

Development Finance Review 2007

A joint publication of the Development Finance Group of SBP &
Development Finance Support Department, SBP-BSC

21 June 2008

The Team

DFG-SBP Team

Dr. Saeed Ahmed

dr.ahmed@sbp.org.pk

Sadaf Zahid

sadaf.zahid@sbp.org.pk

Muhammad Ashraf Khan

ashraf.khan@sbp.org.pk

Mansoor H. Siddiqui

mansoor.hassan@sbp.org.pk

Dr. Muhammad Saleem

saleem.zia@sbp.org.pk

DFSD - SBP BSC Team

Saleem Ullah

saleem.ullah@sbp.org.pk

Amjad Maqsood

amjad.maqsood@sbp.org.pk

Mirza Abdur Rehman

abdur.rehman@sbp.org.pk

Shabbir Ahmad

shabbir.ahmed5@sbp.org.pk

DFR 2007

<u>Contents</u>	<u>Page No.</u>
1. Development Finance – An Introduction	5
2. Overview	6
3. Agriculture Finance	7
4. SME Finance	14
5. Microfinance	17
6. Box: Structure and TORs of Focus Groups	22
7. Key Initiatives	23
8. Future Outlook	30

Development Finance Review –2007

Introduction

Development finance may be broadly described as an extended branch of development economics that explores strategies for providing financial resources to productive sectors of economy with focus on under-served by financial market conditions. Catering to the financial services needs of the sectors it helps enhance the productive capacity of the economy by financing industrial projects, SMEs, agriculture and micro enterprises etc. The State Bank of Pakistan (SBP) defines development finance as provision of financial services to SMEs, agricultural & rural communities, microenterprises and to housing & infrastructure projects. Lack of adequate financial resources has been one of the key impediments in the development and growth of these sectors to their real potential.

Concerted efforts have been made in the past both by Federal and Provincial Governments and SBP to increase flow of funds to these sectors. Interventions in the past subsidized and focused on directed credit schemes. These efforts met with no or limited success and resulted in misallocation and mis-utilization of resources, limited outreach to the target clients, poor credit culture, huge stocks of non-performing loans (NPLs) and non-development of financial markets to serve these sectors.

SBP since last 6-7 years has adopted market oriented approach to achieve a sustained growth in flow of financial services to the un-banked/under banked sectors and regions. SBP's *Financial Inclusion Strategy* envisages development of an inclusive financial system to cater to the financial services needs of all segments of the society and all sectors/sub-sectors of the economy. An Development Finance Group (DFG) has been set up in SBP to spearhead all development finance related initiatives of SBP. Mandate of Agriculture Credit Department (ACD) has been broadened to facilitate development of a self sustainable rural finance sector. Separate Departments have been set up to exclusively focus on improving flow of financial services to SMEs, microenterprises and households. In addition, a dedicated Infrastructure and Housing Finance Department (IHFD) was established in the bank in September 2006. To guide development finance policy, a focused Financial Inclusion Program Office (FIPO) has been recently set up which is also mandated to coordinate, design and implement donor-supported initiatives. Finally, the creation of Development Finance Support Department (DFSD) within the SBP Banking Services Corporation (BSC), in the second half of 2007, to provide field presence to DFG for continuous interaction with the stakeholders at grass roots level was another significant initiative. The DFSD since then has established units in 13 BSC offices and made them operational.

This paper reviews developments in the sector during 2007. Core focus of DFG is to enhance outreach level. It collates a consolidated account of the country's development finance, the

outreach levels achieved, the capacity of banks to serve the sector, and the major issues and key initiatives.

1- Overview

Recognizing that access is critical for dispersing benefits of economic growth across all regions and segments of society, SBP has introduced a policy focused on inclusion of people within the formal financial sector. Development finance focuses on an agile policy and regulatory environment creating a framework to minimize market failures. SBP is encouraging financial market innovations and addressing structural weaknesses across sectors through credit enhancement mechanisms, capacity building across market participants, introducing smart subsidies and creating new avenues for credit distribution especially Islamic financing alternatives.

From 2003 to 2007, despite phenomenal growth of the banking industry, the financial penetration has been low in Pakistan- the overall outreach expanded by 117%. The microfinance sector, which includes MFBs, specialized NGOs and Rural Support Programs, comprised a major share spearhead the Development Finance sector growth during CY07 with 342.4% rise in active borrowers. Growth in agriculture sectors' borrowers remained modest, while SME grew by 78% over four years.

Table 1.1: Outreach of Borrowers, 2003 to 2007

Sector s	Number of Borrowers in Dec 2003	Number of Borrowers in Dec 2007	Percentage Growth
Corporate	17,743	27,054*	52.5
SMEs	91,663	163,213	78.1
Agriculture	1,411,508	1,517,820	7.53
Consumer Finance	721,201	3,014,556*	318.0
Mortgage Loans	425,468	480,569	13.0
Microfinance Loans	332,548	1,471,295	342.4
Others	135,561	126,445*	-6.7
Total	3,135,692	6,800,952	117.0

Source: SBP, PMN, HBFC. The figures marked with asterisk are from September 2007

A 24.2% share of Development Finance in total credit is in sharp contrast to about 51% combined share of Agriculture and SMEs in GDP and about 87% in employment¹. The corporate sector on the other hand absorbs 52% of total credit which is much higher than its

¹ Calculations derived from the figures mentioned in Box 2.2 of the SBP Annual Report 2006-07, page No. 25.

share in GDP². These numbers are indicative of low level of penetration by banks in the Development Finance sector.

Despite these discouraging statistics, several measures are underway to ensure a turnaround. In 2007 licensed institutions have started viewing the development finance sector as a viable market. Particularly, domestic private banks have begun developing capacities for increasing outreach of financial services in unbanked/under-banked areas. Banks especially interested in financing agriculture increased agri. Loan officers by 181 in CY07. SBP has continued strengthening the Development Finance Group. The previously SME & MF Department was segregated to form SMED and MFD to exclusively focus on their respective sectors, and the DFSD and its units in field offices were established as local contact points for continuous interaction with the stakeholders at grass roots level. These measures will result in growth in non-traditional banking and increase the number of banked people in Pakistan.

2- Agriculture Finance

Agriculture sector though continuously losing its share in national income, which slipped to about 20.9% in FY07, is a sector of strategic importance for the country. It still employs 43% of labor force, constitutes significantly to our exports in the form of rice and cotton-based products and is a major source of livelihood for the country's population living in rural areas. In line with the Government's declared priority of uplifting the agricultural sector, State Bank of Pakistan has taken several initiatives during the last 6-7 years to ensure adequate flow of agricultural credit through banks which, inter alia, include simplification & standardization of loan documents; induction of 14 domestic private banks into agri credit scheme apart from 7 Banks (5 major viz. ABL, HBL, MCB, NBP & UBL and 2 Specialized viz. ZTBL & PPCBL); introduction of three years revolving credit scheme with one time documentation and automatic renewal on annual cleanup of principal plus markup for production loans to farmers; booklets & brochures of SBP's schemes and policies have been translated & published in Urdu & other regional languages; separate prudential regulations for agri financing; guidelines for livestock, fisheries, poultry and horticulture financing; updated Report for estimation of agricultural credit requirements; formulation of local advisory committees at SBP BSC offices to resolve problems of the farming community locally; allowed banks to finance against two personal sureties (up to Rs.500,000) in addition to passbook of the land etc.; issuance of financing scheme for small farmers on group based lending methodology; banking facilities for the farmers of Karachi Cattle Colony; training & awareness programs for the banks and farming community.

These initiatives have paid dividend in the form of robust increase in agricultural credit disbursements by more than 300 per cent since 1999-2000. To ensure sustainability in flow of agri. credit and effective implementation of SBP's initiatives, a separate Development Finance Support Department (DFSD) and its subsequent units were established at SBP BSC Offices. These units would focus on developing a network in collaboration with local banks and farming community. The forum will provide a platform for the awareness of banks and farming

² Roughly supposed to be around 35% and includes finance & insurance sub-sectors which are not recipients of bank credit.

community about SBP's schemes and policies on agri. finance. It will also facilitate in streamlining the issues of implementation of these policies at grass-root level.

In the way forward, SBP is in the process of hiring international consultants for capacity building of selected banks in agri. business development & diversification project. Further, as the agri. financing is a highly risky area for financial institutions due to the risk of losses involved because of natural calamities, therefore, in order to mitigate the risk of banks and farming community against losses caused by the natural calamities, SBP has developed a Crop Loan Insurance Framework with the help of a Task Force comprising of representatives of banks, Securities and Exchange Commission of Pakistan, Pakistan Agriculture Research Council, MINFAL, farmers associations and leading insurance companies.

There has always been a great demand from agricultural customers for Islamic financing products for agriculture sector. Islamic banks and Islamic Banking Branches (IBBs) of conventional banks have also shown their great interest in adopting Shariah Compliant agriculture finance as a viable business line. However, there was lack of awareness of Islamic Modes of Financing among traditional agri. financing bankers and Islamic Banks are also naive to the requirements and business cycles of farm and non-farm sectors in the country. Therefore, a Task Force for Agri Financing was constituted by SBP, comprising experts from agriculture & Islamic banking and Shariah Advisers of banks. It was aimed at preparing guidelines to help banks to develop their own Shariah compliant products for financing to agriculture sector. The guidelines are being finalized and will be issued shortly.

SBP has developed a strategy to double the agri credit disbursement and number of agri borrowers in next 3-4 years. The strategy will be reviewed by the consultants under the Financial Inclusion Program financed by DFID (UK).

