## Editorial Board

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<th>PMR Editorial Board</th>
<th>Designation</th>
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</thead>
<tbody>
<tr>
<td>Mr. Ghalib Nishtar</td>
<td>Chairperson</td>
<td>President</td>
<td>Khushhali Bank Limited</td>
</tr>
<tr>
<td>Mr. Noor Ahmed</td>
<td>Board Member</td>
<td>Director AC &amp; MFDs</td>
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<tr>
<td>Mr. Aqeel Ahmed Zeeshan</td>
<td>Board Member</td>
<td>Additional Director</td>
<td>Securities &amp; Exchange Commission of Pakistan (SECP)</td>
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<td>Mr. Blain Stephens</td>
<td>Board Member</td>
<td>Advisor</td>
<td>Microfinance Information Exchange, Inc. (MIX)</td>
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<tr>
<td>Mr. Greg Chen</td>
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<td>Policy Lead</td>
<td>Consultative Group to Assist the Poor (CGAP)</td>
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<tr>
<td>Mr. Yasir Ashfaq</td>
<td>Board Member</td>
<td>Chief Executive Officer</td>
<td>Pakistan Microfinance Investment Company (PMIC)</td>
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<tr>
<td>Mr. Masood Safdar Gill</td>
<td>Board Member</td>
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<td>Mr. Shahzad Shahid</td>
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<td>Ms. Mehr Shah</td>
<td>Board Member</td>
<td>Director Knowledge Management &amp; Communications</td>
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## PMN Team

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<tr>
<th>Name</th>
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<tbody>
<tr>
<td>Mr. Ali Basharat</td>
<td>Author &amp; Managing Editor</td>
<td>Head of Operations</td>
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<tr>
<td>Mr. Zeenoor Sohail Sheikh</td>
<td>Co-Author &amp; Data Collection</td>
<td>Finance &amp; Risk Associate</td>
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<tr>
<td>Ms. Mejzgaan Orakzai</td>
<td>Co-Author</td>
<td>Research Manager</td>
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<tr>
<td>Ms. Maheen Malik</td>
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## Highlights

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<td>42,048</td>
<td>36,053</td>
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<td><strong>Total Assets (PKR billions)</strong></td>
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<td>SBP</td>
<td>State Bank of Pakistan</td>
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<td>SC</td>
<td>The Smart Campaign</td>
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<td>SECP</td>
<td>Securities and Exchange Commission of Pakistan</td>
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<td>SHF</td>
<td>Smallholder Farmer</td>
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<td>SME</td>
<td>Small and Medium Enterprise</td>
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<td>SMFB</td>
<td>Sindh Microfinance Bank Ltd.</td>
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<td>SPTF</td>
<td>Social Performance Task Force</td>
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<td>SRDO</td>
<td>Shadab Rural Development Organization</td>
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<td>SRSO</td>
<td>Sindh Rural Support Organization</td>
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<td>SSSF</td>
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<td>SVDP</td>
<td>Soon Valley Development Program</td>
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<td>TMF</td>
<td>Thardeep Microfinance Foundation</td>
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<td>TMFB</td>
<td>Telenor Microfinance Bank Ltd.</td>
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<td>Ubank</td>
<td>U Microfinance Bank Ltd.</td>
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<tr>
<td>UBL</td>
<td>United Bank Limited</td>
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<tr>
<td>USD</td>
<td>United States Dollar</td>
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<tr>
<td>USSPM</td>
<td>Universal Standards for Social Performance Management</td>
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<tr>
<td>VDO</td>
<td>Village Development Organization</td>
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<tr>
<td>WHRF</td>
<td>Warehouse Receipt Financing</td>
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<tr>
<td>WPI</td>
<td>Wholesale Price Index</td>
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Contents

Section 1: The Year in Review ........................................................................................................... 8
Macro-Economy & Microfinance Industry ...................................................................................... 8
Policy & Regulatory Environment .................................................................................................. 11
  National Financial Inclusion Strategy (NFIS) 2023 Action Plan .................................................. 11
  Warehouse Receipt Financing and Collateral Management Companies ..................................... 12
  NRSP Pilot Warehouse Receipt Financing Project ......................................................................... 12
Industry Initiatives .......................................................................................................................... 13
  Pakistan Microfinance Industry Code of Conduct ......................................................................... 13
  Pakistan Microfinance Investment Company (PMIC) .................................................................... 15
  Innovations in Digital Finance Services ....................................................................................... 16
    CreditFix ...................................................................................................................................... 16
    Tez Financial Services .................................................................................................................. 16
Advancements in Responsible Finance ........................................................................................... 17
  Fair Treatment of Consumer (FTC) Regime – State Bank of Pakistan .......................................... 17
  Consumer Protection Regime – Securities and Exchange Commission of Pakistan ...................... 17
  Client Awareness Campaign ........................................................................................................ 18
Conclusion ....................................................................................................................................... 19

Section II: Financial Performance Review ..................................................................................... 20
Scale & Outreach .............................................................................................................................. 21
  Scale & Outreach: Breadth ............................................................................................................. 21
  Scale & Outreach: Depth ................................................................................................................ 29
Lending Methodology ...................................................................................................................... 30
Gender Distribution ........................................................................................................................ 31
Portfolio Distribution by Sector ....................................................................................................... 32
  Rural – Urban Lending .................................................................................................................... 32
Financial Structure .......................................................................................................................... 33
Asset Base ....................................................................................................................................... 33
Funding Profile ................................................................................................................................. 34
Profitability & Sustainability ............................................................................................................ 35
Productivity ..................................................................................................................................... 40
Credit Risk ...................................................................................................................................... 41
Conclusion ....................................................................................................................................... 42
Section III: Social Performance Review ........................................................................... 44
Analysis of the Sector’s Social Performance Indicators ................................................ 44
Social Goals .................................................................................................................. 44
  Target Market ............................................................................................................. 44
Development Goals ..................................................................................................... 45
Poverty Targeting .......................................................................................................... 46
Poverty Measurement Tools ......................................................................................... 47
Governance and HR ....................................................................................................... 47
  HR Practices ............................................................................................................... 48
Products and Services: Financial .................................................................................. 51
  Credit .......................................................................................................................... 51
Deposits ......................................................................................................................... 52
Insurance ....................................................................................................................... 53
  Other Financial Services Offered .............................................................................. 54
Products and Services: Non-financial .......................................................................... 54
  Transparency of Cost .................................................................................................. 55
Client Protection (CP) .................................................................................................... 56
Environmental Policies ................................................................................................. 57
Conclusion ..................................................................................................................... 58
Section IV: The Way Forward ......................................................................................... 60
Financial Inclusion in Pakistan: The Road Ahead ......................................................... 60
  Impact of AML/CFT Regulations ............................................................................. 60
New Accounting Standards .......................................................................................... 61
  IFRS 9: Financial Instruments .................................................................................. 61
  IFRS 16: Leases ......................................................................................................... 62
Transforming NBMFCs from Non-Profit into For-Profit ............................................... 63
Funding Landscape ........................................................................................................ 63
COVID-19 and the Microfinance Industry in Pakistan ..................................................... 64
Lessons from West Africa: Recovering and Building Resilience in a Post-COVID World 67
Digitization ..................................................................................................................... 68
  Benefits for Customers and Microfinance Provider .................................................. 68
  Challenges and Risks to Mitigate .............................................................................. 68
Section 1: The Year in Review

The year 2019 was a challenging one for the microfinance industry in Pakistan, with macroeconomic instability adversely impacting microfinance providers (MFPs) and their clients. The economic growth of the past few years experienced some turbulence due to rising fiscal and current account deficits. In order to address this imbalance, monetary policy was tightened, and the Pakistani Rupee was depreciated. The resulting inflation and economic slowdown also decelerated microfinance growth, which fell to single digits, the lowest level in seven years. Economic troubles also hurt borrowers’ repayment capacity, contributing to an increase in non-performing loans (NPLs). The rise in NPLs also raised questions about discipline among MFPs - quality of credit underwriting, multiple lending, concentration and internal controls.

Despite these challenges the microfinance industry has remained sustainable and profitable. It continues to be recognized as an important player in the financial landscape of the country and plays a crucial role in furthering the financial inclusion agenda, especially since a majority of microfinance clients belong to marginalized segments such as smallholder farmers (SHFs) and women.

In order to meet financial inclusion goals, the industry has adopted responsible finance practices. Last year, it also adopted a Microfinance Industry Code of Conduct to ensure the same at the institutional level. In addition, practitioners have been digitizing operations in order to reduce costs and have been experimenting with digital credit.

Overall, MFPs remain optimistic about the resilience of the industry in overcoming the adverse macroeconomic challenges and the impending implications of the COVID-19 pandemic.

Macro-Economy & Microfinance Industry

The financial year (FY) 2019 was challenging for the economy. The growth in real GDP declined to 3.3 percent compared to 5.5 percent in the prior year, well below the target of 6.2 percent, while inflation increased from 3.9 percent in FY 2018 to 7.3 percent during the year under review (see Table 1). Monetary policy tightened as interest rates increased sharply, the exchange rate deteriorated, and total revenues declined by 6.3 percent. Despite these tumultuous conditions, the microfinance industry continued to grow as outreach increased by five percent while the outstanding loan portfolio grew by 11 percent¹ (see Table 2).

Table 1: Selected Macroeconomic Indicators²

<table>
<thead>
<tr>
<th>Macroeconomic Indicators</th>
<th>FY 16</th>
<th>FY 17</th>
<th>FY 18 (Revised)</th>
<th>FY 19</th>
<th>Target</th>
<th>Actual (Provisional)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percent Growth</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real GDP</td>
<td>4.6</td>
<td>5.2</td>
<td>5.5</td>
<td>6.2</td>
<td>3.3</td>
<td></td>
</tr>
<tr>
<td>- Agriculture</td>
<td>0.2</td>
<td>2.2</td>
<td>3.9</td>
<td>3.8</td>
<td>0.8</td>
<td></td>
</tr>
</tbody>
</table>

¹ MicroWatch, A quarterly update on microfinance outreach in Pakistan
² Annual Report 2018-2019 (State of the Economy) by the State Bank of Pakistan (SBP)
<table>
<thead>
<tr>
<th></th>
<th>FY 14</th>
<th>FY 15</th>
<th>FY 16</th>
<th>FY 17</th>
<th>FY 18</th>
<th>FY 19</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Discount Rate</strong></td>
<td>9.92</td>
<td>6.53</td>
<td>6.25</td>
<td>6.25</td>
<td>10.55</td>
<td>13.75</td>
</tr>
<tr>
<td><strong>Consumer Price Inflation</strong></td>
<td>8.60</td>
<td>4.50</td>
<td>3.76</td>
<td>4.20</td>
<td>3.90</td>
<td>7.30</td>
</tr>
<tr>
<td><strong>6-months KIBOR</strong></td>
<td>9.50</td>
<td>6.50</td>
<td>6.25</td>
<td>6.01</td>
<td>10.55</td>
<td>13.24</td>
</tr>
</tbody>
</table>

The end of FY 2018 indicated that significant adjustments needed to be made in the upcoming year in order to manage the impending twin deficit crisis. The economy slowed down as FY 2019 saw the central bank adopt measures including tightening of the monetary policy as interest rates increased by a cumulative of 575 basis points (bps) during the year and the Pakistani Rupee was left to align with macroeconomic factors while imports were contained and exports encouraged. By the end of the fiscal year, the International Monetary Fund (IMF) approved an Extended Fund Facility (EFF) worth USD 6 billion to support the government’s economic reform program.

Moreover, growth in the agriculture sector declined due to a shortage of water and a surge in the prices of fertilizers leading to relatively low yields during the year. Marginalized growth in the services and commodity-producing sectors contributed further to this deterioration, while the livestock sector was able to sustain its growth momentum. The manufacturing sector was impacted the most due to higher inflation, the tightening of the monetary policy and exchange rate depreciation, and the impact was reflected in retail prices for consumers.
Despite such demanding macroeconomic conditions, the microfinance industry experienced growth in all major indicators. By the end of 2019, the number of borrowers stood at 7.25 million while the gross loan portfolio (GLP) increased by 11 percent to reach PKR 305.75 billion (see Table 2). The number of active savers increased by 35 percent to stand at 47.6 million clients while the corresponding value of savings was over PKR 267.6 billion. In terms of microinsurance, the total number of policy holders increased by 23 thousand to reach 8.5 million with the total sum insured of over PKR 266 billion. These numbers indicated that the total penetration stood a little over 35 percent nationally.

Table 2: Growth in the Microfinance Industry

<table>
<thead>
<tr>
<th>Details</th>
<th>Micro-Credit</th>
<th>Micro-Savings</th>
<th>Micro-Insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Active</td>
<td>Value (PKR million)</td>
<td>Active</td>
</tr>
<tr>
<td></td>
<td>Borrowers</td>
<td></td>
<td>Savers</td>
</tr>
<tr>
<td>2019</td>
<td>7,249,943</td>
<td>305,753</td>
<td>47,642,271</td>
</tr>
<tr>
<td>2018</td>
<td>6,936,554</td>
<td>274,707</td>
<td>35,293,602</td>
</tr>
<tr>
<td>Change (Net)</td>
<td>313,389</td>
<td>31,046</td>
<td>12,348,669</td>
</tr>
<tr>
<td>Change (%)</td>
<td>5%</td>
<td>11%</td>
<td>35%</td>
</tr>
</tbody>
</table>

Upon analyzing the macroeconomic conditions and indicators, it is evident that a severe balance of payment crisis has been averted. Towards the end of the year, indicators depicted stabilization within the economy with the primary focus shifting from consumption to growth in exports, investment and productivity which is also evident in the monetary and fiscal policy. The effect of these factors has also significantly impacted the performance of the microfinance sector. Although the sector indicates stability, vulnerabilities have appeared. A general increase in NPLs was observed during 2019 as the PAR 30 (percentage of total loan portfolio at risk due to open loans overdue by 30 days) increased from 2.2 percent in the last quarter of 2018 to 4.8 percent by the end of 2019, reflecting a slowdown in growth as NPLs in the small and medium enterprise (SME) sector and agriculture remained high. The increase in inflation, commodity price volatility, and rising interest rates have already affected the ability of microfinance providers’ (MFPs’) clients to service their liabilities. Additionally, the adversity faced within the agriculture sector due to water shortage, low yields and climate change poses a threat to the industry as half of the outreach and portfolio is directly related to this sector.

