

Committee on Rural Finance

**Micro Credit Methodologies and the Role of the Rural Support
Programmes in delivery of Microcredit in Pakistan**

By Dr. Rashid Bajwa
Member (co-opted)
CRF
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Background

South Asia has one of the largest concentrations of the poor in the world. Nearly a billion people in about 180 million households are constrained to live in abject poverty¹. Pakistan is no exception and it is seen that absolute poverty is experienced by about 30.6% of Pakistan's population with a National poverty line of Rs. 670 per capita per month in 1998-99. This entails that about 40 Million poor are living below US \$ 1.65 Per Person Per Day (PPP). This is 65% higher than the internationally accepted norm for absolute poverty i.e. \$ 1 per capita per day (in PPP terms). If poverty is measured by the broader (and more appropriate) human Poverty Index of UNDP, the % below this poverty line is about 50% i.e., about 72 Million Pakistani Citizens are poor². In per capita terms, Pakistan's production and income levels stand less than half of those of Indonesia and the Philippines.

The I-PRSP prepared by the Government of Pakistan emphasizes that many forms of poverty in Pakistan especially income poverty are fairly acute and cannot wait for growth to trickle down before they can be addressed. To deal with such forms, it is required that targeted policy interventions be undertaken to provide quick relief through short-term employment opportunities and financial assistance³. In addition, the paper states that access to credit is the surest way of empowering the poor and improving their income generating opportunities. International experience has also shown that Micro Credit can be an important instrument in improving the income generating capabilities of the poor. The Micro Credit+5 Summit, held in November 2002 in New York has also come to the same conclusion that Micro Finance helps in income generation and Poverty alleviation.

However, due to lack of collateral and weak asset base, it is very difficult for the poor to get credit from public and private financial institutions in spite of the fact that the small borrowers exhibit a lower credit risk than larger borrowers.

Status of Microfinance in Pakistan

According to one estimate, there are about 6.5 Million clients requiring Micro Finance services in Pakistan⁴. Pakistan's Micro Finance strategy has a multi pronged approach. A dedicated legislation has been promulgated to facilitate the growth of this factor. The Government has set up apex institutions like the Pakistan Poverty Alleviation Fund as well as retail institutions like the Khushhali bank for providing retail micro finance services. In addition, the Rural Support Programmes in Pakistan are pursuing a holistic approach which includes micro finance services for poverty alleviation. We even have a network of most NGOs and RSPs in the form of the Pakistan Micro Finance Network that publishes performance indicators on a half-yearly basis; something very few countries are pursuing. However, despite an enabling environment, the outreach and coverage of all Programmes put together remains limited.

Lending Methodologies of MFIs in Pakistan

Public Sector/Commercial Bank model:

Listing of Institutions involved in Micro credit depends upon whether these institutions get collateral for their loan assets. Public sector institutions are generally involved in Agriculture loaning which

¹ Key note address by Begum Sahiba Musharraf in Microcredit summit+5

² Pakistan Human Condition Report 2002, Centre for Research on Poverty reduction and income distribution (CRPRID) 2002, pp 61

³ Pakistan, Interim Poverty Reduction Strategy Paper (I-PRSP), Government of Pakistan, Nov. 2001

⁴ Report of Committee on Rural Finance, State Bank of Pakistan, 2002

they term as micro credit and is usually collateralized. For example, the ADBP (now the Zarai Taraqiati Bank Ltd.) provide loans against agriculture pass book that collateralizes the clients land holdings. Within the purview of the ADBP, several programmes were attempted – this also included a small credit programme for women provided through mobile teams. However, the fact that all these initiatives were subsidized and no measures for sustainability were included, they led to the typical rent seeking outcomes and poor financial performance that have emerged in other developing economies across the board⁵.

Most Nationalized Commercial banks follow suit having been given mandatory targets by the State Bank of Pakistan that also penalizes in case of non-compliance. However, for most of them, the disbursements and recoveries are so tedious that they prefer paying penalties. Mode of all Agriculture Finance is lump sum.