These initiatives have paid dividend in the form of phenomenal growth in agri credit disbursements over the last 6-7 years and reached Rs.169 billion in FY07 from Rs.45 billion in FY01. The target for the FY 08 is Rs.200 billion which is likely to be achieved conveniently as about 93% of the target was achieved during the first 11 months of FY08. Though the number of new borrowers has increased significantly during last 3-4 years, it was offset by a large number of write-offs by ZTBL to its farmers of calamity affected areas announced by Government of Sindh & Balochistan. As such, the number of agriculture outstanding borrowers has remained around 1.5 million.. Similarly, the pace of growth in outstanding Agri-credit portfolio could not match the pace of growth in the disbursements due to revolving credit scheme that allows borrowers for renewal of credit limit based on regular clean up at least once in a year. The revolving credit constitutes around 85% of banks agri production loans.

Table 2.1: Banks' Agri Finance Outreach Levels (Nos.)

Bank Group	Total Branches (No.)		Agri Finance Branches		Agri Finance Officers		No. of Borrowers	
	Dec., 06	Dec., 07	Dec., 06	Dec., 07	Dec., 06	Dec., 07	Dec., 06	Dec., 07
	5 Big Commercial Banks	5427	5523	3080	2792	727	724	473898
Domestic Private Banks	1323	1491	379	434	423	495	59553	61967
Specialised Banks	501	501	500	500	3232	3344	993152	1020390
Total	7251	7515	3959	3726	4382	4563	1526603	1517820

Source: SBP, Agriculture Credit Department

Banks' Agriculture Finance Capacity

While the total bank branches/units operating in the country increased by 3.6% to 7,515 during CY 07, the Agri finance branches reduced by 5.9% to 3,726 in Dec.07 from 3,959 as at close of CY 06 (Table 2.1).The reduction only came from five big commercial banks whose Agri-finance branches reduced to 2,792 at end-Dec.07 from 3,080 in Dec.06. Amongst the five big banks, MCB's Agri-finance branches reduced by 270 and that of HBL's by 64. While there was no change in the agri-finance branches of NBP and ABL, the UBL's agri-finance branches increased by 46 to 614 as at end-Dec.07. The DPBs' Agri-finance branches increased to 434 in CY07 from 379 in CY06, which is in line with their growing interest in the sector and their rising agri-credit portfolio. The geographic depression of reduction in Agri-finance branches shows that AJK lost 14%, N.W.F.P. 8%, Sindh 7% and Punjab 5% of their Agri-finance branches. In absolute terms, Agri-finance branches in Punjab and Sindh reduced by 134 and 39 respectively. One of the main reasons of closing down or shifting of branches to the urban areas was the high cost and non-profitability of the rural branches. Therefore, in order to increase the rural branch net-work, SBP has made it mandatory for them to open at least 20% rural branches while opening the new ones. Moreover, to reduce operational / administrative costs of agri. / rural financing and increasing outreach of financial services to rural community, SBP has allowed banks to adopt concepts of branch less banking and open sub branches, special booths and service centers in remote areas.

The Agri-finance officers (AFOs) however increased to 4,563 in CY07 from 4,382 in CY06. A major chunk of the AFOs was with specialized banks viz. ZTBL and PPCBL; ZTBL alone had (73%) 3,185 as of Dec. 07 AFOs compared to 3,073 as of Dec.06 whereas PPCBL's AFOs remained unchanged at 159. The 5 big commercial banks registered a nominal reduction in the AFOs, which reduced to 724 in CY07 from 727 in CY06. The DPBs' AFOs however increased to 495 in CY07 from 423 in CY06 which is again in line with their growing interest in the sector.

The number of borrowers outstanding almost exhibits the similar trend with 5 big commercial banks registering a decline of more than 38,000 borrowers and DPBs and specialized banks recording an increase of 2414 and 27238 borrowers respectively³. One of the major reasons for the decline in number of borrowers by five big banks has been frequent write offs due to natural calamities and cleaning of defective agri credit portfolio by these banks in last 2-3 years.

Ratios	5 Big Commercial Banks		Domestic Private Banks		Specialised Banks	
	Dec., 06	Dec., 07	Dec., 06	Dec., 07	Dec., 06	Dec., 07
%age of Agri-finance Branches	56.75	50.55	28.64	29.11	99.8	99.8
Agri-officers per Branch	0.24	0.26	1.12	1.14	6.46	6.69
Borrowers per Agri Branch	154	156	157	143	1986	2041
Borrowers per Credit Officer	652	601	141	125	307	305
Loan per Credit Officer (in million)	74.1	76.3	36.5	46.1	23.6	25.1
Loan disbursed per Credit Officer (Rs. mn.)	47.2	62.1	24.1	38.6	8.4	7.9
Average Loan Size (in Rs. million)	0.114	0.127	0.256	0.369	0.077	0.082

Source: SBP, Agriculture Credit Department

The Table-2.2 highlights some more indicators of banks' agri-finance outreach levels. The share of agri finance branches to total branches of 5 big commercial banks declined to 51% in CY07 from 57% in CY06; it however remained almost unchanged for DPBs and Specialized Banks at 29% and 100% respectively.

³ The surge in number of borrowers of specialized banks is unusual and may be due to some data reporting errors by ZTBL. ACD has already taken up the issue with the bank.

The five big banks on average had one Agri-finance officer (AFO) for four Agri-finance branches with individual bank's average ranging from 3 Agri-finance branches per AFO to 11 branches per AFO. One of the 5 big banks⁴ had 18 AFOs to serve its 200 Agri-finance branches and manage a portfolio of Rs.5.1billion. It hired 10 AFOs during CY07 as the number was just 8 in CY06. While reviewing the number of AFOs, traditional structure of 5 big banks needs to be considered where one AFO feeds around 3-5 branches of the area. Under the system, its role was to ascertain the credit needs of the agri borrowers and technical advice on the documentation to the branch. The rest of the system was being carried out by regular branch staff/credit officers. However, under the revamping, these banks are establishing specialized departments and hiring new AFOs to meet the credit requirement of rural/farming community. The DPBs being new in the area have adopted the specialized approach from the beginning of agri credit portfolios and on average had more than one AFO per Agri-finance branch and added 72 AFOs in their fold during CY07. Amongst the DPBs, Askari Bank hired largest number of 79 AFOs during CY07, Bank of Punjab's number of AFOs also increased by 23 to 138 during the year; Bank Al-Falah another active bank in the sector however registered a decline in its AFOs, which reduced to 71 from 86 during the year. The specialized banks on average had 7 AFOs per branch; only ZTBL, the largest Agricultural bank in the country, had 3,185 AFOs.

The average loan size of each of the three groups of banks is reflective of the market segment being targeted by them; the specialized banks with lowest average loan size of Rs.82,000 per borrower are targeting the low end farmers; 5 big commercial banks with average loan size of Rs.127,00 focusing on small farmers, whereas the DPBs with average loan size of Rs.369,000 are covering relatively large and medium sized farmers.

Table 2.4: Consolidated Position of Agriculture Credit (July-Dec. 2007)

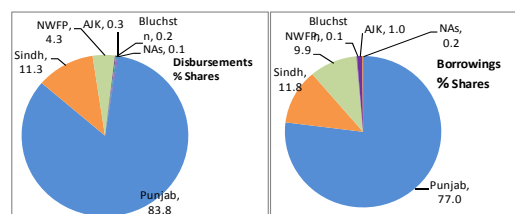
Province/ Regions	Disbursements during July-Dec. 2007		No. of Borrowers Served during July-Dec. 2007	
	Amount (Rs. million)	% Share	No.	% Share
Punjab	75,639	83.8	374,106	77.0
Sindh	10,224	11.3	57,236	11.8
NWFP	3,871	4.3	47,996	9.9
Bluchstn	199	0.2	640	0.1
AJK	229	0.3	4,977	1.0
NAs	116	0.1	1,049	0.2
All Pakistan	90,278	100.0	486,004	100.0

Source: ACD

The banks particularly five big banks are actively working to strengthen their agri credit departments, a number of new AFO are being hired, new innovative products are being developed, recovery teams are being established, modalities are being finalized for collateral free group based lending and increasing outreach on fast track basis.

Inter-Province Analysis of Agriculture Credit Distribution

The Table-2.4 & 2.4b below give province wise position of agriculture credit disbursements during Jul-Dec. 07 and outstanding portfolio at end-Dec.07 respectively. The Punjab Province fetched 84% of disbursements made during Jul-Dec. 07, accounted for 77% of total agri borrowers served during the period and 82% of outstanding portfolio. Sindh absorbed 11% of disbursements, 12% of borrowers served and 11% of total outstanding agri-finance as portfolio. The farmers in N.W.F.P. though obtained just 4.3% of total agri credit disbursed during Jul-Dec. 07, they accounted for 9.9% of the borrowers served which is



⁴ MCB

Table 2.4b: Outstanding Agriculture Credit

Province/ Regions	Outstanding Agri Credit as of end-Dec. 07	
	Rs. Bn.	Ratio %
Punjab	132,165	81.53
Sindh	18,449	11.38
NWFP	8,586	5.30
Baluchstn	1,869	1.15
AJK	631	0.39
NAs	412	0.25
All Pakistan	162,111	100.00

Source: ACD

indicative of relatively smaller loan amounts being disbursed and the low end small farmers being served by banks in the province. Baluchistan, AJK and Northern Areas accounted for less than 1% of disbursements, which among others is attributable to limited agricultural activities in the region, law and order issues, difficult terrains, highly dispersed population and limited presence of banks.

