2008

Development Finance Review

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Introduction

Broadening and deepening of financial system, to extend its coverage to all segments of the country's economy particularly the un-banked/under banked sectors like Micro and Small Enterprises (MSEs) and agricultural and rural communities, is an important strategic objective of SBP. It has developed a ***Financial Inclusion Strategy*** that 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. It has established the ***Development Finance Group (DFG)*** in SBP to spearhead all Development Finance related initiatives in SBP, strengthened Agricultural Credit Department (ACD) to enable it to facilitate development of a self sustainable *Rural Finance Sector* and created separate SME and Micro Finance Departments to exclusively focus on improving flow of financial services to SMEs and Microenterprises. The establishment of ***DFSD*** at SBP BSC in CY07 was another significant initiative to provide field presence to DFG for continuous interaction with the stakeholders at grass roots level.

While the development of housing and infrastructure finance is an important part of SBP Development Finance Strategy, however the DFSD and its field units are presently focusing only on Agriculture, SME and Microfinance sectors as the housing and infrastructure finance warrants more macro and policy level intervention than local or regional interventions. This review thus also focuses only on agriculture, SME and microfinance.

The DFR 2008 is the second annual review compiled by DFSD; the first review was prepared last year for CY07. The review gives a consolidated picture of the country's Development Finance Sector and takes a stock of a) the trends in outreach levels and its geographical dispersion, b) capacity of banks to meet financing needs of SMEs and agricultural communities, c) capacity of Microfinance Providers (MFPs) in catering to the financial services needs of micro enterprises and low income individuals in urban and rural areas, d) the key issues faced by each of the three sectors, and e) major initiatives taken by SBP/SBP-BSC to help develop the sectors on sustainable basis. Wherever necessary, the review also gives recommendations for addressing the issues faced by the sectors and for accelerating the pace of developments of the sectors.

The review will be useful both for internal and external stakeholders of SBP in having a detailed overview of the developments and trends in Agriculture, SME and Microfinance witnessed during CY08 and reasons thereof. The comments, observations, feedback etc may be sent to Mr. Ashfaq Ahmed, AD, DFSD at ashfaq.iba@sbp.org.pk.

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1. Overview

The Calendar Year 2008 (CY08) proved a difficult year for the country, both on economic and political fronts. The year started on a sad note as the country was mourning the tragic assassination of Mohtarma Benazir Bhutto just 3 days before the first dawn of the year. The economic growth rate which had been averaging above 5% in the last 5 years declined to merely 2% in the fiscal year 2008-09. The real economy was hit hard by the combination of several internal and external shocks such as increase in commodity prices, global recession, deteriorating security position, severe power shortage and various political upheavals. These factors led to significant production losses specially in large scale manufacturing, acute wheat shortages, high inflation particularly for low income groups and deterioration of investor's confidence as evidenced by substantial decline in Gross Fixed Investment from 20.4% of GDP in 2007-08 to merely 18% in 2008-09. The economic recession fueled by the aforementioned domestic and international factors adversely affected several sectors of the economy including manufacturing (both large scale and small scale), agriculture and exports.

The problems of the real sector in turn led to increase in credit losses to banks as the repayment ability of several firms/households deteriorated due to the economic and political shocks the country experienced during the year. Consequently the Non Performing Loans (NPL) ratio witnessed a significant rise and reached 9.13% in CY08 from about 7% in CY07. Among the most badly hit were unfortunately the two already underserved areas namely SME and agriculture.

Agrifinance

The credit flows to agriculture sector increased by 18% during the year to Rs. 221 billion from Rs. 187 billion in CY07; this growth is however 7 percentage points lower than the average growth rate of 25% achieved during five years preceding CY08. Further the real growth in the credit flows to the sector would be even lower, if adjusted for the significant rise in prices of agricultural inputs viz. seed, fertilizers, diesel etc during the year. The number of agricultural borrowers grew by more than 15% during the year to about 2 million from 1.73 million as at close of CY07. This was the largest increase in the number of agricultural borrowers reached by banks in any single year during the last ten years. The unusual rise is however attributable to inclusion of more than 200,000 borrowers of some Rural Support Programs (RSPs) in agrifinance portfolio; these RSPs had obtained wholesale funds from commercial banks for onlending to small farmers. The regional distribution of the agrifinance outreach also remained highly skewed towards Punjab as it continued to account for about 85% of the total disbursements to the sector and 85% of total agrifinance borrowers served during the year. The Sindh province accounted for about 11% of the disbursements and 8% of the agrifinance borrowers.

The banks' agrifinance capacity in terms of number of agrifinance branches and the agrifinance officers (AFOs) also increased, though modestly during the year. The number of agrifinance branches reached to 3559 with the addition of 72 branches during CY08 and the number of AFOs increased by 43 to 3439 during the year. The DPBs accounted for most of this growth in banks' agrifinance capacity, which is indicative of their growing interest in the sector. The 5 big banks' AFOs though increased slightly during the year; they still have more than 2 branches for each AFO with some of them having up to 10 branches for one AFO. The 5 big banks are being encouraged to improve this ratio to one AFO for each agri. lending branch during the next 2 years for efficient disbursement, monitoring and recovery of agri loans. The 5 big banks have the largest penetration in rural areas with 72% share in total agrifinance branches and thus are best positioned to significantly increase the outreach of financial services in rural areas. This group however still seems to be hesitant in venturing agrifinance as a viable business avenue; they have had a bad experience in the sector and incurred heavy losses as public sector banks, which is probably still inhibiting them to tap this largely unserved /underserved sector. Their orientation towards the sector, their business model and the quality of their agrifinance staff needs to be improved significantly to optimally utilize their huge network of agrifinance branches.

Microfinance

The Microfinance outreach levels also continued the rising trend during the year, but at a lower rate. The number of borrowers increased by 18% to 1.8 million borrowers; the 18% growth rate was much lower than the average annual growth rate of 40% achieved during 5 years preceding CY08. The slowdown in the outreach growth is largely attributed to significant deceleration in the outreach expansion of RSPs whose portfolio grew by just 10% during the year compared to 57% in the preceding year. This deceleration continued in the first quarter of CY09 and RSPs shed almost 200,000 borrowers. NRSP, the largest MF provider in the country, accounted for most of the deceleration as it could not renew/roll over loans of about 200,000 borrowers due to lack of funds/liquidity; a consortium of commercial banks did not renew/roll over the credit line of Rs.1.6 billion forcing NRSP to repay the loan to the consortium.

The Microfinance Institutions (MFIs) which account for 16% of total MF outreach also grew at a slower rate of 26% during the year as compared to 84% in the preceding year. This slowdown in the MFIs' pace of outreach expansion could be ascribed to consolidation by one of the largest MFIs, which grew exponentially during 4-5 years preceding CY08. The Microfinance Banks (MFBs) whose outreach grew by 27% to 605,000 borrowers during the year accounted for about half of the growth in the total outreach. The largest contribution in this group came from First Microfinance Bank Limited (FMFBL) with 67% increase in number of borrowers; the bank's partnership with Pakistan Post (PP) to market and sell micro loans through the PP outlets proved extremely useful in achieving this fast paced growth in the number of borrowers. Khushhali Bank (KB), the largest MFB in the country, also had a net addition of about 35,000 borrowers in its MF portfolio during the year, which increased to 367,000 as at close of CY08.

While the active microfinance borrowers increased by 15% in CY08, the Gross Loan Portfolio (GLP) of MFBs/MFIs/RSPs grew by 24% to Rs.18,753 million; the average loan size[1] also improved marginally to about Rs.11,000. The most significant contribution in this growth came from MFBs whose portfolio grew by 45% followed by MFIs which registered 18% rise in the GLP during the year. The loan portfolio quality however remained under stress during the year as the delinquency ratio increased by about 1.2 percentage points to 6.78%. The composition of MFPs clientele also changed in favour of female borrowers as for the first time the percentage of female clients (53%) surpassed male clients (47%) in the last quarter of CY08. This change is however largely attributable to deceleration in growth of RSPs, a bulk of whose clientele is male.