Moving forward, while the measures at the macroeconomic front have started to show stability, economic activity is expected to remain subdued. Due to the deterioration in the repayment capacity of borrowers and the recent increase in NPLs, MFPs may remain risk averse in their lending behavior. Additionally, the increase in credit risk because of the decline in asset quality will likely put earnings under pressure. Moreover, the adherence to an Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) framework would bring additional costs of compliance to MFPs and customer due diligence may restrict formal financial services from reaching the target segment. The key would be to find a balance between regulation, sustainability and client needs.
Policy & Regulatory Environment

The microfinance industry is considered an integral component for achieving sustainable and inclusive economic growth in Pakistan keeping in view its ability to reach out to marginalized segments across the country. Financial inclusion continues to remain high on the agenda of the current administration, which took office in August 2018 and released an enhanced National Financial Inclusion Strategy (NFIS) Action Plan within its first 100 days. The industry is being effectively regulated by the State Bank of Pakistan (SBP) and the Securities and Exchange Commission of Pakistan (SECP).

Some of the key policy and regulatory changes initiated in 2019 are summarized below:

National Financial Inclusion Strategy (NFIS) 2023 Action Plan

The NFIS was formally launched and adopted by the government of Pakistan in 2015 with the vision for achieving universal financial inclusion in Pakistan. The Action Plan highlighted high-level measures to address the enablers and drivers of the NFIS and covered the period 2015-2020. As most targets were achieved before 2020, the newly formed government in 2018 developed an amended Action Plan as part of its 100-day agenda and set new targets to be achieved by 2023. The targets of the NFIS 2023 are as follows:

1. Enhanced usage of digital payments (65 million active digital transaction accounts, with at least 20 million accounts held by women)
2. Enhanced deposit base (deposit to GDP ratio of 55 percent)
3. Promotion of SME finance (extended to 700,000 SMEs; 17 percent of private sector credit)
4. Increased agricultural finance (6 million farmers served through digitalized solutions; annual disbursement enhanced to PKR 1.8 trillion)
5. Enhanced share of Islamic banking (25 percent of the banking industry; branches of Islamic banks increased to 30 percent of the banking industry)

The Action Plan is intended to lead to the creation of 3 million new jobs and additional exports of USD 5.5 billion. Enhanced access to finance for SMEs would also help achieve sustainable development. Progress against these objectives is to be monitored by the NFIS Council, co-chaired by the federal Finance Minister and the Governor of the SBP, while the NFIS Secretariat housed at the SBP is responsible for ensuring effective coordination among the relevant stakeholders and implementation of the proposed actions. The NFIS 2023 includes a large number of external stakeholders with the involvement of around thirty implementing agencies in the implementation of the Action Plan.

The implications of the amended Action Plan are considerable for the microfinance industry given its clear advantages over traditional commercial banks and financial institutions in terms of access to the unbanked and underbanked population. Given the sector’s presence at the grassroot level, its lending methodologies to address the needs of the marginalized, and its technical expertise in dealing with such a niche segment, the microfinance industry is a vital stakeholder and implementation partner for the NFIS. The sector is therefore poised to contribute to these developments substantially, provided it can deepen its reach by investing in capacity building and embracing technological solutions.

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Warehouse Receipt Financing and Collateral Management Companies

As defined by the SBP, “Warehouse Receipt Financing (WHRF) is a mechanism whereby farmers, traders and processors may avail financing facility from banks while collateralizing their produce and agricultural commodities as a security stored in accredited warehouses.”

This methodology is a proven tool for allowing the low-income segment, i.e. agricultural and rural communities, to obtain financing secured by their produce deposited or stored in a warehouse. This model is particularly useful as it allows access to funds to this marginalized segment who may lack conventional loan collateral required by traditional financial institutions.

While the prudential regulations for agriculture financing, SME financing, and corporate and commercial banking have been in place for some time, the SBP issued amendments to these in the last quarter of 2019, allowing banks to accept EWRs as collateral for lending against storage of agriculture produce and commodities. Similarly, the SECP also notified the Collateral Management Companies Regulations, 2019 under the Companies Act, 2017 to promote the concept of warehousing of agricultural produce and electronic warehouse receipt (EWR), which is transferrable and tradable at future exchange and can be pledged with financial institutions to obtain finance. Under these Regulations, with the prior permission of the SECP a public limited company with a minimum paid-up capital of PKR 200 million may be incorporated and registered as a collateral management company (CMC) by the SECP. A CMC can engage in warehousing of agricultural commodities, issuance of EWRs, devising a mechanism for pledging, audit of stocks and accreditation of warehouses. A robust regime for monitoring and audit is also in place to safeguard the interest of stakeholders.

Adopting an EWR system will allow CMCs to issue EWRs which can be used by SHFs and depositors of agricultural products to access formal financial service providers. This move would be beneficial as it

NRSP Pilot Warehouse Receipt Financing Project

The National Rural Support Programme (NRSP) has been working on warehousing in Hafizabad through silo-based storage for rice since 2017. At the moment, the organization is working with approximately 2,200 SHFs with landholding below 15 acres due to the fixed capacity of the warehouse. In order to scale up their operations, the NRSP established a for-profit subsidiary: NRSP Agriculture Processing Company Limited, with a capital of PKR 1.5 billion. The subsidiary has also attracted investment from Karandaaz Pakistan for enhancing the storage capacity of the facility and establishing two more such facilities at other locations. The NRSP warehousing facility also links smallholder farmers to the markets where the commodities could be traded.

The key takeaway from this setup by the NRSP indicates that the productivity of smallholder farmers has increased substantially through social mobilization, the provision of technical inputs, microcredit services, storage facilities and the provision of market linkages. Additionally, the NRSP model enables SHFs to gain inputs at a control price while allowing for higher monetary benefit on the sale of their harvest.

---

1 NRSP Pilot Warehouse Receipt Financing Project

4 Warehouse Receipt Financing as defined by the State Bank of Pakistan

5 State Bank of Pakistan allows Electronic Warehouse Receipt as collateral for bank financing – External Relations Department, State Bank of Pakistan
aims to increase access to formal financial services such as credit facilities while significantly condensing losses incurred due to the inefficiencies of crops/commodities once harvested. This would also lead to an increase in the profitability of the market segment that relies solely on agricultural activities as it allows for alternative means of collateral for traditional banks and financial institutions. Moreover, with the already available refinance scheme for facilities set up by the SBP, this initiative would encourage potential investment in modern warehouses by private investors, further allowing growth within the environment. Looking forward, this initiative would also lead to trading at the commodity exchange as new markets are tapped globally.

Industry Initiatives

Pakistan Microfinance Industry Code of Conduct

With the growth of the microfinance sector, the expectations and demands from the industry have also increased given the rising benchmarks set internationally for the microfinance industry overall. Given the operational, legal and reputational risks the microfinance industry faces, there was a need for a revamped code of conduct which considers the evolving needs of the industry and its customers. The increasing competition in the industry requires improved systems and mechanisms for disclosures by MFPs, in terms of disclosing lending costs, reasons for rejection of loan applications, reporting systems and data privacy clauses, internal audit and compliance. Moreover, there is a need for more robust rules pertaining to interaction with clients and loan collection practices.

In 2009 the Pakistan Microfinance Network (PMN) developed a Code of Conduct focused on greater transparency, dignified treatment of customers, fair practices, accountable and robust governance, ensuring client satisfaction, and a need to maintain privacy and fair disclosure. The new 2019 Code of Conduct\(^6\) builds upon and expands the contours of the code, by including best practices borrowed from countries with a flourishing microfinance industry, such as Mexico, Philippines, South Africa, India, Bangladesh and Sri Lanka.

Seeing the need for a better system and mechanism for disclosures by MFPs, PMN drafted and circulated an updated Code of Conduct (see Exhibit 1.2) in 2019. The Code includes clauses on transparency, responsible pricing, fair practices and disclosures, respectful treatment of clients, fair employee recruitment practices and client grievance redressal mechanisms. It further includes provisions pertaining to protection of whistle blowers and peer reporting mechanisms, certification of field staff to ensure client protection and establishment of processes to monitor and enforce the code. The new code also includes rules pertaining to over-indebtedness, which includes proper due diligence as per internal credit policies and regular checks with credit bureaus. The code is introduced as a self-regulatory mechanism and it specifies that signatory institutions have internal audit functions which ensure its compliance. Regular monitoring and reporting are to be conducted and submitted to the Board of Directors.

\(^6\) Pakistan Microfinance Industry Code of Conduct – PMN 2019 (Unpublished)
Core Values – Code of Conduct

Core Value # 1: Transparency
To disseminate transparent and truthful information to clients

Core Value # 2: Fair Practices
To provide services to clients in a manner that is legal, ethical, nondiscriminatory and free of deception

Core Value # 3: Responsible Pricing
To set prices that are not too excessive or beyond a certain threshold while allowing for the financial institution to operate sustainably.

Core Value # 4: Dignified Treatment
To realize the necessity of preserving clients’ dignity always, as well as being respectful of cultural and gender differences.

Core Value # 5: Privacy and Fair Disclosure
To safeguard client information and to maintain client privacy and uphold fair disclosures

Core Value # 6: Governance
To pursue the highest standards of governance and management.

Core Value # 7: Client Satisfaction
To have formal channels of communication in place for clients to provide their feedback to track client satisfaction.

Core Value # 8: Disclosures by MFPs
To ensure self-reporting on social performance indicators and to provide information regarding the presence of various client protection measures

Core Value #9: Rules Pertaining to Over-Indebtedness:
To promote a framework for making investment decisions in a responsible way in order to avoid contributing to potential over-indebtedness

Core Value #10: Recruitment Policies:
To encourage free and just recruitment, which is free from discrimination and harassment based on age, ancestry, citizenship, religion, complexion, ethnic origin, family status, gender, race, sex and any other personal characteristics

Core Value #11: Client Awareness
To enhance awareness which gives clients the knowledge, skills and confidence to understand and evaluate information they receive and to empower them to make the right financial choices for themselves based on their needs.

Core Value #12: Feedback/Grievance Redressal Mechanism
To lay down an appropriate grievance redressal mechanism within the sector to resolve disputes arising, so they are addressed within a promised time by all actors involved.
Pakistan Microfinance Investment Company (PMIC)

The year 2019 was an eventful year for the Pakistan Microfinance Investment Company (PMIC), which showed resilience in the face of several challenges. The economic slowdown, significantly high policy rates, and inflationary pressures impacted the PMIC as well as its clients. However, PMIC remained well capitalized and equipped to ensure strong internal controls and maintained a robust risk management framework to mitigate risks associated with its portfolio.

PMIC disbursed an additional PKR 3 billion to ten partner financial institutions, including three MFBs, as its gross financing portfolio grew by 15 percent on a year-on-year basis to PKR 23.86 billion. It made a debut in the local debt capital market by winning two financial advisory mandates to provide subordinated loan facility and Tier II Privately Placed Term Finance Certificates (PPTFCs) to FINCA Microfinance Bank Ltd and Khushhali Microfinance Bank Ltd respectively. PMIC borrowed Rs 1.8 billion at K-1% from the SBP under its Financial Inclusion and Infrastructure Program. PMIC also signed a subordinated loan agreement of EUR 15 Million with KfW - one of its shareholders - which will be used primarily for a renewable energy program for provision of solar equipment to private households and micro and small enterprises in rural and peri-urban areas through on-lending the funds to microfinance partners. Further, with its prudent lending practices, by the end of 2019, PMIC was able to extend the width of its financial services to reach almost 800,000 end user clients (62 percent of which reside in rural areas and 83 percent are women).

Driven by its mission and thematic focus of supporting the underserved and marginalized segments of the society, PMIC continued to create impact through an array of Microfinance Plus interventions. These interventions included the Crop Productivity Enhancement Initiative, Renewable Energy (PRIME), Livestock Value Chain, Education through Microfinance, Enterprise Development Initiative, and Graduation Out of Poverty, impacting more than 35,000 individuals.

Pakistan Credit Guarantee Company (PCGC)

PCGC is the country’s premier risk-sharing institution instituted to develop the SME sector and to promote access to finance especially for collateral-deficient SME borrowers. It has been playing a critical role in employment generation, business activities and economic growth in Pakistan. It acts as a catalyst for:

- increasing SME lending
- reducing collateral constraints for small farmers and small enterprises
- increasing quality of SME credit granting and risk monitoring
- mitigating against business cycles and external shocks
- enhancing public information dissemination
- facilitating access to reinsurance capital
- improving treatment of risk weighted assets
- reducing risk perception / increasing risk appetite of banks
- lowering financing cost for SMEs
Innovations in Digital Finance Services

Pakistan is home to over 164 million cellular subscribers with a teledensity\textsuperscript{7} of approximately 78 percent. Of these, 74 million have subscribed to 3G/4G services.\textsuperscript{8} The country has a high cellphone penetration rate with significant internet usage. This digital technology had made it possible to accelerate the fight against poverty. By leveraging these technologies coupled with electronic money issuers and an enabling regulatory environment, it is proven that these make up the essential ingredients required for increasing access and usage of affordable, secure formal financial services that contribute to the nation’s development objectives. 2019 witnessed two such initiatives which explore emerging technologies to better understand how they will shape the future of microfinance and development:

CreditFix

CreditFix Financial Service Limited, an artificial intelligence lending fintech in Pakistan, commenced its pilot operations in 2019. It offers Shariah-compliant and use-case based digital credit services, primarily focusing on the youth in the gig economy. CreditFix is in the process of becoming a non-bank microfinance company with the SECP. The organization is funded through private equity and is currently raising its seed round funds from domestic and international venture capital/impact investors.