Credit Distribution and Agricultural Activities – An Exposition:

The dispersion of agri-credit across the four provinces is largely in line with the agricultural activities and thus the absorptive capacity of farmers of the four provinces. The Tables 2.5 & 2.6 and associated charts exhibit share of each of the four provinces in production of the four major crops, fruits and vegetables and livestock. Punjab produces 79% of country’s wheat and cotton, 57% of rice and 66% sugarcane. It also produces 67% of fruits and 74% of vegetables and has a 65% share in rearing of

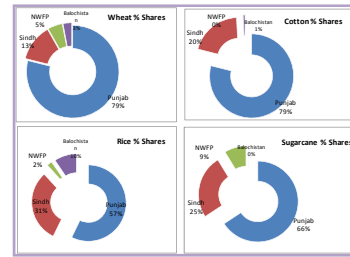


Table 2.5: Province-wise Production and % ShareS of Major Crops - 2005-06

Provinces	Production in '000' Tonnes							
	Wheat		Cotton		Rice		Sugarcane	
	Production	% Share	Production	% Share	Production	% Share	Production	% Share
Punjab	16776	78.8	10268	78.9	3180	57.2	28969	65.7
Sindh	2750	12.9	2648	20.3	1721	31.0	11243	25.5
NWFP	1101	5.2	5	0.0	127	2.3	3834	8.7
Balochistan	650	3.1	98	0.8	529	9.5	15	0.0
Total	21,277	100.0	13,019	100.0	5,556	100.0	44,060	100.0

Source: M/O Food, Agriculture and Livestock, Year Book, 2005-06

Table 2.6: Province wise Prod of Fruits & Vegetables (2005-6)

Provinces	Fruits		Vegetables	
	Prod. Tonnes	% share	Prod. Tonnes	% share
PUNJAB	4764036	66.65	3475462	74.06
Sindh	884332	12.37	211409	4.51
NWFP	519085	7.26	520076	11.08
Bhchstn	980169	13.71	485698	10.35
Total	7147622	100.00	4692645	100.00

Source: MINFAL, Year Book 2005-6

Buffaloes, 49% in cattle, 37% in Goats and 24% in sheep. The accessibility of its rural areas is also significantly better than other provinces, which coupled with relatively better law and order conditions and comparatively proactive and supportive Agricultural and Revenue Departments, makes the farmers of the province more attractive for banks’ lending.

The Sindh Province despite having 13% share in wheat, 20% in cotton, 31% in rice, 26% in sugarcane, 27% in Buffaloes and 23% in Goats, fetches only 11.3% of the agri credit. Its share in agri-credit was about 20% in FY01. The decline in disbursements of agri credit in Sindh was attributed to calamities which resulted in major losses to the farming community of the province. In addition, non-issuance of Passbooks to a large number of farmers by the Revenue Department, wide-spread defaults etc, discouraged banks to expand their outreach in the province.

The Baluchistan Province has also been losing its share in the agri-credit due to declining agricultural activity with most parts of the province experiencing drought-like conditions since the beginning of the new millennium, poor law and order conditions, default culture and frequent government announcements for loan write-offs. The province however has huge potential for development of fruit orchards and livestock, particularly goats and sheep. It has largest share (48%) in sheep and about 22% share in goats,

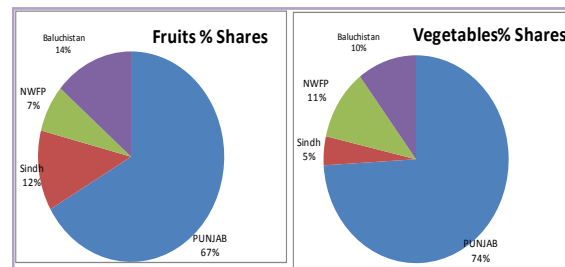


Table 2.7: PROVINCE-WISE POPULATION AND % SHARES OF LIVESTOCKS - 06

livestock	Population in '000' Heads							
	Punjab		Sindh		NWFP		Balochistan	
	Production	% Share	Production	% Share	Production	% Share	Production	% Share
Cattle	14412	48.76	6925	23.43	5968	20.19	2254	7.63
Buffaloes	17747	64.92	7340	26.85	1928	7.05	320	1.17
Sheep	6362	24.02	3959	14.95	3363	12.70	12804	48.34
Goats	19831	36.87	12572	23.37	9599	17.85	11785	21.91
Camels	199	21.61	278	30.18	64	6.95	380	41.26
Poultry	25906	35.18	14136	19.19	27695	37.60	5911	8.03

Source: M/O Food, Agriculture and Livestock, Year Book, 2005-06

which is indicative of the resilience of the province's livestock sector despite heavy odds being faced by the province for quite some time.

Intra-Province (District Level) Analysis of Agriculture Credit

Apart from inter-province disparities, there are intra-province disparities and skewed distribution of agri credit within the Provinces. While, the situation in Punjab is relative better, Baluchistan, Sindh and NWFP have more skewed distribution of credit as well as higher concentration of borrowers in few districts. The following sections discuss the intra provincial disparities in each of the four provinces.

Table-2.9: Districts With Highest Total Production of Four Major * Crops - 2005-06

Production in '000' Tonnes **						
Districts	Total		Districts	Total		
	Total	% Share		Total	% Share	
Punjab	Faisalabad	6406.7	10.8	Charsadda	1479.8	29.2
	Rahimyar K.	5323.6	9.0	Mardan	1439.2	28.4
	Jhang	5248.5	8.9	D.I.Khan	445.4	8.8
	Sargodha	3203.4	5.4	Nowshera	303	6.0
	M. Garh	2963.1	5.0	Malakand	246	4.9
	Prov. Sub. total	59192.2	39.1	Prov. Sub. total	5066.01	77.2
Sindh	Hyderabad	3898.7	21.2	Jafferabad	454.8	35.2
	Badin	2659.2	14.5	Nasirabad	373.5	28.9
	Nawabshah	1672.2	9.1	Khuzdar	112.8	8.7
	Sanghar	1606.9	8.8	Sibi	46.7	3.6
	Thatta	1504	8.2	Chagai	36.6	2.8
	Prov. Sub. total	18362.7	61.8	Prov. Sub. total	1291.2	79.3

Source: W/O Food, Agriculture and Livestock, Year Book, 2005-06
 * The total of four major crops: Wheat, Cotton, Rice and Sugarcane
 ** The sum of four crops may not represent the total value, however, it is taken as a proxy of their contribution.

Table 2.8: Top in Terms of Disbursements & Outstanding of Agri Credit (Rs. Mn) and Borrowers Served (#)

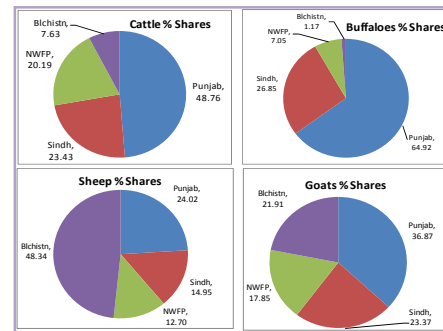
Province	Highest Loan Disbursements		Highest Loan Outstanding		Highest No. of Borrowers Served	
	Rs. Mn	#	Rs. Mn	#	Rs. Mn	#
Punjab	Lahore	10835.8	Jhang	7990.4	Sargodha	25851
	Multan	7283.4	Multan	7382.5	Jhang	23332
	Rawalpindi	7189.9	Rahimyar Khan	7344.9	Bahawalpur	19740
	Jhang	3245.9	Okara	7195.7	Vehari	19279
	Sargodha	3200.8	Sargodha	7108.4	Multan	18579
	Rahimyar Khan	3010.2	Faisalabad	6554.2	Faisalabad	15727
	Faisalabad	2988.9	Gujranwala	5849.5	Gujranwala	15491
	Bahawalpur	2885.8	Bahawalpur	5769.4	Rahimyar Khan	15137
	Okara	2694.3	Lahore	5003.0	Okara	14989
	Vehari	2662.0	Khanewal	4790.8	Muzaffargarh	14423
Province Total (PT)	75639.0		132164.7		374106	
Top 10 Distt. as % of PT	60.8		49.2		48.8	
Top 5 Distt. as % of PT	42.0		28.0		28.5	

Source: SBP, Agriculture Credit Department

Punjab: The table 2.8 gives top 10 districts of Punjab that absorbed highest agri-credit in the Province during Jul-Dec.07. Although the top 10 districts are almost same based on the three

criteria, their

rankings are however different under each criteria. Some districts like Lahore and Rawalpindi have higher rankings with respect to disbursement but lower ranking with respect to outstanding portfolio and number of borrowers.



The top 10 districts of the province account for 49% of total agri borrowers and top 5 districts 29%. The distribution is in line with the agricultural activity in the province. As shown in the table 2.9, the top 5 districts of Punjab with respect to agricultural production are also amongst the top 10 districts with respect to agri-credit.

Sindh: The Table 2.10 gives top 10 districts of Sindh province with respect to agri-credit absorption. The top 10 districts accounted for 85% of borrowers and top 5 districts 66%. This heavy concentration of Agri-credit is attributable to lower number of districts in the province than Punjab, limited penetration of banks in rural/semi urban areas of the province and relatively larger concentration of agricultural activity in few districts of the province. As shown in table 2.9 above, the top 5 districts have

Table 2.10: Top in Terms of Disbursements & Outstanding of Agri Credit (Rs. Mn) and Borrowers Served (#)

Province	Highest Loan Disbursements		Highest Loan Outstanding		Highest No. of Borrowers Served	
	Rs. Mn	#	Rs. Mn	#	Rs. Mn	#
Sindh	Hyderabad	2985.4	Hyderabad	2288.4	Khairpur	11816
	Karachi	1527.8	Khairpur	2058.8	Hyderabad	9780
	Khairpur	1117.6	Sanghar	1637.5	Naushero Feroz	6273
	Sanghar	623.4	Karachi	1418.0	Sukkur	5639
	Sukkur	595.7	Ghotki	1320.8	Ghotki	4464
	Ghotki	493.7	Mirpurkhas	966.8	Sanghar	3362
	Nawabshah	407.1	Nawabshah	966.6	Nawabshah	2687
	Naushero Feroz	330.7	Sukkur	901.1	Larkana	2240
	Mirpurkhas	297.2	Naushero Feroz	840.0	Mirpurkhas	1328
	Larkana	222.8	Kamber & Shadad	798.5	Badin	1282
Province Total (PT)	10224.2		18448.9		57236	
Top 10 Distt. as % of PT	84.1		71.5		85.4	
Top 5 Distt. as % of PT	67.0		47.3		66.3	

Source: SBP, Agriculture Credit Department

62% share in the province's production of major crops compared to 39% in Punjab. Further Thatta and Badin despite being in the top 5 crop producing districts are not amongst the top 10 districts either with respect to disbursements or outstanding credit. Badin with 1282 borrowers is however ranked 10th with respect to number of agri-borrowers served in the province during Jul-Dec07.