The Micro savings registered even better growth and grew by 35% during the year; the number of savers however increased by just 7%, which is indicative of some shift to larger deposits particularly by MFBs. The MFBs accounted for 70% of total savings but only 14% of total number of savers; amongst MFBs, the FMFBL has the largest share of 80% followed by Tameer Microfinance Bank Limited (TMBL) with 15.5% share in total savings of MFBs; NRSP with 977,000 savers has the largest share of 56% in the total number of micro savers.

[1] Average Loan size is equal to Gross Loan Portfolio divided by Number of Active Borrowers

This huge number of micro savers of NRSP are however members of its Community Organizations (COs) who deposit their savings in commercial bank as a mandatory requirement for obtaining loans from NRSP.

SBP also continued facilitating the development of microfinance industry in the country and took several initiatives during the year including promotion of strategic alliance between Pakistan Post office and microfinance providers; issuance of branchless banking guidelines and launching of the Microfinance Credit Guarantee Facility (MCGF), the Institutional Strengthening Fund, and the Improving Access to Finance Services Fund. It also issued license to Kashf Microfinance Bank Limited (KMFB) and NRSP Microfinance Bank Limited; NRSP-Microfinance bank however has not yet commenced operations.

SME Finance

SME finance was hit particularly hard during the year as its share in total outstanding credit declined by about 4 percentage points to merely 11% as at close of CY08. The total number of borrowers however, increased by more than 22% to over 214,000 resulting in increase in penetration from 6.2% of total SMEs in CY07 to 7.15% in CY08. This unusual growth in the number of SME borrowers is however attributable to categorization of about 43,000 auto rickshaw loans extended by NBP as SME loans during the year. The net increase in SME borrowers was negative after adjusting for the auto rickshaw loans. The NPLs in the sector also almost doubled to 16% during the year, which is the highest amongst all the sectors; even higher than agrifinance which is perceived as riskier than SMEs. The hefty surge in NPLs and the negative growth in SME finance etc was however not unexpected due general economic slowdown both domestically and internationally, the uncertain political and economic environment, the severe power shortages and extremely low investor confidence. The overall economic pessimism coupled with rising NPLs has also made the banks more cautious in their lending decisions particularly for SMEs, which are generally perceived riskier by banks.

The sector wise distribution of SME portfolio shows that though about half of the banks' SME loan portfolio is outstanding against manufacturing SMEs, the working capital loans accounted for 77% of total SME loans (70% in CY07). The share of fixed investment however declined to 12% from 14% in the preceding year, which is indicative of banks' reluctance to take longer term exposure in SMEs. This also underlines the need for alternative financing arrangements like equity participation funds, venture capital companies etc as banks are not likely to have any significant improvement in their fixed investment loans to SMEs in the foreseeable future.

SBP during the year continued its efforts to help banks increase their exposure in SMEs. It took several initiatives for the purpose including setting up of the SME Credit Advisory Committee to institutionalize the consultative mechanism for policy formulation on SME finance; launching a comprehensive Capacity Development Program for banks SME Credit Officers across the country; introducing the concept of Indicative SME Credit Targets for Banks; and constitution of SME Core Group to develop recommendations on Financial Innovation and Capacity Development. On the SBP BSC part, the DFSD augmented the policy side by organizing a number of seminars, workshops, fairs etc across the country to enhance financial literacy of the SMEs and thus increase their access to financial services being extended by banks.

2. Agriculture Finance

Agriculture is the lifeline of Pakistan's economy. It contributes 21% to the GDP, employs 44.6% of the labor force and earns about 70% of the country's foreign exchange through export of raw materials and processed and semi processed agricultural products including cotton, rice and textiles. Encouragingly there has been increasingly greater realization of the critical importance of the sector for the country's economy amongst the policy makers since the recent past. The food shortages and unprecedented hike in commodity prices experienced during CY08 further strengthened this realization. The Government has accordingly identified agriculture as a priority area for addressing problems of unemployment, poverty alleviation, food security and for fostering economic development. The overall policy goal is to enhance productivity and profitability of the farming community and thus enabling the rural masses to raise their living standards and become attractive for banks' investment. The Box 1 gives the salient features of the Agri-Package announced in Federal Budget for FY09.

Box 1 Agri-package Federal Budget FY09

- Agriculture package aims at reducing cost of production, increasing output, enhancing water availability and raising income of farming sector;
- The farm sector subsidy increased to Rs.32 billion from Rs.25 billion last year;
- Subsidy on DAP raised by 113 percent or by Rs. 530 to Rs. 1,000 per 50 kg bag to reduce the DAP price and encourage balanced use of fertilizers;
- Exemption of general sales tax on fertilizers and pesticides;
- Elimination of 5 percent excise duty on crop insurance;
- Withdrawal of 10 percent customs duty on import of rice seed;
- Allowed duty free import of bulldozers and laser land levelers to help improve water efficiency at farm gate;
- Allocated Rs.1.5 billion for dairy development;
- Allocated Rs. 75 billion for building new dams and improving existing irrigation network

This increased recognition of the sector as the driver of economic growth however could not accelerate the pace of credit flows to the sector; the banking industry could meet just around 45% of the total credit needs of the sector, thus leaving it largely dependent on informal sector to meet the most of its credit needs. The following section takes a detailed look on the performance of agrifinance sector during the year with particular focus on trends in outreach levels along with the regional dispersion of the agrifinance outreach.

Agrifinance Growth

Agri Credit Disbursement (Bank wise) *(Rs. in million)*

Description	CY-07	CY-08
5 Big Commercial Banks	91,026.69	98,470.00
Specialized Banks	63,517.80	76,521.02
Domestic Private Banks	32,882.14	45,739.78
Total:	**187,426.63**	**220,730.80**

Source: ACD, SBP

The credit flows (disbursements) to the sector though grew by 18% during CY08 to Rs.221 billion from Rs.187 billion in CY07, the inflation adjusted growth in the disbursements was however modest. The year witnessed a substantial rise in agri-inputs prices particularly fertilizer, electricity and diesel which resulted into a significant rise in per acre credit requirements; SBP also increased the indicative per acre credit limits by an average of 70% during the year to make the limits comparable with the actual credit requirements. The low real growth in credit flows to the sector could be largely attributed to tight liquidity conditions particularly during the second half of CY08, high NPLs particularly of the rice growers in Sindh, high mark-up rates and banks' limited capacity to serve the sector and demand side issues like low productivity, non availability of inputs, lack of marketing channels, water shortage, defective land titles and delays in issuance of passbooks etc.

The sector-wise distribution of disbursements shows that the farm sector continued to lose its share in favor of the non-farm sector. The disbursements to the farm sector though grew, however, at a slower pace than the non-farm sector. Amongst the non-farm credit, the credit flows to Livestock sector increased remarkably by 140% to Rs. 22.214 billion during the year. The sharp rise in livestock disbursements is encouraging and is in line with SBP's policy of diversification of agri. credit and government's priority to develop livestock sector. The sector also has great potential for banks' investments due to relatively lower risk and regular cash flows. However, despite the sharp rise in disbursement to livestock sector, its share in overall agri. financing is only 10% compared to 50% share in agricultural GDP.

Agri Credit Disbursement (Sector wise) *(Rs. in million)*

Description	CY-07	CY-08
Farm Sector		
Production Loans	133,819.54	150,388.98
Development Loans	8,667.63	10,615.99
Corporate Farming	1,327.98	1,608.32
Total:	**143,815.15**	**162,613.29**
Non-Farm Sector		
Livestock (Including Dairy Farming)	12,010.39	22,213.65
Poultry	29,097.57	33,718.91
Fishries	555.05	926.18
Forestry	1.94	0.64
Others	1,946.52	1,258.74
Total:	**43,611.48**	**58,118.12**
Grand Total:	**187,426.63**	**220,731.41**

Source: ACD, SBP

The disbursements to poultry farms also increased by 16% to Rs. 33.72 billion during the year. These loans are much larger in size than the normal farm and non-farm loans and can be extended using the existing branch network even in urban areas. The commercial banks have thus started developing exposure in poultry farms which despite being an agricultural loan does not require specialized skills and infrastructure needed for extending the farm and other non-farm loans in rural areas. The loans extended to poultry farms though part of the agriculture credit, however, the very nature of these loans is more like a commercial/SME loan than the agricultural loan.

