

THE REPORT OF THE MICRO FINANCE STUDY TOUR TO INDIA AND PAKISTAN FROM 17TH TO 28TH JANUARY 2005

1. INTRODUCTION

The Management of the Central Bank of Nigeria approved that three teams comprising of members of the Bank's Inter-Departmental Committee on Micro Finance Policy and Programme Development (MPPDC) undertook micro finance study tour to Asia (Indonesia, Bangladesh, Philippines, Indonesia, India, and Pakistan) and Africa (Uganda). The team to India and Pakistan commenced the study tour in India on 17th and completed the assignment on 28th January 2005 in Pakistan, spending one week in each country. The microfinance study tour was co-sponsored by United Nations Development Program (UNDP-Nigeria) and the Central Bank of Nigeria (CBN).

The objective of the study tour was to expose the team to the policy and regulatory environments and support mechanism put in place for the development of microfinance sub-sector in the two countries. It was believed that knowledge and experiences gathered during the study tour would enhance the proposed policy framework as well as enrich its implementation.

The rest of the report is structured into five (5) sections. Section two explained the methodology adopted for carrying out the assignment. Section three highlighted each country's experience in terms role of the central banks and governments as apex regulatory body, microfinance policies and institutional arrangements in each country for microfinance purveyance. Section four contained lessons learnt. While section five concluded the report, section six outlined the recommendations for improving on the policy framework and its implementation in Nigeria.

2. METHODOLOGY

In order to have adequate exposure, the study team held discussions with the central banks and relevant institutions in the micro finance industry of both countries. The lead regulatory institutions in India and Pakistan that is the Reserve Bank of India (RBI) and the State Bank of Pakistan (SBP) were responsible for arranging the team study visit to key institutions (both public and private) involved in the microfinance policy formulation process, implementation and the development of the sub-sector.

During the study tour the following institutions were visited:

- (i) the Reserve Bank of India (RBI), Mumbai, India
- (ii) National Bank for Agriculture and Rural Development (NABARD), Mumbai, India
- (iii) Regional Office of National Bank for Agriculture and Rural Development), Pune, India
- (iv) Bharaitya Agro Industries Foundation (BAIF), Pune, India
- (v) Chaitya (NGO), Raj Gurnagar, Khud Head quarter, Paluka Division of Maharashtra State, India
- (vi) the State Bank of Pakistan, Karachi, Pakistan

- (vii) Network Microfinance Bank, Karachi, Pakistan
- (viii) First Microfinance Bank Ltd, Karachi, Pakistan
- (ix) Khushhali Bank (model micro finance bank), Islamabad, Pakistan
- (x) National Rural Support Programme (NRSP), Islamabad, Pakistan
- (xi) Pakistan Poverty Alleviation Programme (PPAF), Islamabad, Pakistan
- (xii) Pakistan Microfinance Network (PMN), Islamabad, Pakistan

3. COUNTRY EXPERIENCE

Country Experience - India

3.1 Country Profile

India had a land area of 3,287,263 sq. Kilometres with a population of about 1.1 billion and 153 million house holds. Indian's real GDP grew at 8.2 per cent in 2003-04 on the back of a turn around in agriculture. Foreign exchange reserve was US\$113billion, the sixth largest in the world. About 70 percent of the population lived in the rural areas and over 30 percent of the population were poor.

3.2 Financial sector:

The financial sector comprised the Reserve bank of India (RBI) as the apex regulatory institution with 560 banks having 46,700 branches. The banks were 48 commercial banks, 196 regional rural banks (RRB), 316 cooperative banks, and 5 non bank financial centres (NBFC) and 1 rating agency. It was mandatory for NBFC to obtain rating from rating agency to know the extent of deposit they could mobilise.

3.3 Institutions Providing Micro Finance Services in India

There were various types of microfinance institutions in India providing microfinance (MF) services. The SHG-bank linkage strategy was developed as a platform for the intervention of formal sector in banking with the poor. The SHG – bank linkage was a growing and strong movement with NGOs and banks playing important roles as partners.

3.4 National Bank for Agriculture and Rural Development (NABARD)

NABARD was the lead wholesale apex financing institution in India involved in MF services to the poor. It was established on 12 July 1982 with an initial subscribed and paid-up Capital of Rs.100 crore (US\$2.33m). It had a capital base of Rs.2000 crore (US\$46.52m) contributed by Gol (Rs.550 crore or US\$12.8m) and RBI (Rs.1450 crore or US\$33.72m). NABARD had been accredited with all matters concerning policy, planning and operations in the field of credit for agriculture, and other micro-economic activities in rural/urban areas in India. It provides wholesale and refinancing facilities to MF service providers.

3.5 Banks as MF Providers:

The banking sector played crucial role in the provision of various financial services to the poor and the non-poor. There were three categories of formal banking sector institutions serving the poor in India. These were;

- (a) The cooperative banking institutions (mainly serving in rural and urban areas;
- (b) Regional Rural Banks (RRBs) lent mostly to the poor for agriculture and micro-enterprise sectors. The regional rural banks (RRB) were established by the states in order to service clients that were small and with low access to formal financial services, where numerous money lenders operated. RRB operated within small areas, in administrative districts. The RRB had a capital base of Rs.10million and subscribed to 50, 20, 30 percentage points by the federal government and state and local commercial banks respectively; and
- (c) Commercial banks were required, as per the directions of RBI, to provide loans to the priority sector comprising agriculture and allied activities, small, tiny, cottage and village industries, rural artisans, etc., to the extent of 40 per cent of their credit portfolio. This included 18 percent of lending exclusively to agriculture and allied activities. Furthermore, 10% of their loan portfolio was required to be provided to weaker section of the society covering scheduled castes, scheduled tribes, small and marginal farmers, agricultural labourers, rural artisans, etc. These loans were essentially of the nature of MF.

