6 DEVELOPMENT FINANCE

Financial inclusion facilitates economic growth by broadening access to financial services and increasing financial depth. Economic growth is the primary driver in improving the well-being of society by ultimately reducing poverty, and given the positive feedback loop between the financial sector and the real economy, financial deepening tends to reduce poverty through its positive impact on growth. Although the extent of the likely benefits emanating from financial depth may vary from country to country, it has generally been found to have a significant impact on the growth prospects of an economy, particularly in case of developing countries.[1]

An increasing number of studies conducted in recent years have reached the conclusion that financial depth has a positive relationship with income inequality.[2] One study also concludes that the income of the poorest quantile grows faster in countries with better-developed financial intermediaries and where political interference is low. Moreover, it also finds a positive impact on the income growth of the poor, even after controlling for the overall growth in income.[3]

In recognition of the importance of increasing the outreach of financial services and overcoming pervasive financial exclusion in the country, State Bank of Pakistan (SBP) has introduced several initiatives including the formulation of a separate Development Finance Group (DFG) which spearheads policy formulation and implementation to extend the outreach of financial services, primarily in the areas of Agriculture, SME, Microfinance and Infrastructure and housing finance.

6.1 Overview

As shown in **Table 6.1**, the extent of financial penetration in the SME, Agriculture, Housing and Microfinance sectors is very low. Considerable progress has been made only in the agriculture sector, which has a penetration of around 32.5 percent as of end-CY08, whereas the outreach of the remaining sectors is generally less than 10 percent.

Table 6.1: Sectoral Outreach in Terms of Borrowers and Amounts

Sectors	No. of Borrowers as on End			
	CY07	CY08	Potential Market (Estimates)	Current Outreach as % of Potential Market
SMEs	185,039	222,861	3.16 million SMEs in the economy **	7.2
Agriculture	1,727,479	1,996,005	6.6 million farm households ***	32.9
Mortgage Loans	480,569	493,089	6 million houses required ^	8.2
MF Loans	1,591,126	1,732,879	30 million customers ~	5.8

Source: ACD, BSD SBP & PMN
* Position as on Dec. 2007 ** Economic Census of Pakistan - National Report May, 2005 - There are 3.2 million business enterprises in Pakistan out of which 99% are SMEs ***Farm households survey – 2005 ^ I&HF Department SBP ~ Pakistan Microfinance Network

On a broad level, the key supply side reason for under-penetration is the perceived non-viability of these sectors. Banks generally do not find these sectors commercially viable due to various reasons such as lack of adequate collateral, high transaction costs, greater

[1] "The Importance of Financial Sector Development for Growth and Poverty Reduction", DFID 2004.
[2] Lately some studies have concluded that:
- financial depth contributes to lower inequality (Li, Squire and Zou, 1998; Clarke, Xu and Zou, 2003);
- financial depth contributes to lower poverty (Honahan, 2004a);
- financial development has a positive impact on changes in inequality and changes in poverty; it is a causal factor in pro-poor growth (Beck,Demirgüç-Kunt and Levine, 2004);

[3] Beck, Demirgüç-Kunt and Levine, 2004

performance sensitivity to economic fluctuations, inadequate credit history of borrowers etc. In order to increase penetration by facilitating banks, SBP has launched several initiatives in recent years, as discussed below.

In order to promote agriculture finance, 14 private banks have been inducted in the agricultural credit scheme,[4] in addition to the existing big five banks and two specialized banks. Moreover, substantial work has also been undertaken for the standardization of loan documents. Besides prudential regulations for agriculture financing, guidelines for livestock, fisheries, and poultry & horticulture financing have also been issued. To mitigate banks' risk and the farming community against losses caused by natural calamities, a mandatory crop loan insurance scheme was introduced in 2008 for major crops.

To motivate banks to lend to SMEs, SBP has taken several initiatives. One of the major achievements in this context is the completion of an ADB-funded project for "Strengthening Secured Transaction Framework", aimed at enhancing SMEs' and rural entrepreneurs' access to formal sources of finance. Once enacted, this framework would help in establishing a system of charge creation on moveable & immovable assets of small borrowers in urban and rural areas. The necessary changes in the legal framework for the implementation of this measure have also been proposed to the government.