Like disbursements the outstanding agricredit portfolio also grew by 11% during the year to Rs.180 billion as at close of CY08 from Rs.162 billion in CY07. The growth in the outstanding portfolio is encouraging as this shows net increase in flow of credit to the sector during the year. The major rise in the outstanding portfolio was however witnessed in non-farm sector, particularly poultry farm which, as explained earlier, does not constitute the core agricultural activity. A part of the rise in outstanding portfolio could also be attributed to the inclusion of microfinance loans (about Rs. 2 billion) in the banks' agrifinance portfolio during the year.

Agri Credit Outstanding Loans *(Rs. in million)*

Description	CY-07	CY-08
5 Big Commercial Banks	55,227.26	63,094.14
Specialized Banks	84,041.61	89,490.48
Domestic Private Banks	22,842.14	27,469.93
Total:	**162,111.02**	**180,054.55**

Source: ACD, SBP

The number of agricultural borrowers also registered a handsome growth of 15.5% and increased to about 2 million from 1.72 million as of 31st December 07. The largest growth in the number of agricultural borrowers was witnessed in the 5 big commercial banks as this group's agri-borrowers increased by 230,155 during the year to 667,663 borrowers. This hefty

Outstanding Number of Borrowers

Name of Province	5 Big Commercial Banks		Specialized Banks		Domestic Private Banks		All Banks	
	Dec-07	Dec-08	Dec-07	Dec-08	Dec-07	Dec-08	Dec-07	Dec-08
Punjab	304,305	549,050	841,427	877,476	53,104	54,002	1,198,836	1,480,528
Sindh	79,705	67,329	245,382	244,320	6,366	6,932	331,453	318,581
NWFP	45,139	38,862	93,190	92,984	1,572	1,565	139,901	133,411
Baluchistan	3,350	1,275	18,090	19,161	15	28	21,455	20,464
AJK	4,469	10,608	8,517	8,367	0	38	12,986	19,013
N-Areas	540	539	22,286	23,449	22	20	22,848	24,008
Total	**437,508**	**667,663**	**1,228,892**	**1,265,757**	**61,079**	**62,585**	**1,727,479**	**1,996,005**

Source: ACD, SBP

rise in the number of agrifinance borrowers of the 5 big banks is however attributable to inclusion of about 200,000 borrowers of Rural Support Programs which had obtained wholesale funds from commercial banks for onlending mostly to the farming community. After adjusting for these microfinance borrowers, the actual growth in the number of borrowers of the 5 big banks as well as the banking industry as a whole would look modest. The specialized banks' borrowers also rose by 3% to 1,265,757 largely due to relatively better performance by ZTBL. The DPBs registered just 2.5% growth in the number of borrowers which increased to 62,585 at the close of CY08 from 61,079 during last year, despite substantial increase in their number of agrifinance branches and AFOs .

Banks' Agriculture Finance Capacity

The banks continued improving their agrifinance capacity during CY08 though at a lower pace. The banks' agrifinance branches increased by 2% to 3,631 in CY08 from 3,559 in CY07, compared to 7.5% increase in total bank branches during last year. The Domestic Private Banks (DPBs) accounted for about 80% of the growth in agrifinance branches during the year, which rose to 499 in CY08 from 441 in CY07. The noticeable rise in the DPBs' agrifinance branches is attributable to gradually increasing ownership of agrifinance as a viable business avenue and their existing thin presence in rural/agri-dominated areas. Despite this handsome increase in the DPBs' agrifinance branches during the year, they still have just 14% share in total agrifinance branches; the specialized banks with 500 branches also have about 14% share; the 5 big banks with 2632 agrifinance branches have a hefty 72% share in the total agrifinance branches.

Banks' Agri Finance Outreach Levels (Nos.)

Bank Group	Total Branches		Agri Finance Branches		ACOs / MCOs / AFOs		No. of Support Staff	
	Dec. 07	Dec. 08	Dec. 07	Dec. 08	Dec. 07	Dec. 08	Dec. 07	Dec. 08
5 Big Commercial Banks	5,535	5,645	2,618	2,632	1,122	1,153	2,689	2,798
Domestic Private Banks	1,491	1,949	441	499	504	542	95	99
Specialised Banks	501	501	500	500	1,770	1,744	3,161	3,142
Total	**7,527**	**8,095**	**3,559**	**3,631**	**3,396**	**3,439**	**5,945**	**6,039**

Source: ACD, SBP

Similarly a modest rise of less than 2% was observed in the number of ACOs/MCOs/AFOs which increased to 3,439 in CY08 from 3,396 in CY07. The DPBs again accounted for a major chunk (65%) of this growth as their total AFOs rose to 542 in CY08 from 504 in CY07. The DPBs thus have on average more than one AFO for every agrifinance branch. The AFOs of 5 big banks though increased by about 3% to 1153, however on average they have one AFO for 2.25 agri branches; the individual bank wise range is 1.5 branches to 11 branches per AFO. This gross inadequacy of AFOs is a major reason for suboptimal utilization of rural/semi rural branch network of the 5 big banks. The feedback from the BSC field offices and DFSUs suggests that a substantial number of these AFOs have also been deputed on routine bank operations, which makes the position even worse. The AFOs of specialized banks viz. ZTBL and PPCBL reduced marginally by 1.5% to 1744 largely due to non-hiring of fresh AFOs to replenish the AFOs retired during the year.

The table highlights some other indicators of banks' agrifinance outreach levels. The share of agrifinance branches in total branches slightly decreased to 45% in CY08 from 47.3% in CY07, which suggests that the growth in non-agrifinance branches of the banking industry was higher than the growth

Agri-finance Operational Efficiency Ratios

Ratios	5 Big Commercial Banks		Domestic Private Banks		Specialised Banks	
	Dec. 07	Dec. 08	Dec. 07	Dec. 08	Dec. 07	Dec. 08
% of Agri-finance Branches	47.30	46.63	29.57	25.60	99.80	99.80
Agri-officers per Branch	0.43	0.44	1.14	0.92	3.54	3.49
Borrowers per Agri Branch	166	249	139	125	1802	1856
Borrowers per Credit Officer	388	569	122	115	509	532
Loan per Credit Officer (in million)	49.22	54.72	45.32	50.68	47.48	51.31
Loan disbursed per Credit Officer (Rs. Mn.)	81.13	85.40	65.24	84.39	35.89	43.88
Average Loan Size (Rs. million)	0.127	0.096	0.369	0.440	0.082	0.096

Source: ACD, SBP

of agrifinance branches during the year. The DPBs registered the sharpest decline in the ratio which reduced to 26% in CY08 from 30% in CY07; the big 5 had a marginal reduction of 0.67 percentage points to 46.6% and that of Specialized Banks obviously remained unchanged at 100%.

The number of borrowers per agrifinance branch also exhibited rising trends both for the big 5 and the specialized banks; it however reduced marginally for the DPBs as the new agrifinance branches opened during the year would take some time to build the agrifinance portfolios. The rise in number of borrowers per branch though encouraging however it is largely attributed to the inclusion of RSPs borrowers in the banks' agrifinance portfolio. Also the borrowers per credit officer improved both for the big 5 and the specialized banks and declined for the DPBs due to the similar reasons. The amount of loans disbursed by each AFO improved significantly for all the three groups with the DPBs registering the highest rise in the amount disbursed per AFO as it increased to Rs. 84 million from Rs.65 million in CY07. The average loan size of the DPBs and the specialized banks increased to Rs.440,000 and Rs.96,000 from Rs. 369,000 and Rs. 82,000 respectively during the year which could be ascribed to a) the rise in per acre credit requirement due to substantial increase in agri-input prices and b) the tendency particularly of the DPBs to tap relatively high net worth larger farmers. The average loan size of the big 5 commercial banks however decreased significantly to Rs.96,000 as at close of CY08 from Rs.127,000 in CY 07 which is attributable to the inclusion RSPs borrowers in their portfolio.

