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a) What is microfinance

Microfinancing means small size loans. The origins of microfinancing can be traced to Europe. The late nineteenth century saw booming of credit cooperatives to help lower income groups through credit. The cooperatives grew to serve 1.4 million in Germany in 1912. These programs were then replicated in Ireland and Italy. The government of Madras in 1880, then under the imperial rule, introduced the programs to address poverty in India. . By 1912, over four hundred thousands Indians belonged to the new credit cooperatives. By 1946 their members exceeded 9 million.

The cooperatives during this time period took hold in the State of Bengal, now Bangladesh. In the early 1900's, these programs were so well known in Bengal that the leading merchant of Boston, USA, spent time in India to learn about the cooperatives in order to later set up similar programs in Boston.

The credit cooperative eventually lost steam in Bangladesh, but the notion of group lending had established itself and after experimentation and modifications, became one of the bases for the Grameen model in the country. It is, just not coincident that when Bill Clinton was still Governor, it was Muhammad Yunus, founder of the Grameen Bank, who was called on to help and set up the Good Faith Fund in Arkansas, USA.

Microfinance programmes are one of the most important interventions in developing country efforts to reduce poverty. Recent years have seen a huge growth of the sector in terms of numbers and size of organizations, numbers of clients and provision of subsidized donor funding. A large proportion

of MFIs include poverty reduction in their Mission, and donor funding is allocated to microfinance on this basis. At the most basic level there is a need to understand and improve the impact of MFIs as a key premise to successful poverty reduction.

Over time, microfinance has come to include a broader range of services (credit, savings, insurance, etc.) as we have come to realize that the poor and the very poor that lack access to traditional formal financial institutions require a variety of financial products.

Traditionally microfinance was focused on providing a very standardized credit product. The poor, just like anyone else, need a diverse range of financial instruments to be able to build assets, stabilize consumption and protect themselves against risks. Thus, we see a broadening of the concept of microfinance because our current challenge is to find efficient and reliable ways of providing a richer menu of microfinance products.

The typical microfinance clients are low-income persons that do not have access to formal financial institutions. Microfinance clients are typically self-employed, often household-based entrepreneurs.

In rural areas, small farmers and petty traders

In rural areas, they are usually small farmers and others who are engaged in small income-generating activities such as food processing and petty trade

In Urban areas, more diverse

In urban areas, microfinance activities are more diverse and include shopkeepers, service providers, artisans, street vendors, etc. Microfinance clients are poor and vulnerable non-poor who have a relatively stable source of income.

Under-served by the formal and informal financial services

Access to conventional formal financial institutions, for many reasons, is inversely related to income: the poorer you are, the less likely that you have access. On the other hand, the chances are that, the poorer you are, the more expensive or onerous informal financial arrangements. Moreover, informal arrangements may not suitably meet certain financial service needs or may exclude you anyway. Individuals in this excluded and under-served market segment are the clients of microfinance.

Group-based banking method

The poor does not have adequate collateral to secure the credit. Instead of taking collateral, MFIs uses group's shared responsibility to ensure repayments. This banking technology is sometimes called "Solidarity Group" in the case of 2-10 people, and "Village Banking" in the case of 11-50 people. The group monitors and exerts peer pressure for repayments.

Screening methods

Target group is identified by historical data for less default ratio, such as women engaging in small trading activities. Credit analysis is made at the household level considering the cashflos of each economic activity.

Collateral

The group may maintain a compulsory savings to minimize the risk of default by one member. Sometimes, there is a Guarantee Fund created by compulsory share of the loan.

Outreach mechanism

In order to reach a large number of the poor people, MFIs impose maximum income thresholds or limit the maximum amount of loans relatively small. Interest rates are differentiated by loan size, duration, risk level, personnel characteristics and repayment performance.

Repayment Incentives

Usually MFIs impose intensive supervision, using peer group meetings. Also MFIs offer incentives for the borrowers to repay through rebates and progressive lending. MFI staff is also rewarded according to the repayment ratio. Customers and MFI staff are given intensive training programs

b) World history of microfinance and world organizations

Microfinance is the newest darling of aid communities. Donors are eager to provide funds for these schemes. More than 1000 microfinance institutions-commercial banks, credit unions and non-governmental organizations (NGO's) are providing microcredit in more than 100 countries. There are more than 7 billion dollars in outstanding loans. Microcredit Summit, 1997, rallied support to seek more than \$20 billion to provide microfinancing to 100 millions of poor for the next ten years, 2010.