For microfinance (MF), SBP has initiated a credit guarantee facility to facilitate the flow of liquidity to Microfinance Banks (MFBs). The Microfinance Credit Guarantee Facility (MCGF) assures that in case of default, 40 percent of the funds provided by commercial banks to liquidity constrained MFIs will be repaid. SBP has also issued new licenses for the establishment of new entrants in the market in CY08, bringing the total number of MFBs to 8 by end CY08. SBP's focus is on cultivating sustainability in the microfinance sector which is a strategic shift from donor dependency. In order to increase the outreach, SBP also encouraged formation of an alliance between the Pakistan Post Office (PO) network and MF providers. This strategic alliance has leveraged the outreach of the MF providers, given that the PO is currently managing over 4 million savings accounts (mainly small accounts with balances below Rs 10,000), through more than 13,000 branches spread across the country.

With the ongoing implementation of financial sector reforms and various initiatives taken by SBP in collaboration with the Government, access to financial services though still low, has nevertheless improved across all sub-sectors of the development finance group (**Table 6.2**). For instance, the agriculture sector has witnessed an increase in the number of borrowers from 1.7 million at end-CY07 to 2.0 million by end-CY08, while the amount disbursed also increased from Rs. 187.0 billion to 221.0 billion during the period under review.

Table 6.2: Sector-wise Outreach of Development Finance

	Agriculture		Infrastructure & Housing Finance		Microfinance		SMEs	
	CY07	CY08	CY07	CY08	CY07	CY08	CY07	CY08
Number of borrowers (thousand)	1,730	2,000	125.5	123	1,471.3	1,732.9	185	222.9
Amount Disbursed (billion Rupees)	187.0	221.0	246.0	339.3	22.6	31.0	437.0	383.0

Source: SBP

The total disbursement in Infrastructure and housing finance have also increased by Rs 92.7 billion, from Rs.246.0 billion in CY07 to Rs.339.3 billion in CY08. However, the total number of outstanding borrowers recorded a negative growth of around 2 per cent during the period under review.

[4] ACD Circular No. 6 dated October 9, 2003.

The outreach in microfinance has improved as indicated by the rising number of borrowers, which increased from 1,471,295 in CY07 to 1,732,879 in CY08. The amount disbursed also recorded a growth of 37 per cent in CY08. On the other hand, although the number of SME borrowers increased by 20.4 percent to 222,861 in CY08, the amount outstanding actually decreased by 12.4 per cent to Rs. 383.0 billion in CY08 from Rs. 437.0 billion in CY07.

Notably, despite these various improvements, these areas are still underpenetrated and account for a relatively less share of the total banking credit (**Table 6.3**). The following sections give a detailed performance review of each sub-sector

6.2 Performance Review

6.2.1 Agriculture Sector

Due to the crucial role of the agriculture sector in Pakistan's economy, various measures have been taken for improving access of institutional credit for the farmers such that the outreach has increased from 1.1 million borrowers in FY01 to 2 million borrowers in CY08. Following the increasing number of borrowers, the credit outstanding of Rs. 45 billion also touched a peak of Rs. 221.0 billion in CY08. The outreach has also improved in terms of the number of bank branches which disbursed agriculture credit, from 3,559 in CY07 to 3,631 in CY08 (**Figure 6.1**).

Province wise outreach (**Table 6.4**) shows that during CY08, the number of borrowers increased by 15.5 percent. However, this increase has mainly occurred in Punjab and AJK.

Every year, SBP gives participating banks annual indicative targets. In FY09, banks fell short of achieving the indicative target of Rs. 250 billion, as total agricultural credit disbursements amounted to Rs. 233 billion (**Figure 6.2**). On the demand side, the reasons for the shortfall were: (i) the declining prices of fertilizer, (ii) better support prices of wheat offered by the government, (iii) bumper crop of wheat which increased the farmer's cash flows,

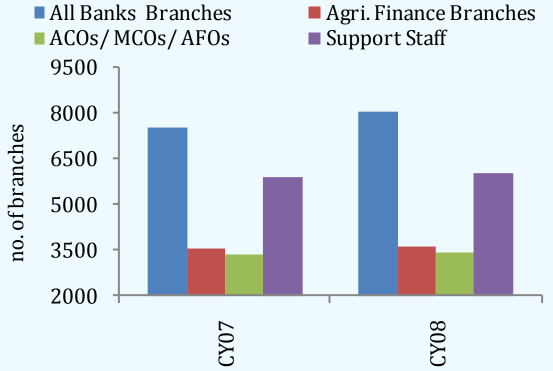
Table 6. 3.Sector-wise Credit Distribution Profile

share in percent

	CY07	CY08
Corporate Sector	56.3	63.2
SMEs	16.2	11.7
Agriculture	5.6	4.9
Consumer Finance	13.8	10.4
Commodity Finance	5.5	7.4
Staff Loans	1.9	2.0
Others	0.8	0.4
Total	100	100