Inter-Province Analysis of Agriculture Credit Distribution

Consolidated Position of Agriculture Credit (Rs. in million)

Province/ Regions	Disbursements				Outstanding				No. of Borrowers			
	CY-07		CY-08		Dec-07		Dec-08		CY-07		CY-08	
	Amount	Share %	Amount	Share %	Amount	Share %	Amount	Share %	No.	Share %	No.	Share %
Punjab	156,577	83.5	186,934	84.7	132,165	81.5	148,862	82.7	813,292	81.5	1302187	84.5
Sindh	21,767	11.6	23,476	10.6	18,449	11.4	20,277	11.3	103,973	10.4	120536	7.8
NWFP	7,961	4.2	8,805	4.0	8,586	5.3	9,005	5.0	69,775	7.0	94248	6.1
Baluchistan	458	0.2	675	0.3	1,869	1.2	910	0.5	1,578	0.2	2828	0.2
AJK	415	0.2	558	0.3	631	0.4	564	0.3	8,097	0.8	19601	1.3
NAs	249	0.1	283	0.1	412	0.3	437	0.2	1,068	0.1	2281	0.1
All Pakistan	**187,427**	**100.0**	**220,731**	**100.0**	**162,111**	**100.0**	**180,055**	**100.0**	**997,783**	**100.0**	**1,541,681**	**100.0**

Source: ACD, SBP

The table gives province wise position of Agriculture credit disbursement, No. of borrowers served during CY08 and outstanding portfolio as at the end Dec-08. This year again the Punjab Province dominated the agrifinance sector and absorbed 85% of total credit flows to the sector across the country. Similarly 85% of the farmers served by banks during the year were from Punjab, which is 3 percentage points higher than the ratio of the province's farmers served by banks during last year. This significant rise in the number of borrowers served in the province, as discussed above is largely due to the RSPs' borrowers which are mostly in Punjab. The share of Sindh in agricredit disbursements though remained almost unchanged at 11%, the number of agri-borrowers served in the province declined to about 8% from 10% during CY07. This decline is however relative and not absolute; as Punjab's share increased un-proportionally due to addition of micro agri. credit borrowers.

The outstanding agrifinance portfolio in Punjab also increased by 1 percentage point to 83% during the year. The share of other provinces in the outstanding agrifinance portfolio reduced marginally with Sindh share reducing to 11.3% from 11.4%, NWFP's to 5% from 5.3% and Baluchistan's to 0.51% from 1.2%. Thus despite concerted efforts by SBP, the provincial disparities in growth of agricredit are persisting which may be attributed to a) relatively better business and economic conditions in Punjab, b) relatively supportive and farmer friendly approach of the Punjab Provincial Government, c) larger penetration of banks in rural/semi rural areas of Punjab and d) relatively better credit culture in Punjab. These positive features in the rural economy of Punjab make the farming community of the province attractive for banks' investment. While the precarious law and order situation in NWFP and Baluchistan may not presently allow much room for improvement in outreach levels in these provinces, the Sindh province with about 20% share in the country's agricultural output may attract larger investment flows in its agriculture sector provided the demand side issues faced by the sector are addressed and provincial government adopts a more farmer friendly approach. The banks need to explore the possibility of investing in more profitable and growing sectors like livestock, horticulture etc. There is also a need for developing smart subsidies to incentivize banks to expand their network and portfolio in the province through regulatory and promotional measures/interventions.

Agri-credit Distribution and Agricultural Activities

The table on the right gives the province wise farm households in each province and number of farm households having access to bank loans, whereas the tables and charts below give the province wise production and share of major crops and fruits & vegetables. The province wise agricredit distribution and the agricultural activities being undertaken in each province shows that though Punjab is absorbing a major chunk of agricredit, it has the major share in the country's agricultural output. It produces 76% of country's wheat, 81% of cotton, 57% of Rice and 68% of sugarcane; its share in the country's fruits and vegetables during FY07 was 62% and 78% respectively. Further its rural areas are relatively better developed and easier to access as compared to other provinces. This endowment coupled with better credit culture enables the farming community of the province to fetch larger flows of credit. This however does not mean that the agrifinance outreach levels in the province are satisfactory as only 38% of farming households in the province have access to bank loans and still a large majority, about 62%, is out of the banking system and accessing informal sources to finance its agricultural activities.

Provincewise Agrifinance Penetration

Name of Province	Farm Household		Outstanding borrowers			
			Dec-07		Dec-08	
	No. of units	Share%	Number	Share*%	Number	Share*%
Punjab	3,883,843	58.34	1,198,836	30.87	1,480,528	38.12
Sindh	1,072,467	16.11	331,453	30.91	318,581	29.71
NWFP	1,368,287	20.55	139,901	10.22	133,411	9.75
Baluchistan	332,697	5.00	21,455	6.45	20,464	6.15
Total:	6,657,294	100.00	1,691,645	25.41	1,952,984	29.33

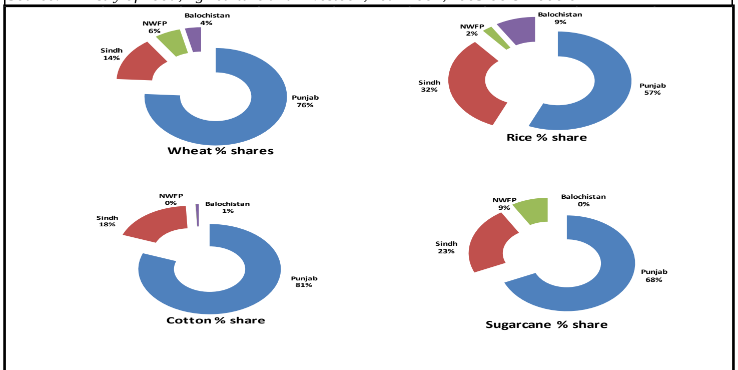
Source: Pakistan Agricultural Census 2000 & ACD, SBP

*% of Province's Farm Households

Province-wise Production of Major Crops

Provinces	Production in '000' Tonnes (*million bales)							
	Wheat		Cotton*		Rice		Sugarcane	
	2005-06	2006-07	2005-06	2006-07	2005-06	2006-07	2005-06	2006-07
Punjab	16,776	17,850	10.27	10.50	3,180	3,076	28,969	37,542
Sindh	2,750	3,409	2.65	2.40	1,721	1,762	11,243	12,529
NWFP	1,101	1,390	0.01	0.01	127	123	3,834	4,800
Balochistan	650	871	0.10	0.09	529	478	15	-
Total	**21,277**	**23,520**	**13.02**	**13.00**	**5,556**	**5,438.52**	**44,060**	**54,871**

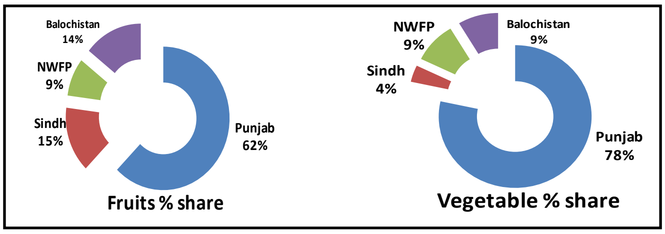
Source: Ministry of Food, Agriculture and Livestock, Year Book, 2005-06 & 2006-07



Province wise Production of Fruits & Vegetables

Provinces	Fruits				Vegetables			
	2005-06		2006-07		2005-06		2006-07	
	Prod. (Tonnes)	Share %	Prod. (Tonnes)	Share %	Prod. (Tonnes)	Share %	Prod. (Tonnes)	Share %
Punjab	4,764,036	66.7	3,744,858	62.3	3,475,462	74.1	4,483,717	78.4
Sindh	884,332	12.4	888,790	14.8	211,409	4.5	215,065	3.8
NWFP	519,085	7.3	516,146	8.6	520,076	11.1	532,007	9.3
Balochistan	980,169	13.7	861,434	14.3	485,698	10.4	488,738	8.5
Total	**7,147,622**	**100.0**	**6,011,228**	**100.0**	**4,692,645**	**100.0**	**5,719,527**	**100.0**

Source: MINFAL, Year Book 2005-06 & 2006-7



The Sindh province however despite having about 20% share in the country's agricultural GDP is absorbing 11% of credit flows to the agriculture sector. It produces 15% of country's wheat, 18% of cotton, 32% of Rice and 23% of sugarcane and has 15% share in fruits and 4% share in vegetables. Only 318,581 farming households of the province have access to bank loans, which constitutes 30% of total farm households in the province; a large majority is thus dependent on informal sources for their credit needs. SBP in collaboration with banks, SBP-BSC offices of Hyderabad and Sukkur and Sindh Board of Revenue has started a pilot project in seven agri. intensive districts of Sindh from Kharif Season 2009 to increase the flow of agri credit on fast track basis. The project is aimed at focusing banks in tapping new borrowers in these districts. For timely completion of the passbook related formalities One Window Operation has also been started by the Sindh Board of Revenue in the Pilot districts.