Microfinancing has become so 'popular' that when President Clinton visited Bangladesh he posed with Mr. Yunus Khan, the founder of Grameen Bank and borrowers in the country. These programs are regionally concentrated, with nearly 76 percent of total loans disbursed in Asia, 21 percent in Latin America and 3 percent in Africa.

In South Asia most of the excitement is based on the fame of a few of the best micro-finance organizations. These include Grameen Bank, Bangladesh Rural Advancement Committee (BRAG) in Bangladesh. Each of these reaches millions of depositors and borrowers. Majority among them are women. More than 1000 NGO's are providing microcredit in the country.

Grameen Bank of Bangladesh has emerged as a successful NGO credit program for rural poverty alleviation. It has inspired similar efforts not only in other developing countries, such as Malaysia and Indonesia, but also in the United States. The success of Bangladesh's Grameen Bank in meeting the credit needs of the rural poor is due in large part to the bank's ability to control the often-high transaction costs of lending to this segment of the market. Grameen Bank overcame this problem through a group-based lending program. This group serves as a social collateral and uses peer pressure to monitor and enforce contracts and to screen good borrowers from bad. The bank targets poor landholders with less than 0.50 acres of land. Borrowers are required to attend weekly meetings and discuss the viability of their project proposals in the group meeting. This enhances the transparency of the loan disbursement and reduces the adverse selection problems. The peer pressure and the group monitoring of the project almost eliminate the chances of moral hazard in the loan utilization process. Because the opportunity cost of the meetings is high and loan amounts are small (average loan is US\$100), large farmers and other rural rich are excluded from the program. The Bank's principal target group is women (who constitute 94 percent of total bank membership and receive 80 percent of total lending). Along with loans, they receive training in maternal health, nutrition, and childcare as part of the Bank's comprehensive social development program.

Started in 1983, Grameen Bank has grown in terms of both members and outstanding loans in a short time. In 1994 there were 1,045 Grameen Bank branches covering 2 million members in 35,000 villages (more than half the villages in Bangladesh). Between 1985-1993, its membership increased 960 percent to 1.8 million members, 98 percent of whom are actually borrowers. Total loans outstanding increased from taka 244 million in 1985 to taka 11 billion in 1994. The bank also has mobilized rural savings, which increased from taka 115 million in 1985 to taka 8.97 billion in mid-1993. The bank has a loan recovery rate exceeding 95 percent. The program drop out rate is low, and borrowers, on average, save 19 percent of the loan amount they receive. This model is being replicated now in 56 countries of the world

c) Microfinance need in Pakistan

The experience in our country about microfinancing is not different from the above countries. The NGO's working in the microfinancing is facing the same issues of poor targeting, dependency on the donors, and low coverage of the poorest in the society. For instance, NRSP is one of the largest lending NGO for microfinancing in the country. It is providing micro credit since last seven years in the different parts of the country. Its total disbursement is above RS. 2.0 billion. The number of its borrowers is over one hundred thousand. The majority of its borrowers, however, are not the poorest people in the country. The borrowers in the program are mainly the better off among the poor. The total coverage of the program is very limited. Even if every borrower in the micro credit program of the organization is considered poor, its total coverage of the poor in the country is just 0.22 percent of the total poor in the country.

If the entire network of NGO's, who are providing microfinance in the country, is taken into account, the total number of their borrowers is hardly one million. It is just above the 2 percent of the poor section of the population in the country. Therefore, the coverage of microfinancing schemes is very low in the country.

Poverty and unemployment are on the rise in Pakistan worsening the misery of the poor and especially women. Human Development Report of South Asia has lamented that **"the changes which are required in Pakistan at the Macro level are the very changes that the ruling groups are likely to resist: for example, land reforms..."** The government has failed to provide institutional credit to the poor in the past. Social safety nets are almost non-existent. Changing socio-economic conditions are reducing the chances of informal credit. The persistence of poverty in Pakistan is rooted in socio political inequalities. In such societies, individual based lending can "perpetuate and reinforce the existing socio-economic inequities and access to scarce financial resources". Under these circumstances there is a dire need of learning from the proven Group based lending of Grameen Bank. The size and modalities can be shaped according to the local sociopolitical factors surrounding the poverty.