Source: SBP

Figure 6.1: Banks' Agriculture Finance Outreach Level



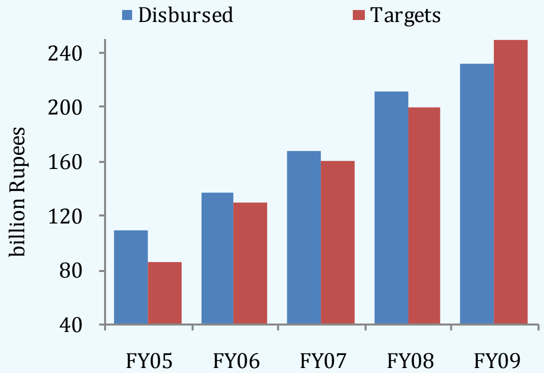
Source: SBP BSC

Table 6.4: Province-wise Number of Borrowers

Name	CY07	CY08	Change (percent)
Punjab	1,198,836	1,480,528	23.5
Sindh	331,453	318,581	-3.9
NWFP	139,901	133,411	-4.6
Baluchistan	21,455	20,464	-4.6
AJK	12,986	19,013	46.4
N-Areas	22,848	24,008	5.1
Total	1,727,479	1,996,005	15.5

Source: S&DWH SBP

Figure 6.2: Agriculture Credit Targets vs disbursements



Source: A&RCD-SBP

and (iv) low investment in agriculture inputs. On the supply side, banks' found it difficult to meet the target due to liquidity strains in Q4-CY08.

Data on bank wise disbursement reveals that the big 5 commercial banks account for the major share (45 percent) of the total agriculture credit disbursements. However, during CY08 the share of the private domestic banks increased to 21 percent, which is an encouraging sign (**Table 6.5**).

Production and development loans have observed a positive and increasing trend since FY05. Development loans have grown by 17 percent in FY09 as against growth of 10 percent in FY08, which is a positive indicator for the future performance of the agriculture sector. Production loans stood at Rs. 209.3 billion at end-FY09, showing 9.4 percent growth over FY08.

Holding-wise classification **(Table 6.6)** shows that in FY09 an amount of Rs. 169.8 billion was disbursed to the farm sector, and Rs. 63.2 billion to the non-farm sector, showing an increase of 6.4 and 21.8 percent respectively over FY08.

In the non-farm category, the biggest portion of credit was disbursed to the poultry sector for breeding farms and feeding mills in FY09 (**Table 6.7**) at Rs. 38.1 billion, showing an increase of 21.7 percent. Negative growth was observed in credit disbursements to fisheries, forestry and others. Notably, NPLs as a percentage of outstanding loans decreased to 15.8 percent at the end of CY08, compared to 18.6 in CY07. However, despite the decrease, this ratio is still higher than the overall NPL ratio of 10.5 percent.

6.2.2 Housing and Infrastructure Finance

Housing sector in Pakistan is also critically under-served. The annual net housing unit shortfall is 270,000 units. To overcome this shortage, SBP, on the recommendation of the Housing Advisory Group (HAG),[5] has introduced reforms in its regulatory framework.

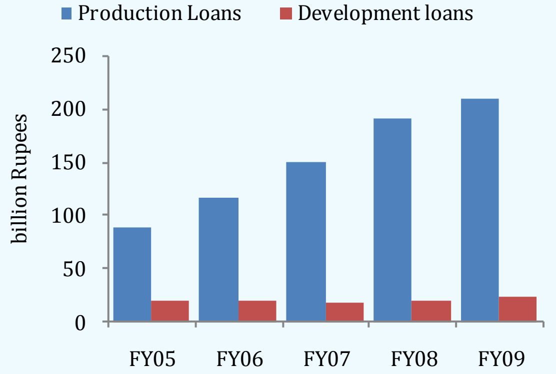
Table 6.5: Bank wise Disbursements

million Rupees, share in percent

	Amount		Share	
	CY07	**CY08**	**CY07**	**CY08**
5 Big Commercial Banks	91,027	98,470	49	45
Specialized Banks	63,518	76,521	34	35
Domestic Private Banks	32,882	45,740	18	21
Total	187,427	220,73	100	100

Source: SBP

Figure 6.3: Purpose wise Agri-Credit Disbursement



Source: A&RCD-SBP

Table 6.6: Holding-wise Agri-Credit Disbursement

billion Rupees

	FY07	**FY08**	**FY09**	**Growth FY09**
Farm	139.5	159.7	169.8	6.4
Economic Classification				
Subsistence	92.3	94.9	107.6	13.5
Economic	32.1	37.9	41.0	8.2
Above economic	15.1	26.9	21.2	-21.3
Non-farm	29.3	51.9	63.2	21.8
Small farms	9.0	12.2	12.9	6.1
Large farms	20.4	39.7	50.3	26.6