In servicing the rural clients financially the RBI leveraged on the structure of the state and rural banks. The arrangement had kept delinquency rate as low as 1% and transaction costs were down including cost of supervision.

Thus, from the above it was obvious that banking with the poor, especially provision of micro finance services has been an essential aspect of the banking policy in India. In the present scenario, banks were not exclusive MF institutions, they served a variety of clients, and still they were major MF service providing institutions.

3.6 Other Institutions Providing Microfinance Services in India

In India, there were wide varieties of other institutions providing MF services to poor families other than the commercial, cooperative and rural regional banks. These comprised NGOs, SHGs' federations and certain non-bank cooperative societies in the non-financial sector. These microfinance institutions (MFIs) could be broadly categorised into three organisational forms:

- (a) Not-for Profit MFIs
 - Societies registered under Societies Registration Act, 1860 or similar State Acts
 - Public Trusts registered under the Indian Trust Act, 1882
 - Non-profit Companies registered under Section 25 of the Companies Act, 1956

NGOs and SHGs federation were examples of these. There were over 3000 NGOs, with over 500 NGO-MFIs engaged in financial intermediation in different parts of the country. In a few cases, the state governments had also taken initiatives in promoting

SHGs by establishing organisations with federal structures. This approach brought synergy in integration of community level programmes using SHG approach.

(b) Mutual Benefit MFIs

- State credit cooperatives
- National credit cooperatives
- Mutually Aided Cooperative Societies (MACS)

(c) For Profit MFIs

- Non Banking Financial Companies (NBFCs), registered under the Companies Act, 1956

Non-Banking Financial Companies (NBFCs) were companies that mobilised deposits and registered under the Companies Act, 1956 and regulated by the Reserve Bank of India.

3.7 **Micro Finance Sector Policy and Legal Framework**

The past two decades had witnessed several interesting innovations in microfinance (MF) in India. MFIs were governed by different Acts depending on their broad objectives and constitution. It was also noted that the MF activities of some of these agencies were not covered specifically by such legislations implying that their operations were to some extent unregulated and unsupervised, compared to the formal financial sector providing such services. However, banks' lendings to weaker section were categorised under the priority sector which formed an important component of MF, were covered as part of general banking under three Acts, viz., Banking Reforms Act, Cooperative Societies Act and Regional Rural Banks Act. By virtue of the powers conferred on it by Reserve Bank of India Act, 1934, RBI undertook regulation and supervision of all the banks promoting and doing microfinance. The RBI Act also governed any Non Bank Financial Companies providing MF services.

The RBI (Amendment) Act, 1997 made it obligatory for NBFCs to apply to the Reserve Bank of India for certificate of registration. One of the conditions for a certificate of registration was that the NBFC must have a minimum Net Owned Funds (NOF) of US\$ 46,511.6 which made it eligible to accept public deposits. Recently, for the new NBFCs, the RBI had enhanced the NOF requirement to US\$58,139.5. NBFCs which did not have the minimum NOF at the commencement of the Act were required to achieve the stipulated minimum NOF within 3 years. The RBI introduced a new regulatory framework for the NBFCs in January 1998 with focus on NBFCs accepting public deposits with a view to safeguarding the interests of the depositors. Accordingly, NBFCs falling short of the stipulated minimum NOF were precluded from accepting public deposits. Ceiling on the quantum of public deposits was related to the level of credit rating given by the approved credit rating agencies. Net owned fund was defined under the RBI Act as the aggregate of the paid-up capital and free reserves as per last balance sheet after deducting therefrom accumulated losses, deferred revenue

expenditure and other intangible assets, etc. The prudential requirements for NBFCs were capital adequacy of 12% and to maintain liquid assets of 15% on public deposits. The interest rate ceiling on public deposits was fixed at 16% p.a.

3.8 Policy to Mainstream and Enhance Outreach of Microfinance Services

A Micro Credit Special Cell was set up in RBI to suggest measures for augmenting flow of micro credit as announced in the Governor of the Reserve Bank of India's Monetary and Credit Policy for the year 1999-2000. while the Task Force on Supportive Policy and Regulatory Framework for Micro Credit was also set up by National Bank for Agriculture and Rural Development (NABARD).

Banks were advised to follow the under noted guidelines for mainstreaming micro credit and enhancing the outreach of micro credit providers:

- (a) The banks may formulate their own model(s) or choose any conduit /intermediary for extending micro credit. Micro credit extended by banks to individual borrowers directly or through any intermediary would be reckoned as part of their priority sector lending.
- (b) The criteria for selection of micro credit organisations were not prescribed. It may, however, be desirable for banks to deal with micro credit organisations having proper credentials, track record, system of maintaining accounts and records with regular audits in place and manpower for closer supervision and follow-up.
- (c) Banks could prescribe their own lending norms keeping in view the ground realities. The intention was to provide maximum flexibility in regard to micro lending, keeping in view the prevalent local conditions and the need for provision of finance to the poor.
- (d) Micro credit was to be included in branch credit plan, block credit plan and state credit plan of each bank. No target was prescribed for the micro credit, utmost priority was to be accorded to the micro credit sector in the preparation of these plans. Micro credit was to also form an integral part of the bank's corporate credit plan and was to be reviewed at the highest level on a quarterly basis.

The Annual Policy Statement for the year 2004-05 (based on the recommendations of the Advisory Committee on Flow of Credit to Agriculture and Related Activities from the Banking System) had announced that, in view of the need to protect the interests of depositors, microfinance institutions (MFIs) would not be permitted to accept public deposits unless they complied with the extant regulatory framework of the Reserve Bank. Currently, Rs.20m (US\$465,116.3) was required to set up a MFI. A simple system requiring minimum procedures and documentation for the poor clients was accepted as a pre-condition for augmenting flow of micro credit.