The existence of widespread poverty in the midst of global prosperity is undeniably the most serious challenge confronting the world today. In a similar vein, the earlier Survey referred to poverty reduction "as the declared goal of all development plans in Pakistan" and poverty reduction at the center of things. Thus poverty being global in nature and scope, it demands global solution and absolves Pakistan of any responsibility. It is like saying that it is for the world to act and remove poverty from Pakistan. In reference to Monterrey Conference held in March 2002 in Mexico, that **"each developing country is primarily responsible for generating growth and reducing poverty through sound macro-economic policies and good governance"**.

Poverty is appalling, HCR notwithstanding. World Bank Human Poverty on developing countries, in 1998-99, ranked Pakistan 68th on Human Poverty Index in the world above Bangladesh etc. and estimated 34% population living below poverty line. Adult illiteracy rate was 56%, people without access to safe water 21%, without health services 15% and without sanitation 44%. This deprivation is heavily concentrated in South Asia and Sub-Saharan Region of Africa. According to World Development Report 1994 there are 46 such countries in these two regions where life expectancy is below 60 years. There are few regions in the world where elementary deprivation is as endemic as in these two regions. India alone accounts for more than half the combined population of these countries. United Nations (UNCTAD) said in its report on Least Developed Countries Report 2002 that the number living at less than a dollar in the world's 49 poorest countries was set to jump 30% by 2015. It recommended economic growth as the only way out. Dr. Ishrat Husain, while writing in 'Mahbub-ul-Haq Human Development Review' (June 2001) has claimed that caloric based poverty has in fact doubled from 17.4% in 1987-88 to 32.6% in 1998-99.

Poverty is far more wide spread and has not been captured by official statistics. About 50% population lives below poverty line. I-PRSP is not a serious effort at poverty alleviation. Political will of the government is translated in allocations, which appear far too inadequate. Whether it is the distribution of state land, zakat or ushr, food support programme or micro credit the problem is much too big. The measures contemplated by the government including micro-finance may not be an appropriate tool in poverty reduction if the poor, who are facing illiteracy, inadequate health facility and poor infrastructure. Empowerment of the poor cannot be achieved through micro-credit schemes or some such palliatives. Providing credit to the people may be necessary but it is not sufficient. Far more crucial are: education, training and technical support that provide the basis for success. Improving the quality of peoples' lives and the ability to shape their own future are important.

d) Microfinance organizations in Pakistan

Impressed with the “successful” and “exciting stories” of micro financing, the present set up has announced that the government will establish a micro finance bank (MFB) very shortly in the country.

Similarly multi-donor and government supported Pakistan Poverty Alleviation Fund (PPAF) is also launching a big initiative to reduce poverty mainly through the provision of micro financing in the country.

Other major NGO’s providing microfinancing in the country are Agha Khan Rural Support Program (AKRSP), National Rural Support Program (NRSP), Sarhad Rural Support Program (SRSP), Orangi Pilot Project (OPP), SUNGI Development Foundations, Kashf Foundation (Kashf), Sindh Agricultural & Forestry Workers’ Cooperative Organization (SAWFCO), Thardeep Rural Development Program (TRDP). Moreover some international donor agencies like OXFAM and Save the Children Fund (SCF) also provide providing microfinance through intermediary NGO’s in different parts of the country.

The main intention and objective of the NGO’s to provide microcredit and government’s proposed plan to establish the MFC is to reduce poverty through the improved access of microfinancing to poor in the country.

For access to credit reliance has been placed on Pakistan Poverty Alleviation Fund (PPAF), Agricultural Development Bank of Pakistan (ADBP), First Women Bank (FWB), The National Rural Support Programme (NRSP), and the government.

