainstreaming microfinance in the Philippines' development goals.

The General Banking Law of 2000 recognized microfinance services and directed the Monetary Board to formulate rules and regulations that recognize the unique characteristics of microfinance such as cash-flow-based lending without collateral.

[5] Source: Q4 2022 Financial Inclusion Dashboard of Bangko Sentral ng Pilipinas (BSP); Sector Assessment (Summary), Inclusive Finance Development Program, Sub Program 2; ADB.

Legislation was passed in 2008 to establish a comprehensive credit reporting registry, under which the Credit Information Corporation was set up, which is mandated to collect credit information from all borrowers. The Personal Property Securities Law (2018) seeks to establish a unified, centralized, online noticed-based collateral registry.

The law creating a nationwide movable collateral registry and the consolidation of existing guarantee funds under the Philippine Guarantee Corporation provides MSMEs with a way to access financing with alternative forms of collateral.

The Islamic Banking Act passed in 2019 as Republic Act No. 11439 provides the general legislative framework for Islamic banking and finance in the Philippines, including the conduct of microfinance operations.

c. Regulatory Model

In the Philippines, regulation of the MF sector is split according to the type of institution. Microfinance banks and commercial banks with microfinance operations are regulated by the central bank, the Bangko Sentral ng Pilipinas (BSP). Credit cooperatives, the largest providers of microfinance, are regulated by the Cooperative Development Authority (CDA).

Microfinance NGOs (or MNGOs) are regulated by the Securities and Exchange Commission. The Microfinance Nongovernment Organizations (NGOs) Act or RA 10693 in 2015 mandated the SEC to establish an accrediting body known as the Microfinance NGO Regulatory Council which shall, among others, institute and operationalize a system of accreditation for Microfinance NGOs, and issue certificate of accreditation to Microfinance NGOs.

d. Government Support

Various governments have provided continuous support to the MF sector in the Philippines via necessary legislation, an enabling environment, policy support, liquidity, and supportive institutional arrangements. Microfinance was adopted early on as an explicitly recognized policy instrument for the government's poverty reduction effort, as espoused in the stand-alone, sector-specific National Strategy for Microfinance issued in 1997, and supported by subsequent legislation and executive orders.

Specific laws relevant to microfinance operations have been covered in the section on "Legislative framework" (see above). Prior to 2018 and 2022 respectively, mandatory credit allocation targets were in place for MSMEs and agriculture.

A National Strategy for Financial Inclusion (NSFI) was launched by the government in 2015, providing a framework for the government and the private sector to collaborate on building a financial system that is accessible and responsive to the needs of the entire population, particularly those that are traditionally unserved or underserved.

The NSFI coordinates broad-based initiatives for greater financial inclusion. Its key elements include digital finance, financial literacy, credit information systems, the development of a movable collateral registry, diversification of financial products and services, and capacity strengthening of MNGOs. The NSFI envisaged the modernization of the National Retail Payment System to expand access to finance by linking e-payment systems to bank accounts. Nationwide financial education programs were also envisaged in partnership with stakeholders.

The supportive institutional architecture put in place by the government includes credit enhancement mechanisms such as a comprehensive credit reporting registry, the Credit Information Corporation, a centralized, online nationwide movable collateral registry, and a credit guarantee mechanism that consolidates existing guarantee funds (the Agriculture Guarantee Fund program and the Industry Guarantee Loan Fund) under the Philippine Guarantee Corporation.

[6] The number of microfinance clients includes borrowers from MNGOs and banks, but excludes, due to lack of disaggregated data, borrowers from cooperatives and any other regulated lending entities. Hence, it could be under-stating the number of microfinance borrowers as well as the other data for the sector presented here.

BOX: PHILIPPINES NATIONAL COORDINATION STRUCTURE FOR IMPLEMENTATION OF NATIONAL STRATEGY FOR FINANCIAL INCLUSION (NSFI)

All implementing agencies of the National Strategy for Financial Inclusion (NSFI) signed a Memorandum of Understanding in July 2015. In addition to Bangko Sentral ng Pilipinas (BSP) and the Department of Finance, the memorandum was signed by the Departments of Education, Trade and Industry, Social Welfare and Development, and Budget and Management, along with the National Economic and Development Authority, Insurance Commission, Commission on Filipinos Overseas, Securities and Exchange Commission, Philippine Statistics Authority, Philippines Deposit Insurance Corporation, and Cooperative Development Authority.

The BSP is to take the lead in monitoring the implementation of the NSFI and provide the necessary Secretariat assistance.

Source: National Financial Inclusion Coordination Structures, Country Examples. World Bank Group

(4) Peru

While financial depth in Peru is still below par in the Latin American context, it has nonetheless made important strides over the past decade. In terms of composite indicators of financial inclusion, Peru ranked joint number 1 in the world in the EIU Global Microscope 2020 (most recent available). In individual indicators, it ranked joint number 1 in "products and outlets" and "infrastructure". According to the Global Microscope 2020, "Latin America remains the region with the most conducive regulatory and policy environment for financial inclusion."

As per the Global Findex Survey 2021, 56 percent of adults in Peru had an account with a financial institution, including 51 percent of the adult women cohort. Rural outreach, measured by the percentage of the adult rural population with an account in a financial institution, was 49 percent. However, due to connectivity issues and relatively low mobile ownership, digital finance penetration is low in Peru, with a high gender imbalance. Only 9 percent of women had a mobile money account, as per the Global Findex Survey data.

In terms of outreach of microfinance, the total number of borrowers stood at slightly over 4.5 million as of the end of December 2022, according to data from ASOMIF Peru. This number for active borrowers translates to 18 percent of the adult population, compared to 13 percent for India, 6 percent for Pakistan, and 30 percent in the case of Bangladesh.

The Gross Loan Portfolio (GLP) of the sector stood at Peruvian Sol 56.6 billion, or around US$ 14.9 billion at the relevant exchange rate for the end of December 2022. The GLP amounted to 6.1 percent of the country's GDP, and slightly nearly 13 percent of total bank credit outstanding to the private sector for the period.

Combined, the MFIs represent about 6 percent of the total financial sector's assets.
a.Industry Structure

The microfinance sector in Peru has several institutional players. These include the following:

- Municipal Savings Banks/Municipal Savings and Loan Institutions (CMAC, or Cajas Municipales del Perú, or System of Municipal Savings and Credit Banks)
- Mibanco
- Financial Institutions Specialised in MF (financieras especializadas)
- Finance companies (empresas financieras)
- Rural Savings and Credit Banks/Rural Savings and Loan Institutions (CRAC, or Cajas Rural de Ahorroy Credito)
- EDPYMES (Entities for the Development of the Small and Microenterprise)
- FOGAPI – Guarantee Fund Foundation for Loans to Small Industries

The system also includes traditional microfinance providers (entidades de desarrollo de la pequeña y microempresa), and financial cooperatives (cooperativas de ahorro y crédito - COOPAC) on which little information is available.