3.9 Master Circular on Micro Credit

In guiding activities in the microfinance industry in India, the Reserve Bank of India (RBI), from time to time, issued a number of guidelines and directives to banks relating to micro credit. In order to consolidate the various circular up to June 30, 2004, a Master Circular on Micro Credit incorporating the existing guidelines and directives were issued by Reserve Bank of India which confirmed the capital requirement for setting up a microfinance institution to be Rs20m (US\$465,116.3).

3.10 Mechanism for MF Sector Development

3.10.1 National Bank for Agriculture and Rural Development (NABARD)

NABARD was the lead institution in India involved in microfinance (MF) services to the poor. NABARD served, (i) as an apex financing agency for the institutions providing investment and production credit for promoting the various developmental activities in rural areas; (ii) takes measures towards institution building for improving absorptive capacity of the credit delivery system, including monitoring, formulation of rehabilitation schemes, restructuring of credit institutions and training of personnel; (iii) co-ordinates the rural financing activities of all institutions engaged in developmental work at the field level. It maintains liaison with Government of India, State Governments, Reserve Bank of India (RBI) and other national level institutions concerned with microfinance policy formulation.

NABARD operated throughout the country through its 28 Regional Offices and one Sub-office, located in the capitals of all the states/union territories. It had 336 District Offices across the country, one Sub-office at Port Blair and one special Cell at Srinagar. It also had six (6) training establishments.

3.10.2 Microfinance Sector Development Funds Managed by NABARD

(a) *Micro Finance Development Fund (MFDF)*: One of the policy incentives for promoting lending to the sector was the creation of the Micro Finance Development Fund. The fund currently with NABARD was Rs.100crores (US\$2.33m), subscribed to 40 percent by Reserve Bank of India, 40 percent by NABARD and 20 percent by 11 commercial banks (public sector). The Fund was set up to encourage banks and NGOs to mobilise self help groups (SHGs). About 3000 NGOs currently operates in India. NABARD extends grants and aids to NGOs to form SHG and provide them with services. At the time of visit over Rs.80m (US\$1.86) had been granted to NGOs.

(b) *Credit and Financial Services Fund [CFSF]*: To support funding of various initiatives leading to design of products and services, creation and promotion of delivery mechanisms, setting up of new organisational structures and devising systems and procedures which would help improve the access of the poor to institutional financial services, a special fund, viz., Credit and Financial Services Fund (CFSF) Fund was set up in NABARD in 1995, with the assistance of the Swiss Development Cooperation (SDC). Most of the MF initiatives of NABARD had been funded through the CFSF. NABARD had also collaborated with, German Technical Cooperation (GTZ) of Germany, since January 2000 primarily for supporting initiatives in the field of training

and capacity building, and development of an appropriate management information system. (MIS)

(c) *NABARD's Support for Capacity Building and Loanable Funds:* NABARD provided capacity building assistance and financial support to its partners for the promotion and broad basing of micro finance operations. As part of its efforts to link larger number of SHGs to the banking system, NABARD also focused on training and sensitisation of partner agencies, through various interventions.

(d) *Liquidity Support to Banks for SHG-bank Linkage:* At present, NABARD provided 100% refinance to all categories of banks [commercial banks, RRBs and cooperative banks] at 6.5% rate of interest against their lending under the linkage banking programme. As regards MFI linkage, it gave refinance only to commercial banks to the extent of 100% of their bulk loans to NGO-MFIs for on-lending. During 2003-04, Rs.18, 555 million (US\$ 412 million) was disbursed as loans to SHGs through various banking institutions. Banks had been refinanced to the tune Rs. 7059 million (US\$ 156 million) by NABARD. Cumulatively till 31 March 2004, bank loans disbursed to the SHGs aggregated to Rs. 39,042 million (US\$ 867 million).

(e) *Promotional Grant Assistance to NGOs/RRBs /DCCBs to function as SHPIs:* NGOs already working in the social sector were encouraged to take up SHG promotion as an "add-on" activity. This not only helped in complementing the core areas of activities of the participating NGOs but also reduced overheads costs in formation and nurturing of groups. NABARD provided grant assistance of Rs 2000 (US\$46.5) to NGOs for promotion and linking of each SHG. This amount broadly covered training of members of SHG, stationery for the group, incentive/part salary of NGO staff etc. NABARD provided grant assistance to the tune of Rs1000 (US\$23.26) per SHG to RRBs for formation and linkage.

India's cooperative institutions like District Cooperative Central Banks (DCCBs) and Primary Agricultural Cooperative Credit Societies (PACS) had emerged as major partners considering their strong presence in rural areas for integrating SHG- bank linkage programme in their existing business activity. NABARD had therefore formulated a scheme for assisting DCCBs to form, nurture and link self-help groups. NABARD provided grant assistance at Rs1000 (US\$23.26) per SHG to DCCBs for formation and linkage. For expansion of SHG programme DCCBs were provided grant assistance at Rs 700(US\$16.28) per SHG. As at the end of March 2004, twenty-nine DCCBs had been provided grant assistance aggregating to Rs12.40m (US\$288,372) for the promotion and linkage of 15,550 SHGs to banks.

(f) *Capacity Building of Partner Institutions in Micro Finance:* Comprehensive training of the staff of banks, NGOs and government agencies involved in the provision of microfinance services was organised by NABARD to improve service delivery to the poor.

(g) *Revolving Fund Assistance (RFA) to MFIs:* NABARD had been providing RFA on a selective basis to NGOs, SHG Federations and Credit Unions and other agencies for

on-lending to SHGs, to help institutions build their financial intermediation capacity and to prepare them to take bank loans in future.