PPAF was set up with an endowment of US\$ 100 million as wholesale lenders to NGOs engaged in providing micro financing. Between July 2000 and March 2002 it had distributed Rs. 365 million (about 6% of the total) in 35 districts. To supplement PPAF’s work government had established Khushali Bank, which by end March 2002 had established branches in 26 districts and disbursed Rs. 277 million. The combined loan works out to Rs. 4.5 per capita of the entire population. If it were divided over 28.2% of the newly defined poor, each would get Rs. 16 per capita.

Khushal Pakistan Programme is the government’s principal social intervention aimed at generating temporary employment and economic activity through public works. A sum of Rs. 15 billion was released during 2001-02 to the districts through the provincial governments. How much of this was spent and if so in what manner has not been reported.

e) Justification of microfinance in Pakistan

The market for microfinance activities in Pakistan is very fertile as all microfinance organizations are covering one million clients, which is less than two percent population of needy people for this service. This is a most effective model to eliminate poverty and it has an

effective character in overall the world for the subject Pakistan is a poor country and extremely needy for these types of activities. So, government of Pakistan has good approach for the establishment of micro finance institutes and organizations for microfinance activities.

Of course, this is a good cause to change the lifestyle of thousands poor families by a reasonable system of microfinance and it has an attractive exposure to convert the operations into a commercial bank.

f) How to establish a microfinance organization

Microfinance organization can be established under Societies Act or Companies Act as a non-profitable organization. It needs no any special requirements or pre qualification. It works like an ordinary firm or NGO. But the most important subject is its working position as a financial institute because a financial institute always has strong monitoring form Donors and Auditors.

A financial NGO can't bear any type of miss commitment form its inner or outer side. It should need to establish a strong monitoring and operational network. It should have a complete designed system for research and growth.

g) Financial projection and Archie

As in general trends, Microfinance Organizations work as a non-profitable and non-governmental organization (NGO). The situation under microfinance is as on same pattern as a financial institute. Grants, donations and credit lines are the basic source for the working of a Microfinance NGO but it has a surprise rate of growth and has enough energy for survival without any source or grant. The most important is it's working, it is same with banking and financial institutes. So, a micro finance NGO or firm can easily survive without donation or donor character.

Another advantage is the conversion into a commercial Bank. As many Micro Finance NGOs transferred into bank because they can generate enough sources and system to change their shape for a strong sustained position of a Bank.

These tables show the operational system with actual position as a baseline for Microfinance Organizations.

Explanation of Heads and others

- Interest rate** 20% (Annual)
Loan Per Head 10,000
1. **No** It is Total number of disbursed loans
 2. **Amount** It means the total money disbursed by total loans
 3. **Cost** It is total cost per month on total operational networking e.g. Salaries, traveling and stationary etc.
 4. **Total** This is a grand total of cost by Amount and Cost
 5. **Recovery** It means recovered amount in shape of installment. In this model, the supposed installments are recovered after 15 (Fifteen Days)
 6. **Status** It indicate us about total utilization of funds in deficit or in profit after deduction of cost and plus recoveries and savings
 7. **M. Output** It shows us the Maximum Output of total utilization of disbursed amount
 8. **Interest Ratio** Total earned service charge
 9. **Net earning per month** This is total output after the deduction of total cost

Position and establishment in First Year (Standard for a Branch)

	No (1)	Amount (2)	Cost (3)	Total (4)	Recovery (5)	Savings (6)	Status (7)	M. Output (8)	Service Charge (9)	Net Earning Per Mont (10)
Jan.	175	1,750,000	65,000	1,815,000	87,500	87,500	(1,640,000)	2,100,000	17,500	(47500)
Feb.	175	1,750,000	65,000	1,815,000	262,500	87,500	(1,465,000)	2,100,000	52,500	(12500)
Mar.	175	1,750,000	65,000	1,815,000	437,500	87,500	(1,290,000)	2,100,000	87,500	22,500
Apr.	175	1,750,000	65,000	1,815,000	612,500	87,500	(1,115,000)	2,100,000	122,500	57,500
May	175	1,750,000	65,000	1,815,000	787,500	87,500	(940,000)	2,100,000	157,500	92,500
Jun.	175	1,750,000	65,000	1,815,000	962,500	87,500	(765,000)	2,100,000	192,500	127,500
Jul.	175	1,750,000	65,000	1,815,000	1,137,500	87,500	(590,000)	2,100,000	227,500	162,500
Aug.	175	1,750,000	65,000	1,815,000	1,312,500	87,500	(415,000)	2,100,000	262,500	197,500
Sep.	175	1,750,000	65,000	1,815,000	1,487,500	87,500	(240,000)	2,100,000	297,500	232,500
Oct.	175	1,750,000	65,000	1,815,000	1,662,500	87,500	(65,000)	2,100,000	332,500	267,500
Nov.	175	1,750,000	65,000	1,815,000	1,837,500	87,500	110,000	2,100,000	367,500	302,500
Dec.	175	1,750,000	65,000	1,815,000	2,012,500	87,500	285,000	2,100,000	402,500	337,500
Total	2100	21,000,000	780,000	21,780,000	12,600,000	1,050,000	(8,130,000)	25,200,000	2,520,000	1,740,000