The Municipal Savings and Loan Institutions, or CMAC, started their operations in the early 1980s and were created with the cooperation of the German government to replicate the success of the German Sparkassen. They are owned by local

[7] According to the Microfinance NGO Regulatory Council (MNRC), the number of accredited MNGOs as of October 2023 stood at 21.

governments and operate in provinces, helping small businesses grow by offering them financial products from funds collected in the communities.
"The Rural Savings and Loan Institutions (CRAC) were created in early 1990 after the Agrarian Bank was closed due to the 1992 financial reforms. They are owned by local private entrepreneurs and operate mainly in rural areas with large exposure in the agriculture and livestock sectors. EDPYMEs were created in the mid-1990s to formalize those NGOs that were granting loans to microentrepreneurs; this formalization became more important by the end of the 1990s when a law was passed that required NGOs to pay value-added tax on all interest from loans. Since NGOs did not have experience collecting deposits from the public, EDPYMEs were created as credit-only institutions."

d. Government and Policy Support

Peru is ranked highly in the Global Microscope rankings for government and policy support – at #7 out of 55 countries ranked by EIU as of 2021. Pakistan is ranked at 9th, while India is ranked at 6th.

In July 2019, the Ministry of the Economy and Finances issued Supreme Decree No. 255-2019-EF, which revised the 2015 ENIF. Structural challenges to financial inclusion have been explicitly recognized, and three pillars have been focused on: access, effective use, and quality services.

Over the past several years, various public money funds have been launched with the aim of broadening access to finance for MSEs and start-ups in Peru. Some of the notable ones include the MSME Fund, created by Law No. 30230; the Support Fund for Small and Medium Enterprises, established by Emergency Decree No. 050-2002; the Business Guarantee Fund – FOGEM, created by Emergency Decree No. 024-2009; and the Fund for the Productive Strengthening of MYPEs – FORPRO, created by Emergency Decree No. 008-2017.

In 2018, the above-mentioned Funds were consolidated into the CRECER FUND, or Fondo Crecer, a trust fund providing guarantees to banks and MFIs for MSE credit.

Similarly, during the COVID-19 pandemic, relief efforts such as Reactiva Peru or FAE MYPE were launched as part of government efforts to mitigate the economic impact. These provided direct concessional credit as well as public guarantees to corporates as well as financial institutions and other lenders. However, Fintechs were not included in the list of eligible entities.

The Peruvian government has made strides over the past few years to bridge the institutional as well as structural gaps in the financial architecture that were hindering greater financial inclusion. However, according to the Global Microscope 2021, Peru's areas for improvement include "connectivity" and "cyber-security".

BOX: PERU'S NATIONAL COORDINATION STRUCTURE FOR IMPLEMENTATION OF THE NATIONAL STRATEGY FOR FINANCIAL INCLUSION (ENIF)

Peru's National Strategy for Financial Inclusion (ENIF, first issued in 2015), is guided by the Multisectoral Commission on Financial Inclusion. The permanent Multisectoral Commission was created under the Ministry of Finance. The Commission was created with the objective of designing and monitoring the implementation of the National Strategy for Financial Inclusion, as well as issuing technical reports on the implementation progress and results.

The Commission is composed of representatives from the Ministry of Economy and Finance (MEF), the Ministry of Development and Social Inclusion (MIDIS), the Superintendency of Banking, Insurance, and Private Pension Funds (SBS), the Central Bank (BCRP), and Banco de la Nación. The Ministry of Education was included later as an additional member. The presidency of the Commission lies within the MEF, as well as its Technical Secretariat. In addition, the Commission can create thematic technical groups for specific areas of work within the purpose and functions of the Commission. Members of these technical groups can come from both public and private entities.

Source: National Financial Inclusion Coordination Structures, Country Examples. World Bank Group

[8] Sourced from Microfinance Regulation in Peru: Current State, Lessons Learned, and Prospects for the Future; Ebentreich, Alfredo. 2005

5. KEY LESSONS

Several countries around the world have had notable success with their financial inclusion ambition, especially in terms of enhancing microfinance outreach. These countries progress on this front has been provided momentum in the context of their pursuit of the SDGs. The countries chosen for this policy note – Bangladesh, India, Kenya, Peru, and the Philippines – have different starting points and diverse contexts, but nonetheless have commonalities in their national approaches to increasing the outreach of microfinance to their respective populations. This sample of countries can thus provide valuable lessons to policymakers on how to enhance the availability of microfinance products and services to a larger population base in a sustainable manner without undermining financial stability.

The key lessons from the approaches and experiences of the sample countries can be distilled as follows:

a. National Mission

Countries that have made notable progress towards enhancing financial inclusion have imbued a spirit and approach of a "national mission" to this goal. This goal is mainstreamed into the larger national development framework. India, together with Bangladesh, is a prime example of the successful mainstreaming of financial inclusion and microfinance in national development goals.

The "national mission" mindset ensures that there is continuous and demonstrable, high-level ownership and commitment to the goal of enhancing financial inclusion, in conjunction with a clear designation of roles and responsibilities together with accountability.

b. Social Returns-Orientation

A major advantage of having a spirit of "national mission" assigned to the successful countries' financial inclusion strategies and their goals for the development of microfinance, is that there has been greater endogenous ownership of this undertaking. Consequently, these countries have focused on social returns (and increasingly on the 'triple bottom line') rather than solely on the profits of lenders, or exclusively on the stability of the financial system.

In comparison, Pakistan's financial inclusion approach has appeared to be too external donor-driven in terms of ideas and initiatives. While Pakistan has benefited tremendously as a result of exposure to international best practices, a significant downside has been that the microfinance sector has been nudged towards 'premature' commercialization and a pervasive for-profit orientation. This has constrained the sector's growth and outreach since it has restricted government support in key areas such as the provision of wholesale liquidity and credit guarantees, or the designation of microfinance as a priority sector for lending, for example.

c. Availability of Liquidity

Since MFIs tend to be relatively thinly capitalized due to their size and nature, their reliance on liquidity to fund their lending operations is disproportionately high. In the selected sample of countries that this note examined, the microfinance sector had diverse sources of liquidity to draw upon, including:

(i) Client deposits
(ii) Institutional:
- Borrowing from banks
- Wholesale liquidity providers/lenders
- Investment by social impact funds, etc.
- Co-lending arrangements

(iii) Public sector sources via:
- Grants
- Lines of credit from the central bank
- Credit guarantee schemes (indirect)
- Equity investment
- Public-private partnerships

Examples of government/public sector liquidity support in the above categories include the Micro-Finance Development Fund managed by RBI in India for liquidity support via loans and refinance or for investment in MFIs, and the India Microfinance

[9] IMF Country Report No. 18/366 (December 2018).