CreditFix extends digital financial services under smart business-to-business-to-consumer (B2B2C) and business-to-consumer (B2C) models focusing on economic uplift of low-income microentrepreneurs – both male and female. It leverages strategic relationships with partner organizations (e.g. BYKEA, FoodPanda, Careem, etc.) to access potential clients. Additionally, CreditFix also entertains online applications and referral clients. CreditFix finances revenue generating assets such as business equipment and machinery, business inventories, motorbikes, smartphones and sewing machines, etc., thus adopting a no-cash approach. For a client, the financing process begins and ends with the CreditFix Mobile Application – the client submits an online application through the app, which takes less than 10 minutes to complete. If the financing is approved, the selected asset is delivered to the client. All repayments are made using a digital payment channel.

Tez Financial Services

Tez Financial Services started its operations in 2018 and is the first fully digital non-bank microfinance company (NBMFC) in Pakistan. The organization aims of providing seamless financial access to the unbanked and under-banked population by a simple smartphone application with the help of powerful algorithms, data analytics and artificial intelligence. By aggregating credit, savings, insurance, and investments into a single platform, Tez aims to reduce the financial vulnerability of many underserved customers. What sets Tez apart from other service providers is that the service is almost instantly available (turnaround time of 15 minutes) and their service charges are calculated on a flat basis.

The organization was set up to cater to customers that are traditionally underserved – such as microentrepreneurs, blue collar workers, students (consumption), stay-at-homes – with the purpose of addressing their short-term liquidity needs. Tez offers credit of up to PKR 10,000 for a maximum period of one month. The procedure is simple (unlike traditional loan applications) and does not require bank

\textsuperscript{7} Defined as the number of telephone connections for every hundred individuals living within an area.
\textsuperscript{8} Telecom Indicators – Pakistan Telecom Authority, 2019
statements, salary statements, guarantees or collateral. Instead, the only requirement is to have a smartphone and users give Tez consent to access data in their smartphone, which is used to determine the eligibility of the applicant. The loan application process is conducted with the help of artificial intelligence to analyze consumers’ digital footprint trends, social behavior and consumption patterns in order to customize its offerings to meet the applicant’s needs. Once approved, the mobile wallet (m-wallet) accounts of applicants are instantly credited.

To provide their customers with an agent network, Tez has partnered with different m-wallet operators such as Easypaisa and UBL Omni. Given the nature of their services it is difficult to compare Tez with traditional microfinance institutions (MFIs). The service provider has a low average portfolio but high disbursements.

Advancements in Responsible Finance

Fair Treatment of Consumer (FTC) Regime – State Bank of Pakistan

The SBP has long had a Financial Consumer Protection (FCP) objective and is in the process of further evolving its Fair Treatment of Customer (FTC) regime – particularly consumer empowerment. The SBP is looking beyond financial inclusion to focus on a “remedial and proactive approach” to empower and engage with consumers. The bank is currently in the process of further evolving its FTC regime with a strategic focus on improving the efficiency, effectiveness and fairness of the banking system. The main components of the FTC include:

a) Enhancement of a Conduct Regulatory Corridor: This involves developing a culture of enhancing supervisory and enforcement frameworks while upgrading the existing regulatory complaint handling framework. Within this, in order to promote responsible banking, the SBP has developed a Conduct Assessment Framework (CAF), a mechanism for self-assessment by the banks. The purpose of this is to develop a periodic, reliable, diagnostic and comparable mechanism for banks to help them comply with their FTC commitments. The tool consists of three modules: i) Culture, ii) Product/Service Design and Disclosures, and iii) Consumer Grievance Handling Mechanism/Complaint Handling.

b) Consumer Empowerment: In addition to financial inclusion, the SBP has prioritized consumer empowerment and will be devoting adequate resources for the implementation of this strategy.

c) Capacity Building and Stakeholder Engagement: The SBP aims to improve the outcomes of conduct regulation by engaging with stakeholders and building the capacity of conduct supervisors.

Consumer Protection Regime – Securities and Exchange Commission of Pakistan

With visible growth over the past many years, the NBMFC has emerged as a promising sector that provides impetus to financial inclusion. Protecting consumers of the NBMFC sector has become even more important and gained attention as a key area of focus for the SECP. Protecting the rights of microfinance consumers, who represent the underprivileged and underserved strata of society, against possible

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9 Financial Consumer Protection, Beyond Compliance – State Bank of Pakistan
malpractices is considered vital by the SECP for promoting sustainable financial inclusion in Pakistan. To effectively implement consumer protection measures, SECP has adopted a multipronged approach, as highlighted below:

a) Grievance Redressal Mechanism - To ensure effective redressal of complaints from borrowers of NBMFCs, the SECP in 2018 issued guidelines on Grievance Redressal System (GRS) for NBMFCs. Subsequently, a specific legal cover has been provided to the guidelines by including an enabling provision in NBFC Regulations 2008. SECP regularly monitors and follows up with NBMFCs to gauge effectiveness of the mechanism and has plans to introduce systematic reporting by NBMFCs for more efficient monitoring of compliance.

b) Capacity building of NBMFCs – SECP plans to support and launch initiatives in collaboration with other stakeholders with focus on areas including capacity building and training of NBMFCs’ staff, translation of GRS requirements in regional languages, code of conduct for sales’ staff and raising customer awareness etc.

c) Enhanced and Transparent Disclosure Regime – Recently, the SECP has made it mandatory for NBMFCs to highlight to prospective clients the key contractual terms and conditions and disclose precisely details including fixed and variable mark-up rate, amount, term and number of loan installments, lock-in period, charges, fees, collateral and contact details. The NBMFCs are further required to adopt continuous disclosure by giving notice of any change in the terms and conditions, rates, charges, fees etc.

Client Awareness Campaign

In 2019, PMN launched a comprehensive Client Awareness Campaign focusing on inclusive finance for marginalized groups (including women, people with disabilities and transgendered persons). The campaign included a focus on rights and responsibilities of consumers, complaint mechanisms, role of credit information bureaus (CIBs), credit application processes, and responsible use of microfinance services for positive impact on financial wellbeing.

The campaign reached a mass figure of 14,532,857 beneficiaries across Pakistan through different modes including television commercials, animated videos, posters and street theater. The following figures indicate the impact of the campaign.

- Two television commercials on financial literacy and inclusion were aired on two leading TV channels for fifteen days.
- The outreach from ARY News was 7,750,000 and 6,780,000 from Samaa TV for a collective reach of 14,530,000 audience members.
- Animated videos were advertised on 76 cable channels through the support of different MFPs.
- The videos are also shown through tabs during community sessions and are now being displayed on LCD screens in offices.
- Campaign posters have been displayed in most branches of participating MFPs and are creating financial awareness regarding rights and responsibilities among the borrowers.
- The roll out of street plays was successfully initiated and completed in Punjab and Sindh. A total number of 47 street plays of 35-40 minutes for potential and existing borrowers were planned both for Punjab and Sindh.
• In Punjab, 1,493 (973 males and 520 females) attended the street plays and in Sindh, 1,311 (503 males and 808 females) attended the street plays.
• The campaign promotion posts and advertisements as well as news, updates, pictures, videos and feedbacks from orientation sessions and street theaters are regularly being posted on the campaign page. The campaign page was promoted and shared among Facebook users to reach maximum amount of public and create financial literacy.

Conclusion
While growth and profitability slowed due to the prevailing macroeconomic challenges and COVID-19, they stayed in the positive. Financial inclusion continued to be on the agenda of the policy makers and regulators.

Another pertinent issue that has resulted in high PAR has been rapid growth that was not matched with robust compliance of internal control policies and risk management. However, most of the institutions have now reviewed the same and are bringing changes and better systems.

In order to keep their operations aligned with best practices, practitioners have adopted the industry Code of Conduct and participated in a nationwide client awareness campaign. The Code encourages transparency, responsible pricing, fair practices and disclosures, respectful treatment of clients, fair employee recruitment practices, and client grievance redressal mechanisms. Importantly, the new Code also includes rules pertaining to over-indebtedness, which is an issue being faced by the microfinance industry as it expands, thereby making it imperative for MFPs to conduct proper due diligence as per their internal credit policies. In addition, PMN launched an industry client awareness campaign focusing on inclusive finance for marginalized groups (including women, people with disabilities and transgendered persons). The campaign included a focus on rights and responsibilities of consumers, complaint mechanisms, role of CIBs, credit application processes, and responsible use of microfinance services for positive impact on financial wellbeing. Furthermore, the industry is keenly adopting digitization to shift their transactions from cash to cashless. Digital credit and renewable energy remain other new avenues that are rising in popularity with MFPs.

Overall, MFPs have mature business models and possess strong balance sheets. Moreover, the resilience shown previously by the industry, whether it was during natural calamities or delinquency crises, proves its strength in managing upcoming macroeconomic challenges and the uncertain situation presented by the COVID-19 pandemic.
Section II: Financial Performance Review

This section provides a detailed analysis of the financial performance of Pakistan's microfinance industry in 2019. The performance has been assessed on three levels: industry wise, across peer groups and institution wise. The analysis is backed by 88 financial indicators, calculated from the audited financial statements of the reporting organizations. These indicators have been compared across time and regions to develop a reliable and fair assessment of sector.

Detailed financial information is provided in the Annex A-I and A-II of the PMR. Aggregate data has been reproduced for five years, while peer group and institution specific data has been made available only for the year 2019.

A total of 38 MFPs submitted their audited financial statements for PMR 2019. For a complete list of reporting organizations refer to Annex B.

Industry players are categorized into three groups for benchmarking and comparison purposes: Microfinance Banks (MFBs), Microfinance Institutions (MFIs) and Rural Support Programmes (RSPs). See Box 2.1 for detailed definitions.

Box 2.1: Peer Groups

Microfinance Institution: A non-bank microfinance company (NBMFC) providing microfinance services. With the introduction of the non-bank microfinance regulatory framework by SECP in 2015, the institutions carrying out microfinance services are required to be registered with the SECP as NBMFCs. Presently, 17 MFIs have obtained the NBMFC license: one is an NBMFC operating with an investment finance service license, three are licensed under section 42 of the Companies Act as not-for-profit companies, while six MFIs are in the process of obtaining licenses.

Microfinance Bank: A bank licensed and prudentially regulated by the SBP to exclusively service the microfinance market. The first MFB was established in 2000 under a presidential decree. Since then, 11 MFBs have been licensed under the Microfinance Institutions Ordinance, 2001. MFBs are legally empowered to accept and intermediate deposits from the public.

Rural Support Programme: A non-bank microfinance company (NBMFC) providing microfinance services. Although an NBMFC, a rural support programme (RSP) is differentiated from the MFI peer group based on the purely rural focus of its credit operations. As of now, all six PMN members classified as RSPs have obtained the NBMFC license.

The distribution of respondents (number of reporting organizations) by peer group is given in Exhibit 2.1. The MFI peer group comprises of the largest number of respondents, followed by MFBs and then RSPs.
Exhibit 2.1: Distribution of Respondents by Peer Group

Scale & Outreach
This section focuses on outreach indicators to provide performance analysis of the industry in terms of credit growth and composition, deposit mobilization, depth of outreach and gender.

Scale & Outreach: Breadth

Outreach witnessed growth in all key indicators in 2019. Microfinance borrowers increased by 11 percent from 6.69 million in 2018 to 7.44 million, while GLP grew from PKR 256 billion to PKR 302 billion, an increase of 18 percent (Exhibit 2.2). Comparatively, the commercial banking GLP stood at PKR 8,147 billion with 3.2 million borrowers.12 This surge comes on the back of the top ten MFPs once again, which performed better despite adverse economic conditions. It is worth mentioning that the outreach figures are different from the ones reported in the MicroWatch due to difference in reporting dates. The data compiled for the PMR is based on the respective year-ends of PMN members as all SECP regulated entities have a year end of June, while SBP regulated MFBs have a year-end of December. Due to the two different reporting dates for financial statements, the outreach numbers are different in MicroWatch and the PMR.

Exhibit 2.2: Growth in Number of Active Borrowers and GLP

12 www.sbp.org.pk
Among the MFPs, growth in borrowers was once more led by Telenor Microfinance Bank (TMFB) which contributed over 202,000 additional borrowers. Mobilink Microfinance Bank (MMFB) and Khushhali Microfinance Bank (KBL) also recorded significant growth by adding over 151,000 and 88,000 new clients respectively. By their respective year-ends, the largest MFPs in terms of active borrowers were: Akhuwat (over 898,000), TMFB (over 896,000), KBL (over 873,000) and the NRSP (over 858,000).

The year-end figures indicated that the largest 10 MFPs continue to hold 80 percent of the total outreach of the industry, a decrease of two percent compared to the prior year (Exhibit 2.3). The top five are comprised of Akhuwat, TMFB, KBL, NRSP and Kashf Foundation with a combined outreach of 54 percent of the industry. The year also saw Kashf replace First Microfinance Bank (FMFB) as the fifth largest MFP in terms of borrowers.

Exhibit 2.3: Active Borrowers of Largest MFPs

Among the peer groups, MFBs remained market leaders and witnessed an increase in their market share in terms of active borrowers from 48 percent in the prior year to 50 percent by the end of 2019. This
was the result of both MFIs and RSPs experiencing a decline of one percent in their market shares which saw them close at 34 percent and 16 percent respectively (Exhibit 2.4). The surge in the proportion of MFBs is courtesy of the telco-led banks, TMFB and MMFB, which aim to improve outreach via digital means by providing nano and micro loans under their respective brands EasyPaisa and JazzCash. These products have exhibited wide reach to a large customer base by leveraging the high teledensity in the country while offering the convenience of m-wallet acquisition.