The N.W.F.P. province has minor share in major crops; 6% in wheat, 2% in rice and 9% in sugarcane crops; it also contributes 9% each in fruits and vegetables. The overall share of the province in agricredit though largely comparable with the agricultural contribution of the province, however the overall outreach levels are low at 10%. The proportion of small and subsistent farmers in the province is also higher compared to other provinces. The Baluchistan province also has a meager share in agricultural production; 4% in wheat, 9% in rice, 14% in fruits and 9% in vegetables. It however has tremendous potential in livestock (particularly sheep and goat) and fisheries; these sectors however are also largely undeveloped or under developed. The agrifinance outreach levels in the province have been exhibiting declining trends since the recent past due to political unrest, poor law and order situation and rampant default culture. The frequent loan write off packages announced by successive governments have contributed significantly in promotion of default culture in the province's agricultural/farming community.

Intra-Province Analysis of Agriculture Credit

The following sections discuss the intra provincial disparities in each of the four provinces:

Punjab: The table gives top 10 districts of Punjab that absorbed highest Agri-credit in the province during CY 08. Among the top 10 districts of the province 6 are the same based on each of three parameters viz. the disbursements, the outstanding portfolio, and the number of borrowers served[2] during CY08; their rankings are however different under each criterion. Whereas, Lahore, Rawalpindi, Faisalabad and Multan are amongst

Top Districts in Terms of Agri Loan Disbursments, Outstanding and No. of Borrowers (Jan-Dec 08)

	Highest Loan Disbursements (Rs. in million)		Highest Loan Outstanding (Rs. in million)		Highest No. of Borrowers	
Punjab	Lahore	22,114.38	Bahawalpur	8,311.12	Bahawalpur	171,585
	Multan	15,591.97	Lahore	8,252.31	Sahiwal	106,431
	Bahawalpur	12,485.52	Okara	8,077.27	Bahawalnagar	60,492
	Rawalpindi	11,782.92	Rahimyar Khan	7,404.33	Sargodha	56,804
	Gujranwala	10,202.48	Faisalabad	7,064.87	Rahimyar Khan	49,501
	Rahimyar Khan	8,460.43	Multan	6,660.01	Jehlum	47,398
	Sahiwal	7,954.95	Sargodha	6,539.38	Bhakkar	44,888
	Okara	7,493.40	Gujranwala	6,052.79	Vehari	41,603
	Sargodha	7,447.01	Sahiwal	5,793.52	Gujranwala	40,875
	Faisalabad	6,852.29	Sheikhupura	5,688.39	Okara	40,764
	Province Total (PT)	**186,933.71**		**148,861.66**		**1,302,187**
	Top 10 Distt. as % of PT	**59.05**		**46.92**		**50.71**
	Top 5 Distt. as % of PT	**38.61**		**26.27**		**34.16**

Source: ACD, SBP

[2] Number of borrowers served during the period means the borrowers who obtained loans during the period; they include both the rolled over and new loans.

the top districts based on disbursements and or outstanding portfolio but ranked quite low (not part of top 10) based on the number of borrowers served.

The top 10 districts of the province accounted for 59% of agricredit disbursements, 47% of outstanding agri-loans portfolio and 51% of agri borrowers served during the year; more or less similar was the distribution of the agricredit outreach in the province in CY07. The top 5 districts' share in total number of agri-borrowers in the province increased substantially to 34% during the year from 29% in CY07; their share in disbursements and outstanding portfolio however decreased to 39% and 26% respectively from 42% and 28% in CY07. The position is attributable to the inclusion of microcredit borrowers in banks' agrifinance portfolio, most of which are in Punjab and have small tickets but large volumes.

Sindh: The table gives top 10 districts of Sindh province with respect to agri-credit disbursement, loan outstanding and No. of borrowers served during CY 08; almost all the top 10 districts are the same as in CY07. The province witnessed substantial reduction in the intra province concentration of agricredit during the year. The top 10 districts' share in disbursements, outstanding loans and number of borrowers served reduced to 77%, 68% and 80% respectively from 84%, 72% and 85% in CY07. Despite this weakening in the intra province concentration levels, they are still on higher side and have ample space for further downward adjustment by bringing the farmers of other agriculturally rich districts in the banking fold. The low penetration of banks in interior Sindh, relatively higher default rates, the structural/procedural weaknesses of the revenue department, limited awareness about the benefits of obtaining bank loans etc. are largely responsible for the low outreach of financial services in the province. The overwhelming reliance of the farming community on specialized institutions like ZTBL which extend agri-loans at subsidized rate of 8% has also been responsible for discouraging the commercial banks to expand their agrifinance portfolio in the province. The anecdotal evidence suggests that a very large majority of the province's farmers consider ZTBL as the only bank extending agri-loans. As discussed above also a Pilot Project has been initiated in 7 districts of Sindh in March, 2009 in collaboration with Sindh Revenue Department for increasing outreach of agrifinance in these districts; the model adopted in the pilot project, if proved effective will be replicated in other districts of the province.

Top Districts in Terms of Agri Loan Disbursments, Outstanding and No. of Borrowers (Jan-Dec 08)

	Highest Loan Disbursements (Rs. in million)		Highest Loan Outstanding (Rs. in million)		Highest No. of Borrowers	
Sindh	Karachi	3,961.96	Sukkur	1,791.76	Hyderabad	19,939
	Hyderabad	2,726.44	Hyderabad	1,622.80	Sukkur	10,859
	Kashmore - Kandhkot	2,260.93	Kashmore - Kan	1,615.88	Nawabshah	10,564
	Sukkur	2,035.85	Karachi	1,551.97	Kashmore - Kandhl	10,181
	Nawabshah	1,930.42	Nawabshah	1,431.48	Matiari	10,171
	Mirpurkhas	1,321.83	Mirpurkhas	1,360.58	Jamshoro	7,719
	Ghotki	1,174.19	Ghotki	1,321.55	Larkana	7,357
	Larkana	1,056.75	Sanghar	1,258.46	Mirpurkhas	6,976
	Sanghar	851.01	Badin	917.58	Ghotki	6,796
	Thatta	827.22	Larkana	908.81	Sanghar	6,220
	Province Total (PT)	**23,475.99**		**20,276.80**		**120,536**
	Top 10 Distt. as % of PT	**77.3**		**68.0**		**80.3**
	Top 5 Distt. as % of PT	**55.0**		**39.5**		**51.2**

Source: ACD, SBP

N.W.F.P. The table on the right gives the top 10 districts that absorbed most of the agricredit during the year. The province witnessed slight reduction in the intra province concentration of agricredit during the year. The top 10 districts of the province accounted for 76% of agricredit disbursements and about 83% of the borrowers as at

Top Districts in Terms of Agri Loan Disbursments, Outstanding and No. of Borrowers (Jan-Dec 08)

	Highest Loan Disbursements (Rs. in million)		Highest Loan Outstanding (Rs. in million)		Highest No. of Borrowers	
N.W.F.P	Mardan	1,480.08	Dera Ismail Khan	1,416.03	Mardan	20,943
	Dera Ismail Khan	1,418.81	Mardan	1,315.21	Charsadda	13,879
	Charsadda	768.35	Charsadda	824.10	Malakand	10,161
	Swat	607.81	Swat	664.82	Swat	8,669
	Peshawar	555.98	Bannu	526.92	Chitral	5,965
	Swabi	531.61	Swabi	475.24	Swabi	5,925
	Bannu	398.00	Peshawar	457.42	Dera Ismail Khan	4,237
	Nowshehra	338.97	Chitral	446.35	Bannu	3,297
	Dir Lower	308.89	Lakki Marwat	404.00	Mansehra	2,823
	Mansehra	301.90	Mansehra	317.98	Dir Lower	2,563
	Province Total (PT)	**8,804.92**		**9,005.16**		**94,248**
	Top 10 Distt. as % of PT	**76.2**		**76.0**		**83.3**
	Top 5 Distt. as % of PT	**54.9**		**52.7**		**63.3**

Source: ACD, SBP

close of CY08 compared to 79% of the disbursements and 84% of the borrowers as at close of CY07. The change may be ascribed to inclusion of about 10,000 RSPs' borrowers from the province in the agri portfolio, which increased the geographical diversity of the agrifinance outreach in the province.