Equity Fund (IMEF).

Two other important sources of financing/liquidity are:

(i) Donors
(ii) Capital markets

The way forward for Pakistan's microfinance sector in terms of augmenting the supply of liquidity and financing appears to be as follows:

(i) Allow deposit-taking by MFIs with safeguards to enhance their financial self-sufficiency.
(ii) Setting up an apex fund or organization that wholesales funding from donors and the government (on the lines of the original PPAF)
(iii) Converting Pakistan Microfinance Investment Company (PMIC), currently registered with, and regulated by, the Securities and Exchange Commission of Pakistan (SECP) as an Investment Finance Services company, to a Development Finance Institution (DFI) regulated by SBP. This will allow PMIC to tap a deeper and more varied pool of financing, enabling, in turn, the upscaling of its own wholesale lending operation to the industry.
(iv) The launch of a dedicated line of credit or a refinance facility from the central bank
(v) Use of co-lending arrangements. Co-lending or co-origination arrangements allow for the preservation of capital of MFIs/NBMFCs who typically have smaller capitalization, as well as for risk mitigation.
(vi) Graduate not-for-profit MFIs to for-profit status, thus improving their governance structure and management practices and processes, thereby enhancing their access to funding from the capital markets or external investors.

On access to capital markets, it is pertinent to note that Pakistan has amongst the smallest market capitalizations in its peer cohort, with a relatively modest contribution of the equity market in primary capital-raising.

To put this in perspective, the market capitalization of India's equity market was around 123 percent of GDP in 2023, Bangladesh 28 percent of GDP (2020), Peru 43 percent of GDP (2020), and Philippines 75 percent of GDP (2020). By comparison, the market capitalization of Pakistan's equity market stood at slightly over 8 percent of GDP as of the end of September 2023, according to data from the Pakistan Stock Exchange.

The above highlights the inter-connectedness of reforms in many different areas, and the importance of not viewing reforms in one area in isolation. Deeper capital markets would support financial inclusion goals among other economic objectives.

d. Innovation

A feature of successful country examples in terms of expanded microfinance outreach is product and delivery channel innovation. This has allowed MFPs in these countries to tailor their products according to client requirements and hence, increase their geographic footprint by introducing a wider suite of products delivered via multiple delivery channels. Coupled with greater use of technology, this innovation-driven approach has improved economies of scale and brought down transaction costs.
The broader product suite available in these countries, and that needs to be adopted more widely in Pakistan, includes:

(i) Financing for improving climate-resilience of communities (enhanced adaptation and mitigation), such as home improvement loans, weather index-based crop insurance, improved access to water, etc.
(ii) Green finance should be complemented by community training and skills development for improved natural disaster resilience.
(iii) Microinsurance products
- Crop insurance.
- Livestock insurance
- Other

(iv) Micro-pensions
(v) Micro-savings
(vi) "Factoring" or discounting of accounts receivables of MSMEs
(vii) Islamic, or Shariah-compliant, financial products, including micro-loans, savings, insurance, and pensions.
(viii) Co-lending arrangements are also in use in some markets or are being explored in others. The Reserve Bank of India (RBI) introduced amended guidelines for co-lending (or co-origination) in 2020, after which banks have tied up with

[8] Sourced from Microfinance Regulation in Peru: Current State, Lessons Learned, and Prospects for the Future; Ebentreich, Alfredo. 2005

NBFCs in an 80:20 share to lend to priority sectors such as microfinance.

Co-lending arrangements will allow for the preservation of capital of MFIs/NBMFCs who typically have smaller capitalization, as well as for risk mitigation.

Overall, a more diversified client need-driven product suite is provided in the countries with high outreach of microfinance, beyond 'credit-only'. In terms of innovation in delivery channels, one that has been adopted widely in other markets is the use of agents and Business Correspondents (BCs) by MFBs to expand their outreach.

e. Extensive Financial Literacy Programs

Another observable feature in the performance of the sample countries examined is the prevalence of extensive financial literacy programs aimed at the unbanked and under-served segments of the population, which not only enhance client protection but also prove to be an important driver for expanded outreach of financial services.

In addition to financial literacy programs, MFPs in the countries studied appear to offer a host of non-financial community capacity-building services, such as skills development. Many MFPs serving economically vulnerable or poor communities appear to have an approach of social entrepreneurship rather than a pure for-profit orientation.

f. Client Protection

According to the literature and cross-country experience, stronger client protection safeguards are an important prerequisite for greater adoption of microfinance by target populations, as they enhance the trust of potential borrowers. Pakistan has a strong consumer protection framework. According to the Global Microscope 2020, Pakistan ranks joint 14th out of 55 countries ranked globally, behind Peru at joint 5th, and India at 9th in terms of strength of the consumer protection framework. Nonetheless, there are areas of improvement as evidenced by the gap in scores with better-ranked Peru and India, or with top-ranked South Africa. Closing gaps in regulation, along with better outcomes with regard to financial literacy, especially digital literacy, will help improve client protection safeguards and in turn have a beneficial impact on the microfinance penetration rate.

In addition, the extension of the ambit of bank deposit insurance to MFBs will also enhance client protection and increase the trust of potential microfinance clients.

g. Credit Information.

Pakistan also needs to improve the coverage of its public credit registry as well as that of the private credit bureaus. According to data from the Global Microscope 2020, the coverage of the public credit registry stood at 11.7 percent of the adult population in Pakistan, compared to 39.4 percent in the case of Peru. Coverage of private credit bureaus stood at 6.7 percent in Pakistan, compared to over 36 percent for Kenya, 63 percent for India, and universal coverage (100 percent) in the case of Peru.

[9] IMF Country Report No. 18/366 (December 2018).