Exhibit 2.4: Share in Active Borrowers by Peer Group

In terms of GLP, MFBs account for 71 percent of the total GLP, followed by MFIs with 19 percent and RSPs with a share of 10 percent (Exhibit 2.5). The overall GLP of the sector increased by 18 percent to touch PKR 302 billion by the end of the year.

Exhibit 2.5: Share of GLP by Peer Group
This surge of PKR 46 billion was led by MFBs which added close to PKR 35 billion. The drivers of this increase were KBL, Apna Microfinance Bank (AMFB) and FMFB as they accumulated an impressive PKR 11.3 billion, PKR 8 billion and PKR 7.7 billion respectively. The GLP of MFIs increased by PKR 5.4 billion while RSPs added PKR 5.9 billion to their portfolio. Exhibit 2.6 shows the trend in GLP by peer groups over the last five years.

The average loan size of the industry increased from PKR 38,339 to reach PKR 40,578. MFBs maintain the largest average loan size, which increased from PKR 56,691 in 2018 to PKR 57,781 in 2019, while MFIs saw their loan size increase from PKR 21,422 to PKR 22,319, and RSPs from PKR 22,166 to PKR 25,600. This indicates that MFBs have been catering to the upper segment in terms of income of the market while NBMFCs have been successful in tapping into the lower income segment. Moreover, considering the effect of rising inflation, the loan sizes have also increased in order to cater to the needs of the underprivileged which could previously be addressed with a lower loan size.

**Exhibit 2.6: GLP by Peer Group**

In terms of GLP, the largest providers were mostly the MFBs led by KBL (PKR 54.8 billion), FMFB (PKR 31.6 billion), NRSP Bank (PKR 28 billion), TMFB (PKR 27.5 billion) followed by NRSP (PKR 23.3 billion). TMFB slipped from second largest provider in 2018 to the fourth largest while NRSP replaced FINCA as the fifth largest provider during the year under review (Exhibit 2.7). Of the MFIs, Kashf and Akhuwat remain in the top 10 while NRSP remained the only RSP in the list. It is pertinent to mention that the largest 10 providers in terms of GLP account for 84 percent of the total portfolio in the sector as compared to 87 percent in the previous year.
In the year under review, the sector experienced an impressive increase in depositors by 38 percent, from 32 million in 2018 to almost 44 million by the end of 2019. Correspondingly, the value of deposits also grew by 11 percent in the same period, from PKR 239 billion to PKR 266 billion (Exhibit 2.8). The bank deposits for commercial banks in the same time period stood at PKR 14,350 billion with more than 54,731 million depositors. With these numbers, deposits now represent 81 percent of the total liabilities of MFBs as compared to 86 percent in the prior year.

Exhibit 2.7: GLP of top 10 Largest MFPs

Exhibit 2.8: Growth in Deposits and Number of Depositors

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13 As per the prevailing regulations, only MFBs (regulated by the SBP) can mobilize deposits.
The growth in the number of depositors was led by TMFB which added almost 8 million new depositors. TMFB was followed by MMFB which contributed over 3 million new depositors. Branchless banking activities, particularly m-wallet accounts, along with increasing government disbursements for safety net programs significantly contributed to this growth. Moreover, the provision of value-added services such as debit cards for cash withdrawal, utility bills payments, funds transfer facilities and home remittance services have also been pivotal while improving mWallet usage. The telco-backed banks, MMFB and TMFB, remain the largest providers of microsavings in terms of depositors with an outreach of 19.6 million and 17.1 million clients respectively, followed by KBL with 2.3 million depositors.

In terms of the value of deposits, KBL accumulated the most deposits with PKR 7.8 billion followed by FMFB and MMFB which contributed over PKR 7 billion each. KBL remains the largest provider of microsavings in terms of value of deposits with a balance of PKR 64 billion, followed by TMFB and FMFB with deposits worth PKR 41 billion and PKR 38 billion respectively by the end of 2019 (Exhibit 2.9 (a)). With deposits worth PKR 29 billion, MMFB jumped from being the seventh largest to fourth largest provider during the last year.

**Exhibit 2.9 (a): Deposit Growth by MFB**

The average deposit size of MFBs fell from PKR 7,488 in 2018 to PKR 6,049, a decline of 19 percent.

**Exhibit 2.9 (b): Average Deposit Size of MFBs**
The numbers indicated that deposits continue to outgrow the loan portfolio of MFBs. This is evident from the deposits-to-gross loan portfolio ratio which currently stands at 123 percent despite declining from 133 percent in the previous year (Exhibit 2.10). The ratio highlights the reliance of MFBs on deposits as a primary source of financing, especially during the difficult economic conditions faced during the year. This was also reflected when analyzing the cost of fund for MFBs, which grew from six percent in 2018 to nine percent by 2019.

Exhibit 2.10: Deposit-To-GLP Relation of MFBs

Microinsurance indicators also showed improvements during the year under review. While the sum insured increased by seven percent, growth in the number of policy holders was marginal. By the end of
the year, the total number of policy holders stood at 8.48 million with the sum insured at PKR 267 billion as compared to PKR 249 billion previously (Exhibit 2.11).

MFIs held the largest share in terms of the number of policy holders with 50 percent. The share of MFBs stood at 32 percent after declining from 34 percent previously, while the market share of RSPs increased from 17 percent to 18 percent by the year-end. The increase in policy holders was driven by Kashf as it added over 142,000 new clients, followed by NRSP and KBL as their contribution was 125,000 and 63,000 clients respectively. The three also remained the largest provider of microinsurance in terms of policy holders as Kashf accounted for 2.6 million policy holders, NRSP 1.3 million and KBL over 998,000.

In terms of the sum insured, the market shares of each peer group remained unchanged. MFBs held 51 percent of the total sum insured in the industry, followed by MFIs at 34 percent and RSPs at 14 percent. The growth in the insurance portfolio was led by KBL, FMFB and Kashf as they accumulated PKR 8.7 billion, PKR 6.7 billion and PKR 4.2 billion each. Kashf proved the largest provider in terms of sum insured once more, as its insurance portfolio stood at PKR 65.6 billion by the year end, followed by KBL and NRSP which stood at PKR 59.4 billion and PKR 36.6 billion as they made up the top three with the most sum insured.

Among the types of insurance policies, credit life insurance policies constitute almost 53 percent of total policies compared to 55 percent in the prior year, while health insurance policies comprised of 46 percent compared to 44 percent previously.

**Exhibit 2.11: Growth in number of Policy Holders & Sum Insured**

Table 2.1 below represents key highlights of the Banking sector of the country for the last 3 years as a comparison.

<table>
<thead>
<tr>
<th>Year</th>
<th>Policy Holders</th>
<th>Sum Insured</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>4.59</td>
<td>81</td>
</tr>
<tr>
<td>2016</td>
<td>5.86</td>
<td>151</td>
</tr>
<tr>
<td>2017</td>
<td>7.31</td>
<td>199</td>
</tr>
<tr>
<td>2018</td>
<td>8.46</td>
<td>249</td>
</tr>
<tr>
<td>2019</td>
<td>8.48</td>
<td>267</td>
</tr>
</tbody>
</table>

Table 2.1: Key Indicators of the Banking Sector
### Banking Sector Indicators

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Assets (PKR Billions)</strong></td>
<td><strong>24,619</strong></td>
<td><strong>28,815</strong></td>
<td><strong>29,842</strong></td>
</tr>
<tr>
<td>- of which advances (PKR Billions)</td>
<td>6,047</td>
<td>7,201</td>
<td>8,147</td>
</tr>
<tr>
<td>-- total borrowers (000)</td>
<td>3,327</td>
<td>3,298</td>
<td>3,239</td>
</tr>
<tr>
<td><strong>Total Equity (PKR Billions)</strong></td>
<td><strong>1,297</strong></td>
<td><strong>1,293</strong></td>
<td><strong>1,423</strong></td>
</tr>
<tr>
<td>- of which Capital (PKR Billions)</td>
<td>658</td>
<td>519</td>
<td>546</td>
</tr>
<tr>
<td>- of which Reserves (PKR Billions)</td>
<td>640</td>
<td>774</td>
<td>877</td>
</tr>
<tr>
<td><strong>Total Liabilities (PKR Billions)</strong></td>
<td><strong>23,322</strong></td>
<td><strong>27,522</strong></td>
<td><strong>28,419</strong></td>
</tr>
<tr>
<td>- of which Deposits (PKR Billions)</td>
<td>11,742</td>
<td>12,800</td>
<td>14,350</td>
</tr>
<tr>
<td>--total depositors (000)</td>
<td>49,006</td>
<td>53,112</td>
<td>54,731</td>
</tr>
</tbody>
</table>

### Scale & Outreach: Depth

The depth of outreach is associated with the quality of outreach. Thus, outreach depth concerns the measure of the most underprivileged in a society that have been served. In microcredit operations, it is measured by a proxy indicator: average loan balance per borrower in proportion to per capita gross national income (GNI). A value of below 20 percent of GNI is assumed to mean that the industry is poverty focused.

The comparison of this indicator revealed an increase in the value of the industry from 24 percent previously to 25 percent by 2019 (Exhibit 2.12). The historic trend over the last five years also depicts a gradual rise in the overall value of the industry as well as individual peer groups. Comparison among peer groups indicated that while MFIs and RSPs remained below the cut-off mark of 20 percent at 14 percent and 16 percent respectively, the increase over the benchmark was due to the growth in MFBs, which peaked at 36 percent. This suggests that MFIs and RSPs continue to target the underprivileged, while MFBs have been catering to the relatively developed segment of the same market. Another interpretation of this ratio depicts the implications of loan sizes as a demand for higher loans has been witnessed due to inflation.

**Exhibit 2.12: Depth of Outreach by Peer Groups**
Lending Methodology

The historic trend highlights how the sector has transitioned from the predominant group lending methodology to individual lending. Over the years MFPs have shifted their focus from the traditional group lending to individual lending, as it increased gradually. A comparison of the year-end figures indicated that 65 percent of the clients were based on individual lending in 2019 as compared to 59 percent last year (Exhibit 2.13). The push towards this mode was driven by the MFB peer group, particularly TMFB, NRSP-B, and FMFB. On the other hand, some MFIs still focus on group lending such as Ghazi Barotha Tariqi Idara (GBTI) and Rural Community Development Programmes (RCDP) and Safco Support Foundation (SSF).

Exhibit 2.13: Trend in Lending Methodology
Gender Distribution

The year-end figures for women borrowers indicated a declining trend in the proportion of women borrowers in the industry. Women borrowers accounted for 51 percent of total borrowers compared to 53 percent in the last year (Exhibit 2.14 (a)). In contrast, the proportion of women depositors increased from 19 percent in 2018 to 20 percent by the end of the year under review. The breakdown of the total outreach by peer groups depicts that 25 percent of the total credit outreach of MFBs were women clients compared to 77 percent of the total credit outreach MFIs and 78 percent of the credit outreach of RSPs (Exhibit 2.14 (b)). NRSP, KBL and MMFB contributed the most to this increase in women borrowers while Kashf, Damen Support Program, Sindh Microfinance Bank (SMFB), Sarhad Rural Support Programme (SRSP) and FFO Support Program lend exclusively to women.

Exhibit 2.14 (a): Outreach to Women

Exhibit 2.14 (b): Gender Distribution of Outreach by Peer Groups
Portfolio Distribution by Sector
The distribution of the industry credit portfolio by sector indicated little difference when compared with last year. The share of the trading sector declined by four percent to reach 21 percent, the agriculture and manufacturing/production sectors experienced a decrease of one percent each which brought their proportion to 15 percent and five percent respectively, while the livestock/poultry sector remained unchanged with 27 percent of the total credit portfolio, which was the highest. In contrast, the services sector experienced a slight increase of three percent to close at 12 percent and the housing sector grew to one percent as some MFPs started exploring this sector.

Exhibit 2.15: Active Borrowers by Sector

Exhibit 2.16: Active Borrowers by Urban/Rural Areas

Rural – Urban Lending
Towards the end of 2019, rural clients continued to dominate the industry. The breakdown indicated that 53 percent of the total microfinance clientele was comprised of rural clients, an increase of two percent compared to the prior year, while the remainder 47 percent were based out of urban districts. KBL, NRSP and FMFB were the largest providers to rural clients, with a combined rural outreach of 1.8 million by the end of 2019. On the other hand, the largest providers of urban clients were Akhuwat, TMFB and Kashf, as their combined outreach surpassed 1.9 million clients in these districts. Nevertheless, it is evident the industry continues to focus on the underprivileged in underdeveloped regions.
Financial Structure

Asset Base

The asset base of the industry grew from PKR 426.6 billion in 2018 to PKR 493.3 billion by the end of 2019, showing an impressive growth of 16 percent. The proportion of the total asset base remained unchanged compared to the previous year as MFBs, MFIs and RSPs continue to maintain a share of 76 percent, 15 percent and nine percent respectively (Exhibit 2.17 (a)).

Exhibit 2.17 (a): Proportion of Asset Base by Peer Group

The increase in the asset base was primarily due to the growth in the asset base of MFBs by PKR 47.7 billion as the figure closed at PKR 374 billion. MFIs saw their assets grow by over PKR 12 billion to PKR 75.2 billion, while RSPs witnessed a growth of PKR 6.7 billion to close at PKR 43.9 billion (Exhibit 2.12(b)).

Exhibit 2.17 (b): Total Asset Base by Peer Group
Among the individual MFPs, KBL continued to be the largest in the industry with a balance sheet of PKR 81 billion compared to PKR 70 billion in the prior year. TMFB maintained its spot as the second largest MFP in terms of total assets, despite experiencing a decline in the total asset base of almost PKR 1 billion to close at PKR 61 billion. The third largest MFP was now FMFB with PKR 47 billion in assets compared to PKR 38 billion previously (Exhibit 2.18).