3.10.3 SHG-Linkage Banking Programme

In India the SHG- Linkage Banking Programme was the major platform for delivering social and finance services to the poor. Broadly, the three variants micro-credit delivery mechanism of this programme adopted by the financial sector to reach the micro-entrepreneurs and poor;

- (i) NABARD - Bank - SHG (without NGO intervention),
- (ii) NABARD - Bank - SHG (with NGO or other SHPI as a facilitating agency), and
- (iii) NABARD - Bank - NGO - SHG (with NGO as financial intermediary).

An interesting aspect was the increasing proportion of the second model where linkage of SHGs was established by banks with NGOs as facilitators. The progress under the SHG-Bank linkage programme was quite tremendous and impressive with banks lending cumulatively Rs.39.04b (US\$867m) to 1,079,091 SHGs. The 1million SHGs providing credit to 100million poor and reaching 70 million households.

3.11 Consultative Working Group

In order to deepen and expand the role of SHGs and NGOs in the rural sector, RBI in 1994, constituted a Working Group comprising eminent NGO functionaries, academicians, consultants and bankers under the Chairmanship of Shri S.K. Kaila, the then Managing Director, NABARD. In 1996, the Working Group recommended that SHG should be treated as:

- (i) normal lending activity as part of their main stream credit operations both at policy and implementation level;
- (ii) separate segment under priority sector by reporting it as 'Advances to SHGs';
- (iii) service area approach, whereby banks identified branches having potential for linkage and provided necessary support services to such branches and included SHG lending within their Service Area Plan. The Service Area Branches could fix their own programme for lending to SHGs as in the case of other activities under the priority sector, and;
- (iv) progress report to be sent to both RBI's Rural Planning and Credit Development (RPCD) and NABARD's Micro Credit Innovation Department (MCID) on half yearly basis.

Country Experience -Pakistan

3.12 Country's profile

Pakistan had population of 132 million people with a land area of 796,096 square kilometres. The population density was 166.3 (persons/sq. km) and the average household size was 6.8. Pakistan's GDP was 5.1 percent with a foreign reserve of US\$13.155 million. Inflation rate was about 8 percent. The MRR was 7%, while the interbank rate and, T-bills was 5% and 4.2% respectively. The financial sector was comprised of the State Bank of Pakistan (SBP), 3 nationalised banks, 3 denationalised banks, 15 local privatised banks, 14 foreign banks, 3 specialised banks, 2 provincial banks, 4 microfinance banks, 6 development finance institutions (DFIs), 2 rating agencies and credit bureau in the State Bank of Pakistan (SBP). Others were leasing, investment, assets management, exchange, and housing finance companies. Added to the above were the modarba, mutual funds, venture capital and brokerage houses. Pakistan's credit bureau was the oldest in Asia, established in 1989.

More than 33 percent of the population lived below poverty line, with 6.5 million poor households requiring financial services. Current coverage of services was only 5.0 percent. There was significant demand supply gap for financial services, with limited out reach of MFIs. Women and other marginalised sections had limited access to micro finance services.

3.13 Regulatory authority in Pakistan-State Bank of Pakistan (SBP)

The State Bank of Pakistan as the apex regulatory body was very proactive and supportive of the micro finance banks. SBP recognised micro finance (MF) as an important tool for poverty alleviation. Thus, SBP's vision was to promote and encourage the provision of financial services through commercially viable micro finance banks (MFBs) to those who don't have access to formal financial institutions. The microfinance banks were considered as an important component of country's financial system. The SBP also had commitment to ensure a conducive regulatory framework for MFIs and strengthened own capacity to ensure effective supervision of MFIs.

3.14 Regulatory/Legal Framework for Micro Finance Banks (MFB) in Pakistan

There was a huge un-served market, due to gross failure of specialised institutions to provide funding for the sector. In addition, the commercial banks had limited capacity to provide requisite financial services to the poor. The mandate and culture of commercial banks was also not compatible with this sector. The operating NGOs too had limited capacity to increase outreach levels in the medium and long term. The general consensus nationally, was to promote sustainable institutions to cater for the financial needs of the poor.

The SBP therefore in its efforts to develop the sector as the apex regulatory and supervisory authority for licensing banking institutions produced a guideline for

prospective microfinance Banks. Its regulations were not applicable to NGOs-MFIs undertaking MF business through sources other than public savings. The regulatory framework comprised criteria for granting license for establishing MFBs, prudential regulations for MFBs, and guidelines on different areas such as mobile banking guidelines, due diligence guidelines on portfolio review and guidelines for transforming NGO-MFIs . There was also self-regulation of NGO-MFIs through their representative network, the Pakistan Micro finance Network (PMN).

In order to be responsive to the peculiar nature of operations of MFBs, the main focus of the Regulatory Framework were on capital adequacy, risk management, know your customers, maximum loan size, corporate governance, audit and disclosure, assets classification and provisioning, liquidity management, and monitoring periodical returns.

3.15 *Micro Finance Ordinance 2001*

It was in view of the above that the Micro Finance Ordinance (MFO) 2001 was issued after consultation and consensus of the stakeholders in the microfinance industry. Some of the issues covered in the MFO inter alia: application, definition and categorisation of MFIs, ownership structure, functions and powers, capital requirements, audit and disclosure requirements, regulatory powers of SBP, and winding-up procedures.

3.15.1 *Application for Micro Finance Banking License*

The MFIs interested in mobilisation of public savings to finance their operations as specified under the MFO were required to obtain license from SBP. The NGO-MFIs extending micro-credit and allied services to the poor through sources other than public deposits were not subject to the provisions of the Ordinance.

3.16.2 *Categorisation of MFIs*

Three types of MFBs/MFIs could be established under the MFO of MFIs' framework. These were:

1. District based MFIs with a minimum capital of Rs 100million(US\$2m)
2. Province based MFIs- minimum capital of Rs.250million(US\$5m)
3. Country-wide MFIs- minimum capital of Rs.500million(US\$10m)

3.15.3 *Ownership structure and functions*

Only companies incorporated with the Securities Exchange Commission of Pakistan (SECP) could apply for a MFB license. Such MFB would be required to have as it main focus some of the following:

1. extension of credit to the poor/micro enterprises in cash or kind and with or without collateral
 2. housing finance for the poor
 3. savings mobilisation- both demand and time deposits, not members of clearing house
 4. finance and technical advisory services to the poor/micro enterprises
- not eligible to deal in business of foreign exchange.