	Bangladesh	India	Kenya	Peru	Philippines	Pakistan
Legislation/policy framework						
Sector-specific legislation	in place	in place	in place	in place	in place	in place
Policy framework	in place	in place	in place	in place	in place	in place
Nat'l Financial Inclusion Strategy	in place	in place	in place	in place	in place	in place
Institutional mechanism for NFIS	in place	in place	in place	in place	in place	in place
Institutional architecture						
National citizen database	in place	in place	in place	in place	in place	in place
National credit registry coverage	partially in place	not in place	not in place	in place	not in place	partially in place
National movable collateral registry	information not available	information not available	information not available	information not available	in place	in place
Credit information bureaus coverage	not in place	in place	in place	in place	in place	partially in place
Regulatory space for financial innovation (eg sandbox)	information not available	information not available	information not available	information not available	in place	in place
Government support						
Liquidity support mechanism	in place	in place	information not available	in place	not in place	partially in place
Credit guarantee scheme	in place	in place	information not available	in place	in place	not in place
Mandatory credit allocation for MF	in place	in place	not in place	not in place	not in place	not in place
Client protection						
Client protection regime overall	partially in place	in place	partially in place	in place	in place	in place
Deposit insurance	not in place	not in place	in place	in place	in place	not in place
National financial literacy programs	in place	in place	partially in place	in place	in place	in place
Digital literacy	in place	in place	partially in place	in place	in place	not in place
Data regime coverage						
Unique borrowers	not in place	in place	not in place	not in place	not in place	not in place
Women	not in place	in place	not in place	not in place	not in place	in place
Rural areas	in place	in place	in place	in place	in place	in place
Micro-enterprises (MSMEs/MSEs)	in place	in place	not in place	not in place	in place	in place
Geographic coverage	in place	in place	in place	in place	in place	in place
Credit quality (loans overdue, NPLs)	in place	in place	in place	in place	in place	in place
Financial indicators - MFPs	in place	in place	not in place	in place	in place	in place
Social impact measurement	in place	in place	not in place	not in place	in place	not in place

○ information not available ● not in place ● partially in place ● in place

6. REGULATORY FRAMEWORKS AND APPROACHES IN MICROFINANCE

As noted earlier, there are two broad types of regulatory models used for microfinance providers (MFPs) around the world. These are:

- A single, apex regulator model, where a single regulatory authority is responsible for overseeing the entire microfinance industry in a country. This can either be the country's central bank or a specialized agency created specifically for regulation and supervision of the microfinance sector.
- The second model is the tiered approach to regulation or the so-called twin peaks model. This splits the responsibility of financial regulation between two separate agencies. The first agency is responsible for prudential regulation, which involves ensuring the safety and soundness of deposit-taking financial institutions. The second agency is responsible for market conduct regulation, which involves ensuring that financial institutions treat their customers fairly and transparently.

According to the World Bank, this approach can be useful in designing regulatory standards that recognize the basic differences in the structure of capital, funding, and risks faced by different kinds of microfinance institutions. In the World Bank's view, "the tiered approach to regulation can be effective in promoting the growth of microfinance institutions and expanding access to financial services for low-income individuals and small businesses."

It suggests that a transparent, inclusive framework for regulation can preserve the market specialties of different types of microfinance institutions and promote their activities, ultimately integrating them into the formal financial system. However, "the success of the tiered regulatory model depends on several factors, such as the quality of the regulatory framework, the capacity of the regulatory authorities, and the level of compliance by microfinance institutions."

Regulation of financial institutions, including MFIs, generally consists of two components:

- Prudential regulation aimed at ensuring financial system stability and integrity, to protect small depositors from losses.
- Non-prudential regulation pertains to "market conduct" or "conduct of business" regulatory issues relevant to microfinance. These issues include: enabling the formation and operation of microlending institutions; protecting consumers; preventing fraud and financial crimes; setting up credit information services; supporting secured transactions; developing policies with respect to interest rates; setting limitations on foreign ownership, management, and sources of capital; identifying tax and accounting issues; and addressing a variety of crosscutting issues surrounding transformations from one institutional type to another.

A key objective of non-prudential regulation in microfinance in most countries around the world relates to consumer protection, in particular protecting borrowers against abusive lending and collection practices, and providing borrowers with truth in lending—accurate, comparable, and transparent information about the cost of loans.

There are some generally recognized considerations in the design and application of regulatory and supervisory frameworks for microfinance. A few of the important ones include:

A trade-off between financial stability concerns and microfinance outreach and sector growth. The intent of regulation can be two-fold: prevention of abuses and fraudulent practices, or as an "enabler" for sector growth in terms of outreach, number of entities operating, their size, scope, and scale, etc. Promoting healthy competition and innovation in the sector should be among the key objectives of policymakers and regulators, and often these goals can be compromised by overly restrictive regulations.

The regulatory design should be based on the relative "maturity" of the sector. Given the rather small share of the microfinance sector overall in the country's financial assets and system, systemic risk issues arising from the failure of MFPs, especially MFBs, are relatively minor now. This suggests that regulation should be geared more towards depositor protection rather than overall financial stability considerations, though the two have important overlaps, and separating one from the other may not be entirely feasible. Nonetheless, relatively light-touch regulation with enhanced supervision, surveillance, and monitoring may provide an optimal model for microfinance institutions in the growth phase.

However, as the scale of the microfinance sector in the country increases, with regard to deposit-taking institutions, systemic risk considerations will increasingly become important while designing regulations for MFPs. At this stage, the regulatory approach and perhaps even model can be switched to a more conventional one used for financial institutions involved in intermediation.

There is a case for "special" prudential standards for microfinance. Minimum capital requirements, capital adequacy standards, provisioning requirements, or loan documentation requirements are necessary tools for risk management. However, applying the same standards as commercial banks to MFBs, especially in the early growth phase of the sector, may be too restrictive.

An example is the application of Basel III enhanced risk weights for determining capital adequacy to MFBs. For a non-systemically important part of the banking sector that is on the cusp of a potential growth spurt, the application of standards that are fitter for mature, systemically important institutions appears overly conservative.

An "end goal" should be to ultimately integrate fully the microfinance sector into the country's overall financial sector.

Avoiding using burdensome prudential regulation for non-prudential purposes.

Using minimum capital requirements as a rationing tool for prudential regulation. Conducting prudential supervision is resource-intensive and expensive, especially for many small/smaller institutions. To circumvent this, minimum capital requirements are used as a rationing tool.

Avoiding regulatory arbitrage

A well-established practice in many countries of the world is that regulation should be according to activity, not driven by type of institution per se. Hence, in the case of microfinance, all deposit-taking institutions are treated as traditional commercial banks and regulated by the central bank. The choice of regulator for Fintech is usually based on the same principle.