Source: Agriculture Credit Department, SBP

Table:6.7 Non Farm Sector wise Credit Disbursement

billion Rupees

	FY08	**FY09**	**Growth in FY09**
Livestock	17.36	22.24	28.11
Poultry	31.36	38.163	21.69
Fisheries	0.80	0.65	-18.78
Others	2.35	2.11	-10.05

Source: Agriculture Credit Department, SBP

[5] SBP constituted a Housing Advisory Group in 2002 for the promotion and development of housing finance.

The number of outstanding borrowers in this sector stood at 123,107 at end-CY08, showing 1.9 percent decline as compared to CY07. The total reported outstanding amount increased from Rs. 76 billion as of end-CY07 to Rs. 88.2 billion by end-CY08. However the overall outreach of housing finance is still well below its potential.

Table 6.8 shows the category and bank-wise disbursements. Compared to the past when the House Building Finance Corporation (HBFC) used to dominate a major share of the market, private commercial banks are now the dominant players as they account for 55 percent of the total outstanding housing credit. The total share of banks and DFIs has risen to 88 percent such that HBFC now accounts for only 12 percent of the housing market. Category-wise break up reveals that outright purchase (53 percent) is the most common mode of financing, followed by loans for construction (33 percent) and renovation (14 percent).

Table 6.8: Bank and Category wise share of Outstanding Credit
million Rupees

Name of Banks	Construction	Outright Purchase	Renovation	Total	Institution wise share (percent)
Public Sector Banks	10,316.4	307.91	924.6	11,548.9	13.5
Private Banks	8,125.7	30,282.3	8,225.7	46,633.8	54.6
Islamic Banks	2,311.9	7,495.2	495.2	10,302.2	12.1
Foreign Banks	693.2	4,887.5	419.6	6,000.3	7.0
All Banks	21,447.2	42,972.9	10,065.1	74,485.3	87.3
DFIs	18.1	401.1	120.2	539.4	0.6
Total Banks and DFIs	21,465.3	43,373.9	10,185.4	75,024.7	87.9
HBFC	6,408.0	2,058.0	1,857.0	10,323.0	12.1
Total	27,873.3	45,431.9	12,042.4	85,347.7	100
Category wise share (percent)	32.7	53.2	14.1	100	

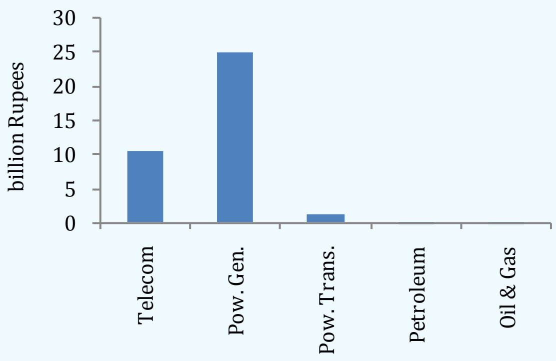
Source: BSD,SBP

Infrastructure Finance

Acknowledging the importance of infrastructure in the development of an economy, several measures have been taken by SBP to facilitate access to infrastructure financing, given its long-term nature in reaching fruition. One of the major steps was the formulation of a task force to devise recommendations for improving the flow of credit to the infrastructure sector, which has submitted its recommendations to SBP. A new training program for bankers, titled "Frontiers in Infrastructure Financing" is also in the offing.

Total infrastructure finance stood at Rs. 251.1 billion at end-CY08, showing 47.7 percent increase against CY07 where the outstanding infrastructure finance was Rs. 170 billion. Among the sub sectors the biggest share of credit, in particular during the last quarter of CY08, was utilized by the power generation sector, which availed Rs. 25 billion representing 65 percent of the share among all sectors (**Figure 6.4**). High demand in the country compelled the power generation sector to avail huge funds for investment, while 27 percent of the share in credit was consumed by the telecom sector, at Rs.10.4 billion, the second largest sector in terms of credit usage.