3.15.4 Licensing criteria for MFBs

Both foreign and domestic investors were eligible for MFB license. Credentials of the sponsors and senior management team's track record, integrity and capacity to manage a financial institution were checked. Also the capital mobilisation plan with the firm commitment from the sponsors/investors to subscribe to the capital and the net-worth of sponsors to commensurate with the proposed investment in the MFB. In addition if the MFB was going to raise capital from the public, firm commitment from underwriters (at least A-rated) for underwriting the IPO was required. Feasibility study and business plan and incorporation certificate with SECP as public limited company must accompany the application.

3.15.5 MFIs Mobile Banking Operations

To help minimise cost of setting up a full fledged branch, the following criteria was prescribed:

1. opening of service centres within a 50km radius of the licensed branch
2. provision of local contact point to poor clients
3. ensure cost effectiveness and financial viability of the operation
4. create awareness in the area about banks' products
5. provision of micro-loans to the clients

3.16 Criteria for Portfolio Review (transformation of NGOs/Rural Support Programmes (RSPs) into MFBs)

To facilitate the transformation of NGOs/RSPs into MFB the following conditions were prescribed:

1. review of credit and interest accrual/non-accrual policies
2. review of accounting and information system
review of internal audit function

3.17 Organisational structure of State Bank of Pakistan (SBP) for Micro Finance Sector Development (MFSD)

In order to enhance the implementation of various policies for the development of the MF sector the SBP created in its Banking Supervision Department, a Micro Finance and Rural Finance Support Division with the following offices:

1. Micro Finance Policy Unit
2. Project Management Unit-MSDP
3. Micro Finance Supervision Unit
4. Rural Finance Unit
5. Micro Finance Development Unit

The MFRSD's mandates included supervision, enforcement, granting licenses, policy, off-site, support and prudential activities. Furthermore, a human capital pool of 25 officers was created through drafting of officers from three Departments, namely Banking Supervision, Banking Inspection and Banking Policy, within the SBP to form the initial human capital for the Micro and Rural Finance Support Division established to develop the MF sector. In addition there was a credit bureau at the SBP.

3.18 Mechanism for MF Sector Development in Pakistan

The State Bank of Pakistan had in place a formidable mechanism for microfinance sector development. Some of these were:

3.18.1 State Bank Partnership for Microfinance (SBPM): Since SBP was entrusted with MF regulatory and supervisory role, Swiss Agency for Development and Cooperation had assisted SBP in building/enhancing its capacity to effectively play its role as a regulator and supervisor of licensed MFIs. To further strengthen the cooperation, it entered into partnership with SBP by providing technical assistance grant to SBP to help build the SBP capacity to effectively supervise the microfinance banks as well as develop policies and set standards for operators in the MF sector in Pakistan. .

The Phase 1 of the SBPM Project commenced from 1st August 2003 to 30th July, 2006, with a project cost of Rs. 30million (\$517,241.37) approximately. The projects components were: (a) SBP skill enhancement and enrichment in micro finance, (b) development of off-site monitoring system for MFIs, (c) development of on-site examination manual for MFIs.

Building the capacity of the SBP staffers on MF involved various programmes: (a) exposure visits, (b) orientation workshops/training programs, (d) conferences on MF to promote on going dialogue within the sector, international exposure visits/short attachment with regulatory agencies/MFIs. All these were arranged by State Bank of Pakistan.

3.18.2 Micro Finance Consultative Committee: Policy was formulated through a consultative mechanism comprising representatives of stakeholders in government and private sector organisations. Members of the consultative committee were SBP, representatives of National Rural Support Programme (NRSP); Pakistan Poverty Alleviation Fund (PPAF); Khushhali Bank; Network Micro Finance Bank, First

microfinance Bank Ltd, commercial banks; and Pakistan Microfinance Network (PMN). It was the highest policy making organ for MF in Pakistan.

3.18.3 Credit Bureau: The Credit Bureau domiciled in the SBP was established 1998 and the oldest in the region. It charged Rs.5 (N300.00) for its services. The Pakistan Micro Finance Network was also planning to set up its own credit bureau.

3.19 Micro Finance Sector Development Programme (MSDP)

The Government of Pakistan was granted loans by the Asian Development Bank for the development of the microfinance sector. SBP was the executing agency for the MSDP, while Ministry of Finance (MOF) and Khushhali Bank (KB) were the implementing agencies.

The Government of Pakistan had through the MSDP issued a Micro Finance Policy. The objective of MSDP was to provide affordable financial and social services to the poor for a significant impact on poverty reduction through: (1) increased income of poor households, (2) enhanced outreach, particularly to women, (3) build social capital and (4) reduce risks faced by the poor. MSDP provided an integrated package of policy reforms, institutional development and outreach expansion to catalyse the growth of microfinance sector.

Objectives: Objectives of the MSDP was the reduction of poverty and gender development by:

1. creating a conducive policy environment
2. developing appropriate financial infrastructure
3. developing linkages with NGOs and community organisations
4. investing in building social capital
5. mitigating risks of poor households
6. capacity building of SBP to play effective and proactive role in development of the sector.

The MSDP comprised two loans from Asian Development Bank. These were:

1. a policy loan of US\$70m meant to support a reform program for the micro finance sector
2. an investment loan of US\$80m to provide MF services to the poor and institutional strengthening
3. counter-part funds of US\$70m for loans was placed as government's contribution to four of the above components.