Baluchistan: The agrifinance outreach levels in the province are also extremely low with only 6% of total farm households having the access to agri-loans; during CY08 only 2828 borrowers/farmers obtained bank loans which were just 0.85% of total farm households in the province. The huge difference between the outstanding borrowers and the numbers of borrowers served during the year is attributable to long overdue and defaulted loans of ZTBL and 5 big banks which are not being serviced since long but appearing in the banks' books.

Top Districts in Terms of Agri Loan Disbursments, Outstanding and No. of Borrowers (Jan-Dec 08)

	Highest Loan Disbursements (Rs. in million)		Highest Loan Outstanding (Rs. in million)		Highest No. of Borrowers	
Baluchistan	Nasirabad	303.32	Jaffarabad	238.58	Jaffarabad	844
	Jaffarabad	197.09	Kalat	220.91	Nasirabad	773
	Quetta	94.01	Nasirabad	144.32	Quetta	686
	Gawadar	21.15	Quetta	102.44	Sibbi	104
	Mastung	11.09	Mastung	44.98	Mastung	73
	Kohlu	5.78	Panjgur	25.80	Gawadar	65
	Panjgur	4.81	Kohlu	23.64	Kohlu	41
	Qilla Saifullah	4.59	Lasbela	13.02	Bolan	36
	Sibbi	4.55	Sibbi	10.99	Panjgur	36
	Kech (Turbat)	4.44	Pishin	10.35	Lasbela	33
	Province Total (PT)	**675.26**		**909.58**		**2,828**
	Top 10 Distt. as % of PT	**96.4**		**91.8**		**95.2**
	Top 5 Distt. as % of PT	**92.8**		**82.6**		**87.7**

Source: ACD, SBP

Most of the borrowers served during the year (88%) were concentrated in 5 districts and about 30% in Jaffarabad only. The banks though have some rural branch infrastructure in the province, the precarious law and order situation, political unrest and high default culture don't allow banks to develop and expand their agrifinance portfolios in the province.

Key Initiatives

In view of the vital importance of agriculture sector for the country's economy , SBP has been taking steps to ensure adequate flow of credit for the farm and non-farm activities. The initiatives include assigning indicative targets to banks and monitoring thereof, arranging capacity building programs for banks, removing policy and regulatory hurdles and organizing awareness programs, farmers meetings/melas etc. During the year the following major initiatives were taken:

- **Crop Loan Insurance Scheme-** A mandatory Crop Loan Insurance Scheme for five major crops viz. wheat, rice, sugarcane, maize and cotton has been introduced effective from Rabi crop 2008-09 to safeguard the risks of losses of banks and farming community in case of natural calamities. The insurance premium for the subsistence farmers will be by the government up to a maximum of 2% per crop.

- Indicative per acre credit limits have been enhanced on an average by 70% for major & minor crops, orchards and forestry. The enhancement in limits has been made on the basis of current prices of inputs like seed, fertilizer, pesticides, fuel, electricity, etc.

- **Capacity building of Banks**- to build and enhance the banks' agrifinance capacity, SBP launched one week Crash Training Program in May 2008 on cost recovery basis. Over 600 officers have been imparted training through 20 programs held at various offices of SBP BSC and /or regional offices of commercial banks. The SBP also arranged study visit of its officers and agri heads of banks to the Bank for Agriculture and Agricultural

Cooperatives (BAAC), Thailand in August 2008 with the objective of learning from its experiences in agri/ rural finance.

- **Guidelines on Islamic Agricultural Finance**- Keeping in view rising demand for Islamic Banking products for Agriculture, the Guidelines on Islamic Financing for Agriculture were issued facilitate banks in developing Shariah compliant products for agriculture financing.

- **Sindh Pilot Project**- In view of lower outreach levels of agri finance in Sindh province, a Pilot program was launched in seven agri intensive districts of the province viz. Hyderabad, Tando Allahyar, Mirpurkhas, Sanghar, Khairpur, Nawab Shah and Larkana from Kharif Season 2009. Under this project 220 agri designated branches have been given specific branch wise targets for agricredit disbursements. Above 10,000 farm households are likely to be extended loans in these 7 districts during Kharif season of CY09. For timely completion of revenue formalities and issuance of passbooks, One Window Operation has also been launched by the Sindh Board of Revenue in the pilot districts. The progress of the project implementation is being monitored regularly through field offices in Hyderabad and Sukkur offices.

Key Initiatives – SBPBSC

The DFSD being an extended arm of the SBP is responsible for dissemination and implementation of SBP policies through its field offices across the country. Some of the key initiatives taken by the department and its units for agrifinance include:

- **Farmers' meetings/Agri-Melas-** The DFSD Field Units arranged 10 Agrifinance Melas for enhancing farmers' and other stakeholders' awareness and understanding about SBP and financial sector initiatives for increasing flow of funds to the agriculture sector. The Agri-Melas have been instrumental in bringing all agri finance stakeholders under one roof for educating the farmers about their respective services and initiatives for the sector. These Melas attracted large number of farmers and got significant media coverage and have been quite successful in creating awareness about banking products among the target stakeholders.

- **Focus Group Meetings**- Separate Focus Group meetings for Micro, SME and Agriculture finance are held on quarterly basis at 13 offices of SBP-BSC to discuss issues/problems faced by stakeholders and to evolve local level operational strategies for increasing the outreach of financial services amongst the SMEs, farmers, micro enterprises and low income communities in both urban and rural areas. The Groups have representation of banks' regional chiefs, trade/industry/agri associations, women chambers of commerce, SMEDA, relevant government departments, NGOs etc and the members meet on quarterly basis to discuss the issues, developments etc in their respective sectors. Besides being an effective forum for dissemination of SBP policies, the Groups are also an important source of grassroots level feedback on SBP policies and initiatives for Development Finance.

- **Linkages with Educational and Research Institutions-** The DFSU units are also entrusted with the task of developing linkages with educational institutions and reputed Research Institutes to sensitize them about the emerging DF market. These linkages are instrumental in enhancing stakeholders' understanding about their functions, latest research and new developments in their respective areas.

- **Coordination with provincial Governments-** DFSD also coordinates with provincial agricultural, livestock and revenue departments to share and disseminate the provincial governments' initiatives and best practices for facilitating the farming community. In this respect Interprovincial Agricultural Workshops were held in June 2008 and May 2009 to bring the banks and the relevant government departments closer to each other and share their observations/concerns, experiences and plans for farmers' facilitation.

- **Agricultural Surveys-** Agriculture surveys of Sukkur and Gujranwala districts were prepared to explore the components of rural economies of the districts, the demand for financial services and issues faced by the rural population in accessing institutional finance. The survey reports have been placed on SBP website for wider dissemination of the survey findings.