NWFP: The top 10 districts of the province absorbed 79% of agriculture credit during Jul-Dec 2007 and accounted for 84% of total borrowers served during the period. Newshehra and Peshawar which are amongst the top 10 districts based on disbursements are not amongst the top 10 districts based on number of borrowers served. Like Sindh Province, about 67% of the borrowers are concentrated in 5 districts in N.W.F.P. viz. Mardan, Swabi, D.I Khan, Chitral, and Bannu. Here again all the top 5 Districts with respect to agri production except Malakand are amongst the top 10 districts with respect to agri-credit absorption.

Table 2.11: Top in Terms of Disbursements & Outstanding of Agri Credit (Rs. Min) and Borrowers Served (#)

	Highest Loan Disbursements		Highest Loan Outstanding		Highest No. of Borrowers Served	
N.W.F.P.	Dera Ismail Khan	649.0	Dera Ismail Khan	1534.6	Mardan	16016
	Mardan	625.3	Mardan	1064.5	Swabi	7037
	Swabi	339.4	Charsadda	781.6	Dera Ismail Khan	4228
	Swat	323.6	Swat	675.8	Chitral	3454
	Charsadda	314.0	Bannu	538.0	Bannu	2756
	Newshehra	260.7	Swabi	486.4	Swat	2605
	Mansehra	208.0	Chitral	423.7	Charsadda	1984
	Peshawar	170.2	Peshawar	413.4	Mansehra	1649
	Bannu	169.1	Lakki Marwat	392.7	Dir Lower	1132
	Chitral	145.2	Fata	357.0	Lakki Marwat	1074
Province Total (PT)	4060.8		9359.7		49924	
Top 10 Distt. as % of PT	78.9		71.2		84.0	
Top 5 Distt. as % of PT	55.4		49.1		67.1	

Source: SBP, Agriculture Credit Department

Baluchistan: This province absorbs nominal amounts of Agricredit and that too by only a few districts. During Jul-Dec.07 almost 93% of the agricredit disbursements in the province went to five districts. Similarly, the financial outreach in terms of borrowers in Baluchistan is highly skewed as 86.3% of the total borrowers served during the period were concentrated in fivedistricts viz; Jafferabad, Neseerabad, Lasbela, Kech (Turbat), and Quetta.

Table 2.12: Top in Terms of Disbursements & Outstanding of Agri Credit (Rs. Min) and Borrowers Served (#)

	Highest Loan Disbursements		Highest Loan Outstanding		Highest No. of Borrowers Served	
Baluchistan	Jaffarabad	60.3	Kech (Turbat)	947.8	Jaffarabad	284
	Quetta	55.4	Jaffarabad	233.9	Nasirabad	158
	Nasirabad	43.9	Panjgur	177.0	Lasbela	43
	Lasbela	17.7	Nasirabad	165.5	Kech (Turbat)	37
	Pishin	7.5	Quetta	103.0	Quetta	30
	Loralai	2.3	Gawadar	51.5	Pishin	27
	Qilla Saifullah	2.1	Lasbela	35.5	Loralai	11
	Ziarat	1.7	Khuzdar	26.7	Khuzdar	7
	Kohlu	1.5	Pishin	24.9	Qilla Saifullah	6
	Nushki	1.2	Loralai	23.9	Kohlu	5
Province Total (PT)	198.9		1868.5		640	
Top 10 Distt. as % of PT	97.3		95.8		95.0	
Top 5 Distt. as % of PT	92.9		87.1		86.3	

Source: SBP, Agriculture Credit Department

3- SME Finance

SME is another strategically important sector of our economy that contributes 30% in GDP, employs about 78% of non-agricultural labor force where SMEs share in total employment is 44% and account for 25% of country's export earnings from manufacturing sector. A very large majority of 3.2 million economic establishments⁵ in the country are SMEs; about 99% of these establishments employ 1-10 employees which is indicative of almost absolute dominance of small and low end SMEs in the country's economic/business establishments. It also highlights huge potential of the sector in employment generation and economic growth.

The total outstanding portfolio of banks to SME Sector has increased marginally by 7.11% to Rs.437 billion in CY07 from Rs.408 billion in CY06 as compared to growth of 13% for the previous year (Table-3.1 & Table-3.2 and the Charts). However, share of SME Financing as part of total outstanding portfolio of banks marginally decreased to 16.19% in CY07. This decline in the share of SME Finance is a reflection of the hardships faced by SMEs. The SME financing has primarily been dwarfed by growth in financing to corporate sector. The mere share of SME Financing in total portfolio of banks reflects a sharp contrast to the sector's contribution toward national income, employment generation and export earnings. This is also an indication of the fact that the sector is underserved.

Facility	Dec-05	Dec-06	Dec-07
Fixed Investment	34.1	41.8	60.3
Working Capital	267.7	308.4	309.1
Trade Finance	59.6	58.1	67.9
SME Credit	361.4	408.3	437.4

Facility	Dec-05	Dec-06	Dec-07
Fixed Investment	12,076	16,191	18,709
Working Capital	141,513	141,140	157,879
Trade Finance	11,064	14,953	12,608
No. of SME Borrowers	161,316	168,233	185,039

Source: BSD

However, during the period CY07 the increase in SME borrowers by 10%, in a way compensated for a slower growth of SME borrowers in previous year. These SME borrowers formed 3.87% of total borrowers of the banks and approximately 5% of total SME establishments in the country. This comparison of SME borrowers with total SME establishments in the country does not depict exhaustive picture as in our opinion a number of small sized self-employed business enterprises may be meeting financing requirements through consumer finance products like credit cards, personal loans, mortgage loans etc. Nevertheless, seemingly over-rehearsed conclusion that SMEs particularly the small sized SMEs are underserved is true.

⁵ The figures taken from Box 2.2 of SBP' Annual Report 2006-07 which refers to FBS, Census of Establishments.

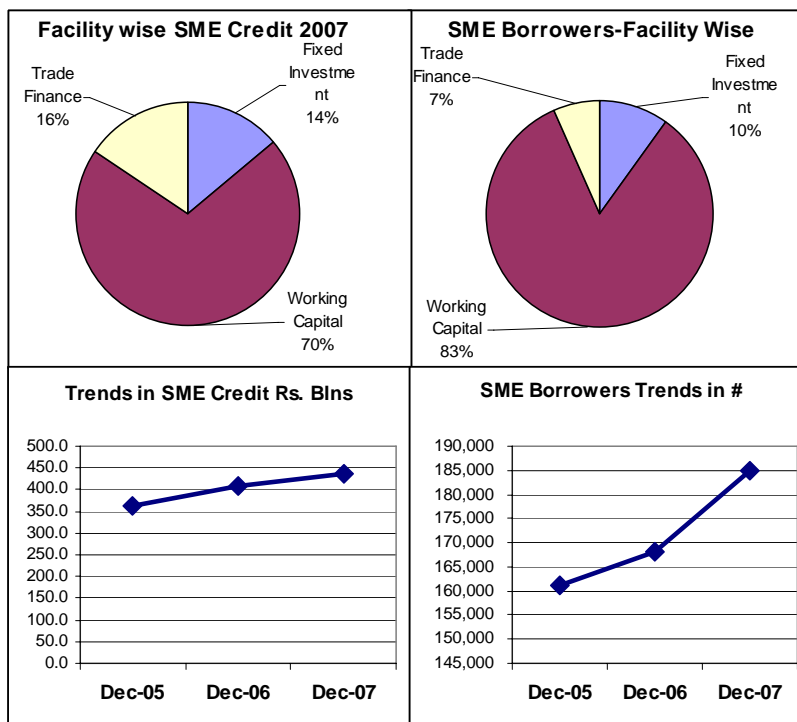
Further, the per borrower outstanding SME financing from banks is Rs. 2.4 million as on Dec-07 which along-with anecdotal evidence gathered by DFSD and its field units in their interactions with SMEs and their associations across the country suggest that most of the SME loans are going to Medium Enterprises while the Small Enterprises (SEs) i.e. ‘S of the SMEs’ still have limited access to banking resources. These SEs are likely to be major affectees of reduction in SME portfolio and SME borrowers during CY07 as they are more vulnerable to shocks like business failures, power shortages, interest rate hikes, political uncertainties etc.

The facility-wise analysis of SME Finance Portfolio shows that an overwhelmingly large proportion of banks’ SME Portfolio (86%) comprises of Working Capital (71%) and Trade Finance (15%) and long-term Fixed Investments

(14%). This becomes more anomalous when compared with financing to Corporate Sector where around 36% of total financing went towards Fixed Investments. This low share of Fixed Investments in SME Portfolio could be one of the impediments for slower

growth of SME Sector in the country. However, against a decreasing trend of share in Fixed Investments to Corporate Sector, its share in SME Portfolio increased from 9% in CY05 to 14% in CY07. The Fixed Investments portfolio grew by 77% since Dec. 05 to Rs.60 billion whereas the number of borrowers availing Fixed Investments facility grew by 55% to 18,709. Further, growth in Fixed Investments Portfolio during CY07 was 44% as compared to 22% in the previous year. This is a positive trend and if continued would substantially improve productive capacity of the sector while creating employment opportunities for both skilled and the semi/unskilled labor force. Further, State Bank would also continue with its efforts to encourage banks for developing specialized SME financing products through its various forums like SME Credit Advisory Committee and the SME Core Group.