The industry continues to be dominated by the top 10 largest MFPs which account for 84 percent of the total assets of the sector, compared to 82 percent previously. Out of these 10, eight were MFBs while the remainder were one MFI and RSP each as Akhuwat dropped out of the 10 largest MFPs.

**Exhibit 2.18: Asset Base of Larger MFPs**

Funding Profile

The capital structure of the industry observed marginal change. While the deposits maintained 59 percent of the total capital structure, a slight decline in equity and an increase in debt saw their proportion change to 17 percent and 24 percent respectively (Exhibit 2.19). The trend of the past three years indicates that the overall proportion of the capital structure has remained the same with marginal
changes in the proportion of individual categories. The reliance of MFBs on deposits have resulted in the total deposit base rising to almost PKR 265 billion in 2019 from PKR 238.6 billion previously. Consequently, debt of the sector rose from PKR 90.7 billion to over PKR 105 billion, while equity grew from PKR 71.9 billion to PKR 76.3 billion by the end of 2019.

Exhibit 2.19: Industry Capital Structure

![Exhibit 2.19: Industry Capital Structure](image)

Apart from this marginal change which saw the deposit base of MFBs increase by one percent at the cost of equity, the proportion of debt remained unchanged. The MFI peer group saw no change within their proportion of debt and equity, which remained at 79 percent and 21 percent respectively. In the case of RSPs, they experienced a considerable change within their capital structure, as equity increased from 37 percent to 46 percent while debt declined from 63 percent to 54 percent.

Exhibit 2.20: Capital Structure by Peer Group

![Exhibit 2.20: Capital Structure by Peer Group](image)

Profitability & Sustainability

The total revenue for the industry increased by 24 percent from last year to close at around PKR 111 billion. Unfortunately, the year also experienced a significant decline in the net income from PKR 10 billion previously to a loss of PKR 5.8 billion (Exhibit 2.21 (a)). The decrease in the overall profitability of the sector was caused due to TMFB which incurred a loss of over PKR 16 billion during the year, while
other MFBs and most NBMFCs remained profitable. A major part of TMFB’s net loss can be attributed to investments in expanding the digital payments business, the other contributor is credit impairment loss, for which a provision of PKR 8.9 billion was made by taking into account expected losses and credit irregularities that also include fraud. It is worth mentioning that the total revenue of the industry stood at PKR 92 billion with a profitable net income of PKR 10.5 billion excluding the financial effect of TMFB.

**Exhibit 2.21 (a): Total Revenue & Net Income**

The overall loss within the industry also affected the already declining adjusted return on assets (ROA) and adjusted return on equity (ROE). The adjusted ROA declined from 0.7 percent in 2018 to -1.8 percent, while the adjusted ROE dropped from 4.3 percent to -7.4 percent during the year under review. It is noteworthy that the adjusted ROA and ROE of the industry stood at two percent and 7.8 percent respectively without considering TMFB.

**Exhibit 2.21 (b): Adjusted Return on Assets & Return on Equity**

In terms of peer groups, both MFIs and RSPs had an adjusted ROA of 3.6 percent and 3.8 percent respectively, while the indicator for MFBs dropped to -3.5 percent. The adjusted ROE of MFIs and RSPs
also remained positive with 17.2 percent and 7.3 percent respectively compared to the -16 percent of MFBs.

**Exhibit 2.21 (c): Adjusted Return on Assets & Return on Equity by Peer Group**

The industry experienced a decline in operational self-sufficiency (OSS), which dropped below 100 percent (Exhibit 2.21 (d)). The OSS of the industry stood at 97 percent from 119 percent in the previous year. If we leave out the losses from TMFB, the OSS of the industry stood at 116 percent. This decline in the OSS was due to losses suffered by TMFB which adversely affected the bottom line of the industry.

Out of the 38 reporting organizations, only three had an OSS less than 100 percent i.e. TMFB, Saath Microfinance Foundation Pakistan (Saath) and Punjab Rural Support Programme (PRSP). Among the peer groups, MFBs had an OSS of over 89 percent, while both MFIs and RSPs boasted an OSS of over 100 percent, with 137.5 percent and 117.5 percent respectively.

The financial self-sufficiency (FSS) of the industry also witnessed a decrease from 109 percent in the previous year to 95 percent by the end of 2019. However, the FSS without the effects of TMFB, witnessed an increase to 112 percent. FSS remained the highest for MFIs with 119.4 percent, followed by RSPs with 116.5 percent and 89 percent for MFBs.

**Exhibit 2.21 (d): OSS and FSS Trend**
The total revenue ratio of the industry improved from 22 percent to 24 percent during the year under review. The yield on portfolio (nominal) stood at 35 percent in 2019 compared to 38 percent in 2018. While the revenue from loan portfolio increased by 20 percent to close at over PKR 99 billion, this was met by a subsequent increase of 30 percent in the average GLP during the year, which stood at over PKR 283 billion, leading to a decline in the yield. This reveals that the pricing of assets has plateaued in 2019 despite increasing revenues, which can be improved with increased loan sizes and improvement in efficiency.

**Exhibit 2.22: Yield on Portfolio Trend**

The total revenue of the sector stood at over PKR 110.7 billion during the year under review (Exhibit 2.23). Of this figure, PKR 81.2 billion was attributable to MFBs, PKR 18.6 billion to MFIs while the remainder PKR 10.9 billion was attributable to RSPs. Most of the revenue of the industry continues to come from earnings on the loan portfolio which comprised 90 percent of the total revenue of the sector, which translates into over PKR 99.2 billion. However, this year also saw the proportion of revenue from investments in financial assets improve from two percent previously to six percent of total revenue or PKR 7 billion. The remainder PKR 4.5 billion or four percent of total revenue was associated with income from financial services.

The increase in the income from loan portfolio was driven by MFBs as they added over PKR 11 billion to stand at PKR 74 billion by the end of 2019. MFBs were followed by MFIs and then RSPs which added PKR 4.2 billion and PKR 1.4 billion each to close at PKR 16.9 and PKR 8.2 billion respectively. The investment in financial assets was also led by MFBs as they placed surplus funds into financial assets to improve their financial cushion and meet liquidity needs. This resulted in a sizeable increase in the income from investments of MFBs to surpass PKR 5 billion during the year.

**Exhibit 2.23: Revenue Streams**
The total expense for the industry stood at PKR 113.7 billion out of which PKR 57.1 billion was classified as operating expenses. This was followed by financial expense of PKR 34.2 billion and loan loss expense of PKR 17.7 billion. The expense to assets ratio continued to rise for the last two years (Exhibit 2.24) as the ratio increased to 25.2 percent from 20.1 percent previously. The increase is largely due to the increase in the Loan Loss Provision expense from 5.5 percent last year to 7.9 percent in the year under review. Additionally, the considerable increase in the non-operating expenses also led to this surge in total expenses which was due to rising inflation and the consequent cost of doing business in the industry.

Exhibit 2.24: Expense Ratio Trends

The operating expense to GLP and personnel expense to GLP ratios continued to decline for consecutive years (Exhibit 2.25). Operating expense to GLP ratio decreased from 22.4 percent last year to 20.2 percent in this year, whereas the personnel expense to GLP ratio increased from 8.7 percent to 9.1
percent in the same time period. The year also saw a decline in admin expenses as they fell to 11.1 percent from 13.8 percent previously.

**Exhibit 2.25: Operating Expense to GLP**

![Operating Expense to GLP Graph]

**Productivity**

The total staff in the industry increased by 10 percent in 2019 to stand at 46,163 of which 23,870 were loan officers compared to 21,614 in the prior year. The Personnel Allocation ratio remained unchanged this year when compared with 2018 (**Exhibit 2.26**). By the end of the year, the ratio for MFBs declined from 45.5 percent in the preceding year to 44.3 percent, followed by RSPs which dropped from 73.8 percent to 69.3 percent. MFIs were the only peer group that experienced a growth in the ratio from 51.3 percent to 57.1 percent.

**Exhibit 2.26: Personnel Allocation Ratio**

![Personnel Allocation Ratio Graph]
The productivity indicators over the last five years indicate a general growth, while some indicators represented stability in the ratios (Exhibit 2.27). The borrowers per staff ratio increased from 159 to 161 while the borrowers per loan officer rose from 309 to 312 in 2019. The loans per staff grew from 159 in the prior year to touch 161 loans per staff during 2019. Similarly, the number of loans per loan officer depicted substantial growth as they improved from 758 in 2018 to 952 loans per loan officer by the end of the year under review. On the deposit side, the depositors per staff remained somewhat stable by increasing only marginally from 307 to 312. In terms of peer groups, RSPs had the highest loans per staff ratio with 184, followed closely by MFIs with 182, while MFBs had 144 loans per staff. MFBs maintained the highest loans per loan officer with 326 compared to 318 for MFIs and 265 for RSPs.

It is anticipated that the productivity of MFPs, based on these indicators, will improve considerably when considering the impact of digital credit. This is observed when analyzing these indicators for the telco-led banks currently involved in digital lending. In 2018, the borrowers per staff stood at 195 for TMFB and 152 for MMFB. These indicators experienced significant increase by the end of 2019 as they stood at 243 for TMFB and 227 for MMFB. In terms of savings, the depositors per staff ratio also increased from 2,585 in 2018 to 4,651 in 2019 for TMFB, while it declined from 14,248 to 13,593 during the same period for MMFB.

Exhibit 2.27: Productivity of MFPs

Credit Risk

The PAR 30 remained below the five percent benchmark despite increase in the ratio. The year saw the PAR 30 to GLP ratio jump from 1.6 percent previously to 3.9 percent while the PAR 90 (percentage of total loan portfolio at risk due to open loans overdue by 90 days) increased from 0.8 percent to 2.6 percent. Similarly, a surge in write-offs was also observed as the write-offs to GLP ratio increased to 3.1 percent compared to 0.5 percent previously (Exhibit 2.28 (a)).

Exhibit 2.28 (a): Portfolio at Risk at Write offs
The increase in the PAR 30 indicator was primarily due to MFBs as they experienced a considerable rise in the ratio to 5.1 percent by the end of the year compared to 0.9 percent and 1.3 percent for MFIs and RSPs respectively. PAR for MFBs was higher due to higher reported PAR by TMFB or Correspondingly, the PAR 90 days ratio also increased for MFBs to touch 3.5 percent while MFIs and RSPs managed to contain it at 0.5 percent and 0.8 percent each. MFBs also contributed to the increase in write offs as they saw their write offs to GLP close at 4.1 percent compared to 0.3 percent and 0.8 percent for MFIs and RSPs.

Exhibit 2.28 (b): PAR 30 to GLP and Write offs to average GLP

Conclusion

Microfinance industry witnessed another year of growth in outreach despite macroeconomic challenges. The industry continued to serve marginalized segment with women and rural borrowers making up most of the borrowers. The sector balance sheet is nearing PKR 500 billion marks and is dominated by the MFB peer group.

The sector risk witnessed an increase which was natural given the adverse economic conditions, however, it remained below the five percent benchmark. Also, sector profitability and sustainability also took a hit. However, the decrease was due to one MFP reporting a loss while the rest of the sector
remained profitable and sustainable. Expenses rose over the year mainly due to increase in borrowing costs and loan loss provision.

The sector looks towards the year 2020 with looming challenges included macro-economy, COVID-19 epidemic and locust attack on crops which will test its business models, financial sustainability and management acumen.
Section III: Social Performance Review

The microfinance sector in Pakistan has shown constant and consistent commitment in incorporating Social Performance Management in its processes, operations and practices and there has been an increasing focus on balancing social performance with financial sustainability. Social Performance Management broadly is an indication of how well a microfinance institution meets the social goals outlined in its mission and vision. Social performance is reflected in a wide range of indicators, including an MFI’s policies towards its target market, its policies of governance and for its employees, credit policies, level of transparency in interest rates and loan terms, client protection and policies on environmental conservation.

MFPs have been engaged in pursuing a range of social and development goals, which include increasing access to financial services, development of start-up and existing enterprises, poverty alleviation, employment generation, promoting gender equality and empowerment. These development goals form the foundation of the microfinance sector and are significant for MFPs to gauge their progress towards achieving their respective social goals. This is done by using social performance indicators in the same way as financial data is used to manage the financial bottom line.

The following section will outline key social performance indicators as monitored across the Pakistan microfinance landscape. We will attempt to analyze industry trends across various Social Performance (SP) indicators, including social goals, poverty targets, governance & HR, diversity in financial and non-financial service provision, client protection and environmental protection.

Analysis of the Sector’s Social Performance Indicators

The Microfinance Information eXchange (MIX), in collaboration with the Social Performance Task Force (SPTF), has developed an annual social performance reporting framework for MFPs. The framework categorizes social performance into five main categories and includes a comprehensive set of indicators on institutions’ social goals, target segments, governance and HR practices, financial and non-financial services and environmental safeguard. As self-reported data, the MIX framework allows MFPs to select multiple categories that are applicable to their respective institution. For example, within the ‘target population sub-section, an MFP may report to targeting all or none of the following; ‘women’, ‘clients living in the urban area’, ‘youth and adolescents’ and ‘clients living in the rural areas’ categories if those are applicable to their practices.

At the time of this publication, 33 PMN members have reported their organizational data using the new MIX social performance framework. The PMN members that have reported the data include 11 Microfinance Banks (MFBs), 17 Microfinance Institutions (MFIs) and five Rural Support Programs (RSPs).

Social Goals

Target Market

The target market defines the type of clientele being served by the MFPs. The social performance reporting framework highlights four main categories in the target market section which are “clients living in rural areas”, “clients living in urban areas”, “women”, and “adolescent and youth”. 
Having a target market helps the organization channel its overall goal and mission in a focused manner and can help to optimize the use of their limited resources. Providing services that are relevant, client oriented and effective in serving an organization’s mission requires a thorough identification of the target market.