3. Microfinance

Province wise penetration of MF		
Province	**Potential MF Market**	**Penetration Rate(%)**
NWFP	4,083,817	4
Punjab	15,233,924	8
Baluchistan	1,656,762	1
Sindh	6,357,795	6
Islamabad	74,750	5
Source: PMN		

The success of microfinance (MF) stems from the economic theory that access to finance by poor households is not only pro-growth but pro-poor as well. Access to financial services allows poor people to save, invest and make secure payments, which aid household well-being and business development. The overall outreach levels of financial services in Pakistan are however very low as only 14% of the adult population has access to formal financial services according to the Access to Finance Survey-2008[3]. The situation is even worse for poor and low income communities as less than 2% of poor/low income population is having access to financial services compared to over a quarter in Bangladesh, India and Sri Lanka[4]. While the MF penetration rate is low in all the provinces, it is more pronounced in resource poor provinces of NWFP and Baluchistan as evident from the table above.

Pakistan's microfinance sector is still relatively young and growing, gearing up for rapid growth. The sector is characterized by its institutional diversity, well-developed legal and regulatory framework, specialized financial infrastructure, and innovation-led approaches in delivery channels etc. The sector grew exponentially during 6-7 years preceding CY08, increasing its outreach levels to about 1.5 million clients. The CY08 however witnessed some deceleration in the pace of growth due to consolidation in some of the large MFPs and tight liquidity environment particularly in the 2nd half of the year. With this slowdown in the growth rate it is uncertain if the National Microfinance Strategy (NMS) target of reaching three million clients is achievable. Some realignment of the NMS targets with the recent developments in the sector and capacity of MFPs may thus be required to achieve the medium and long term targets envisaged in NMS. The following section reviews in detail the developments and trends in the sector with particular focus on outreach expansion and its regional distribution during CY08.

MF Sector Growth during CY08

The sector exhibited mixed trends during the year, some of the MFPs fared well while others found struggling to absorb the liquidity and/or rising loan delinquency shocks experienced by the sector during the year. The outreach measured in terms of number of active borrowers grew by just 18% to 1.8 million as compared to 47% during CY07 and an average annual growth rate of 40% achieved during the period 1999-2007. The slowdown that started in the second half of CY08 could be attributed to a) severe liquidity shortages particularly experienced by RSPs, which has the largest share in the country's MF market, b) a sudden rise in delinquency ratio particularly in Central Punjab after loan write off announcements by some political figures, c) consolidation by some of the MFPs, which was needed after a long period of steep growth and d) worsening law and order situation particularly in NWFP and Baluchistan.

The fast pace expansion of microcredit during the last eight years was being financed by a mix of subsidized funding and commercial loans from donors and commercial banks respectively and to some extent by the MFBs' deposits. As the interbank market was fairly liquid during

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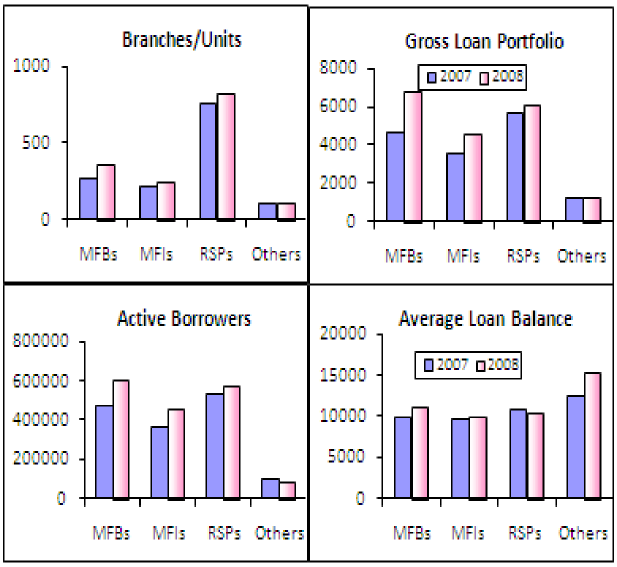
[3] Access to Finance Survey, 2008 in Pakistan carried out by the World Bank
[4] World Bank, "Bringing finance to Pakistan's Poor" 2009.

this period, the MFPs didn't face much difficulty in raising commercial loans from banks. The liquidity scenario however changed substantially during CY08 as severe liquidity shortage was witnessed, particularly in the second half, forcing SBP to reduce CRR and SLR rates to release/inject some liquidity in the market.



The liquidity crunch coupled with some bad news regarding rising loan delinquency ratios of some of the MFPs made the banks extremely cautious in renewing the existing and/or approving the fresh credit lines to MFPs. A consortium of commercial banks did not renew/roll over the credit line of Rs.1.6 billion of NRSP forcing it to deny renewal/rollover of loans of about 200,000 borrowers during the last and first quarter of CY08 and CY09 respectively. The CY08 thus proved a difficult year for Rural Support Programs (RSPs) as the growth in their active borrowers, Gross Loan Portfolio (GLP) and Branches/units retarded to 10%, 8% and 7% respectively from 57%, 72% and 18% in the preceding year. This retardation is likely to continue during CY09 as the liquidity conditions though improved somewhat, however the banks' appetite for lending to MFPs has yet not improved. The Microcredit Guarantee Facility (MCGF) announced by SBP in December, 2008 to incentivize banks to extend wholesale funds to MFPs may convince some banks to take exposure on MFPs; however the overall response of the banking industry towards lending to MFPs remained muted by the second half of CY09.

Comparative Analysis of MF Sector's performance during 2007 & 2008

Parameter\ MFP		MFBs		MFIs		RSPs		Others		Total	
		2007	2008	2007	2008	2007	2008	2007	2008	2007	2008
Branches/Units	#	269	366	217	256	758	820	99	110	1,343	1,552
Active Borrowers	#	476,909	605,151	369,032	463,160	530,937	581,513	94,417	83,055	1,471,295	1,732,879
Gross Loan Portfolio	Rs. Mln	4,702	6,801	3,552	4,594	5,694	6,084	1,186	1,274	15,134	18,753
Average Loan Balance	Rs	9,860	11,238	9,626	9,919	10,724	10,462	12,553	15,334	10,286	10,821
No.of Loans Disbursed	#	490,396	646,622	536,023	662,295	640,885	753,309	83,297	64,338	1,750,601	2,126,564
Disbursements	Rs. Mln	6,273	9,281	6,036	8,496	9,135	12,105	1,162	1,088	22,606	30,970

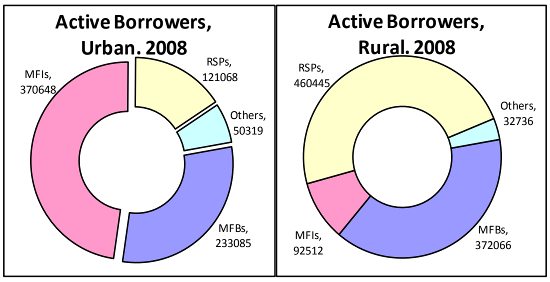
Source: PMN

The MFIs also experienced massive reduction in the growth rates as their active borrowers, GLP and Branches/ units grew by 26%, 29% and 18% respectively as compared to the last year's growth of 84%, 81% and 68% respectively. This hefty deceleration in the MFIs' growth thus also contributed significantly in overall slowdown in the MF sector growth during the year. The MFIs' growth deceleration is attributable to consolidation by one of the largest MFI which grew exponentially during five years preceding CY08. The consolidation was necessitated by a significant rise in loan delinquency ratio of the MFI which among others was also triggered by loan write off announcements by some political functionaries in Central Punjab. The deceleration in MFIs' growth is also likely to continue during CY09 due to continuation of the consolidation phase as well as the tight liquidity position of the MFIs as discussed above.

The MFBs' performance during the year however remained relatively better as they achieved 27% growth in active borrowers, 45% in GLP and 36% in branches/units as compared to the last year's growth of 29%, 20% & 12% respectively. The MFBs in fact accounted for almost half of the MF sector growth in terms of active borrowers during the year; in terms of GLP, the MFBs contributed about 58% of the sector growth during the year. This relatively better performance is attributable to a) relatively better liquidity position of MFBs, particularly the two oldest and largest MFBs and b) partnership with Pakistan Post (PP) and the two largest MFBs. While one of the largest MFBs (KB) has sufficient funding from ADB under Microfinance Sector Development Program (MSDP), the other largest MFB (FMFBL) has developed its own deposit base and thus remained insulated from the liquidity crisis experienced by the sector during CY08. FMFBL in fact is a success story in savings mobilization as it has been able to build and enhance its deposit base even in difficult times. The partnership with PP for marketing and selling micro loans through PP outlets also enabled MFBs to achieve better growth rate during the year. The PP has about 13,000 outlets across the country, even in far flung and remote rural areas. The PP and MFBs collaboration is thus an important beginning of public private partnership in the MF sector and will be instrumental in achieving fast pace expansion of MF services across the country.