An important consideration in the case of Fintech-enabled digital lenders is to ensure channel neutrality i.e. there should not be any regulatory arbitrage that provides advantages to certain segments of the industry emanating from differences in regulatory oversight or burden while disadvantaging others. Such a situation can distort incentives within the sector.

Considerations of the capacity of the central bank in conducting a supervisory role for deposit-taking MFIs

Since MFIs tend to be, relative to banks, smaller in size and larger in number, operating in local, regional, and provincial environments, allowing MFIs to accept retail client deposits will widen the span of supervision by the central bank of deposit-taking institutions. This could potentially affect its supervision of the systemically important segment of the financial system, the commercial banks.

Institutional knowledge and experience of the regulator of the market segment it has to regulate.

An important consideration in the regulatory model adopted or the choice of specific regulator should be the depth of experience and institutional memory of the sector that is being regulated, along with technical expertise and related capacity. With regard to the debate on whether specialized microfinance providers should face looser or tighter capital adequacy requirements, an interesting perspective appears in the literature on the philosophy of regulation of microfinance banks. In the chapter on "Guiding Principles on Regulation and Supervision of Microfinance" in the 2008 publication of the IMF titled Current Developments in Monetary and Financial Law (Vol. 4), it is argued that there is a need for greater conservatism in the case of specialized MFBs than for diversified commercial banks. In the authors' view, this is justified by the following factors:

Even though, typically, delinquency rates of well-managed MFIs are lower than for commercial banks, the loan portfolio of MFBs tends to be more volatile than the portfolio of a commercial bank and can deteriorate quickly. "The main reason for this is that a microfinance portfolio is usually unsecured, or secured by assets that are insufficient to cover the loan once collection costs are included. The borrower's main incentive to repay a microloan is the expectation of access to future loans. Thus, outbreaks of delinquency in an MFI can be contagious."

Furthermore, because the cost base of MFBs and MFIs is usually higher than that of conventional commercial banks, a given level of delinquency is likely to decapitalize these institutions much more quickly than in the case of a typical bank. Another relevant consideration calling for conservatism, according to the IMF, is the fact that in most countries, MFIs do not have a very long track record.

Management and staff of the MFIs tend to be relatively inexperienced, and the supervisory agency has little experience with judging and controlling microfinance risk. In addition, given the early growth stage of the sector in many countries, many new MFIs are in a rapid growth phase, which puts a heavy strain on management and systems.

Finally, according to the IMF, some important supervisory tools do not work very well for specialized MFIs. "For all these reasons, a prudent conservatism would seem to suggest that specialized MFIs be subject to a higher capital-adequacy percentage than is applied to normal banks, at least until some years of historical performance have demonstrated that risks can be managed well enough and that the supervisor can respond to problems quickly enough so that MFIs can then be allowed to leverage as aggressively as commercial banks." Conventional wisdom with regards to microfinance, however, holds that applying a higher capital-adequacy requirement to MFIs, or an equivalent risk-weighting requirement to microloan portfolios in diversified institutions, will tend to lower the return on equity in microlending, thus reducing its attractiveness as a business, and affecting its ability to attract investment capital or new sources of funding. To this argument, the authors of the IMF volume have this to say:

"On the other hand, the demand for microfinance is less sensitive to interest rates than is the demand for normal bank loans, so microlenders have more room to adjust their interest-rate spread to produce the return they need, as long as all microlenders are subject to the same rules and the government does not impose interest rate caps."As highlighted earlier, Pakistan follows a split or two-tiered regulatory model, with SBP as the designated regulator for all deposit-taking institutions (MFBs), and SECP for all entities undertaking microfinance activities other than deposit-taking (NB-MFCs or MFIs).

The model appears to have worked well for Pakistan in many ways. Both regulators appear to have developed a deep understanding and knowledge of the segments they regulate and supervise. Both have engaged with industry players and stakeholders extensively and deeply; and both have been responsive to the demands and challenges presented by the sector in terms of development and growth, as well as in the case of external shocks such as the Covid-19 pandemic.

In the case of MFBs, SBP has, in its own words, "consciously tried to maintain a 'proportional' regulatory approach to promote innovation and stability." According to the central bank, "[T]he underlying principle has always been to keep balance between inclusion and

prudence."
The Prudential Regulations for MFBs relate to:

i) Stability (Capital / managing credit/operations/liquidity risks)
ii) Financial Integrity (AML/CFT), and
iii) Consumer Protection

Prudential Regulations have been segregated into four categories, namely Risk Management (R), Corporate Governance (G), Customer Due Diligence and Anti Money Laundering (M), and Operations (O).

7. A REGULATORY MODEL FOR DEVELOPMENT OF MICROFINANCE IN PAKISTAN: POTENTIAL PATHWAYS

While the existing model employed in Pakistan for the regulation and supervision of MFPs has worked well in the initial phase of development, it appears to be unsuited for the next phase of growth of the microfinance sector.
To graduate into the next phase, Pakistan's microfinance sector requires the conversion of MFIs into deposit-taking, 'for-profit' entities with access to the capital markets. It is also likely to witness a proliferation of mobile banking/branchless banking and Fintech-enabled digital lenders, with the volume and geographic spread of lending increasing substantially.

To be able to cater to this "explosive" growth, in terms of the number of institutions, volume of lending, number of active borrowers, outreach to new-to-credit borrowers, and introduction of new delivery channels, regulators will require significant dedicated resources, additional capacity, and a greater degree of coordination than before.

To be able to better position for this challenge, it may be prudent to consider moving to a single, dedicated, and specialized apex regulator for microfinance in which both prudential as well as market conduct or non-prudential regulations are combined under one roof. This is the regulatory model that is currently followed in Bangladesh, India, Bolivia, Indonesia, Cambodia, and Kenya.

With microfinance penetration and outreach relatively low in Pakistan, the share of all MFPs combined in total banking sector assets is miniscule, at 2.4 percent as of December 31, 2022. The share of all Microfinance Banks (MFBs) in the country's banking sector assets stood at 2 percent, while the asset base of the largest institution within the sector in terms of assets, U-Bank, was 0.6 percent.

Hence, the sector does not represent systemic risk issues at present that require singular supervision and surveillance of the central bank. On the other hand, a steep increase in the number of deposit-taking microfinance institutions coming under the purview of the central bank will stretch the supervisory and surveillance capacity of SBP. In such circumstances, effective supervision is unlikely and could even dilute the focus of the central bank on systemically important banks and financial institutions – its primary mandate in terms of banking supervision.