While the banks have had this bias against non-traditional sectors; the policies allowing subsidized or directed credit that remained in vogue till mid 90s also did not allow the banks to develop internal capacities to tap such sectors as viable business opportunities. Further, limited success of Business Development Services (BDS) and institutions linked with the development



of SMEs particularly also resulted in limited access towards loans and financial services for SMEs.

In order to address the financial exclusion of SMEs, all the major stakeholders that include SBP, the Financial Sector in general along with Federal/Provincial Governments would need to work in conformity and take corrective measures/ interventions. In this regard, State Bank of Pakistan has adopted a number of initiatives that include, issuance of Prudential Regulations for SMEs, assigning indicative targets to banks for SME Financing, organizing training programs for capacity development of banks, encouraging establishment of credit enhancement mechanisms for SMEs like Credit Guarantee Schemes, credit rating mechanism etc. Going forward, improvement in performance of BDS will also help improve the flow of financial services to SMEs and minimize the level of financial exclusion.

4- Microfinance

The CY 07 proved one of the most remarkable years in the short history of Pakistan's Microfinance (MF) Sector. The National Microfinance Strategy, which envisaged increasing the outreach of the sector to 3 million active borrowers by 2010, was approved by Prime Minister in February 07, SBP established MF Department to exclusively focus on facilitating development of a robust MF sector in the country, and most importantly the remarkable growth of 47% in active borrowers and 41% in Gross Loan Portfolio (GLP) (see Table 4.2). Further the number of active savers increased substantially during the year and reached to 1.53 million from 1.26 million last year (details in Table 4.7). This is indicative of the sector's continued graduation to a financial services' provider from a single product (microcredit) sector till the recent past. This exceptionally fast pace of growth is attributable to increasingly favorable policy environment, growing capacity of Microfinance Providers (MFPs) both in terms of branches/units and trained human resources and rising awareness levels of the low income communities particularly women and microenterprises about the financial services being extended by MFPs. It also gives the optimism that the sector is on track to achieve the medium term targets of reaching 3 million active borrowers set out in the National MF Strategy.

Table 4.1: Analysis of MF Sector's Performance as of End-2007

Parameter \ MFP		CFI	NGO	RSP	MFI	MFB	Total
Branches/Units	(No.)	22	77	758	217	269	1,343
Active Borrowers	(No.)	17,823	76,594	530,939	369,032	476,909	1,471,297
Gross Loan Portfolio	Rs. Min.	342	844	5,694	3,552	4,702	15,134
Average Loan Balance	(Rs.)	19,167	11,014	10,724	9,626	9,860	60,391
No. Of Loans Disbursed	(No.)	12,888	70,409	640,885	536,023	490,396	1,750,601
Disbursements	Rs. Min.	273	889	9,136	6,036	6,273	22,607

Source: PMN

Share of MF Banks/Institution/NGOs (%) as of Dec. 2007

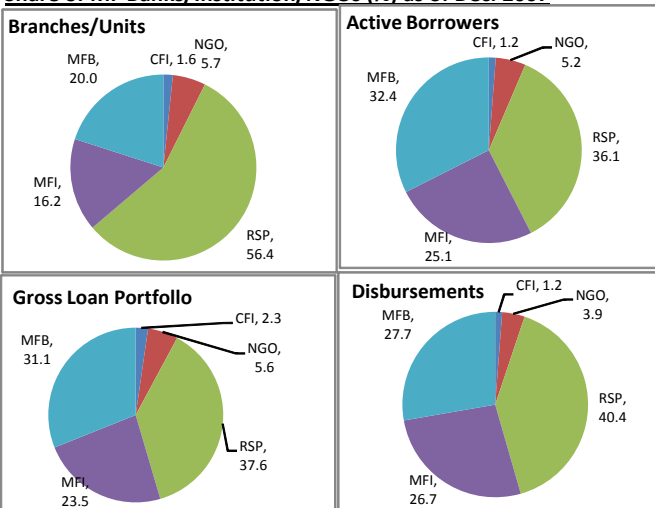
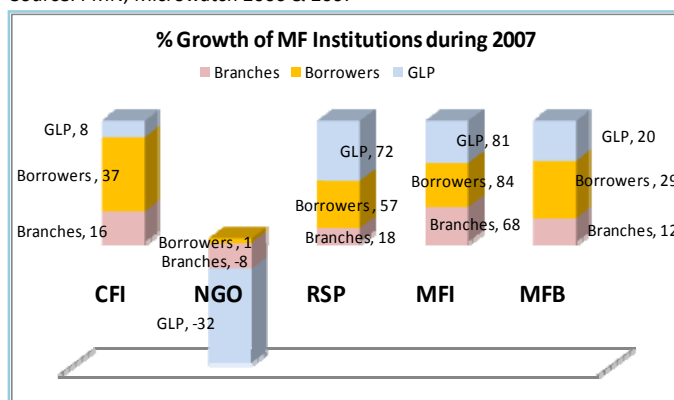


Table 4.2: Growth of MF by Institutions during 2007 (%)

Parameter \ MFP	CFI	NGO	RSP	MFI	MFB	Overall MF Growth
Branches	16	-8	18	68	12	20
Borrowers	37	1	57	84	29	47
Gross Loan Portfolio	8	-32	72	81	20	41
Avg Loan Bal.	-21	-33	10	-2	-7	-4

Source: PMN, Microwatch 2006 & 2007



The RSPs, MFIs and MFBs contributed major chunk, about 98%, of the growth in number of active borrowers achieved by the sector during the year (Table 4.1). The RSPs' active borrowers increased by 57% to 531 thousand, GLP by 72% to Rs.5694 million and branches/units by 18% to 758. The MFIs' active borrowers, GLP and branches/service outlets grew by 84%, 81% and 68% respectively to 369 thousand, Rs.3552 million and 217. The MFBs' active borrowers increased by 29% to 477 thousand, GLP by 20% to Rs.4702 million and the branches/units by 12% to 269. The Kashaf Foundation and NRSP were the major growth drivers in the growth of MFIs and RSPs respectively, whereas the MFBs' growth during the year largely came from Khushali Bank, First Micro Finance Bank Limited and Tameer Micro Finance Bank. The NRSP, KB, Kashaf, FMFBL & Tameer MFB were the five largest MFPs both with respect to active borrowers and geographic spread (Table 4.3 & 4.4). They collectively accounted for 82% of total active borrowers of the sector. The table 4.5 gives the largest MFPs with respect to No. of active savers, the RSPs dominate this group.

Table 4.3: Largest Providers of Microcredit (Active Borrowers #)

MFP	# of Active Borrowers		% Growth over the Year	Market Share (in 2007) % of
	2006	2007		
NRSP	236329	407641	72.5	27.7
KB	280526	330952	18.0	22.5
KASHF	136012	295275	117.1	20.1
FMFBL	52679	102604	94.8	7.0
PRSP	48084	69361	44.2	4.7
Total of 5	755,636	1,207,840	59.8	82.0

Source: PMN

Table 4.4: Microcredit: Largest Geographic Spread

Geographic Spread (# of Districts)			
MFP	2006	2007	% Growth over the
KB	-	86	-
NRSB	37	50	35.14
FMFBL	19	42	121.05
KASHF	11	22	100.00
PRSP	20	20	0.00
Total of 5	87	220	

Source: PMN

Table 4.5: Largest Providers of Micro-Savings (Active Savers #)

MFP	# of Active Savers		% Growth over the Year	% of Active Savers (2007)
	2006	2007		
NRSP	581739	760425	30.7	49.7
PRSP	170425	333714	95.8	21.8
TRDP	202572	210271	3.8	13.7
FMFBL	39161	81158	107.2	5.3
TMFB	24461	44560	82.2	2.9
Total of 5	1,018,358	1,430,128	40.4	93.4

Source: PMN

The Kashaf Foundation which is growing at an exceptionally fast pace for the last 3-4 years crossed the 300,000 borrowers mark in the 1st quarter of CY 08. During CY07 its active borrowers grew by 117% to 295,000, which is highly remarkable given the informal status of the MFI and its access to only limited sources of funds. The MFI has been evaluating the possibility of transformation into MFB for quite some time, the exceptionally fast pace expansion has made it all the important for the MFI to go for an early transformation to have access to wider sources of funds including public deposits to finance its growing portfolio and also to have a control and governance system necessary to manage such a large portfolio as well as the fast pace expansion.

Similarly NRSP, the largest MFP in the country with presence largely in rural areas, added another 168,000 borrowers in its fold during the year and crossed the 400,000 borrowers mark. It also needs to be transformed into formal MFBs on fast track basis to enable it to better leverage its financial, managerial and technical capital to increase the outreach of microfinance services in the country. The transformation would enable the MFI/RSP to have continuous access to relatively cheaper public deposits and thus would also be instrumental in reducing their cost of funds and improving their sustainability levels. The policy and legal hurdles in the

transformation of MFIs/RSPs like tax exempt status of MFIs/RSPs, which is not available to MFBs, has been tackled by providing tax exemption to MFBs for the five years provided they do not declare dividends (Finance Bill – 2007).. Please see tables 4.3 to 4.6 for top performing aspects of the MFPs)

Geographical Dispersion

The Punjab province, like agriculture finance, is absorbing almost two third of the total MF credit being extended by MFPs in the country with 66% share each in MF branches/units and number of active borrowers, 68% in GLP, 55% in number of active savers and 29% in total savings. The Sindh province is absorbing 19% of total MF credit with similar share in branches/units, 21% in active borrowers and 27% and 49% in active savers and total savings respectively. The NWFP is absorbing about 12% of MF services whereas Baluchistan and Islamabad/AJK sharing 1% each.

