Celebrating the past: Shaping the future

STATE BANK OF PAKISTAN

Development Finance Conference

"Expanding Frontiers of Financial Access in Pakistan"

Karachi, July 1 of 2008

SUMMARY OF CONFERENCE PROCEEDINGS

1. The Development Finance Conference held at the State Bank of Pakistan on 1st July was attended by over 250 policy makers, practitioners, donors, academics, and other stakeholders. The Conference was inaugurated by Syed Yousuf Raza Gilani, Prime Minister of Pakistan.

2. Dr. Shamshad Akhtar, Governor SBP, after welcoming the Prime Minister and guests, unfolded a 10-year strategy for financial sector development. Dr. Akhtar expounded that the strategy will position financial markets to better serve a large segment of population and geography and the growing demands for investment and infrastructure and address the exposure associated with the emergence of financial conglomeration in the country that poses a systemic risk to banks. The strategy will aim to diversify financial markets by launching reforms of securities and debt markets, as well as the insurance and pension sectors. She highlighted that within the region, Pakistan's financial system, despite its growth, is still small relative to the Asian emerging financial markets that are twice or three times larger, and the Gulf States. while outlining the objectives of the financial sector strategy, she hoped that broadening and deepening of the financial system will help Pakistan to: (i) achieve higher and sustainable economic growth, (ii) develop a dynamic, robust and stronger system, (iii) mobilize the domestic and foreign resources for private investment (which has to be the key driver of the economy), and (iv) deepen financial penetration for the poor and underserved regions.

3. Prime Minister Syed Yousuf Raza Gilani inaugurated the one day Development Finance Conference. Mr. Gilani highlighted current economic challenges and reiterated the Government's firm resolve to restore macroeconomic stability through proper coordination between the monetary and fiscal authorities. Mr. Gilani welcomed State Bank's effort to establish a holistic Development Finance Group to broaden and deepen financial access across the country to meet the requirements of the economy, infrastructure and industry, and the population at large. He said efforts to develop a regulatory framework and guidelines for agriculture, livestock, fisheries etc. as well as for

SME, Housing and Microfinance, are going to catalyze lending and added proper training being delivered for specialized lending will also contribute to this goal.

4. This was followed by four sessions focussing on microfinance, agricultural/rural financing, SME financing and low-income housing finance were held. Prominent international speakers in each of these four areas gave their views on strategies to promote an inclusive financial sector that offers appropriate products and services; panelists added their perspectives on improving outreach in each of these areas.

5. The Conference afforded an opportunity to contemplate ways of "Expanding Frontiers of Financial Access in Pakistan". It became clear from the discussions in the Conference that we must view the prism of challenges and opportunities of financial inclusion from varying angles and come up with a comprehensive set of policy, regulatory and implementation measures. In fact, these prescriptions cannot be static and must evolve to tackle generations of problems as we do in traditional banking.

6. **Key Messages of the Conference:** During the Conference, it was observed that a common thread of principles serves as the foundation of promoting inclusion:

    a. **First**, inclusion is an undertaking not of a few institutions but of a diverse range of players that are able to forge partnerships across sectors to enable access.
    b. **Second**, the drive for inclusion must not target credit only, rather ought to promote alternative products such as savings and insurance, which are the main financial drivers of poverty reduction.
    c. **Third**, as historically witnessed in Pakistan and other countries, institutions that have time bound support from the public sector are likely to fare better than their counterparts who are supported without a clear strategy for public players. Hence, the State Bank will act to curb market failure rather than take the place of private sector institutions.
    d. **Fourth**, there is urgent need to develop cost-effective delivery mechanisms through use of technology and the State Bank has issued branchless banking guidelines to allow financial institutions to build synergies with other service providers.
    e. **Finally,** principles of best practice dictate that development finance will flourish with an extensive understanding of final consumers in mind and their response to product offerings. With this mode of understanding, the financial market in Pakistan can expand to cater not only to the corporate sector, which has limits for growth, but go down-market and expand.