Endowment Funds: Under the MF sector reforms, 4 endowment funds have been established at the SBP to support the poor with periodic contributions from both, the government and Khushhali Bank to ensure sustained ownership. These measures were construed as a catalyst for broadening and deepening Pakistan's micro finance market. The Funds included:

1. MSDF- US\$40m to provide credit for social mobilisation,

2. Community Investment Fund (CIF) -US\$20m to provide credit for small infrastructure projects. It extends matching grant to communities to build small infrastructure to be contributed 20% by the borrowers/community and 80% by the fund managers. The Board of the Fund included representative of SBP, 2 rep of Khushhali Bank and a member of the board.
3. Risk Mitigation Fund(RMF)-US\$5m to protect borrowers in case of natural calamity. The borrower will claim reimbursement on outstanding amount of the loans to enable him return to business. The Board of Directors must approve the claims list., and
4. Depositors' Protection Fund (DPF) -US\$5m to protect borrowers' interest in case of liquidation of KB.

The amount was invested in government approved securities i.e Pakistan Investment Bonds and Treasury-bills. The interest earned on the MSDF and CIF on a six month basis was credited to KB's account with the National Bank of Pakistan (NBP), Islamabad by the Fund Committee. The principal as well as interest earned on RMF and DPF were reinvested in government-approved securities by MFSD. A Fund Committee of Joint Director, Micro Finance Support Division, SBP; President KB; and one Director on the Board of Directors of Khushhali Bank manages the MSDF and CIF.

Rural Finance Sector Development Program (RFSDP)

The Rural Finance Sector Development Program (RFSDP) comprised of two loans from ADB as follows:

1. A Policy Loan of US\$225m to develop the country's rural finance sector on sustainable basis., and
2. An Investment Loan of US\$80m for SBP's institutional strengthening for supervision and regulation of rural finance and for agricultural bank restructuring.

The objectives of the RFSDP included: (a) creating a favourable policy environment for the Rural Finance Sector, (b) institutional restructuring –restructuring of agricultural bank, establishment of Rural Finance Resource Centre (RFRC), and (c) Pilot Credit Union Plan-reviewing the existing cooperatives structure and initiating Credit Union Plan in four districts.

Under the RFSDP a New Bank Fund (NBF) was established to give soft loans to new MFIs for institutional strengthening, and products and process innovation –initiation of pilot insurance program for agricultural bank borrowers.

3.20 Supporting Institutions Providing Micro Finance Services in Pakistan

3.20..1 Pakistan Poverty Alleviation Fund (PPAF)

The Pakistan Poverty Alleviation Fund (PPAF) was an innovative model of public/private sector partnership sponsored by the Government of Pakistan (GoP) and funded by the World Bank. The PPAF was incorporated as a private company limited

by guarantee, under the regulatory supervision of the Securities and Exchange Commission of Pakistan. It was established to enhance the availability of resources and services to the poor to address the problem of poverty at grass root levels.

Operating windows: The Fund primarily had the following three main windows through which financial assistance was provided:

1. Lines of credit for expansion of poverty targeted micro-credit programs,
2. Grants and loans for community physical infrastructure, on a cost sharing basis, and
3. Grants to strengthen and build the institutional capacity of partner organisations and communities.

As a lead institution of the country providing funds to civil society organisations, the PPAF endeavours to form partnerships with relevant institutions based on well spelt out criteria. Before finalising partnerships the PPAF ensures that the partners had well targeted community outreach programmes that were committed to enhancing the economic welfare and incomes of the disadvantaged peoples. In addition they should be seen to be moving towards sustainability, and had transparent and democratic decision making processes.

The Board of Directors of PPAF comprised three government nominees while the other eight were members of the civil society.

Strategy to development: PPAF strategic policies included a two pronged approach: (1) to support those partner organisations which had existing capacity or potential to absorb PPAF funding and (2) to simultaneously broaden the base, by building up the capacities of smaller institutions. It also adopted integrated area development strategy to actualise its programs, which encompassed a community managed infrastructure development programme, micro credit, health and education of two of its partner organisations: National Rural Support Programme (NRSP) and Human Development Forum (HDF). NRSP took the responsibility for infrastructure and micro-credit. While HDF helped in the establishment and management of health and education facilities.

The Chief Executive was given full powers to make operational policies, while the Board of Directors took policy decisions.

Objectives of PPAF and its resource base: The PPAF provided funding for community physical infra structure component with the usual micro credit and capacity building components. This was a holistic approach to development. The small community development projects were for the improvement of the economic, social and marketing infrastructure of clients. In support of these activities partner organisations and communities were to be capacitated by strengthening their institutional competencies.

PPAF had US\$100million subscribed to by the World Bank -90% and Government of Pakistan -10% . In line with the objectives of PPAF, its resource base was allocated as follows:

World Bank Funding

<u>Component</u>	<u>Category</u>	<u>Amount</u>
Credit & Enterprise Development	Credit	US\$ 45 m
Community Physical Infrastructure	Grant	US\$ 28 m
Capacity Building	Grant	<u>US\$ 17 m</u>
		<u>US\$ 90 m</u>

The Government of Pakistan's commitment to the programme which was in form of equity, was invested in government bonds and securities, and the earnings from this investment was to meet the operational costs of the PPAF.

Organisational Structure: For cost effectiveness and sustainability of PPAF the institution had no provincial and district level offices. It operated from one central office. Communications with the partners were made by undertaking frequent field visits to the sites of the partner organisations. This was backed up by modern communication technologies.

3.20.2 **Khushhali Bank (Kb) – Model Micro Finance Bank**

The Khushhali Bank(Kb) was established in 2002 as part of the Government Islamic Republic of Pakistan's Poverty Reduction Strategy and its Micro Finance Development Program (MSDP) that was developed with the assistance of Asian Development Bank. It was established as **a model micro finance bank**, under the central bank's supervision (SBP) with commercial banks as its shareholders. Its mandate was to retail microfinance services and act as a catalyst in stabilising Pakistan's newly formed micro finance sector. The Kb was a major initiative to bridge the demand and supply gap for microfinance services. Integral to micro finance services was the intensive and sustained social support for mobilisation, management and development of all community organisations and access to basic infrastructure services.