The predominance of Punjab province in the sector is attributable among others to a) presence of two of the five largest MFPs in the country viz. Kashaf Foundation and PRSP only in Punjab, b) un-proportionally larger presence of the remaining two of the three largest MFPs viz. KB and NRSP in Punjab, c) relatively better credit culture and awareness levels of target clients about the services being extended by MFPs, and d) relatively better roads and communication infrastructure and accessibility of the target areas.

Similarly the low penetration of MFPs in Baluchistan can be ascribed to highly dispersed population and difficult to reach terrain of the province, poor law and order situation, low business and economic opportunities, severe drought conditions since the recent past that has badly affected the agricultural sector of the province.

Provinces	Branches/Units#	Microcredit		Micro-Savings	
		Active Borrowers #	Gross Loan Portfolio (Rs. mn)	Active Savers #	Savings (Rs. mn)
NWFP	134	153,461	1,756	141,871	535
Islamabd & AJK	34	20,821	160	94,768	282
Punjab	890	974,877	10,265	843,223	1,169
Balochistan	24	17,957	126	38,252	55
Sindh	259	304,179	2,826	412,261	1,958
Grand Total	1341	1,471,295	15,134	1,530,375	4,000

Source: PMN; various issues of Microwatch

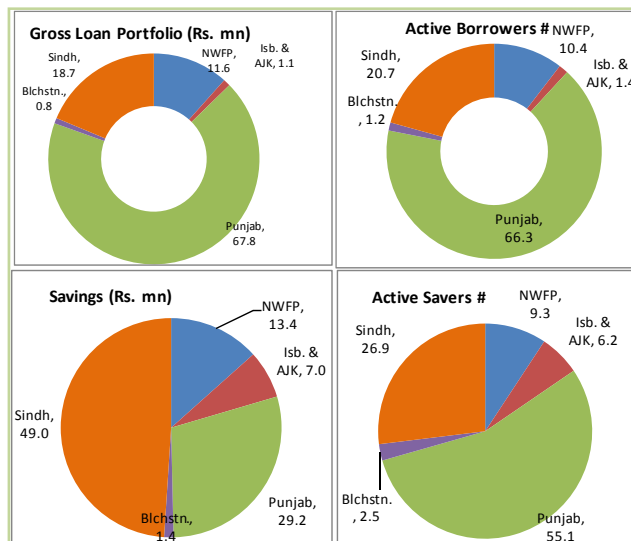


Table 4.8: Punjab Highest Borrowers and Loan Portfolios

Borrower wise Top Districts		Gross Loan Portfolio wise Top Districts	
	(#)		Rs. Million
Lahore	169,332	Lahore	1785.1
Faisalabad	88,413	Bahawalpur	900.3
Bahawalpur	62,531	Faisalabad	741.8
Gujranwala	52,479	Bhawalnagar	591.6
Multan	48,507	Gujranwala	566.4
Kasur	48,287	Multan	442.0
Rawalpindi	45,175	Kasur	431.4
Bhawalnagar	38,900	Rawalpindi	389.2
Sargodha	30,050	Sheikhupura	334.1
Sheikhupura	29,178	Lodhran	300.2
Top-10 total	612,852		6,482
% Share of 10	63.2		63.6
Top-5 total	421,262		4,585
% Share of 5	43.4		45.0
Prov. Total	969,845		10,184

Source: Pakistan Microfinance Network

Intra-provincial Analysis

The intra provincial analysis shows that all the 34 districts of Punjab province have MFPs' presence with Lahore district having largest number of MFPs' branches (120), active borrowers (169,000) and GLP (Rs.1785 million) and the district Nankana-Sahib having lowest number of active borrowers (5,431) and GLP (Rs.53 million). The MF outreach dispersion in the province improved significantly during CY07 with top ten districts' share reducing to 63% from 71% as of December 06 and bottom 10 districts' share improving to 10% in CY07 from 4% in CY06. This trend may be ascribed to stiff competition being faced by MFPs in bigger cities like Lahore, Faisalabad and increasing acceptance and popularity of microfinance as an important instrument for income enhancement/augmentation (Table 4.8).

The Sindh province exhibits almost similar picture like Punjab; all its 21 districts except Shadadkot have MFPs' presence and Karachi has largest number of MFPs' branches (72), active borrowers (60,789) and GLP (Rs.304 million) in the province, whereas the district Shikarpur had just one branch serving 1154 borrowers. Like Punjab the outreach dispersion improved significantly during the year with the share of top ten districts of the province reducing to 80% in CY07 from 92% in CY06 and that of bottom 10 improving to 20% from 8% in CY06 (Table 4.9).

The Frontier province including FATA which accounts for 12% of the total outreach levels achieved by the sector across the country, doesn't have any MFP in 10 districts and 5 districts have less than 1,000 MF borrowers. The 79% of the total MF borrowers of the province are concentrated in 10 districts compared to 87% in CY06; district Mardan accounts for 23% of the province's total borrowers. Contrary to Punjab and Sindh, the bottom 10 districts' share in the active borrowers decreased to 9% in CY07 from 13% in CY06 (Table 4.10).

The peculiar trend in the NWFP can be attributed to relatively low presence of the 5 largest MFPs in the province, limited penetration and outreach of SRSP in the province, difficult terrain, poor law and order conditions in some districts and limited acceptance of interest (*Riba*) based MF products.

The province of Baluchistan which absorbs just 1% of the total MF outreach has MFPs only in 13 of the 29 districts with 5 districts having less than 1,000 borrowers (Table 4.11). The top 10

Table 4.9: Sindh Highest Borrowers & Loan Portfolios

Borrower wise Top Districts		Gross Loan Portfolio wise Top Districts	
	(#)		Rs. Million
Karachi	60,789	Karachi	304.5
Jamshoro	32,736	Khairpur	282.1
Hyderabad	32,612	Jamshoro	250.4
Khairpur	27,051	Hyderabad	226.5
Sanghar	17,751	Nawabshah	169.6
Tharparkar	16,005	Sanghar	136.4
Nawabshah	15,922	Tharparkar	121.5
Dadu	11,547	Larkana	117.2
Larkana	10,537	Jacobabad	106.8
Umer Kot	9,576	Dadu	101.0
Top-10 total	234,526		1,816
% Share of 10	79.7		77.1
Top-5 total	170,939		1,233
% Share of 5	58.1		52.3
Prov. Total	294,120		2,356

Source: Pakistan Microfinance Network

Table 4.10: NWFP Highest Borrowers & Loan Portfolios

Borrower wise Top Districts		Gross Loan Portfolio wise Top Districts	
	(#)		Rs. Million
Mardan	33,464	Mardan	331.0
Swabi	12,817	Chitral	158.9
Peshwar	12,521	Gilgit	143.6
Charsadda	11,283	Charsadda	125.2
Malakand	9,706	Malakand	122.5
Chitral	7,942	Peshwar	116.7
Nowshera	7,229	Swabi	111.1
D.I. Khan	6,759	Skardu	92.1
Kohat	6,162	D.I. Khan	90.1
Gilgit	5,755	Nowshera	50.5
Top-10 total	113,638		1,342
% Share of 10	79.5		86.0
Top-5 total	79,791		88.1
% Share of 5	55.8		56.5
Prov. Total	142,972		1,559

Source: Pakistan Microfinance Network

districts accounts for almost 100% of the province's outreach levels and top 5 including Quetta absorb 74% of the outreach levels. Given the un-proportionally larger poverty levels in the province one would wish larger penetration of the MFPs in such areas. However for microfinance to be successful, adequate economic and business opportunities are a pre-requisite as otherwise the microcredit increases the indebtedness of the poor and ameliorate instead of alleviating the poverty. The MFPs also needs some minimum roads and communication infrastructure and security of their material and human resources to operate in the difficult terrains and serve the widely dispersed low income population of the province. There is thus a need for substantially larger investment in the province for improving the basic infrastructure and law and order situation besides creating business, economic and job opportunities to check the rising poverty levels and also to enable MFPs to expand their outreach in the province.

Table 4.11: Baluchistan Highest Borrowers & Loan Portfolios

Borrower wise Top Districts		Gross Loan Portfolio wise Top Districts	
	(#)		Rs. Million
Quetta	5,025	Quetta	29.9
Sibi	2,319	Jafarabad	24.7
Jafarabad	2,265	Sibi	15.5
Loralai	1,915	Loralai	11.5
Gwadar	1,692	Nasirabad	10.4
Pishin	1,281	Gwadar	10.1
Nasirabad	1,145	Pishin	9.5
Barkhan	1,030	Barkhan	6.9
Zhob	770	Zhob	4.6
Mastung	419	Mastung	2.9
Top-10 total	17,861		126
% Share of 10	99.5		99.7
Top-5 total	13,216		92
% Share of 5	73.6		72.9
Prov. Total	17,957		126

Source: Pakistan Microfinance Network

Also the regional trends need to be monitored on continuous basis to minimize the regional disparities in flow of financial services as well as the credit absorptive capacity of the regions to develop an inclusive financial system in the country. The Regional MF Focus Groups constituted recently in 13 SBP-BSC offices to review the regional MF trends and evolve local level operational strategies to increase the MF outreach in their respective jurisdiction, could be instrumental in analyzing the reasons for the disparities and developing recommendations to minimize the same. Please see Box-1 on next page for structure and TORs of the focus group.