**Exhibit 3.1: Target Market for Peer Groups**

![Target Market for Peer Groups](image)

MFPs target markets by peer group which are highlighted in Exhibit 3.1. Out of 11 reporting MFBs, the majority cited multiple targets, including clients living in rural areas and clients living in urban areas. 10 of the 11 also reported extending services to women. Of the 17 reporting MFIs, all 17 of them target clients in rural areas, clients in urban areas and women. Out of the five reporting RSPs, five cater to clients in rural areas, while four have also expanded operations to clients in urban areas and four prioritize lending to women. Overall, clients are targeted based on gender and location, with a specific preference for women in most cases, with some institutions lending exclusively to women. There is 100 percent coverage of rural areas by all MFPs, 96 percent outreach to urban areas and 94 percent outreach to women as a specific target market.

**Development Goals**

The data analysis of MFPs’ social performance indicators shows that all MFPs have social development goals at the foundation of their mission. The most common mission statements include a focus on expanding the reach of quality financial services to the lower-income population, contributing to poverty eradication, spurring employment generation and jumpstarting business and enterprise growth. By focusing on these medium-term goals, the overarching goal is to improve the quality of life of the population, socially and economically. Themes of poverty alleviation, increased access to finance and expansion of economic opportunities are more common elements in non-bank MFPs. Women empowerment is also seen as a frequently occurring theme as well. The MFPs are seen to have explicitly designed products, services and procedures to achieve their social goals.
**Exhibit 3.2: Development Goals**

The most common objectives were found out to be increased access to financial services by 29 MFPs closely followed by poverty reduction by 28 MFPs. Other commonly cited objectives included employment generation (25), growth of existing businesses (26) and gender equality and women’s empowerment (25). A rising trend can be seen for development of start-up enterprises (14) as a higher number of MFPs report it as part of their development goals. In addition, the government is increasingly focusing on low-cost housing projects, which could indicate an increase in housing finance in the upcoming years.

**Poverty Targeting**

Almost all reporting MFPs target more than one segment of the marginalized population. Overall, the most common target market for the sector in terms of income is low income clients with 30 reporting MFPs citing this as their target market. A smaller number of 24 reporting MFPs is seen to target poor clients, while only eight MFPs reported targeting very poor clients. A relatively higher number of MFBs are seen to lend primarily to low-income clients while MFIs and RSPs are seen to be targeting poor and very poor clients vis-à-vis MFBs.

**Exhibit 3.3: Poverty Targets**
Poverty Measurement Tools

Many MFPs in Pakistan’s microfinance sector have established poverty measuring processes in their operations. These tools measure the intensity of poverty within a defined area by using a relevant dimension and indicator, determining a threshold level and selecting a poverty measure for reporting. Various tools collect economic, social, and/or other types of wellbeing indicators from clients for the purpose of determining and/or tracking these clients’ poverty levels.

Assessing and analyzing the poverty level of clients helps guide client targeting, establish baselines of client poverty for subsequent impact evaluations, appraisal of financial services to better suit needs of clients and overall measurement of the program’s effectiveness.

Exhibit 3.4: Poverty Assessment Tools Used by MFPs

<table>
<thead>
<tr>
<th>Poverty Assessment Tools Used by MFPs</th>
</tr>
</thead>
<tbody>
<tr>
<td>MFB</td>
</tr>
<tr>
<td>------------------------</td>
</tr>
<tr>
<td>Grameen Progress out of Poverty Index (PPI)</td>
</tr>
<tr>
<td>USAID Poverty Assessment Tool (PAT)</td>
</tr>
<tr>
<td>Per capita household expenditure</td>
</tr>
<tr>
<td>Per capita household income</td>
</tr>
<tr>
<td>Participatory Wealth Ranking (PWR)</td>
</tr>
<tr>
<td>Own proxy poverty index</td>
</tr>
</tbody>
</table>

Some reporting MFPs employ only one method to measure poverty levels while others use multiple assessment tools, as shown in Exhibit 3.4. A higher number of MFPs report use of the per capita household income metric (13), followed by per capita household expenditure (7) and the use of their own proxy poverty index (6). Other infrequent but used measures include Grameen Progress out of Poverty Index, Participatory Wealth Ranking and the USAID Poverty Assessment Tool.

Governance and HR

Governance and HR practices are considered imperative to complement the overall social mission of MFPs. Two standards of the USSPM pertain to Governance and Human Resource (HR) Management, indicating policy design to further the organizations’ social goals. The rationale behind incorporating social performance indicators in governance and HR structures is to allow MFPs to gauge commitment to their social development goals at the institutional level.

Ensuring commitment to social goals in the governance structure entails sensitization of board members to the social mission of the MFP, the presence of a Social Performance (SP) champion at the board level and board members with relevant experience in Social Performance Management.
To this end, majority of the reporting institutions have reported conducting board orientation for their respective social missions.

**Exhibit 3.5: Board Commitment to Social Performance Management**

8 of the 11 reporting MFBs said that their board members are oriented on the organization’s social mission while 15 out of 17 MFIs reported that orientation session is carried out for their board members. Four out of five RSPs also reported conducting orientation sessions for their board members.

Similarly, four out of 11 MFBs reported that they have an SPM champion or a committee at the board level whereas only eight out of 17 MFIs and three out of six RSPs have an SPM champion or a committee at the board level. Regarding the experience of board members in SPM, seven of 11 MFBs, 16 out of 17 MFIs and four out of five RSPs reported compliance on this indicator.

**HR Practices**

About HR practices pertaining to social goals, this assessment tool measures if staff incentives are related to social performance, how number of clients are incentivized and whether HR policies are related to Social Performance. The last section shows the average percentage of female representation at different levels in the microfinance institutions (MFBs, MFIs and RSPs).

**Exhibit 3.6: Staff Incentives Related to SPM**
Staff incentives measure the MFPs’ adherence to social performance as per the number of clients entertained by the field staff, the quality of interaction with clients based on client feedback mechanisms, quality of social data collected and/or the portfolio quality maintained by field staff.

Amongst the MFB peer group, seven out 11 MFBs reported that their staff incentive was linked to the number of clients and 10 MFBs reported that their incentive structure was linked to portfolio quality. Only two MFBs reported that the quality of interaction of their staff with the clients was also linked to staff incentives while only one MFB reported in the affirmative for quality of social data collected for the same.

Amongst the MFI peer group, 11 out of 17 MFIs reported that their incentive structure was linked to the number of clients while 13 MFIs reported that the incentive structure was linked to the portfolio quality. Amongst the RSP peer group, all of them reported that their incentive structure was linked to the portfolio quality while four RSPs have also deployed the indicator of number of clients to incentivize their staff.

**Exhibit 3.7: Methods for Calculating Staff Incentives**

<table>
<thead>
<tr>
<th>Method for Incentivizing Number of Clients</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Incentive on &quot;client retention&quot;</td>
<td>13</td>
</tr>
<tr>
<td>Incentive on &quot;number of new clients&quot;</td>
<td>14</td>
</tr>
<tr>
<td>Incentive on &quot;total number of clients&quot;</td>
<td>17</td>
</tr>
</tbody>
</table>

The second aspect measures how MFPs reward staff based on metrics of social performance; incentives or bonus systems are tied (in whole or in part) to the number of clients in field officers' portfolios. These can be based on the total number of clients, number of clients meeting specific criteria and/or retaining existing clients.

Exhibit 3.7 shows that all MFPs use a combination of these measures for calculating staff incentives, with the most common being incentives related to “total number of clients” followed by number of new clients and client retention.

**Exhibit 3.8: HR Policies Related to Social Performance**
The third indicator encompasses the USSPM standards for responsible treatment of employees.

Exhibit 3.8 shows that all reporting MFPs have effective HR policies related to Social Performance with strong reporting on anti-harassment, staff grievance resolution, social protection and non-discrimination. However, there appears to be a gap in policies pertaining to safety of staff members since only 18 of the reporting 33 MFPs cited having any safety mechanism in place.

**Exhibit 3.9: Average Percentage of Females in MFPs**

Exhibit 3.9 shows that there are on average 31 percent females who are board members, 23 percent females who are loan officers, 13 percent females who are managers and an overall 18 percent females form part of the personnel. The data for this section was available for 28 MFPs, but it can be considered a representative sample since it includes the major players in the industry.
Given that the microfinance industry is largely geared towards women borrowers, the sector itself does not have an adequate representation of women in day-to-day operations and management, even though it fares slightly better at the board level.

**Products and Services: Financial**

Microfinance encompasses a range of financial services for the low income and poor households, including savings, insurance and money transfer services along with credit. This section describes the further subdivision of these products to examine the level to which the financial products and services are adapted to serve the client needs.

**Credit**

All reporting organizations offer microcredit services, for income generating purposes as well as for non-income generating (consumption) purposes.

**Exhibit: 3.10: Types of Credit Products Offered by MFPs**

![Bar chart showing types of credit products offered by MFPs]

As Exhibit 3.10 shows, all the reporting MFPs offer income-generating loans, while only 10 MFPs offer non-income generating loans in addition to income-generating ones.

The income generating loans extended by MFPs include microenterprise loans, SME loans, agriculture/livestock loans and express loans. While for the non-income generating loans offered, the main categories include education loans, emergency loans, housing loans and other household consumption loans.

**Exhibit 3.11: Credit Offerings by Peer Groups**
Exhibit 3.11 shows the comparison of MFBs, MFIs and RSPs with respect to the category of income generating loans offered to their clientele. Almost all reporting MFPs offer microenterprise loans whereas most of them also extend credit for agriculture/livestock loans while a growing number of MFPs offers SME and express loans.

**Deposits**

Given the regulatory structure in Pakistan for savings product/deposits, only MFBs can intermediate deposits and hence offer voluntary deposit accounts (both demand deposit accounts and time deposit accounts). Exhibit 3.12. shows that 10 of the 11 reporting MFBs offer either demand or time deposits or both.

**Exhibit 3.12: Savings Products Offering by MFPs**

All MFBs, being regulated banks, can intermediate client deposits, and thus all reporting MFBs can take deposits. Non-bank MFPs can only mobilize deposits.
Insurance

Insurance products are increasingly gaining popularity among clients of the microfinance sector and there is enough demand for MFPs to offer these services. Various micro-insurance products are being developed and offered to serve the base of the pyramid. Most of the reporting MFPs offer insurance products to meet their clients’ needs and to protect them against the risk of losses.

**Exhibit 3.13: Types of Compulsory Insurance**

![Types of Compulsory Insurance](chart1.png)

As Exhibit 3.13 shows the most common compulsory insurance product offered by MFPs to its clients is the credit life insurance product, with 19 of 33 MFPs offering it. Other compulsory insurance products include life/accident insurance and agriculture insurance.

Some MFPs offer voluntary insurance products on a needs-basis to customers through partnerships with insurance providers. While most MFBs offer compulsory insurance, there are a few that offer voluntary insurance products.

**Exhibit 3.14: Types of Voluntary Insurance**

![Types of Voluntary Insurance](chart2.png)
Exhibit 3.14 shows that voluntary insurance products include credit life insurance, life/accident insurance, agriculture insurance and health insurance.

**Other Financial Services Offered**

Other financial services offered by MFPs include provision of debit/credit card, mobile/branchless banking services, savings facilitation services, remittance/money transfer services, payment services, micro-leasing and scholarship/educational grants. Exhibit 3.15 shows that amongst the MFPs, the main provider of these financial services is the MFB peer group with the most common financial services of debit/credit card, branchless banking, payment and money transfer service being extended to the clients.

**Exhibit 3.15: Types of Financial Services Offered**

<table>
<thead>
<tr>
<th>Types of Financial Services Offered</th>
<th>MFB</th>
<th>MFI</th>
<th>RSP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debit/credit card</td>
<td>8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mobile/branchless banking services</td>
<td>5</td>
<td>8</td>
<td>1</td>
</tr>
<tr>
<td>Savings facilitation services</td>
<td>3</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Remittance/money transfer services</td>
<td>5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payment services</td>
<td>6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Scholarship/educational grants</td>
<td></td>
<td></td>
<td>1</td>
</tr>
</tbody>
</table>

However, some MFIs and RSPs are now offering clients other services such as, mobile/branchless banking services while some are extending support to clients through savings facilitation and educational grants/scholarships.

**Products and Services: Non-financial**

MFIs usually provide non-financial services to their clients, in addition to financial services. These non-financial services are offered by MFPs to build the capacity of their clients to fight poverty and strengthen their livelihoods. These services can include education related to running a business, provision of entrepreneurial skills and women empowerment among others. Nonfinancial services can be offered by the institution directly or through a partnership.

The range of skills given differs for each institution, depending on their capacity and vision, but the overarching purpose remains helping clients develop additional skills in supporting their enterprises. These can take the form of provision of basic services like health and education or business and/or technical skills.
trainings. For the purpose of this analysis, such services are grouped into four main categories: enterprise, education, health and women’s empowerment.

Contrary to the MFBs having a lead in provision of other financial services, in this domain, MFIs and RSPs are more active in providing all types of non-financial services in the market; especially those committed to a particular social mission (see Exhibit 3.16.).

**Exhibit 3.16: Non-Financial Services Offered**

The MFB peer group has primarily concentrated its efforts in provision of education services with a focus on financial literacy education. The most common service provided by MFIs includes women’s empowerment services followed by education and enterprise services. RSPs are also actively providing enterprise, women empowerment and education services. A handful of MFIs and RSPs also offer health services like basic medical and special medical services for women and children.

**Transparency of Cost**

Ensuring pricing transparency is a primary responsibility of the financial service provider. It is considered an essential requisite for sound consumer protection, social performance and responsible microfinance. The microfinance sector at large is making efforts to disclose this information to the borrowers in a standardized way which allows comparison and simplifies the process of decision making.