Goal of Kb: Its primary purpose was to (1) establish a sustainable, scaleable pro-poor financial services platform with retail delivery capacity to reach 600,000 poor households by the year 2006, (2) Catalyse an enabling environment, within which the microfinance institutions can develop in Pakistan, (3) Assist the central bank in setting up an appropriate and responsive regulatory framework within which micro finance can operate on sustainable grounds, thereby expanding outreach to the poor. (4) Promote transparency, financial rigor and good governance as leading indicators of excellence within microfinance sector in Pakistan.

Ownership of Kb: Sixteen commercial banks, including two multinational banks, collectively contributed US\$30million as equity. The bank had an autonomous private-sector board comprising of professional bankers and social developers which governs the bank, provided policies and guidance to the management in establishing a robust, customer-centred products.

GoP's support for Kb: The Government of Pakistan had obtained a loan of US\$150 million from the Asian Development Bank to support the operations of Kb and to promote micro finance sector. Kb utilised a US\$70m component of this loan for micro loans to the poor particularly to women in the country's rural and urban areas and a US\$ 10m component had been allocated toward institutional capacity building. Another US\$70m component was allocated to support policy reforms of microfinance sector of Pakistan. The bank could however go to the market to raise funds.

Kb's Partnering with NGOs: The Government of Pakistan (GoP) recognised the role of NGOs in poverty reduction efforts as envisaged in the MSDF Policy. The bank benefited from the endowment funds, namely MSDF and CIF, established by the Government and Asian Development Bank by directing the proceeds to its partnering NGOs for social mobilisation, capacity building of communities and providing small infrastructure projects within the Bank's service areas. The MSDF revenues was solely used as service provider fee for eligible NGOs. Service provider NGOs could also be paid a fee from CIF revenues for assisting the Community Organisations mobilised using MSDF resources in identification, design, and implementation of small infrastructure projects. This unique arrangement allows the Khushhali bank to channel specialised social services through NGOs while its delivers financial services to the same market segments.

Services rendered by the Bank: The Bank's product included short-term tenure micro loans ranging up to US\$500 for working capital and asset purchase. It also mobilised deposits and continued to expand its range of services to address client needs. Services were rendered with objective of sustainability.

3.20.3 **National Rural Support Programme (NRSP)**

NRSP aimed to foster a countrywide network of community organisations (COs) at the grassroots level. It enabled rural communities to plan, implement and manage their development plans, employment, alleviation of poverty and improvement in quality of life.

Approach: In order to mobilize people through social guidance, NRSP identified micro investment opportunities at the household, group and village level and prepared plans for its execution if it met the prioritised needs of the community among others.

NRSP adopted a two - pronged strategy: (1) working to harness people's potential to do whatever they could with limited resources, and (2) attempting access resources to channel them to the rural poor for effective use. For this purpose NRSP linked the

community organisations with a number of service delivery agencies. For harnessing people's potential, NRSP used the micro investments plans (MIP) as the basis for determining the kinds of interventions that were required to reduce poverty. Each community organisation member prepared an MIP, indicating the kinds of activity he or she would like to be engaged in order to improve his or her economic activity.

Urban Poverty Alleviation Program (UPAP): the NRSP initiated the UPAP to improve the quality of life of the disadvantaged and low income people living in urban areas focussing on women, but not excluding men. It was also started to develop a self-financing indigenous model to provide micro credit service to the poor living in urban areas of Pakistan.

3.20.4 *Pakistan Microfinance Network (PMN)*

The PMN was a network for organisations engaged in microfinance and dedicated to improving the outreach and sustainability of microfinance services in Pakistan. The apex association became active in 1999. The PMN had built greater awareness among policy makers, arranged specialised trainings, and established initial standards for financial transparency. The PMN's mission was "to support the microfinance sector to provide financial services to the poor, with focus on retail microfinance." The mission was achieved through three objectives: (1) promote an enabling environment that benefits the work of all stakeholders; (2) promote the capacity of stakeholders, especially retail microfinance institutions; (3) improve transparency and accountability by promoting the publication and widespread use of performance measures and standards related to the work of retail microfinance institutions. The PMN had 12 member institutions.

The PMN entered into an agreement with The Mix Market to create its members' profile on the Mix Market. The PMN was funded by Aga Khan Foundation, Pakistan and Department for International Development (DFID) of Great Britain.

4. *FINDINGS AND LESSONS LEARNT*

The study tour to India and Pakistan was rich, rewarding and had brought to fore the various processes and institutional arrangements that smoothen the implementation of any microfinance policy. The governments of both countries were forth coming in supporting the development of the microfinance sub-sector. The governments and central banks of India and Pakistan considered the issues relating to microfinance as germane to economic development. Therefore solid institutional arrangements were put in place to ensure that credit was made available to the disadvantaged sector, the poor or those living below poverty line in a sustainable manner.. The Reserve Bank of India continued to issue various circulars to achieve this, coupled with the policy categorising advances to the poor as priority sector. In Pakistan a Micro Finance Ordinance was issued as regulatory and supervisory instrument for the activities of microfinance finance banks.

Both governments had in place solid institutional arrangements and incentives to drive the development of the microfinance sector. In addition incentives were put in place to encourage SHGs' mobilisation through NGOs, Community Based Organisations. A Micro Finance Development Fund of Rs.1,000 crores (US\$23.3m) was specifically created for the purpose in India, and contributed by the Government of India, the Reserve Bank of India and commercial banks in India. In Pakistan funding of such activities was provided for by National Rural Support Programme, Pakistan Poverty Alleviation Fund and State Bank of Pakistan.