When, however, any MFI reaches a certain pre-determined threshold in terms of the size of assets and deposits, it will automatically "graduate" to the regulatory and supervisory jurisdiction of SBP. This mechanism will ensure that the goal of financial stability is not compromised.

The merits and de-merits of a move to an apex regulatory agency for the microfinance sector are discussed below.

Merits:

- A single apex regulator will provide greater regulatory focus to the microfinance sector and have a higher degree of accountability as well as intra-agency coordination for the development of the sector.
- Bringing the functions of two regulatory agencies into one institution will avoid institutional fragmentation. It will also serve to pool limited resources, especially in terms of human capital with requisite technical expertise and experience.
- By subsuming the two existing regulatory agencies into one supra-agency, rather than merging one into the other or transferring the regulatory functions relating to microfinance from one to the other, the unique institutional memory, knowledge, experience and understanding of the sector of both SBP and SECP will be preserved.
- Adoption of a single regulator model for non-systemically important microfinance institutions will allow for less-restrictive prudential regulations to be enforced and will permit sector players to explore growth opportunities with fewer constraints, such as deposit-taking by MFIs or roll out of a BC model.
- Transferring the regulatory and supervisory responsibility for non-systemically important MFIs to a newly created supra-agency will prevent the stretching thin of the supervisory and surveillance capacity of SBP caused by the steep increase in the number of deposit-taking microfinance institutions. This will ensure that SBP's effective supervision of systemically important banks and financial institutions is not compromised in any way.

De-merits:

- Any move of such a nature is likely to cause a degree of disruption during its adoption and implementation stage. However, this can be minimized by extensive prior consultation with all stakeholders, effective coordination, and a well-laid out and clearly articulated timetable as well as the sequence for rollout.
- In addition, the creation of a new supra-regulatory agency requires substantial resources, especially but not limited to, human resources. While initial staffing issues may be temporarily tided over by secondments of redundant staff from existing regulators, the full-fledged operation of a new regulator will require additional human resources which may not be readily available.

- What also may not be easily available are the fiscal resources to set up the new agency. Given Pakistan's binding fiscal constraint, with the exigencies of mounting debt servicing on the one hand, and stringent stipulations of an IMF program on the other, finding the budgetary allocation for this initiative may not be feasible in the near term.
- An important concern is that a new agency created from scratch is open to regulatory capture, not least by a political government keen to launch vote-grabbing initiatives in the microfinance space in an environment that is increasingly politicized.
- Finally, there is the potential for conflict of interest within a single apex regulator charged with competing objectives of development of the sector versus its regulation.

Any contemplated move to a new or different regulatory model for a sector with a "mature" number of players is not without risk. The costs and benefits need to be carefully considered before committing to this line of action. However, on balance, and based on experience in a sampling of countries, it appears that the advantages for Pakistan's microfinance sector of moving to a single apex regulator may outweigh any potential risks.

8. MAIN POLICY RECOMMENDATIONS

(1) Re-defining the National Mission with regards to Financial Inclusion

Pakistan's financial inclusion ambitions, and its microfinance outreach goals, will be better served by imbuing a "national mission" spirit and approach. India is a prime example of the successful mainstreaming of financial inclusion and microfinance in national development goals; while increasingly entangled in electoral politics, it nevertheless offers important lessons, together with Bangladesh, on how to achieve this mainstreaming.

Pakistan also has a similar model that it can draw a lesson from – the successful implementation of the Benazir Income Support Programme (BISP) for cash transfers to poor and vulnerable households.

Currently, Pakistan's financial inclusion strategy, and its goals for the development of microfinance, are too external donor-driven in terms of ideas that have nudged the sector towards "premature" commercialization and a pervasive 'for-profit' orientation. In the words of Hulme and Maitrot (2014):

> "Microfinance has 'lost its moral compass' by focusing more on the profitability of lenders than on the poverty of customers."

While financial stability concerns are of prime importance, the sequencing in the introduction of these concerns is mission-critical in terms of the development of a poverty alleviation platform such as microfinance. It is a difficult call for regulators, but it appears that Pakistan may have erred too early on the side of caution. Restrictive practices may have been applied that, it can be argued, may not have been warranted by the non-systemic nature of the risks posed by the microfinance sector.

(2) Elevating National Commitment and Ownership

A potential pathway in the case of Pakistan is to have a cabinet-level apex committee chaired by the finance minister overseeing the implementation of a National Action Plan on Financial Inclusion. While under the National Financial Inclusion Strategy, a national Council co-chaired by the finance minister and Governor SBP has been created, it has not been able to meet consistently to provide direction and guidance. In addition, a cabinet-level committee on the lines of cabinet committees on privatization, state-owned enterprises, etc. will be under the cabinet directly, reporting to the prime minister. Elevating the approach to the sector will provide greater purpose and 'accountability' to financial inclusion development goals.

(3) Move to a Single, Apex Regulator Model

The regulators of the microfinance sector in Pakistan, SBP, and SECP, have provided competent, supportive, and responsive stewardship since the sector's early days. However, while the existing model employed in Pakistan for the regulation and supervision of MFPs has worked well in the initial phase of development, it appears to be unsuited for the next phase of growth of the microfinance sector. To graduate to the next phase, Pakistan's microfinance sector requires the conversion of MFIs into deposit-taking, 'for-profit' entities with access to the capital markets. It is also likely to witness a proliferation of mobile banking/branchless banking and Fintech-enabled digital lenders, with the volume and geographic spread of lending increasing substantially.

To be able to cater to this expected "explosive" growth, in terms of the number of institutions, volume of lending, number of active borrowers, outreach to new-to-credit borrowers, and introduction of new delivery channels, regulators will require significant dedicated resources, additional capacity, and a greater degree of coordination than before.

To be able to better position for this challenge, it may be prudent to consider moving to a single, dedicated, and specialized apex regulator for microfinance in which both prudential as well as market conduct or non-prudential regulations are combined under one roof. This is the regulatory model that is followed in Bangladesh, India, Bolivia, Indonesia, Cambodia, and Kenya.

(4) A Richer Institutional Architecture

Gaps in institutional infrastructure with regard to microfinance need to be filled for the sector to graduate to a higher plane. These pertain to regulation of digital lenders (discussed above), the creation of a Disaster Risk Facility (see below), introduction of a credit rating agency specific to the MF sector on the lines of M-Cril (Micro-Credit Ratings International Ltd.) in India, public sector liquidity support mechanisms, scaling-up PMIC by converting it to a DFI (preferred option) or introducing greater institutional competition in provision of wholesale lending, deposit insurance, and launch of a well-designed credit guarantee scheme.