Session 1: Microfinance strategy: towards providing cost-effective opportunities

(Speaker: Mr. Steve Rasmussen, Lead Advisor World Bank/CGAP, **Panelists:** Mr. Hussain Tejani, CEO First Microfinance Bank, Dr. Rashid Bajwa, CEO, NRSP, Mr. Mohammad Ghalib Nishter, President Kushhali Bank, Ms Sadaffe Abid, CEO Kashf Foundation, **Moderator:** Mr. Haroon Sharif, Senior Adviser, DFID)

7. Specific challenges and opportunities have presented themselves in front of us in different industries. The conference participants concurred that the target for microfinance borrowers for three million clients by 2010 will be met. However, it is absolutely critical that growth is backed by sustainable and strong institutions for us to ensure long-term availability of microfinance in Pakistan. While SBP is already taking concrete steps for development of the sector in Pakistan through regulations and credit guarantees and smart subsidies, market players must especially play a strong role, particularly, in laying the groundwork for strengthening human resource capacities through training programs and appropriate market based incentives. There is also great potential for unleashing the benefits of technology after the introduction of appropriate policy framework through branchless banking in the microfinance sector and beyond.

8. The microfinance session panel discussion highlights included:

    - There is immense potential of technology to deliver financial services especially payment services. An MFB is already experimenting with technology and is conducting a pilot program.
    - The 3 million target for microfinance borrowers will be met, however growth is slowing down and one panelist suggested that there is a possibility that the 10 million mark may be missed as intermediation costs are still high.
    - Persistence of lack of diversified products especially those effective in poverty alleviation such as health insurance and savings.
    - As the number of MFBs has risen recently, their market share will rise in the years to come.
    - Policymakers and practitioners need to decide the kind of business model best suited to Pakistan's microfinance sector: large banks or grassroots organizations such as credit unions and NGOs conducting microfinance. The regulatory structures for both models will be different.
    - MFBs suggest that there is not a level playing field with commercial banks as they do not have access to the clearing house.

SESSION 2: Expanding Outreach of Agri/Rural Financial Products & Services

(**Speaker:** Mr. Benedicto S. Bayaua, Secretary General, Asia Pacific Rural & Agricultural Credit Association (APRACA), **Panelists:** Mr. Zakir Mahmood, President HBL, Dr. Qadir Bux Baloch, Agriculture Development Commissioner MINFAL, GOP, , Mr. Muhammad Ashraf Khan, Director ACD SBP **Moderator:** Mr. Ali Munir, SEVP, MCB Bank Ltd.)

9. There are many good reasons to invest in agriculture. The rewards can be impressive. Agricultural research and extension yield returns of around 35 percent in Sub-Saharan Africa and 50 percent in Asia, according to the latest *World Development Report* of the World Bank. In addition, rural finance, as reiterated in today's conference, is a powerful tool to fight poverty, in a country, which remains largely rural. Moreover, rural financial

services for on-farm and off-farm activities will ensure macroeconomic and microeconomic gains for the country particularly in times of a global food crisis. Traditional and alternative financial institutions will maximize profits and serve markets well by defining target clientele across income segments and other relevant socio-economic characteristics given the broad needs of the market. The introduction of new products especially insurance for crop and livestock by companies exploring market niches is commendable, but must be scaled-up to make deeper inroads in the largely under-developed sector of rural finance in Pakistan. These products could be delivered by a number of institutions including insurance companies, banks, microfinance banks, credit unions and cooperatives and others as country experience indicates proliferation of a type of institution depends on a country's cultural environment and no single type of institution has particularly higher chances of success.

10. In the hour discussion on rural finance, the following points were raised:

    a. Knowing the market size is essential. In Pakistan little information about farmers exists as we do not know the number of farmers in Pakistan. For instance in Thailand, all farmers must register with a bank regardless of being borrowers.
    b. Identification of the poorest groups is also important. Fishermen tend to be the poorest as they are landless.
    c. The bank led model is often an inefficient model for promotion of rural finance. However, there are exceptions. BRI has an efficient commercial model in India.
    d. As minimum capital requirements are high in Pakistan, it may be difficult to set up rural banks and the structure may not suit the needs of the people. An alternative suggested was to operate many small banks with low capital requirements, regulated by apex institutions at the provincial level.
    e. Products suited to the needs of the agricultural sector do not exist for instance crop insurance does not exist in Pakistan.