Figure 6.4: Disbursements in Infrastructure Sectors



Source: SME Finance Department, SBP

6.2.3 Microfinance

In CY07, SBP introduced a national microfinance strategy in collaboration with the Government which aims to increase the outreach of microfinance to 3 million borrowers by 2010, and 10 million by 2015. This strategy aims to substantively up-scale the sector through entry of new players, development of market infrastructure and promotion of alternative delivery channels through fostering partnerships and enhanced use of technology. To achieve these objectives in letter and spirit, State Bank under the Institutional Strengthening Fund (IFS), signed a Memorandum of Understanding (MOU) with Pakistan Microfinance Network (PMN) under which SBP will provide Rs. 133 million over the next five years as a grant to help build Pakistan Microfinance Network's capacity to foster transparency and promote information exchange in the microfinance sector. Similarly another MOU was signed with National Rural Support Program (NRSP) Microfinance Bank to provide Rs. 82 million over the period of one year for promotion of microfinance services in the country. Moreover, an agreement was reached with Tameer Microfinance Bank for Rs. 82 million to launch branchless banking operations over the next one year.

State Bank has also launched the Microfinance Credit Guarantee Facility (MCGF, Institutional Strengthening Fund (ISF)) and Improving Access to Finance Services Fund (IAFSF) as part of the Financial Inclusion Program (FIP) supported by DFID (UK), in addition to an endowment fund of US$20 million for IAFSF by ADB. On implementation, these agreements will help increase people's access to the formal financial system.

Besides above initiatives, during the year under review SBP also issued license to Kashf Microfinance Bank Limited and to NRSP Microfinance Bank Limited (which is yet to start its field operations). In order to further supplement the outreach of microfinance, SBP also issued branchless banking guidelines to promote banking in remote/rural areas.

At present, the microfinance sector can be classified into three categories as microfinance banks (MFBs), Rural Support Programs (RSPs) and NGO based Microfinance Institutions (MFIs). MFBs are regulated by SBP whereas the other two are at present under the domain of the Pakistan Microfinance Network (PMN). Lastly there are also leasing companies involved in micro leasing business which are being regulated by the Securities and Exchange Commission Pakistan.

Table 6.9: Extent of Microfinance Outreach in South Asia

Country	Population (million)	Poverty Ratio (%)	Poor Families (million)	Microfinance Clients (million)	Microfinance Poverty Outreach (%)	Microfinance Coverage of Poor Families (%)	Borrowing Clients, (% of population)
Afghanistan	22	55	2	0.12	50	3	_
Bangladesh	143	50	13	16	50	62	13.1
India	1100	30	60	15	35	9	1.1
Nepal	26	35	1.6	0.5	45	14	1.5
Pakistan	155	33	8.5	0.58	35	2	_
Sri Lanka	20	25	1	2.5	25	63	4.3

Source: Getting Finance in South Asia Phase IV, World Bank 2008

Outreach

Table 6.9 shows regional comparison of microfinance outreach levels. In terms of microfinance coverage of poor families, Pakistan covers only 2 percent families, which is the lowest degree of outreach in South Asia. However, the situation will improve over time due to the abovementioned measures taken by SBP, PMN and other stakeholders in the country.

Notably, the improvement in trends is already visible (**Table 6.10**). Industry performance in terms of outreach, operations and total number of active borrowers has shown rapid growth. In CY08, total number of active MFB borrowers reached 558,057, showing a growth of 28 percent in CY08 over CY07, whereas for MFIs the number of borrowers increased to 439,515, depicting growth of 5 percent. Number of savers increased by 70 percent in CY08 for MFBs, and decreased by 58 percent in MFIs, largely due to the conversion of two large MFIs into MFBs. The increase is also attributed to the fact that a number of MFBs introduced saving products that are well-matched to the need of micro savers. Similarly the gross loan portfolio has depicted growth of 54 percent for MFBs and 10.9 percent for MFIs in CY08.

Table 6.10: Outreach of Microfinance Institutions

	MFB's		NGO MFI's		Others	
	CY07	CY08	CY07	CY08	CY07	CY08
Number of Active Borrowers	435407	558057	418234	439515	9362	16216
Gross Loan Portfolio (million Rupees)	4456.3	6886.4	4104.0	4553.4	132.3	165.2
Number of Savers	146258	248842	292975	122752	0	0
Saving outstanding (million Rupees)	2822.8	4111.7	22.2	21.5	0	0

Source: PMN

Table 6.11: Outreach of Microfinance Banks

	CY05	CY06	CY07	CY08
Institutions age (year)	5	6	7	8
No of Branches	91	145	185	271
Advances (million Rupees)	2,258	3,435.1	4,328.3	6,461.5
Borrowers	248,000	326,498	435,407	542,641
Deposits (million Rupees)	680,	1,451.8	2,824.1	4,115.7
Depositors	32,000	70,891	146,258	254,381
Borrowings (million Rupees)	4,328	5,139.5	4,951.3	5,069.8