(5) Embed Financial Inclusion Goals in Wider Reform

No national goal or objective can be seen in isolation. Pakistan's financial inclusion aspirations, well thought-out and clearly articulated by competent and responsive policymakers, have suffered, however, by negative externality produced by the overall environment of political and economic instability.

The resulting "entropy" has not only affected the demand side of microfinance, in terms of its socio-economic impact on the poor and vulnerable but has also impacted adversely the "supply side" in terms of consistent and continuous demonstration of ownership at the highest levels of policymaking, or the roll-out or implementation of an economic reforms plan that would lead to greater depth in the country's capital markets, or improvements in human capital, for example. Much-needed wider reform will also free policymakers as well as the sector from the fiscal constraints that straitjacket the regulators and the sector.

Break-through conditions in key areas of reform are often "networked" or path-dependent on other reform areas, and success in one mission-critical area provides a platform for success in several others.

(6) Special Prudential Standards

As noted earlier, there is a case for regulatory forbearance for the microfinance sector via "special" prudential standards. Minimum capital requirements, capital adequacy standards, provisioning requirements, or loan documentation requirements are necessary tools for risk management. However, applying the same standards as commercial banks to MFBs, especially in the early growth phase of the sector, may be too restrictive.

An example is the application of Basel III enhanced risk weights for determining capital adequacy to MFBs. For a non-systemically important part of the banking sector that is on the cusp of a potential growth spurt, the application of standards that are fitter for mature, systemically important institutions appears overly conservative.

Similarly, the introduction of IFRS 9 will increase the potential loan loss provisioning requirements of MFBs to an unfeasible extent. The implementation of IFRS 9 has been rightly deferred for the time being by SBP, but indicating an implementation timeline for MFBs simultaneous to commercial banks appears unwarranted. The latter presents greater potential systemic risks to financial sector stability than the former.

(7) Address Sector's Liquidity Constraints.

One of the key binding constraints to the microfinance sector's development has been the lack of sufficient liquidity to cater to growth. This has been well recognized by policymakers and regulators since the National Microfinance Strategy launched under the aegis of SBP in 2007. Recently, SBP has introduced a Line of Credit worth US$ 75 million. This is a step in the right direction. However, initiatives such as these may need to be augmented to be able to finance the sector's growth ambitions.

The way forward for Pakistan's microfinance sector in terms of augmenting the supply of liquidity and financing appears to be as follows:

(i) Allow deposit-taking by all MFIs with safeguards to enhance their financial self-sufficiency.
(ii) Setting up an apex fund or organization that wholesales funding from donors and the government (on the lines of the original PPAF)
(iii) Converting Pakistan Microfinance Investment Company (PMIC), currently registered with, and regulated by, the Securities and Exchange Commission of Pakistan (SECP) as an Investment Finance Services company, to a Development Finance Institution

(DFI) regulated by SBP. This will allow PMIC to tap a deeper and more varied pool of financing, enabling the upscaling of its wholesale lending.
(iv) The launch of a dedicated line of credit or a refinance facility from the central bank
(v) Use of co-lending arrangements. Co-lending or co-origination arrangements allow for the preservation of capital of MFIs/NBMFCs who typically have smaller capitalization, as well as for risk mitigation.
(vi) Graduate not-for-profit MFIs to for-profit status, thus improving their governance structure and management practices and processes, thereby enhancing their access to funding from the capital markets or external investors.

However, with regard to access to capital markets, it is pertinent to note that Pakistan has amongst the smallest market capitalizations in its peer cohort, with a relatively modest contribution of the equity market in primary capital-raising. The market capitalization of Pakistan's equity market stood at slightly over 8 percent of GDP as of the end of September 2023, according to data from the Pakistan Stock Exchange. This compares to around 123 percent of GDP for India, 28 percent of GDP in the case of Bangladesh, and 75 percent of GDP for the Philippines.

The foregoing highlights the inter-connectedness of reforms in many different areas, and the importance of not viewing reforms in one area in isolation. Deeper capital markets would support financial inclusion goals among other economic objectives.

The issue of liquidity gains more importance in light of the fact that a vast number of the communities the sector serves are not just vulnerable to climate change but have experienced its devastating effects with increasing magnitude and frequency.

Given the vulnerability to climate change of the country, and of the communities the microfinance ecosystem serves, the microfinance sector requires a liquidity safety net in the form of a Disaster Risk Facility. This is especially important as well as urgent given the frequency as well as the magnitude of climate-related events the country has experienced.

(8) Enhanced Client Protection

While overall, the sector has client protection safeguards, enhancements are necessary, especially in the case of Nano loans by digital lenders. Greater transparency and client disclosure of effective interest rates charged, the impact of hidden fees and charges, and improved monitoring of client indebtedness appear necessary. Expanding the outreach of financial literacy is a critical objective. Underwriting client deposits via the extension of the bank deposit insurance scheme to MFBs will also enhance client protection.

(9) Avoiding Regulatory Arbitrage

With Fintech-enabled digital lenders operating in the same "space" as conventional MFPs, but with relatively fewer safeguards and lighter regulatory oversight due to their difficult-to-monitor nature, there is the danger of regulatory arbitrage. Regulators need to ensure channel neutrality.

(10) Product Innovation

Greater clients' need-driven product innovation is required in the sector. The emphasis on the current 'credit-only' model needs to be widened to a 'credit-plus model'. Overall, a more diversified client need-driven product suite is provided in the countries with high outreach of microfinance, beyond 'credit-only'. A sampling of the product suite available in these countries, one that needs to be adopted more widely in Pakistan, is as follows:

(i) Financing for improving climate-resilience of communities (enhanced adaptation and mitigation), such as home improvement loans, weather index-based crop insurance, improved access to water, etc.
(ii) Green finance should be complemented by community training and skills development for improved natural disaster resilience.
(iii) Financing of agriculture value chains
(iv) Islamic, or Shariah-compliant, financial products, including micro-loans, savings, insurance, and pensions.
(v) Microinsurance products
i. Crop insurance.
ii. Livestock insurance
iii. Other
(vi) Micro-pensions
(vii) Micro-savings
(viii) Low-cost housing
(ix) "Factoring" or discounting of accounts receivables of MSMEs
(x) Vendor financing

(xi) Co-lending arrangements are also in use in some markets or are being explored in others. The Reserve Bank of India (RBI) introduced amended guidelines for co-lending (or co-origination) in 2020, after which banks have tied up with NBFCs in an 80:20 share to lend to priority sectors such as microfinance-lending arrangements will allow for the preservation of capital of MFIs/NBMFCs who typically have smaller capitalization, as well as for risk-mitigation.