**Exhibit 3.17: Method to State Service Cost by Peer Group**
As of 2019, 16 MFPs reported using the declining balance method for calculating interest rates while 22 reported using the flat methodology for interest rate calculation. It is seen that a significant number of MFPs in Pakistan continue to use the flat methodology to communicate prices to clients – where interest rate is communicated based on the stated initial principal amount of the loan irrespective of the payment plan. A relatively smaller number of MFPs report the use of a declining balance method – which means interest is communicated on the amount of the loan principal which the borrower has not yet repaid.

All MFBs in Pakistan are required by the SBP to disclose the interest cost to the borrower. Exhibit 3.17 shows that seven MFBs use the declining balance interest method and six MFBs use the flat interest method. It is also seen that five MFIs and four RSPs use the declining balance interest method while 13 MFIs and three RSPs use the flat interest method.

**Client Protection (CP)**

There are seven all-encompassing principles of client protection developed by the SMART Campaign, an international consortium of microfinance stakeholders, in the area of pricing transparency, which include:

- Appropriate product design and delivery
- Prevention of over-indebtedness
- Transparency
- Responsible pricing
- Fair and respectful treatment of clients
- Privacy of client data
- Mechanisms for complaint resolution

For analysis of the sector with respect to client protection, the parameters included presence of policies supporting good repayment capacity analysis, internal audit compliance, full pricing terms disclosure, APR disclosure, CP code of conduct violations, clear reporting systems and data privacy clauses.

Overall, the sector shows positive compliance to CP principles, particularly with all reporting MFPs showing compliance on disclosure of prices and APR and contracts including data privacy clauses. A majority of MFPs also have defined codes of conduct and clear reporting systems for clients’ complaints.

Due to the regulatory framework, instituted by State Bank, under which MFBs fall, all reporting banks show full compliance to the basic CP indicators. With MFIs now falling under the regulatory framework of SECP, any shortfalls in compliance are likely to be removed.

**Exhibit 3.18: Client Protection Indicators**

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14 See the Smart Campaign website for more details on the seven CP principles and how these are promoted and monitored through Smart Assessment tools: [http://www.smartcampaign.org/](http://www.smartcampaign.org/)
Environmental Policies

In recent years, the objective of achieving a triple bottom-line by incorporating environmental and social performance management in addition to the financial goals has gained traction; this incorporates meeting a target of environmental and social goals in addition to the financial targets. This assessment looks at indicators which are broadly classified into two main categories, namely the presence of environmental policies and types of environmentally friendly products and/or services offered.

These environmental policies refer to MFPs promoting awareness on environmental impacts, having the necessary tools to evaluate environmental risks of client’s activities and products including clauses in loan contracts to ensure mitigation of environmental risks through the clients’ businesses and specific loans linked to environmentally friendly products.

**Exhibit 3.19: Environmental Policies in Place**
Exhibit 3.19 shows that a significant number of MFIs have policies in place to promote environmental protection. The most common area within the domains of environment being addressed by MFIs are ‘awareness raising on environmental impacts’ and requiring clients to improve environmental practices as a total of 12 MFIs out of 17 MFIs are working on this. Seven out of 11 MFBs and all five RSPs are seen to be focusing on awareness raising.

At sector level, as evident from Exhibit 3.19 there is a growing focus on developing tools to evaluate environmental risks of clients as well as on provision of specific loans linked to environmentally friendly products and/or practices.

**Exhibit 3.20: Environmentally Friendly Products/Services Offered**

Exhibit 3.20 shows that within the category of providing environmentally friendly loans, the most common loan product being offered relates to renewable energy with a total of 14 MFPs focusing on this aspect. A rising number of MFPs is also focusing on loan products for adopting environmentally friendly practices.

**Conclusion**

The analysis of the MFPs with respect to their social performance shows there is strong commitment to improve on the indicators to address the needs of the various marginalized segments of the society. The sector shows positive trends for social performance management at the board levels and the HR policies in place also show compliance on most social performance indicators. This implies regular oversight and reporting on social performance metrics at the highest level which is likely to ensure compliance in management and operations. There is, however, a need for the sector to pursue an active policy of increasing representation of women at all levels of operations. This would not only increase women employment, but it will strengthen microfinance industry image as an equal employment opportunity sector.

Regarding the target market, microfinance covers a significant portion of the poor and low-income segments in urban and rural areas and there is an explicit focus on women borrowers as well. However, there are certain segments that are still underrepresented and underserved such as the adolescent and
youth, transgenders and persons with disabilities. There is a significant market particularly in the youth cohort to expand to and customizing products and services for these segments could go a long way in meeting the goal of universal financial inclusion.

The sector can also play an instrumental role in providing the lower-income sector with insurance products. There is a need to expand insurance services to cover the wider set of risks that vulnerable clients face, particularly in the agricultural sector, where due to climate change, the vulnerabilities of poor farmers are exacerbated manifold. This can be done my MFPs increasing the range and volume of insurance products offered and by raising awareness around the benefits of existing insurance products.

The microfinance sector should expand operations and target markets to include a focus on impact-oriented businesses and social enterprises. These generally include investments in low-cost private schools, low-cost housing, renewable-energy projects, agricultural value chains, micro-enterprise lending etc. This would not only increase outreach and provide a diversified mix of products but also positively impact the triple-bottom line goals of the MFPs.
Section IV: The Way Forward

The challenges and opportunities facing the microfinance industry in Pakistan in the coming years are discussed below.

Financial Inclusion in Pakistan: The Road Ahead

Financial inclusion has remained a key agenda of policy makers in Pakistan for more than two decades now. MFPs are recognized as one of the key pillars in expanding access to finance in the country.

In order to facilitate access to finance, rules and regulations have not been stringent especially in case of MFPs as compared to their bigger financial institution counterparts. However, exogenous changes like inclusion of Pakistan in the Financial Access Task Force (FATF) Grey List and push for greater transparency and disclosures due to the introduction of new accounting standards has increased the compliance requirements for the MFPs.

For the year 2019, added regulations such as AML/CFT and sanctions compliance, along with the introduction of new accounting standards, are considered to be among the bigger challenges facing the microfinance industry.

Impact of AML/CFT Regulations

With Pakistan under enhanced scrutiny by the FATF and its regional Asia Pacific Group (APG), the country has established laws like Anti-Terrorist Act 1997, Anti Money Laundering Act 2010, National Counter Terrorism Act 2013, and prepared the National Action Plan. Moreover the regulators, SBP and SECP, have periodically proposed amendments in their AML/CFT frameworks in order to align existing regulations with FATF recommendations. While these developed amendments are focused on preserving the integrity and soundness of the financial systems in place, they have posed certain risks to the unbanked population and financial service providers.

In response to the AML/CFT regulations, MFPs have faced increased compliance costs, adopted sound internal control practices, established enhanced KYC and CDD measures, and in some cases, been forced to end their relationships with certain clients where compliance costs were deemed to outweigh potential profits. It is rational to conclude that these increased costs of compliance are necessary, given the economic situation of the country and the risks faced by the financial system. Moreover, enforcement and penalties faced by service providers amplify the regulatory ambiguity, contributing to a risk-averse attitude from financial institutions. From the perspective of the client, the additional costs associated with the compliance of AML/CFT regulations are borne by the entity, which bite into the profitability of these entities. However, it could be argued that the cost of AML/CFT compliance goes past the increased operational costs for MFPs, and regulations need to be evaluated in the context of the costs borne by the society.

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15 SBP regulated entities are not allowed to pass on the cost of identity verification to their customers.

Ref: Regulation M-1 Para 5

Such high costs may encourage clients to rely on informal means that are relatively affordable and convenient. Furthermore, the absence of appropriate identification documents and insufficient financial information, in the case of the underprivileged, present further barriers to financial inclusion. For these clients, the informal economy is much more attractive for legitimate transactions, which test AML/CFT efforts.

For MFPs, there are other challenges apart from the obvious financial implications of non-compliance. This is particularly true for small to medium sized NBMFCs which struggle with setting up the resources and technological infrastructure needed to ensure adequate compliance. One of the basic challenges faced by these MFPs is the continued scarcity of skilled compliance personnel. While the demand for these skilled resources is high, it comes at a cost which smaller MFPs are unable to afford. Another challenge faced by MFPs is the technological infrastructure to tackle the increased regulatory changes and assist in managing the many facets of organization-wide compliance. The need for a robust, compliance-driven platform with governance capabilities is proving to be critical in order to remain relevant today.

With an increase in compliance-related costs and rising associated risks, MFPs look to prioritize how to best allocate existing resources in order to remain compliant and mitigate risks. While MFBs and large NBMFCs have been successful, smaller entities have been unable to take complete advantage of the existing technologies that could prove vital to effectively leverage their operations. The formulation and execution of a clear strategy for the adoption of new technology and the development of existing resources must take precedence in order to remain relevant in the industry.

**New Accounting Standards**

Pakistan has been proactive towards the adoption of all effective International Financial Reporting Standards (IFRS) for accounting. The year 2019 saw developments from the regulators for the implementation of IFRS 9: financial instruments, and IFRS 16: leases to replace their dated versions. While the SECP has authority to notify accounting standards for all companies, the SBP being the banking regulator has a role in prescribing the accounting and reporting requirements for banks and certain categories of financial institutions.

**IFRS 9: Financial Instruments**

The SECP had notified all registered entities of the replacement of International Accounting Standard (IAS) 39: “Financial Instruments – Recognition and Measurement” with IFRS 9: “Financial Instruments” effective 1st of July 2018. However, the regulator moved to defer the effective date of IFRS 9 for the reporting period or year ending on or after 30 June 2021 for all NBFCs, while allowing early application of the accounting standard.16 Similarly, upon the request of the banking sector, the SBP also deferred the implementation of the standard till December 31st, 2020 for all banks and financial institutions under its regulatory ambit after the review of the impact assessment and stakeholder representation17. This was subject to certain conditions which stated that banks were to perform parallel runs of IFRS 9 implementation starting from Jan 1, 2020 to test the IFRS 9 outcomes, submit quarterly reports on the status of IFRS 9 implementation to the regulator, review internal systems and procedures, put in place required governance structures, processes and systems for implementation of the standard, and establish

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a subcommittee at the board level to ensure oversight and appropriate compliance. The circular also prescribed deadlines for each activity to be conducted within that timeframe.

The major distinction between IAS 39 and its superseding standard IFRS 9 is the introduction of the “expected credit loss approach” as opposed to the “incurred loss approach” for the impairment of financial instruments. The key impact of the implementation of this standard on financial institutions would be a significant increase in the extent of their credit loss allowances, which aims to increase their resilience to adverse economic situations. However, the implementation of this standard presents certain challenges for financial institutions which have led to the deferment of its implementation by the regulators to begin with. For instance, in terms of financial impact, institutions would expect an increase in the balance sheet allowances due to the new “expected credit loss approach” which would have a negative impact on equity while also increasing volatility in their income. The implementation of the standard would also affect the appetite and risk management strategy of institutions which could influence entities to reconsider their existing business models and their products. Another significant challenge would be maintaining minimum levels of historical and forward-looking data to support the new expected credit loss approach. Moreover, this would also require robust infrastructure and systems to be in place in order to conduct the complex modeling and the consequent forecasting by utilizing the large amount of data in a limited time. Additionally, the costs associated with the establishment of such systems would transition far beyond the capital investment and increase operational expenditure associated with the specialized resources required.

It’s understood that MFBs and larger NBMFCs would eventually muster their resources and invest in the necessary infrastructure to implement the standard according to the issued guidelines and within the prescribed timeframe. However, it will be relatively challenging for medium and smaller NBMFCs. The accounting treatments needed for the adoption of the standard would require modification in the existing bookkeeping and financial reporting systems of these MFPs. Moreover, the large size of loan portfolio needs significant time and efforts for the estimation of provisions on ECL model, which would prove difficult with the limited human resources and information systems capacity at the institutional level. Lastly, the adoption of this standard would also ultimately affect the marginalized segment, in terms of fees, interest or return in order to remain sustainable. Thus, it is essential to assess and consider the social implications of the adoption of this standard as well.

IFRS 16: Leases

International Financial Reporting Standard (IFRS) 16: Leases was first introduced in January 2016 and supersedes International Accounting Standard (IAS) 17 of the same name. In 2018, the SECP issued a notification to all registered companies regarding the adoption and implementation of IFRS 16 with effect from January 1st, 2019.18

Under IAS 17, lessees account for lease transactions either as an operating or a finance lease, depending on the prescribed rules and tests resulting in all or nothing being recognized on balance sheet. In contrast, the new standard, IFRS 16, requires lessees to recognize nearly all leases on the balance sheet which will reflect their right to use an asset for a period and the associated liability for payments. The standard does not highlight changes in accounting for Lessors significantly as the operating and finance lease distinction remains for them. Other major changes to the standard include new requirements for subleases, sale and lease back transactions and modifications to leases, additional disclosures, guidance on whether a contract contains a lease, and clarity on how to deal with service contracts.

18 S.R.O. 434 (I)/2018 – Securities & Exchange Commission of Pakistan
IFRS 16 would have considerable implications on financial service providers. For instance, institutions with material off-balance sheet leases applying IFRS 16 will report higher assets and lower equity which could affect their regulatory capital. Moreover, the standard requires a financial institution to disclose assets arising from leases of properties as tangible assets. The depreciation of the lease asset and the interest on the liability is recognized in the income statement over the lease term, like the treatment of finance lease under IAS 17, which basically leads to higher expenses at the beginning of the term of the lease. Finally, due to the requirements in the new standard, financing models like sale and-leaseback are expected to cease to be relevant which may lead to changes in business practices.

Transforming NBMFCs from Non-Profit into For-Profit

The year 2019 was a difficult year for the industry due to increasing inflation and interest rates coupled with rapid currency devaluation. These developments presented the sector, particularly NBMFCs, with growing financial challenges and prompted NBMFCs to consider transforming into for-profit entities. While this could be considered an essential indication of the sector maturing, it is argued whether it is possible to effectively align non-profit ideals with for-profit business practices.