BOX - I

Regional Focus Groups – Structure and TORs

1.a - Structure of FG on Rural Finance

- Regional Business Chief/Agri/rural finance Heads of top 10 Commercial Banks (based on their Agri/rural finance portfolio size in the region)
- Regional Chief/ Head ZTBL
- EDO Agriculture/Regional Director/Head Provincial Agricultural Research & Extension Department
- President/Secretary Regional Chamber of Agriculture
- President/Secretary Anjuman Kashtkaran Punjab/Sindh/Baluchistan /NWFP
- President/Secretary Regional Market committee of local fruits, vegetable, grains etc

1.b - Structure of FG on SMEs

- Regional Business Chiefs/SME Heads of top 10 Commercial Banks (based on their SME portfolio size in the region)
- Regional Chief/ Head of SME Bank and First Women Bank
- Regional Head SMEDA
- Regional Director Punjab Small Industries Corporation (PSIC)/Sindh SIC/Sarhad SIC/Baluchistan SIC
- President/Secretary Regional Chamber of Commerce & Industry
- President/Secretary Regional Women Chamber of Commerce & Industry
- President/Secretary Regional Traders' association/Chamber

1.c - Structure of Microfinance FG

- Regional Heads/Area Managers of all MFBs
- Regional Heads/Area Managers of up to 3 renowned NGO-MFIs/RSPs in the area (to be nominated by PMN)
- Regional Head/Area Manager of First Women Bank Ltd.
- President/Secretary of local Microenterprises' Associations/Women's Association/women Chamber

2- Terms of Reference (TORs) of Focus Groups

- To discuss and evolve operational strategies for increasing outreach of financial services amongst the micro enterprises and low income communities in both urban and rural areas;
- To organize awareness & information dissemination programs for increasing awareness of the targets groups about the financial and business development services;
- To discuss the regional growth trends biannually and give recommendations for increasing outreach levels for consideration of DFSD/DFG of SBP;
- To collect feedback on various SBP/ banks/ Government policies for growth and development of microfinance sector in their respective area for submission to DFSD for onward submission to DFG Departments;
- The Groups on need basis may invite Professionals, Researchers, Teachers/Professors etc for input on some projects/programs/initiatives and or to enhance the understanding of the group on certain new developments/research studies in their respective sectors.
- The Groups will meet on quarterly basis

5- Key Initiatives

While SBP took number of initiatives to facilitate development of a sound DF sector in the country including establishment of DFG in SBP and DFSD in SBP-BSC, this section briefly highlights the key policy, operational and promotional measures taken by DFG and DFSD to achieve sustained rise in flow of financial services to agricultural communities, SMEs and microenterprises and low income/asset-less households.

Agriculture & Rural Finance

- **Policy Guidelines-** ACD during the year issued guidelines for banks for extending financial services to fisheries, poultry and horticulture farms. The guidelines are aimed at facilitating banks in expanding their outreach to these non-traditional sectors. The impact of these guidelines and those issued in the recent past however is not yet measured. The anecdotal evidence however suggests that the guidelines could make only limited impact on the flow of funds to these sectors. Limited understanding and interest of banks in these sectors and key focus of the guidelines on designing the financing products for the sectors instead of explaining the sectors' dynamics, current market size & growth potential, cash flow cycles, risks faced and risk mitigation methods, the best practices adopted elsewhere to serve these sectors etc could be the possible explanations for this low impact.
- **Awareness & Information Dissemination Programs-** ACD organized about 10 programs at different stations for creating awareness amongst the farming community about financial services they can avail from banks. The programs being arranged since FY02 have been very effective in enhancing the awareness levels of farming community about the financial services. The structure of the programs which remained unchanged since the initiation of the programs in FY02 however needs to be reviewed to make them more productive.
- **Farmers Meetings-** the DFSUs established in 13 BSC offices in the second half of CY07 have started holding *Farmers' Meetings and Agrifinance Melas* in their respective area in collaboration with banks. The meetings/Melas are aimed at creating awareness amongst the farming community and bringing the banks and the farming community closer to each other. In FY09 each DFSU will arrange up to four such meetings in their respective area and in total more than 50 such meetings would be arranged. These programs are likely to give further boost to agrifinance activity across the country and could also be instrumental in addressing the regional disparities in flow of agricredit.
- **DFSUs' Capacity Building-** the DFSUs have been established in 13 BSC offices as local contact points for continuous interaction with the stakeholders. So far 7 out of 13 units have been manned by suitably qualified staff and imparted some training in Agriculture, SME & Microfinance; the remaining units would also be staffed with the suitably

qualified and trained staff by the close of CY08. This field presence across the country would enable SBP/SBP-BSC to effectively implement and disseminate its development finance policies and collect regular feedback about its policy and promotional interventions.

- **Regional Agrifinance Focus Groups**-The Regional Focus Groups on Agriculture Finance were established in 13 BSC offices to review the regional trends in agrifinance and evolve local level operational strategies to increase outreach of financial services in their respective region. The Box 1 gives the structure and TORs of the focus groups.
- **Agricultural Survey**- the agricultural survey of two districts viz. Sukkur in Sindh and Gujranwala in Punjab was initiated in consultation with Agricultural Credit Department to identify the key issues faced by the sector in accessing the financial services as well as key dynamics of the agricultural activities in these two districts. The survey questionnaire contains more than 200 questions and responses of 300 farming households from each district (75 from each Tehsil of each district) to be selected randomly would be collected and analyzed. The surveys likely to be completed by the 1st half of CY08 would provide some real insights about the agricultural activities in these two districts. The similar surveys of other key districts' would be initiated based on the findings and quality of these two surveys.

SME Finance

- **Establishment of SMED**- A separate SME Department was established at SBP during CY07 which signifies the key focus and emphasis of the Central Bank on increasing flow of credit and other financial services to SMEs. The department would be a focal point for all SME related policies, program and projects in SBP and would ensure an enabling policy and regulatory framework for easy and sustained access of SMEs to financial services. It would also work on capacity building of banks/DFIs through training and awareness building measures.
- **SME Strategy**: SME Department has prepared an SME Strategy which has also been approved by Governor State Bank of Pakistan. The objective of this SME Strategy is to create a conducive regulatory & policy framework and support mechanisms so as to provide necessary stimulus for commercial banks to meet the credit requirements of SMEs in next five years. This Strategy targets surpassing threshold of Rs. 1 trillion SME financing by banks with a year-on-year growth of at least 25% over next five years. The SME Department is presently following a focused approach for implementation of its recommendations like indicative targets, establishment of SMECAC, credit guarantee agency, credit rating agency etc. defined in its SME Strategy. The Financial Inclusion Program (FIP) design team has also agreed to develop an Implementation Plan for the

SMEs Strategy. It may be mentioned here that implementation of some measures under the Policy would require support from other stakeholders. These include:

- Promulgation of SME Act
 - Triennial Survey of SMEs
 - SME Specific Tax Regime
 - National SME Board
-
- **SME Credit Advisory Committee**-The SME Credit Advisory Committee (SMECAC) has been established by SBP with the Governor, SBP as its Chairperson. The objective behind formation of this committee was to evolve national policies and strategies for increasing flow of financial services to SMEs. The constitution of this committee is again indicative of seriousness and thrust of the Central Bank towards development of a vibrant SME Finance Sector.
 - **Indicative SME Lending Targets:** As per decisions made at the first meeting of SMECAC, held on February 28, 2008 under chairmanship of Governor, SMED obtained SME Financing Profile from selected twenty-one (21) commercial banks having significant outstanding SME Financing which inter-alia included proposed indicatives SME Financing targets for Period 2008-2012. The performance of commercial banks against these targets will be monitored and reported to SMECAC. However, it would be important to note that these targets are indicative and voluntarily in nature and have been proposed by banks on the basis of their Annual Business Plans and growth targets.
 - **Concept for Credit Guarantee Scheme (CGS):** The objective of CGS is to alleviate credit market imperfections for increased flow of credit to SMEs specially the smaller SMEs. SME Policy also recommends establishment of CGS in Pakistan. In the first stage, SME Department internally developed a Concept Paper on Credit Guarantee Scheme for Pakistan wherein it reviewed the international experiences and proposed the basic structure of a specialized SME Credit Guarantee Agency for Pakistan. In the second stage, feedback was taken internally from SBP Banking Policy Committee and externally from Pakistan Banks Association and the SME Core Group that comprises of representatives from major banks with focus on SME Finance. Currently, we are coordinating with International Financial Institutions on a plan for detailed Financial Feasibility and its implementation. Further, it is also an important component of Financial Inclusion Program (FIP) that would be implemented by SBP in coordination with DFID.
 - **Credit Rating of SMEs:** In order to provide extensive support to banks in credit evaluation/decision making process and enable SME clients to negotiate competitive mark-up rates with banks a Task Force has been established by SBP that is working with the existing two rating agencies in Pakistan for developing a viable methodology for rating of SMEs. Further, in light of the experiences of other countries like India and

Japan, SMED has developed a Concept Paper for establishing a Specialized SMEs Rating Agency. In the first stage, feedback is being sought from PBA. Later, after its finalization, a detailed feasibility would be carried out before moving forward with implementation plan. The same is also included in the overall FIP to be implemented by SBP in coordination with DFID.

- **SME Core Group:** An SME Core Group has been established under the aegis of SMECAC that will review existing Policy Framework and suggest improvements wherever required, give recommendations for capacity building of banks, financial innovations, etc.
- **SME Training Workshops for Commercial Banks:** The SME Department also organized two separate training programs for banks at NIBAF in Islamabad. The first Two-day Program held from April 21-22, 2008 specifically focused on training requirements of front-end SME officers and middle management of banks while the second One day Seminar held on April 23, 2008 provided an overall review of Initiatives in SME Financing to higher-end management staff of banks. In view of the encouraging feedback received from the participants, SME Department plans to organize similar training programs in other cities too.
- **Establishment of SME Help Desk:** A specialized SME Help Desk has been established at SME Department that will redress grievances of SMEs regarding various banking issues.
- **SME Private Equity Funds:** In order develop the much needed equity financing options that play the role of a catalyst in development of Equity Finance Industry for SMEs a Concept Paper has been developed for discussions with PBA and the SMEs Core Group comprising of major stakeholders, viz. SBP and the major financial institutions to deliberate on the broader modalities for establishing a Private Equity Fund.