Source: Microfinance Department, SBP

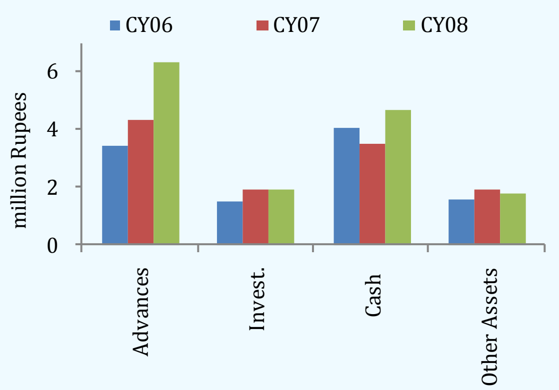
On the whole outreach indicators of MFBs remained encouraging (**Table 6.11**). Number of MFB branches has grown by 46.4 percent which helped the microfinance sector in expanding the base of borrowers. MFB borrowers depicted growth of 24.6 percent in CY08. State bank of Pakistan together with Pakistan Microfinance Network has developed a 5-year growth strategy by setting a target of 3 million active borrowers by 2010 and 10 million by 2015.

MFBs' depositor base is also increasing over time. It rose by 73.9 percent in CY08 whereas total deposits grew by 45.7 percent in CY08 over CY07.

Assets and Liability Structure

Total assets of the sector stood at Rs. 14.6 billion by end-CY08, registering a growth of 25.5 percent. Increasing trend was observed in advances, which increased by 46.0 percent. The second highest growth was observed in cash due to injection of fresh equity in Kashf and Tameer in CY08. Slight decline was observed in investments and other assets in CY08 over CY07 (**Figure 6.5**). MFBs share in total assets is the highest among MFIs, followed by Rural Support Programs (RSPs) **(Fig 6.6&6.7).**

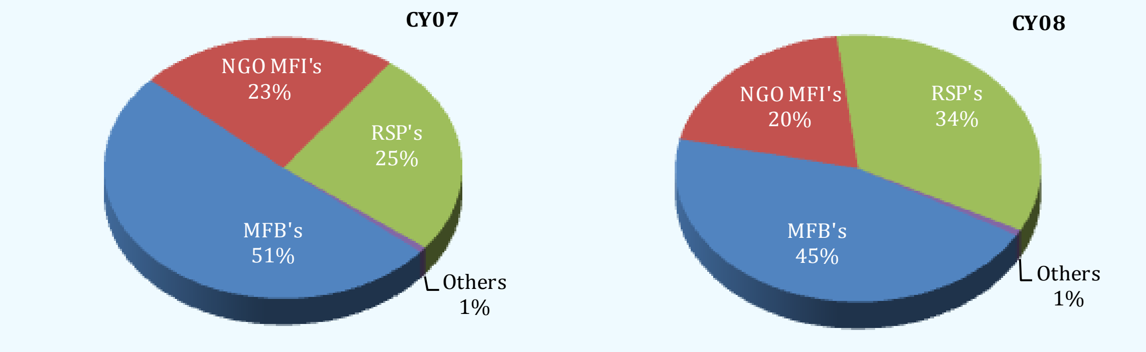
Figure 6.5: Assets of MFB's



Source: MFD, SBP

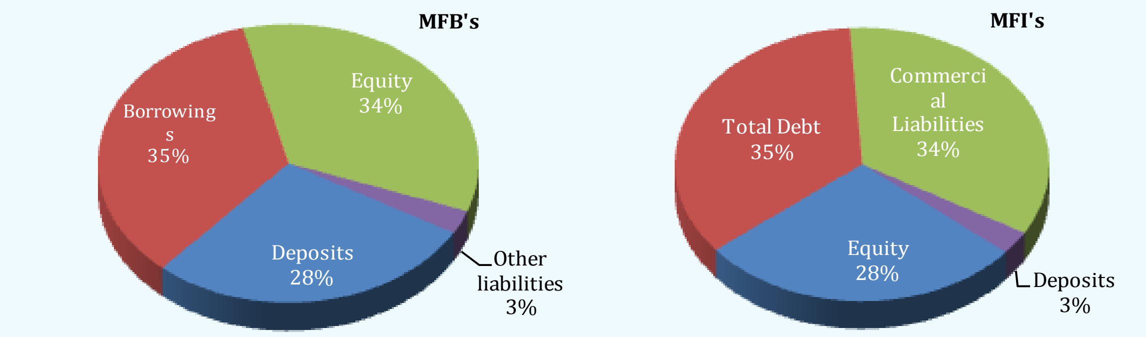
Funding structure of the MFBs is largely based on borrowings. 69 percent of the total funding structure is dominated by equity and borrowings whereas in MFIs 87 percent of the funding structure is driven by equity and debt. The share of borrowings declined to 34.6 percent of total funding from 43 percent in CY07. Growth of 2.4 percent and 42.9 percent was posted by borrowings and equity in CY08. The equity growth is mainly ascribed to addition of fresh equity in two MFBs named Kashf and Tameer.