In terms of innovation in delivery channels, one that has been adopted widely in other markets is the use of agents and Business Correspondents (BCs) by MFBs to expand their outreach.

(11) Expanding the Coverage of Financial Literacy Programs

A significant impediment to greater financial inclusion in Pakistan is the overall low educational attainment of a large part of the population, especially with regard to financial literacy. The latest available Global Financial Literacy Survey conducted by Standard and Poor's Ratings Services showed that only 26 percent of adults were financially literate in Pakistan.

Without an understanding of financial products and basic self-financial management, a significant portion of the target population for microfinance services will either remain excluded due to a lack of knowledge of, as well as confidence and trust in, the products and financial services on offer or may potentially fall prey to abusive practices. In addition, without the requisite basic numeracy and financial skills, potential borrowers are vulnerable to over-indebtedness. Hence, financial literacy programs can not only enhance client protection but are also likely to increase the demand for financial products and services. In all cases, enhancing financial literacy will prove to be an important driver for expanded outreach of financial services.

Currently, there are several initiatives and programs to promote financial literacy in the field. These include:

a. The National Financial Literacy Program (NFLP)

NFLP was rolled out in 2017 by SBP across 77 districts of Pakistan through SBP—BSC field offices in collaboration with commercial/ microfinance banks and partner institutions (NGOs, MFIs, and RSPs). This was originally a five-year program with a total target of one million beneficiaries.

b. The National Financial Literacy Program for Youth (NFLP-Y)

The basic aim of the program is to impart essential financial literacy education to Pakistani youth and school-going children to strengthen their money-management skills and understanding of financial matters.

c. The JamaPunji Program

SECP launched the JamaPunji program to inculcate a culture of financial literacy among the public and to reduce the vulnerability of investors to fraud. A web portal was launched by SECP to provide online education, while also reaching out to its target audience through other means such as print media. SECP also requires all publicly traded organizations to include a link to the JamaPunji website on their own website.

d. Farmers' Financial Literacy Programs (FFLP)

In addition to NFLP, SBP has also taken measures to engage with other target segments such as farmers. The Farmers' Financial Literacy Program (FFLP) is one such financial literacy and awareness-building program.

e. Pakistan Remittance Initiative (PRI)

To increase the financial literacy of migrant laborers, PRI launched a program in 2016. PRI also provides education through its pre-departure program located in seven Protectorate of Emigrant Offices across the country, where banks can also market their Asaan accounts to migrants so that they may open accounts before going overseas.

Success in expanding financial literacy will require the coordinated effort of various stakeholders, including the regulators, financial institutions, MFPs (both MFBs as well as MFIs), RSPs, telecom companies, schools, and higher educational institutions, as well as corporates.

(12) Credit Information

Pakistan also needs to improve the coverage of its public credit registry as well as that of the private credit bureaus. According to data from the Global Microscope 2020, the coverage of the public credit registry stood at 11.7 percent of the adult population in Pakistan, compared to 39.4 percent in the case of Peru. Coverage of private credit bureaus stood at 6.7 percent in Pakistan, compared to over 36 percent for Kenya, 63 percent for India, and universal coverage (100 percent) in the case of Peru.

At the meso level, the path for graduation appears to be to move the MFIs to a for-profit model (which the regulator has in its sights), allow deposit-taking by MFIs with safeguards to enhance their financial self-sufficiency, greater digitalization, and technology adoption to drive down costs, a more client need-driven product suite, expanded financial literacy programs, and greater innovation in products as well as delivery channels.

REFERENCES

Asian Development Bank. (2020). Inclusive Finance Development Program (Subprogram 2): Sector Assessment (Summary) – Finance.
Beck, T. (2015). Microfinance—A Critical Literature Survey. IEG Working Paper 2015/4.
Convergences. (2019). Microfinance Barometer 2019.
Credit and Development Forum. (2021-2022). Bangladesh Microfinance Statistics 2021-22.
Economist Intelligence Unit (EIU) 2020. Global Microscope.
European Microfinance Platform. (2023). The Financial Inclusion Compass 2023.
Hartungi, R. (2007). Understanding The Success Factors of Micro-Finance Institutions in A Developing Country.
Hulme, D., & Moore, K. (2006). Why Has Microfinance Been a Policy Success in Bangladesh (and beyond)?
International Finance Corporation. (2015). Small Beginnings for Great Opportunities: Lessons Learned From 20 Years of Microfinance Projects In IFC.
International Monetary Fund. (2018). Peru –Financial Sector Assessment Program. IMF Country Report No. 18/366.
International Monetary Fund. (2008). IMF: Current Developments in Monetary and Financial Law (Vol. 4).
Microfinance Industry Network (MFIN) India. (2023). India Microfinance Review FY2022-23.
Microcredit Regulatory Authority. (n.d.). Microcredit Regulatory Authority Bangladesh. Www.mra.gov.bd. Accessed 29 January 2024.
Pakistan Microfinance Network. (2023). Microwatch (Issue 67).
Reserve Bank of India. (n.d.). RBI website. Www.rbi.org.in. Accessed 27 January 2024.
Securities and Exchange Commission of Pakistan. (n.d.). SECP website (www.secp.gov.pk): regulations, rules, microfinance guidebook. Accessed at various dates.
State Bank of Pakistan. (2022). Financial Stability Review.
State Bank of Pakistan. (2015). National Financial Inclusion Strategy.
State Bank of Pakistan. (2015). Access to Finance (A2F) Survey.
State Bank of Pakistan. (2011). Strategic Framework for Sustainable Microfinance in Pakistan.
State Bank of Pakistan. (2007). National Microfinance Strategy.
State Bank of Pakistan (n.d.). Prudential regulations, rules, circulars. www.sbp.org.pk. Accessed at various dates.
World Bank. (2021). Global Findex Survey.
World Bank. (n.d.). MIX Market database. Www.datacatalog.worldbank.org. Accessed at various dates.
World Bank Group. (2022). National Financial Inclusion Strategies Resource Centre. Www.worldbank.org. Accessed at various dates.

PMIC
Pakistan Microfinance Investment Company Limited

21st Floor, Ufone Tower, 55 C, Main Jinnah Avenue, Blue Area,
Islamabad 44000, Pakistan
Tel: (+92-51) 8487820-45 | Fax: (+92-51) 8487846-7
Email: info@pmic.pk

www.pmic.pk /PMIC