SESSION 3: SME Finance: Scaling up innovations and tackling constraints

(Speaker: Greg Rung, Principal, Oliver Wyman, **Panelists**: Mr. Shahid Rashid, CEO SMEDA, Mr. Shehzad Naqvi, President ABN Amro Bank, Mr. Khawaja Iqbal Hassan, President / CEO NIB, Mr. Mansoor Hassan Siddiqui, Director SMED SBP, **Moderator:** Mr. Kaiser H. Naseem, IFC)

11. More than 95% of the SMEs in Pakistan remain untapped by a variety of financial service providers. SME finance in Pakistan is a huge potential market for banks if products are tailored to the needs of the market. Reducing transactions costs is particularly important for enabling access for enterprises that are small in size as anecdotal evidence suggests that they tend to remain ignored in lending. Small enterprises in particular, need to be bolstered with business development activities of institutions including SMEDA and others. Moreover, some of the challenges of SME credit scoring that have been identified particularly in data collection inputs for the SME scorecard requires extensive cooperation between the regulator, government and market players.

12. The session on SME finance highlighted the following key points:

a. Use of mobile phones can transform banking especially in the area of SME finance as it will drastically lower costs
b. Lending to SMEs is risky as loss loans are higher and the ability to charge costs to ensure commercial viability is important
c. In order to tap into the SME market effectively, banks must think about SME finance differently and not think of an SME as a small corporate.

SESSION 4: Expanding Housing Finance to Lower Income Groups

(Speaker: Mr. Olivier Hassler, Senior Housing Finance Specialist, World Bank Washington, **Panelists:** Ms. Ashna Mathema, Specialist Housing for the poor, World Bank, Mr. Aun Rehman-Country Director, Acumen fund Pakistan, Mr. Munir Kamal, President KASB Bank, Mr. Rizwan Pesnani, Director-IHFD, SBP, **Moderator:** Mr. Zaigham Rizvi, Chairman HBFC)

13. Low income housing finance does not only provide people the chance to build a home, but collectively develop planned cities and reduce urban slums and diversification of risk for lenders and developers. These are important considerations for SBP to assist in expanding the housing finance market. Challenges that persist include:
    a. High housing prices
    b. Weak land titling systems
    c. Inappropriate products for the lower segment of the market

    However, the presence of Islamic banks is promising and they are likely to explore housing finance as an important target market. The challenge in down-scaling their product suited to the lower income segment, however remains. The subprime lending crisis, while likely to not occur in Pakistan, has significant lessons for us as responsible lenders of which, the most important one is to pay attention to fundamentals of the borrowers.

14. For the development of low Income housing, public housing finance scheme and public private partnerships were considered essential. Panelists considered that:
    a. Demand for housing in Pakistan exists due to rapid urbanization
    b. There is severe shortage of land around cities and good policy requires that high rise buildings are financed.
    c. US housing model may not be the best one to promote as history of ghettos has shown.
    d. There is need to implement a public housing finance scheme by the government
    e. People require basic structures with three rooms to move in and require financing to support such simple structures. However building housing schemes is not enough as people also need access to adequate sanitation, water and other facilities.
    f. Financing for low income housing should go to developers and for people through NGOs or microfinance institutions. In Pakistan, *Saiban* is working with Acumen Fund on low income housing finance in slums.

15. Mr. Jameel Ahmed, Executive Director SBP in his concluding remarks highlighted the significance of the day's proceedings. While summarising the proceedings of the day he observed that, a common thread of principles serves as the foundation of promoting inclusion. First, inclusion is an undertaking not of a few institutions but of a diverse range of players that are able to forge partnerships across sectors to enable access. Second, the drive for inclusion must not target credit only, rather ought to promote alternative products such as savings and insurance, which are the main financial drivers of poverty reduction. Third, as historically witnessed in Pakistan and other countries, institutions that have time bound support from the public sector are likely to fare better than their counterparts who are supported without a clear strategy for public players. Fourth, principles of best practice dictate that development finance will flourish with an extensive understanding of final consumers in mind and their response to product offerings. Finally, country experience indicates that development finance, while challenging is not an impossible undertaking. He reiterated SBP's commitment towards creating the right incentives for a dynamic, robust and inclusive financial sector in Pakistan. He thanked the participants for sharing their perspectives on access to finance for all which has afforded SBP an opportunity to contemplate ways of "Expanding Frontiers of Financial Access in Pakistan".