Figure 6.6: Share of Assets



Source: PMN, Spotlight on Microfinance (Feb, 2009)

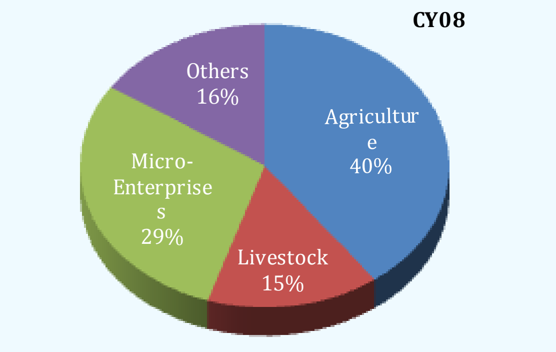
Figure 6.7 Funding Structure -CY08



Source: PMN, Spotlight on Microfinance (Feb, 2009)

Increase in MFBs deposit base by 45.7 percent is seen to be a positive development in the funding structure of the microfinance sector, as apprehensions are often voiced about the ability of the microfinance sector to generate deposits. The microfinance sector as a whole is striving to offer new products in order to attract deposits from clients.

Figure 6.8: Activity-wise Distribution of MFBs Loans



Source: MFD, SBP

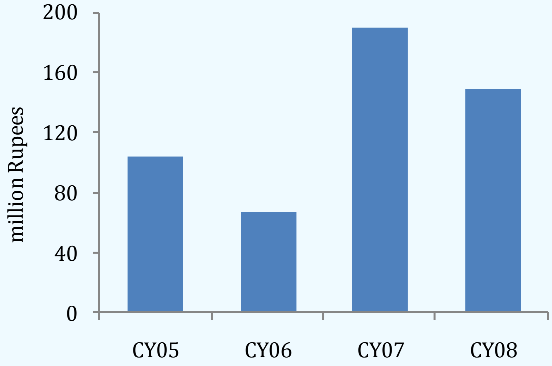
Activity-wise Distribution of MFBs Loans

Largest share of loans is being consumed by the agriculture sector due to the rural areas' dependency on micro loans. The second largest share of loans is being utilized by micro enterprises representing 29 percent of the total loans (**Figure 6.8**).

Gender-wise Distribution of Loans

Gender-wise distribution of loans is an important indicator in microfinance as women empowerment is one of its major aims. Male borrowers' domination was witnessed in MFBs loan portfolio over the years, with 81 percent of the loans disbursed to male borrowers (**Table 6.12**). This share increased by 2 percent in CY08 as compared to CY07. However, in the microfinance sector as a whole, female clients have exceeded the number of male clients and now account for 53 percent of total borrowers. NPLs of the MFBs stood at Rs. 148 million at end-CY08, as compared to Rs. 190 million NPLs in CY07. In December, CY08 NPLs stood at Rs. 148 million, showing a decline of 22 percent (**Figure 6.9**).

Figure 6.9: NPLs of MFBs



Source: MFD, SBP

Table6.12: Gender-wise Distribution of Loans – MFBs

percent

	CY06	CY07	CY08
Male	83	79	81
Female	17	21	19

Source: MFD, SBP

Overall profitability of the microfinance sector not only remained negative but it also deteriorated in CY08. ROA of the overall sector was -7.6 percent whereas it was -6.4 percent in CY07. Similarly ROE was -29.5 percent in CY08, whereas it was -20.9 percent in CY08. These losses are largely due to the high operating and administrative expenses, such that the former increased by 28.3 percent in CY08 (**Table 6.13**). Cut in operational expenditures is one of the needed measures for the sustainability of this sector.

Table: 6. 13 Profitability Indicators for CY08

percent

	MFB	NGO MFI	RSP	Others
Adjusted Return-on-Assets	-9.2	15.7	0.2	5.5
Adjusted Return-on-Equity	29.4	63.9	1.2	20.7

Source: PMN

In sum, this brief review of the microfinance sector reveals encouraging developments in the industry in terms of outreach and expansion of infrastructure over the past few years. However, issues related to the sector's sustainability need to be addressed on a priority basis for the future growth of the sector.