SHGs were the pivots for economic and social re-engineering of the rural communities. Both countries had made pioneering efforts in conceptualising and implementing the SHG - Bank linkage programme which had been recognised by the Government of India and Government of Pakistan as potential tool for banking with the poor.

There was enormous support from the Reserve Bank of India to NABARD which was the apex wholesale bank for agriculture and rural development.. Most Government of India and Reserve Bank of India programmes for the microfinance sector development were administered through NABARD. In Pakistan the Pakistan Poverty Alleviation Fund (PPAF) provided wholesale fund for microfinance banks.

The central banks of both countries were the key drivers of microfinance development programmes through deliberate policies and provision of substantial financial investment (pool of development funds) in order to create congenial legal/regulatory environment for operators in the sector. In Pakistan, Microfinance Finance Ordinance (Policy and Regulatory Guidelines pioneered by State Bank of Pakistan became effective in Year 2000. State Bank of Pakistan had a full fledged unit (microfinance division), that drive and provide direction to the microfinance sector activities through the Microfinance Consultative Committee The micro finance institutions in India had also requested for regulation and supervision just like in Nigeria.

The capital base for setting up a micro finance institutions in India was Rs.20crores (US\$465,116.3). In Pakistan, microfinance banks were categorised based on the extent of area covered as Federal, Regional and District microfinance banks. They were required to capitalise with US\$10m, US\$5m and US\$2.50m respectively. The start-up capital requirements were quite substantial compared to the N20m (US\$150,534.4) requirement in Nigeria's microfinance policy. Various financial services and products such as savings, credit, housing, credit cards, micro leasing and insurance were provided by different agencies in varying degrees.

We observed the deliberate and comprehensive institutional arrangements and collaboration among public sector institutions, private sector organisations, local communities and NGOs and donor agencies to bring about microfinance sector development in both nations, especially Pakistan.

In Pakistan, NGOs transforming to microfinance banks were required to be rated by a rating agency. Beyond this the State Bank of Pakistan had in place transformation

guidelines for NGOs requesting transform to microfinance bank. This was to guide against systemic risk.

In order to confirm their commitment to the need to grow the microfinance sub-sector sixteen (16) commercial banks in Pakistan jointly established a model microfinance bank – Khushhali Bank Ltd., with a view to setting standard for the sub-sector.

5. CONCLUSION

The study tour revealed that enabling policy and viable institutional arrangements matters a lot for microfinance to thrive. Deliberate remedial efforts were been made by the countries visited to promote micro finance through provision of inducements, prerequisite policy and institutional framework too develop the microfinance sub-sector as well as foster linkages with the formal banking sector.

Since the activities of micro entrepreneurs, who were dominant force in the economic landscape of the countries visited, were similar to what obtain in Nigeria, we advocate that such sustainable approaches that would help build an inclusive financial system that caters for low income group and the poor, should be adopted with the Central Bank of Nigeria playing the lead role in the development of microfinance sub-sector.

6. RECOMMENDATIONS

Microfinance is a useful tool in building the capacities of the poor in management of sustainable self-employment activities besides providing other financial services to them. The acceptance and recognition of MF as an essential tool for poverty alleviation therefore envisages adoption of a national policy on microfinance. We thus recommend as follows:

- (i) that a 'Micro Finance Development Fund' should be set up by the Bank and the Federal Government to provide necessary fillip for the micro finance sector. Such Fund could be sourced through partnering with African Development Bank (AfDB).
- (ii) that the capital base for establishing MFI as specified by the proposed policy document be reviewed upward to conform with current realities in the banking system as well as meet international standard and licensing categorised based on local government, state and nationwide coverage.
- (iii) that the Bank should develop separate guidelines for NGOs transforming to a microfinance bank. In order avoid possible systemic risk that could occur from transformation. The policy document should provide for the assessment of a transforming NGO by an international rating agency. Cost of rating should be charged to microfinance development fund to be established as an incentive to the transforming institution.
- (iv) That NACRDB should be institutionally reformed and strengthened as an apex microfinance bank to provide wholesale funds to retail microfinance

- institutions that finance micro entrepreneurs, agricultural and rural and projects.
- (v) That a micro-credit Bureau should be set up in OFID of the CBN to provide relevant credit information on microfinance institutions and their clients.
 - (vi) that NAPEP should be reorganised and restructured as permanent Federal institution devoid of political interference to be charged with social mobilisation of the civil society, using NGOs, CBOs, to develop Self Help Groups (SHGs), and provide social infrastructures. This would require the establishment of 'rural infrastructural development fund' by government which could be domiciled in NAPEP.
 - (vii) That a survey of NGOs and community organisations should be conducted, so that their infrastructure could be leveraged for the development of the sector. NGOs have emerged as effective change agents by organising, nurturing and stabilising SHGs and affecting their linkage with microfinance banks and also by adopting other delivery mechanisms for providing financial services directly or indirectly to the poor. SHGs should be mobilised to form federations.
 - (viii) That a risk mitigating funds for natural occurrences like death of a micro-client, flood, fire and epidemic out break on farms to make provision for write-off of outstanding loans in order to further encourage the banking sector to provide services to the poor be set up.
 - (ix) That the CBN encourage the universal banks in Nigeria to establish a wholesale or model retail microfinance bank using the ten percent set aside for financing micro-entrepreneurs activities under the SMEEIS
 - (x) Encouraging initiatives and participation of different types of institutions in microfinance,
 - (xi) That the CBN create policy environment for closer linkage of the microfinance sub-sector with the formal banking sector, and
 - (xii) Empowerment of women through microfinance. Issues such as rights to own properties, minimal functional literacy and primary health care to be addressed by Government.

Microfinance Study Tour Team to India and Pakistan

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