5% Lost in Market as non-refunded credit	6,30,000	1,110,000
10% Lost in Market as non-refunded credit	12,60,000	480,000
13.8% Lost in Market as non-refunded credit	17,38,800 (A limit for no profit and no loss)	1,200

h) Technical structure of funds distribution and recovery

Micro-financing mechanism has many comparative advantages than the formal bank lending for large number of small size of loans. **Firstly**, loans are provided on the basis of group lending. Main benefit of the group lending is that it reduces the transaction cost of credit delivery and mitigates problems of adverse selection. This may also provide benefits by inducing borrowers not take risks that undermine the bank's profitability. Peer monitoring within the group reduce the risk of default and moral hazard. For instance, in-group lending the responsibility of the credit is not only individual, but also the whole group and community is responsible for the repayment of loan. Incentive for other members is that if repayment is timely the other members will get loan facility. In case even if one member defaults, the whole group will be affected adversely from the loan facility.

Secondly, microcredit enables substitution of physical collateral. Majority of these programs do not require physical collateral as demanded in the formal banking. It is substituted often with social collateral and a fixed proportion in emergency fund or pledge of fixed proportion of borrowing in favor of the organization. For instance, Grameen Bank uses a small proportion of emergency fund as collateral. Similarly, national rural support program (NRSP), one of the leading NGO in micro financing, in Pakistan does not require any physical collateral.

The organization, however, substitutes it with social collateral and pledging of one forth of each borrowing amount in advanced in the favor of the organization. If a borrower is taking loan of RS. 10,000. He/she has to pledge RS. 2,500 in advance. Therefore, social reputation and ability to pledge the fixed proportion of the applied loan is substituted with the physical collateral.

Thirdly, the instrument provides dynamic incentives. To secure high repayment rates, micro financing programs begin by lending small size of loans and then increasing loan size upon satisfactory repayment. The repeated nature of interaction and threat to cut off loan in case of default is used to overcome asymmetric information problem and improve efficiency of loaning. Therefore, these incentives motivate high recovery rate and low default rate. For instance, the recovery rate for Grameen Bank is above 90 percent. Similarly, in Pakistan, the recovery rate for NRSP is also above 90 percent.

Fourthly, the cost of borrowing is lower for the clients. As no physical collateral and other formal requirements are involved in the loan procedure, transaction cost is lower for the borrower. Similarly, it is also believed that the rate of interest paid by the borrower in these schemes is lower than the interest rate charged by local moneylenders in their areas.

i) Basic of microfinance

The pivot of banking business is "collateral" which serves as an explicit guarantee against the possible risk associated with the inter-temporal trade of money. One who does not have this explicit or implicit guarantee is not considered bankable. The poor in the past have not been able to get credit from the existing institutions on these grounds. This denial of opportunity has bound them in a

vicious circle. They are poor because they are already in a poverty trap of low initial endowments, low income, low savings and low investment. The poverty of opportunity, on the other hand, has worsened their ability to tap their capabilities in the direction of "self actualization". These poor need credit as the markets have failed to provide credit to them. They have not been able to satisfy the collateral requirements grounded in individual property rights. The annual report 1996 of Kashf Foundation emphasizes the necessity of banking with the poor in the following words

"One very genuine reason to bank is that the financial markets are prone to neglect the needs of the rural poor women, simply because the existing criteria of financial worthiness requires contacts, collateral and accessibility."

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