Recently the Khushhali bank has been set up by the Government of Pakistan which is providing retail micro finance pursuing more or less the RSP model. The Khushhali Bank initially started its operations by undertaking a joint venture with the NRSP in 4 different locations, however, after some time this strategy could not work out. During the pilot stage several new mechanisms were tested and the concept of growth through “hubs” was developed. The Bank offers two basic loan products, that is a bullet loan which is primarily for supporting agricultural activities and a monthly installment based loan for trading activities. The term period of the trading loan is less (usually 1 year) than the agricultural loan, which can be up to 3 years. The current portfolio is equally divided between the two types of loans. In terms of outreach, the bank has 30 branches

The RSP Model

The RSPs uses the forum of COs for delivering small loans. Loans are given through CO to individual members for productive purposes only. Prime responsibility for identifying borrowers and assessing the character of the borrowers' lies with the CO. RSP staff appraises requests for credit to determine profitability of the proposed activities and assessing repayment capacity of the borrowers. RSP disburses loans at the CO level and the CO is responsible for depositing the repayments with RSP mobile staff or RSP offices. Thus, the CO acts as a guarantor for the RSP loan. The forum of CO creates social pressure for the borrowers to repay RSP loans on time. RSP recovers service charges on loans. Rate of service charges is determined after careful market surveys and assessment of capacity of poor borrowers.

The RSPs continue to be the largest service providers in the Micro Finance sector. Their combined outreach is almost 2/3 rd of all micro credit activities in Pakistan.

The NGO Model

NGOs that are prominent in delivery of MF services have missed methodologies. Some pursue the Grameen methodology and are called Grameen replicators. Others use solidarity group based approach. Most of them are in the Urban/peri urban areas, focus on women clients but have a limited outreach. Some of them like the Kashaf have plans to grow rapidly. NRSP also has an Urban Credit Programme that follows a group based, women focused approach which is different from the RSP rural credit approach.

⁵ Roshaneh Zafar, Country paper on Pakistan Microfinance in the private sector, 2002

Lending methodologies of major MFIs in Pakistan as part of the Pakistan Micro Finance Network (PMN) is as follows:

NRSP (The RSP Approach)

The National Rural Support Programme is the largest MFI in the country. It was set up with a grant from the Government of Pakistan. The methodology used by NRSP is now known as the RSP approach towards Micro Credit in Pakistan. The details of lending methodology of NRSP is attached at Annex A.

NRSP uses the forum of COs for delivering small loans. Loans are given through CO to individual members for productive purposes only. Prime responsibility for identifying borrowers and assessing the character of the borrowers lies with the CO. NRSP staff appraises requests for credit to determine profitability of the proposed activities and assessing repayment capacity of the borrowers. NRSP disburses loans at the CO level and the CO is responsible for depositing the repayments with NRSP mobile staff or NRSP offices. Thus, the CO acts as a guarantor for the NRSP loan. The forum of CO creates social pressure for the borrowers to repay NRSP loans on time. NRSP recovers service charges on loans. Rate of service charges is determined after careful market surveys and assessment of capacity of poor borrowers.

AKRSP (The RSP Approach)

The Microfinance Program offers four main financial services. Traditionally the Village and Women's Organizations AKRSP works with have accumulated their savings collectively to be deposited in bank branches in the local area. AKRSP continues to provide V/WOs the training and audits that facilitate this savings service. Using these V/WO savings as collateral AKRSP offers a Group Loan to V/WOs. These Group Loans are disbursed to the V/WO, who then disburse and collect the funds from their individual members. AKRSP also offers an Individual Loan for any V/WO member that wants to approach AKRSP directly for a loan to finance an enterprise. Finally, AKRSP has started a new Business Committee Loan, which is intended for groups of business owners in the urban centers of Northern Pakistan.

The Bank of Khyber (Individual lending and financial intermediation)

Besides direct lending to individual micro-entrepreneurs, BOK uses the concept of financial intermediation for linking up with remote communities through NGOs. Group loans to men and women organizations are also introduced thereby replacing the traditional forms of security with peer pressure and collective liability. BOK also has the privilege to explore lending relationships with industrial clusters and skill-based organizations. BOK has the following for the following four four-pronged strategies:

- Direct lending to individual micro-entrepreneurs
- Group lending through facilitators in rural areas
- Lending through business clusters in urban centers and
- Small towns wholesaling of funds to facilitators for on-lending in rural areas

DAMEN (Group-Lending)

DAMEN's Revolving Loan Fund Program was initiated in October 1996 with the aim of social and economic empowerment of women engaged in income-generating activities. A credit management

team was formed and through training and exposure visits to other organizations an idea for a model credit management system based on 'group-lending' was developed. While formulating the program policy special consideration was given to the fact that women were at liberty to opt for the business of their choice.