In addition to the above mentioned policy initiative adopted by SME Department, the Development Finance Support Department established in SBP-BSC (Bank) as an extended arm of Development Finance Group of State Bank of Pakistan has been pursuing with the following initiatives to assess the ground status of SME Financing and provide feedback to Development Finance Group.

- **Regional SME Focus Groups-** SME Focus Groups have been established at 13 BSC officers to explore issues pertaining to SMEs. The structure and TORs of these groups are given in Box-1. Some of the offices convened meetings of the groups minutes of which were later circulated to all stakeholders. It is expected that these Groups would be

instrumental in enhancing understanding of SBP Policies and its initiatives at the grass root level, which would ultimately translate into substantial improvement in the flow of credit to SMEs.

- **SME Survey-** An SME survey was also launched in two districts viz. Sukkur and Gujranwala to identify key constraints in growth of SMEs and their access to financial services. The questionnaire contained more than 130 questions and here again information from 300 SMEs, both manufacturing and trading concerns, is being collected. This Survey is also likely to be completed by end July 08.

Microfinance

- **National MF Strategy-** SBP prepared National MF Strategy in consultation with all stakeholders and launched it in February 07 after approval by the Government. The strategy that envisages increasing MF borrowers to 3 million in the medium term (by 2010) and to 10 million afterwards provides a road map to both policy makers and the practitioners to play their respective role in achieving the targets set out in the strategy.
- **Establishment of MFD-** like SME a separate Microfinance Department was established to exclusively focus on developing a self sustainable and sound MF sector in the country.
- **Mobile/Branchless Banking Guidelines-** SBP issued mobile/branchless banking guidelines to allow banks/MFBs to use mobile phones technology for increasing outreach of financial services. The fast pace expansion of mobile phones and telecommunication in the country during last 4-5 years has provided an exciting opportunity both to MF policy makers and practitioners to substantially improve the outreach of financial services across the country at substantially lower cost. The use of technology would be a key factor in achieving the long term goal of increasing the outreach of MF services to 10 million clients by 2015.
- **District wise MF Data-** Entered into a data sharing mechanism with Pakistan Microfinance Network (PMN) whereby PMN is sharing District-wise MF data with us thus enabling us to monitor the regional trends in MF outreach expansion.
- **Regional MF Focus Groups-** the regional MF focus group have also been constituted in 13 BSC offices. The Box-1 gives the structure and TORs of the group.

Infrastructure and Housing Finance

A brief description of the major initiatives taken in these areas is given hereunder:

Infrastructure Finance

- Infrastructure financing is at its nascent stage in Pakistan. SBP, being conscious of the importance of infrastructure sector, established infrastructure task force, by roping in the experts from financial and infrastructure sectors viz. power, roads, and water and sanitation etc. The task force has identified a broad array of issues and proposed measures for enhancing flow of credit to different projects. The underlying idea is intensive public private partnership in line with international best practices to increase the availability of credit in sectors which are essential for overall improvement of infrastructure in Pakistan.
- The involvement of private sector is vital to the improvement of infrastructure because government alone cannot efficiently shoulder the responsibility of initiating and financing new infrastructure projects due to fiscal constraints. The role of private sector is overwhelming in developed countries for the prompt delivery and enhanced efficiency of infrastructure services. Participation of private sector in infrastructure development also ensures the availability of public funds for other social development projects. SBP believes that to promote public private partnership it is imperative to work out a conducive policy framework for public-private participation by enhanced coordination between local, provincial, and central governments. Undue cost and time in execution of government contract hinders the participation of private sector so a strategy is required for smooth execution of contracts on the part of government. Alternative financial mechanisms, including establishment of bond market and capital market for long term funds are also desired for long term funding of infrastructure projects.
- SBP has also taken the initiative to ensure availability of reliable data regarding infrastructure project financing. Total disbursements against infrastructure financing were Rs 210.11 billion till last quarter of FY 06 which rose to Rs 233.66 billion in first quarter of FY 07 and further increased to Rs 250.34 billion in second quarter of FY07. Stock value of outstanding stood at Rs 143 billion at the end of last quarter of FY06 which rose to Rs 156 billion by first quarter of FY07 and further increased to Rs 169 billion at the end of December 2007. This relative growth in lending for project financing supports the view that demand for project financing is increasing and banks are expanding project financing. Keeping in view the low level of project financing i.e. around 2% of GDP, It is important to formulate infrastructure financing related policies to reinforce public-private partnership to enhance the flow of credit towards infrastructure development. SBP is also focusing hard on capacity building, in collaboration with multilateral development institutions, and has been planning to conduct training for developing skills and knowledge of professionals associated with infrastructure financing activities.

Housing Finance

- Since 2002 SBP, in association with private and public sector stakeholders is playing a facilitating role for creating an enabling environment for promotion and development of a market based housing finance system in the country. As part of its first initiative in this direction, SBP during 2002 hosted a Housing Finance Conference that intended to create awareness amongst bankers and financiers for promoting housing finance.
- Following the conference and in an attempt to provide an institutional arrangement and direction to the much needed reforms in housing finance, a Housing Advisory Group (HAG), comprising of various stakeholders, was constituted at SBP. The HAG after extensive deliberations identified a number of issues hindering the development of housing finance in the country and submitted a set of recommendations for implementations by the concerned quarters.
- SBP has also conducted a training program on ‘Mortgage Finance’ in collaboration with IFC and Canada Mortgage and Housing Corporation (CMHC) that aimed at enhancing the capacity of primary mortgage lenders in Pakistan.
- The initiatives taken by SBP have contributed in enhancing the level of housing finance which increased from Rs.1.9billion in March 2003 to Rs.66.4 billion in March 2008. The increased participation of private banks and very recently of Islamic banks too, are reflective of the growing need of a well-structured mortgage market.
- SBP is also working to ensure that progress made in infrastructure and house financing is sustainable in the long-run by developing Long-term funding mechanisms and by ensuring continuous efforts in the capacity building of the financial sector in infrastructure and housing finance.
- SBP is also working closely with World Bank Group (World Bank and IFC) to initiate a comprehensive reform project to expand the housing finance system to lower income group and to develop a secondary mortgage market including the creation of long term financing facility for mortgage lenders.
- All the activities confirm that SBP is playing an important role in credit enhancement to the priority areas such as housing and infrastructure development in Pakistan. Both areas are key players for economic growth and development in Pakistan.

6- Future Outlook

The economy is going through trying times. Up to this juncture, the development finance sector has shown good growth performance, which may lose some points; yet retain momentum, in the current economic circumstances. The agriculture sector, which has had negative terms of trade historically, is expected to spearhead this growth as unprecedented rise in global food prices has made it attractive from an investment standpoint. There seems to be greater realization amongst policy makers about the importance of agriculture sector in addressing the economic woes particularly after the current food shortages experienced both within the country and across the world. This realization is expected to translate into larger investment flows and budgetary allocations both by Federal and Provincial Governments for improving the agricultural infrastructure and removing the policy, regulatory and procedural hurdles in attracting private investment in the sector. This would also improve the credit absorptive capacity of the sector and would encourage banks to expand their portfolio in the sector.

SBP's policy thrust is to encourage and persuade banks to increase their capacity to better serve agriculture and other priority sectors would also continue and would be instrumental in enhancing the credit flows in the sector. The presence of DFSUs in 13 BSC offices across the country for continuous interaction with stakeholders as well as monitoring regional trends is also expected to translate into improved flows of funds to the agriculture sector. SBP's tightening monetary policy likely to continue at least in the near term, may squeeze liquidity in the interbank market and reduce the additive margins on agricultural lending and thus may discourage the banks to expand their outreach in the sector.

Expected improvement in investment levels in the agricultural sector may also enhance the absorptive capacity of microfinance clients in rural areas. Four of the five largest MFPs (NRSP, PRSP, KB and FMFBL) have extensive rural presence and about 60% of MFPs' clientele being rural, the improvement in agricultural activity would give big boost to MF sector. Kashf Foundation one of the largest MFPs with more than 300,000 active borrowers operating in urban and peri-urban areas of Punjab is also likely to maintain its growth momentum and cross the 400,000 borrowers mark during CY08. The sector overall is likely to remain on track to achieve the medium term goal of reaching three million borrowers by 2010. However, rising interest rate and inflationary trends may exert some pressure on MFPs' cost of funds as well as operating cost and may cause further surge in MFPs' lending rates. Although MF demand usually remains less responsive to interest rate changes, the rise in interest rates beyond a certain level may impair the poverty alleviation goal of microfinance.

SMEs are likely to be under stress in the short to medium term as they are most vulnerable to the shocks like power shortages, rising energy prices, exchange rate fluctuations, rising interest rates and political uncertainties and so forth. Though exact numbers are unavailable, a number of

SMEs, particularly the SEs, are incurring heavy production losses due to energy shortages and extended load shedding, which is likely to continue at least during next one to two years. While rupee depreciation may give some boost to exports, operating cost is also likely to soar in the wake of rising input prices and labor cost. Monetary policy tightening would also discourage the SMEs to invest in productive capital assets. Increasing the flow of financial services to SMEs under such circumstances would thus be a challenge for the financial sector and would require coordinated efforts by Federal and Provincial governments, SBP/financial sector and business community. The SME Focus Groups established in 13 BSC offices would be instrumental in reviewing the regional trends and developing linkages with all the stakeholders to make collaborative efforts to facilitate SMEs in attracting requisite financial services from banks and financial institutions.