These NBMFCs were traditionally NGOs with a mission of anti-poverty or poverty alleviation. The primary objective of these organizations has always been to increase outreach to the poor or marginalized segment of the society, while the secondary objective has been financial stability. They have traditionally relied on grants or subsidized sources of funding for expansion. However, their financial position indicates that these institutions are not only struggling to expand outreach, but also to generate adequate income to sustain themselves. Moreover, the limited flow of funds is restricting the ability of these institutes to service those in need of credit.

The move to become for-profit entities means that these service providers receive access to diverse sources of commercial funds. The for-profit orientation should transform them into more appealing entities as they adapt appropriate pricing strategies and improve efficiency, and thus attract the required investment with little trouble. This would also translate into the social impacts that these NBMFCs deliver to be more sustainable. However, this transition brings secondary implications for the sector, as the question arises whether a for-profit entity can continue to uphold its mission of poverty alleviation while meeting its duty to maximize returns. This change in focus from its social goal towards profit is referred to as “Mission Drift”.

The other implication is the challenges related to taxation that would arise during the transition of these entities, such as Income Tax and Withholding Tax on dividends.

With the support of a proactive and enabling regulator; the SECP, this transformation could be well facilitated especially when regulatory and legal obstructions are considered. Their support will prove vital for these NBMFCs to attract both debt and equity capital from the private sector and be recognized as a mainstream part of the financial landscape in Pakistan.

Funding Landscape

The funding landscape of the microfinance industry continues to vary across the two main peer groups i.e. MFBs and NBMFCs. Each peer groups’ funding requirements are discussed as below.
MFBs being deposit taking entities, rely on deposits for meeting their funding need. However, these deposits are being raised from corporate entities and high net worth individuals by offering them above market rates for the last several years. Resultantly, this pushes up cost of funds for the MFBs. In the previous years, the increase in policy rate further pushed up the cost of funds for the banks as they continued the practice of offering above market rates to entice depositors. This increase in cost led banks to either increase their lending rates or take a hit on their bottom line or a combination of both. While it is widely endorsed and understood that low cost retail deposits are the way forward, however, it is seen that this requires product innovation on the part of MFPS while policy makers need to strengthen MFBs by providing access to deposit protection insurance and access to banking courts. Also, access to SBP discount window shall further enhance the trust of retail depositors.

Last year also saw the successful issuance of Tier 2 capital by a couple of MFBs with help from PMIC. It is likely that other MFBs will take the same path in order to meet their capital adequacy requirements. Moreover, backed by strong balance sheets and sponsors, MFBs are geared to successfully tap the capital markets.

In contrast, the NBMFCs are reliant on borrowed funds to meet their funding needs. Most of the entities, except for some smaller ones, have diversified their sources of funding from the national apex, PMIC. At present, funding for NBMFCs is sources roughly in equal proportion from PMIC, local commercial banks and international lenders. International borrowing despite being expensive compared to local sources after considering their original pricing and hedging premium remain popular with NBMFCs. Larger and mid-sized MFPS have all availed such loans. Their popularity is to do more with the ease of access of availing such loans and absence of requirement of tangible collaterals despite being expensive.

On the other hand, local lenders which mainly include commercial banks continue to shy away from NBMFCs except for couple of larger MFPS. Loans that have been extended by commercial banks are secured by full or partial cash margins. Despite having lent to the sector for over a decade, local lenders remain reluctant to work with NBMCS. Clear synergies exist where NBMFCs can help commercial banks achieve their agricultural credit targets, extend coverage to geographic areas where they do not have a footprint or tap women clients. In order to encourage lending by commercial banks to NBMFCs and exploit such synergies a risk sharing facility like the now defunct Microfinance Credit Guarantee Facility (MCGF) need to be set up.

COVID-19 and the Microfinance Industry in Pakistan

In Pakistan, the lockdown began in March 2020. All provinces implemented varying degrees of lockdown which was gradually eased afterwards. There has been a general resistance towards a complete and strict lockdown due to the negative impact on poor and daily wage earners. The government thus allowed businesses to operate on May 9th, 2020. Nevertheless, business activity in the global economy and Pakistan has slowed down as containment measures and smart lockdowns continue to be implemented to contain the spread of the virus.

Micro and small entrepreneurs are particularly susceptible to economic shocks due to their modest capital base, limited clientele, and vulnerable work force. A survey by PMN revealed that 82 percent of the microfinance clients faced a decline in business revenues and almost three-fourth recorded a decline in market demand as a main driver of reduction in revenues. Almost 85 percent reported that their incomes had been significantly or somewhat decreased. This greatly reduces the clients’ capability to repay their
loans as their main concern was to secure food and liquidity in case lockdown was maintained for an extended period of time. Similarly, MFPs’ operations have also been impacted to due to the lockdown. A reduction in clients’ repayment capacity has in turn caused liquidity challenges for MFPs especially the non-deposit taking institutions.

On March 27th, the central bank announced debt relief measures for individuals and businesses. The SECP also announced similar relief measure on March 31, 2020 for NBMFCs and their borrowers. Repayments on principal could be delayed by up to one year upon request from the client. Initially, some MFPs announced a moratorium of one-month on loan repayments for all customers. As the lockdown continued into April 2020, most MFPs extended deferment of loan repayments up to six months. PMN has been tracking loan repayment rates of the NBMFCs and MFBs. According to data reported, in February 2020, MFPS achieved a 98 percent loan repayment rate. This declined to 81 percent in March and 34 percent in April\(^\text{19}\). This was partly due to loan moratoria and partly borrowers losing their incomes. In May 2020, repayment rate was about the same as it was in April. The sectors that have been affected the most so far are service sectors and retail. The agriculture sector has been less affected. Women-led businesses have particularly been impacted and were eight percentage points more likely to experience a 100 percent decrease in business revenue than those run by men\(^\text{20}\).

Liquidity is one of the critical challenges faced by the microfinance industry. SBP is continuously reviewing the liquidity and risk profile of the MFBs. A similar exercise was conducted for NBMFCs and shared with SECP. The regulators are in discussions with a range of stakeholders on responses to the liquidity question. The MFBs, as deposit-taking entities, do not have severe liquidity challenges as yet. Their deposits have remained relatively stable and are diversified. However, since MFBs do not have access to discount windows, which can be critical in these challenging times. Expanding access to the window would require SBP supervisory review.

The NBMFCs, in the absence of a lender of last resort and for not taking deposits, are generally more vulnerable to sharp declines in revenues and other risks as compared to MFBs. In addition, NBMFCs are faced with uncertainty about their own credit lines from domestic banks due to an increase in perceived risk associated with the microfinance sector.

However, notable are the efforts by PMIC which promptly deferred repayments due from borrowers for up to one year. This afforded borrowing MFPS the leeway to extend deferrals to end-clients for the short term as well. In addition, PMIC’s own strong liquidity position and financial health were re-assuring to commercial lenders which, in turn, felt comfortable both deferring repayments, and taking exposure to the sector.

Both the regulators, SBP and SECP, responded proactively to the crisis and took steps to provide relief to clients and businesses. SBP cut the policy rate to eight percent over a span of two months, introduced financing of wage bills and a risk sharing facility, enhanced debt burden ratio for consumer loans, waived inter-bank funds transfer fees and encouraged MFBs to introduced electronic account opening forms\(^\text{21}\). Many MFPS expressed a desire to use this crisis to accelerate the shift towards digital financial services and mobile banking. They worry, however, that it will be a struggle to ‘go digital’ within a business model that is so reliant upon close personal relationships with clients. A survey conducted by the PMN in April

\(^{19}\) COVID-19 and the Future of Microfinance: Evidence and Insights from Pakistan. LUMS, University of Oxford, New York University, Lahore School of Economics. April 2020

\(^{20}\) Ibid.

\(^{21}\) Details can be accessed on this link: [http://www.sbp.org.pk/corona.asp](http://www.sbp.org.pk/corona.asp)
to gauge the impact of the crisis on MSEs revealed that only 11 percent of microfinance clients were using digital channels and another 33 percent were even willing to do so.

Recently, a discussion began about creating a disaster risk fund to provide liquidity to MFPs in future disasters. This discussion is supported by the federal government and includes the regulators, donors and MFPs.
Lessons from West Africa: Recovering and Building Resilience in a Post-COVID World

The outbreak of the Ebola Virus Disease (EVD) in 2014 in West Africa was considered the most severe instance of this epidemic with a substantial socio-economic impact. A significant number of people lost their employment, devastating livelihoods of many families, particularly in the rural areas. Given the havoc COVID-19 is wreaking on the global economy and on the microfinance sectors throughout the world, looking at the experiences of these African countries can offer some insight in dealing with the impact of the current pandemic.

During the EVD emergency, markets were shut down and movements were restricted making it challenging for credit officers to collect payments. This case study outlines the effect of the EVD crisis on the operations of BRAC’s MFIs in Liberia and Sierra Leone. This note draws lessons from the experiences of these MFIs which, following the outbreak of the coronavirus, can be applicable to the microfinance sector in Pakistan, in terms of operational viability, institutional resilience and client relationships.

Post-Crisis Provision of Credit is Crucial

BRAC’s experience with the Ebola outbreak showed that following the resumption of microfinance operations, there was an increased demand of credit from borrowers to recover from the initial financial shock. Borrowers required new capital to rebuild existing businesses or for building new ones. This demand for credit and the promise of its provision by MFIs proved to be instrumental in high rates of repayment and for the resilience of both clients and microfinance institutions following the economic shock. Following this, MFIs in Pakistan can also reassure clients of their continued presence and provision of credit in their time of need to invest in existing or new businesses. This positive messaging will not only help retain clients but also assist in encouraging timely loan repayments as they recover from lost incomes.

Job Security for Staff

From BRAC’s experience it can be seen that ensuring staff members of their job security, paying their salaries on time and communicating with them was crucial for maintaining their levels of motivation throughout the period of suspension of operations. By retaining members of the regular staff, the MFIs ensured that critical ties to clients were also maintained. Maintaining staff salaries and regular communication with them paved the way for a smoother restart of operations once the restrictions were eased.

Effective Communication with Clients

During the crisis, BRAC benefitted considerably from maintaining communication with its clients and following up with them. This social contract was not only limited to ensuring their continued support for its clients vis-à-vis their operations, but it also involved active engagement with the community in relief efforts and provision of emergency loans. Harnessing effective and regular communication and ensuring presence in the community is an imperative for maintaining lasting client relationships, which are crucial to the success of the MFI post a crisis.

Complementary Financial and Non-Financial Services

In the aftermath of the Ebola crisis it was seen that client demand for additional financial and non-financial services provided by the MFIs increased. These included savings, money transfer services and micro-insurance while financial education and business training also gained traction among the clients. A post-COVID era might entail a shift in business and entrepreneurship opportunities and requirements. MFIs are well-positioned to provide training on reskilling of clients if the need arises on newer entrepreneurship opportunities. This coupled with the provision of more digital financial services (for loan repayment, distance account opening, savings etc.) might go a long way in building client resilience and retention.

Improved Reporting and Data Collection on Clients’ Repayment

Another lesson which can be derived from BRAC’s experience in a Post-Ebola setting is more consistent reporting and improved transmission of borrowers’ information to gauge their capacity to repay. It was seen that there was no formal system for reporting on the borrowers’ repayment capacity from the credit officers to the management. The absence of these links did not give data on the borrowers who were unable to repay. From this it can be gauged that having robust reporting mechanisms in place can give a better visual on clients’ repayment ability, following which

Digitization

With the evolution of technology and innovators entering the financial services, the convergence of digitization with microfinance is becoming inevitable. The need to digitize is being felt even more in the wake of Covid-19 crisis as MFPs realize that it is no longer an option but is crucial to staying competitive while increasing outreach to low-income and remote clients. While digitization offers benefits to both clients and MFPs, it presents its own challenges and risks.

Benefits for Customers and Microfinance Provider

The benefits of digitizing operations and providing alternative digital channels to clients have been well documented. For clients, it offers convenient access to a wide range of products and services even in remote areas through mobile phones or agents. It offers a safe and fast mode of transacting large amounts of cash. Moreover, having a transaction history can help clients access microloans or other products and services more easily.

For MFPs, leveraging technology can achieve operational efficiency by automating processes and eliminating paper-based forms to acquire customer information. It also has the potential to lower costs and increase access to remote areas. Through digital means, MFPs can improve customer experience and address queries/grievances more efficiently while maintaining a more loyal customer base.

Challenges and Risks to Mitigate

Providers and policy makers must understand the challenges faced if universal financial inclusion is to be achieved. Digital finance puts the exclusion of vulnerable groups at risk as they do not possess the ability to own a mobile phone, operate it for financial transactions or interact with the interface due to low levels of literacy and numeracy. Operating in remote areas is particularly challenging due to poor infrastructure and internet connectivity issues. Moreover, the clients may not be able to access uninterrupted services when the system is down resulting in a poor customer experience. Lack of interoperability is another issue that providers face which increases their cost of operations and creates inefficiencies in their processes.

Products launched must respond to customer needs. Therefore, in order to mitigate these risks and challenges, microfinance and DFS providers must address them through designing customer-centric products, customer engagement and education while complying with client and data protection policies. Mitigation strategies that MFPs could adopt include; responsible design and delivery of digital loans and services, including user-centric design and recourse mechanisms. Adhering to consumer protection policies, while educating clients about products that integrate both a savings and loan component are also essential to develop a successful digital product. This enables MFPs to use customers’ digital data in a responsible manner, which is critical in digital finance\textsuperscript{23}. Providers could do this by leveraging their loan officers to provide the necessary education.

To ensure active usage of digital finance, these challenges must be overcome by microfinance and digital finance providers while regulators look to create an enabling regulatory framework.

\textsuperscript{23} Digital Transformation of Microfinance and Digitization of Microfinance Services to Deepen Financial Inclusion in Africa. August 2018. Alliance for Financial Inclusion Special Report.