6.2.4 SME financing

Keeping in view the importance of SMEs in an economy, many initiatives have been taken by the government and by SBP to facilitate financing to these enterprises. The 'Small and Medium Enterprises Development Authority' (SMEDA) was established in order to boost the development of SMEs in the economy. A project named "Women Business Incubation Center" was initiated in order to provide support to female entrepreneurs. Likewise, Industry Support Program was started in order to provide technical assistance to different industries in the country. Separate prudential regulations were issued for SME financing by SBP in order to address specific nature of financing needs of the sector. During the year under review the following major steps were taken: setting up of SME Credit Advisory Committee; launching of a comprehensive Capacity Development Program; introduction of Indicative Target Mechanism for Banks in SME Finance; formation of SME Core Group (recommendation paper on Financial Innovation and Capacity Development has already been completed by the Group); setting up of a Credit Guarantee Fund for SMEs in Pakistan under DFID Program; introduction of credit ratings for SMEs in Pakistan; and publication of Development Finance Quarterly Review with the objective of highlighting the role of DFG coupled with concrete information dissemination to all stakeholders.

Outreach

Outreach of the banking sector has improved significantly in the SME sector over the period of assessment. Total number of SME borrowers stood at 215,302, showing 16.35 percent increase in comparison with CY07. Among three categories of borrowers i.e. trading SMEs, service SMEs and manufacturing SMEs, highest share of 41.2 percent of borrowers are represented by trading SMEs.

The overall trend of credit to SMEs is positive over the time. Its outstanding credit stood at Rs. 383 billion in absolute terms at the end of December CY08 showing increase of 12 percent as compared to 16 percent in CY07 (**Table 6.14**). Contraction in the SME credit was mainly due to deteriorating condition of the economy.

Table:6.14 SME Outstanding Loans

billion Rupees

	Dec-04	Dec-05	Dec-06	Dec-07	Dec-08
SME-Outstanding	284.0	361.4	408.3	437.4	383.0
Total Outstanding	1620.4	2043.0	2400.8	2700.9	3191.8
Share in Total Advances	17.5	17.7	17.0	16.2	12.0

Source: SME Finance Department, SBP

Utilization of Credit

The biggest proportion of SME credit is utilized by working capital. Working capital credit is increasing over time but it declined in CY08 by 6.6 percent as the credit to whole industry declined due to weakening macroeconomic indicators. Its share in total SME credit is around 77 percent showing SMEs financing needs to run day to day business operations. The second largest portion of SME credit is utilized by trade finance representing 12 percent of the credit followed by fixed investment, availing 11 percent of the total credit to SMEs (**Table 6.15**).

Table 6.15: Nature of Facilities

billion Rupees

	Dec-04	Dec-05	Dec-06	Dec-07	Dec-08
Fixed Investment	23.91	34.10	41.81	60.27	43.88
Working Capital	204.21	267.70	308.42	309.15	288.78
Trade Finance/Other	55.89	59.60	58.08	67.93	42.32
Total	284.0	361.4	408.3	437.4	375.0

Source: SME Finance Department, SBP

SME's NPLs have been increasing since CY04. Incremental NPLs increased sharply in CY08 by 50 percent when compared to CY07 due to weakening economic conditions which affected the repayment capacity of borrowers.

Table 6.16: Sector and Bank Group wise distribution of SME loans in 2008

million Rupees

Type of Banks	Trading	Manufacturing	Services	Total	Share (percent)
Public Sector Banks	29,110	17,402	8,313	4,825	14.3
Specialized Banks	5,052	3,963	1,035	10,050	3
Domestic Private Bank	100,781	159,991	48,969	309,742	81
Islamic Banks	3,742	2,135	9,489	6,825	2
Foreign Banks	752	761	251	1,764	1
Total	139,437	184,251	59,517	383,206	100
Percent Share	36.4	48.1	15.5	100	

Source: S&DWH SBP

Bank wise and category wise disbursement

Examining the types of banks it is clear that domestic private banks are the largest financiers of SMEs, given their dominant position in banking sector assets. **Table 6.16** suggests that banks are most likely to give credit to SMEs which are in the manufacturing sector, as it accounts for 48 percent of total credit.

6.3 Conclusion

Extending outreach of financial services to the un-banked and underserved areas in a cost effective manner is a major step towards poverty alleviation. Emerging progress in information and communication technology and its widespread usage offers a tremendous opportunity to achieve this goal by making available non-traditional ways of providing financial services. As the domestic banking sector continues to make headway in its efforts to serve under-penetrated sectors of the economy, emphasis on appropriate risk pricing and mitigation procedures would be required in order to ensure sustainable growth and minimizing existing vulnerabilities.

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