Kashaf Foundation (Group-lending...Grameen approach)

Kashaf's approach is where women from low-income communities form into centers comprising of core groups of five, who then take responsibility for each others repayments. The entire centre ensures both the timely repayment of loans and provides a key resource for managing businesses and sharing information. The strategy also relies on setting up decentralized operations through a network of local branches, which are staffed by women from the local area. This ensures confidence building, trust and the ability to cater to women's economic needs on an on-going basis.

OPP (Individual Lending)

OCT supports people's initiative through providing credit to existing micro-enterprises at the bank rate of interest, without collateral (personal guarantee of 2 neighbors), of amounts ranging from Rs. 2,000 to Rs. 50,000 through simple procedures. Also to train NGOs/CBOs to enable them to initiate micro credit programmes in their community. Selection, disbursement and recovery of loan are done by OCT with the help of good borrowers.

SRSP (The RSP Approach)

SRSP's Credit Program aims at increasing the access of the rural poor to credit for productive purposes, ensuring that a local pool of capital is generated for long term community access to credit and encouraging micro-enterprise development initiatives for increasing productivity and income. Small loans required by the members of the Community/Women Organizations are given through a transparent process of identification of deserving members (with a primary focus on poorest of the poor) by the community itself. The community as a group undertakes to ensure the timely recovery of such loans. Clients avail credit for livestock, micro-enterprise and agriculture from three credit windows of SRSP i.e. short, medium and long-term. The tenure for credit loan repayment ranges from six to thirty months depending upon the purpose for which the credit is needed.

SAFWCO (Group Lending)

The Credit and Enterprise Development (CED) sector aims to enhance the socio-economic status of vulnerable groups through sustainable income generation activities. It specifically operates to:

- Mobilize the community groups for saving
- Form male and female saving groups in the villages
- Provide credit facility to the poor/vulnerable groups specially women
- Accelerate economic development through local investment
- Create job opportunities
- Train potential entrepreneurs for managerial and technical skills
- The program area consists of District Sanghar, Sindh.

The social organization sector identifies the villages for credit and saving activities on the basis of their socio-economic situation. The Program Officer of the CED sector then holds meetings with the COs on credit and saving policies and forms a credit committee to identify the poor for loans and for

monitoring the credit program. Later, applications for credit are invited from the potential users through CCs. They initially scrutinize the applications and recommend the applications to the CED for credit disbursement. Members of credit committee, guaranteeing proper use and recovery, give the final approval for credit. The targeting, processing, disbursement, utilization and recovery procedures for credit are based on community participation, involving all members of the CO.

Sungi Development Foundation (Group Lending)

The program was started on a theme of saving first-credit later; which reflects the importance of community saving for their economic uplift. The major responsibilities of CED include:

- To support in mobilization of community savings.
- Credit disbursement to the of village committee members for economic or critical social needs.
- Training to the communities for financial management (Saving, Credit and Entrepreneur ship"
- Vocational Skill Enhancement Support

Taraqee Foundation (Group lending...Grameen approach)

The main objective of Taraqee is to improve the living conditions of the rural and urban population of Baluchistan, especially the least prosperous and deprived section of communities. In order to achieve this objective TF works for:

- Awareness creation regarding the concept of true development, aiming at quality of life improvement based on self-help reliant community organization participants.
- Problem identification and need assessment, which will clearly identify in the minds of community members the main problems, core issues and the greatest priority needs to be addressed. It has been experienced that communities are generally aware of ways in which their environment can be improved and have been requesting for various development programmes.
- Resource mobilization, which identifies the resources, human materials, finances that already exist and/or may be needed in addition.
- Assisting the communities to establish self-help organizations for implementation/realization, which is the actual process of satisfying the needs.

TRDP (RSP Approach)

TRDP's credit programme as it stands today was developed and implemented in March 1997. It extends microcredit to the community organizations (COs) without collateral, and on the basis of social guarantee. Micro credit is extended in the field of enterprise, livestock development, and small infrastructure development schemes, agri-input, etc

Outreach

The following table gives a picture of outreach of most MFIs in the private sector as part of the Pakistan Microfinance Network.

Portfolio Quality of MFIs in Pakistan

January – June 2002

			OPP	SAFWCO	Sungi	TRDP	Taraqee	DAMEN	Kashaf	NRSP	SRSP	AKRSP	BOK	Total
L	Loans disbursed during the period	Rs. (000)	14,018	5,631	4,467	27,214	18,466	20,240	27,101	289,882	18,217	93,640	34,089	552,965
M	No. of loans made during the period	No.	789	896	412	2,779	406	3,857	5,866	26,628	1,084	2,407	877	46,001
N	No. of borrowers	No.	789	896	412	2,779	2,026	5,679	15,706	143,979	1,084	6,996	922	181,268
O	No. of new borrowers	No.	357	845	400	2,084	1,897	3,645	1,677	12,827	844	-	825	25,401
P	No. of active loans	No.	1,281	1,181	2,115	4,042	4,198	5,554	13,346	54,611	9,414	3,398	8,300	107,440
Q	No. of credit officers	No.	6	7	3	7	37	5	64	188	46	31	23	417
R	Loans recovered during the period	Rs. (000)	7,439	2,022	2,709	12,915	3,930	5,736	36,185	272,705	21,147	86,391	66,497	517,675
S	Cumulative loan recovered	Rs. (000)	146,701	7,520	16,064	38,474	16,416	10,938	93,603	2,762,046	155,280	1,555,431	351,176	5,153,647
T	Loans outstanding at the start of the period	Rs. (000)	18,821	1,989	9,940	14,649	19,853	7,881	42,217	445,464	70,298	108,506	300,573	1,040,191
U	Loans outstanding at the end of the period	Rs. (000)	23,207	5,598	11,699	28,948	19,639	22,404	32,981	507,563	67,394	114,971	266,475	1,100,878
V	Cumulative Loans falling due	Rs. (000)	154,307	8,130	19,559	39,421	16,416	11,048	93,926	2,938,691	185,486	1,483,540	406,711	5,357,235
W	Loans overdue at start of the period	Rs. (000)	8,676	521	1,800	940	12	38	292	142,456	24,505	16,932	35,681	231,854
X	Loans overdue at the end of the period	Rs. (000)	7,606	611	3,495	947	-	110	323	176,645	30,232	14,468	55,534	289,971
Y	Portfolio at risk – end of the period	Rs. (000)	2,700	453	1,695	947	-	224	313	63,022	30,579	-	103,994	203,927
Z	Adjusted portfolio at risk – end of the period	Rs. (000)	2,700	453	1,695	947	-	224	313	51,061	30,579	3,897	86,058	177,927
A1	Loan loss reserve	Rs. (000)	-	-	-	-	-	237	323	40,810	5,261	3,515	-	50,146
14	Cumulative Repayment Rate	(S/V)	95.1%	92.5%	82.1%	97.6%	100.0%	99.0%	99.7%	94.0%	83.7%	104.8%	86.3%	96.2%
15	Overdue as % of outstanding	(X/U)	32.8%	10.9%	29.9%	3.3%	0.0%	0.5%	1.0%	34.8%	44.9%	12.6%	20.8%	26.3%
16	Portfolio at risk as % of outstanding	(Y/U)	11.6%	8.1%	14.5%	3.3%	0.0%	1.0%	0.9%	12.4%	45.4%	0.0%	39.0%	18.5%
17	Adjusted portfolio at risk as a % of outstanding	(Z/U)	11.6%	8.1%	14.5%	3.3%	0.0%	1.0%	0.9%	10.1%	45.4%	3.4%	32.3%	16.2%
18	Loan loss reserve as % of portfolio at risk	(A1/Y) *	0.0%	0.0%	0.0%	0.0%	#DIV/0!	105.7%	103.2%	79.9%	17.2%	90.2%	0.0%	13.1%

Current issues relating to Microcredit in Pakistan

- The foremost issue that the sector faces is that of outreach/scaling up.
- Most MFIs are unable to recover the financial or even the operational costs. The current trend of declining interest rates is further going to aggravate the situation.
- Microfinance is not about micro loans only. It involves other products like savings; micro insurance; micro leasing etc. Most MFIs in Pakistan only pursue the Micro Credit option
- Most Micro Credit programmes offer a single loan product for their clients. There is a need to diversify the products
- MFIs do not focus on the entire cycle of “Business development Services”. For them, provision of loans and maintaining good recoveries is an ultimate end.
- Major portfolio of Micro credit in the rural areas is for Agriculture that is traditionally susceptible to droughts, floods or natural calamities. This requires rigorous risk management measures
- The current Microfinance products do not necessarily target the bottom poor. Special research and innovative products that can target this group is required.