Rural Urban Mix of MF Outreach

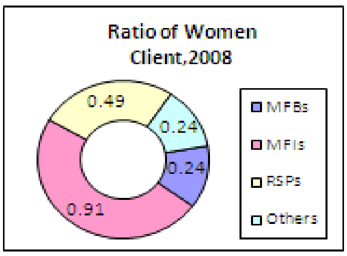
Despite the hefty reduction in rural borrowers of RSPs, the MF outreach levels in rural areas improved by 18% during CY08 to 0.958 million from 0.814 million in CY07. The MFBs here again had a lion's share (64%) in this significant improvement as their rural borrowers improved by 32% to 372,066 borrowers in CY08 from 280,520 in CY07. Amongst MFBS, the FMFBL registered the largest increase in its rural borrowers which increased to 103,000 from 45,000 in the preceding year. This stellar growth in the bank's rural portfolio is largely attributable to its partnership with Pakistan Post, which enabled it to add more than 38,000 borrowers during the year, all of which were rural. In contrast, the RSPs could have just 4% increase in the number of their rural borrowers that reached to 460,445. This apparently low growth is mainly due to drastic decline in the number of active borrowers of NRSP in the last quarter of CY08 from 604,776 to 463,383; all this reduction was in rural borrowers. The MFIs, which are largely urban based, also made significant contribution in expanding the outreach in rural areas; their rural borrower grew by 35% during the year to 92,512.



The urban outreach levels also improved by 18% during the year to 0.775 million from 0.657 million in CY07. The MFBs with 19% rise in their urban borrowers contributed 31% of the MF growth in urban areas; the MFIs despite having predominantly urban focus could register a growth of just over 6% in their urban borrowers and had 19% share in the sector's urban growth; the RSPs registered a significant rise of 37% in their urban borrowers and accounted for 28% of the total growth in urban borrowers. About 23% of the growth in urban borrowers also came from other institutions like BRAC, CWCD, Orix Leasing etc whose urban outreach levels more than doubled to 50,000 during the year.

MF Outreach- Gender wise Composition

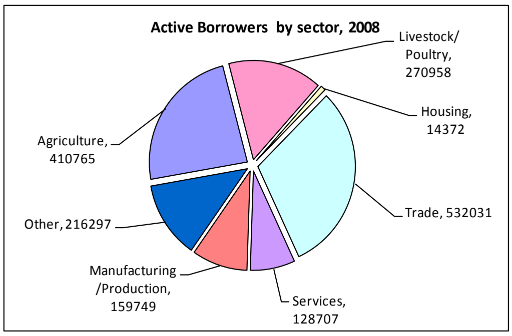
Another positive development in the MF sector during the year was more than 3 percentage point improvement in share of female borrowers to 53%. Probably for the first time in the relatively short history of MF in the country, the female active borrowers have surpassed their male counterparts; the chart (on the right side) gives ratios of female clients for each type of MFPs. This shift in favor of female clients is more due to



reduction in male borrowers and less due to addition of female borrowers; as discussed earlier the RSPs experienced big decline in their rural portfolio, which is largely male denominated. However some of this improvement can also be attributed to appreciable performance of BRAC which is female focused MFP that started operations in the country a couple of years ago.

MF Outreach- Sector wise Composition

In line with last year's trend, the borrowers from Trade, Agriculture and livestock/poultry sectors remained the major beneficiaries of the micro credit from MFPs during CY08. However, the shares of Trade and Services sectors have witnessed a decline from 37% & 11% to 31% & 7% respectively during the year. The reduction in RSPs' trading portfolio by 90,000 borrowers accounted for most of this decline in the share of trading and services sector in the total MF outreach.



Micro Saving

The Micro-savings in terms of savings volume grew by 35% during the year. The MFBs with over 70% share in total savings of the sector accounted for most of this growth in the savings. Amongst MFBs, the FMFBL has the largest share of 80% followed by TMBL with 16% share in total savings of the MFBs. The MFBs however have just 14% share in active micro savers which suggests that bulk of the MFBs' savings/deposits are from high net worth individuals and or institutions. This though reflects the MFBs' ability to attract high net worth individuals and institutions to use MFBs' banking facilities, particularly in tight liquidity environment when deposits were relatively hard to mobilize, however the greater reliance on high value accounts may make the MFBs vulnerable to liquidity shocks due to sudden withdrawal of the high value deposits. The MFBs should thus also focus on broadening their deposit base to minimize such liquidity risks.

The number of active micro savers grew by 14% during the year. The RSPs have the largest share in terms of number of savers; amongst the RSPs, NRSP with 977,836 active savers is the largest player in the sector, its share in total active micro savers improved by more than 6 percentage points to 56% during the year. The RSPs' micro savers however, are not having separate accounts with banks; they are in fact members of Community Organizations (COs) formed by RSPs which open their accounts in commercial banks who deposit their savings as a mandatory requirement for obtaining loans from RSPs.

The micro-savings though increasing at a appreciable rate since last 3-4 years there is still a huge unmet demand for micro-savings in the country. According to the recent study on access to finance by World Bank[5], the demand for savings is more than the demand for credit and that micro savings could prove to be a promising long-term, low cost source of funding for MFPs. The severe liquidity crunch and the resultant slow down in MF growth rate witnessed during the year has also highlighted the critical importance of developing self sufficiency in resource mobilization for MFPs to finance their credit growth. The MFPs having stable sources of funds faced no difficulty in absorbing the liquidity shock and preformed much better than those with uncertain funding sources.

[5] World Bank, "Bringing finance to Pakistan's Poor" 2009

MF Outreach- Regional Trends

Geographically, MF outreach expanded across the four provinces at varied rate and ratio. The Table on the right gives province wise distribution of MF outreach viz. the number of MF branches, borrowers, GLP, savers and savings. Although the MFPs' branch network expanded by about 16% during the year, however almost all the branches were opened in the districts/ areas that already had some branches as hardly any new district was added in the MFPs' network.[6]

MF Outreach- Geographical Spread

Provinces	Branches/Units #		Active Borrowers #		GLP (Rs. in mln)		Active Savers #		Savings (Rs. in mln)	
	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008
NWFP*	134	164	153,461	166,200	1,756	1,880	141,871	174,382	535	727
Isb & AJK	34	34	20,821	25,957	160	204	94,768	114,515	282	332
Punjab	890	1025	974,877	1,167,558	10,265	12,634	843,223	945,136	1,169	1,576
Baluchistan	24	22	17,957	20,021	126	154	38,252	32,090	55	17
Sindh	259	307	304,179	353,143	2,826	3,880	412,261	477,486	1,958	2,731
Grand Total	**1341**	**1552**	**1,471,295**	**1,732,879**	**15,133**	**18,752**	**1,530,375**	**1,743,609**	**3,999**	**5,383**

* including figures for FATA & FANA regions

Source: PMN

The table on the right gives top 10 districts of the country based on number of active borrowers, GLP, number of micro savers and the savings volumes. While the top 10 districts based on number of borrowers and GLP are almost the same with slightly different rankings, they are different based on number of micro savers and the savings volumes. The Sindh province is seemingly more fertile in attracting savings whereas Punjab is apparently a better credit market for MFPs as 9 out of top 10 districts based on number of borrowers and GLP are from Punjab and only one from Sindh. The relatively better share of Sindh in savings is attributable to Thardeep Rural Development Program (TRDP), a Thar based NGO with predominant focus on promoting savings amongst its members; Tharparkar with about 133,000 savers is top ranking district in the country based on number of micro savers.

Top 10:Districs in terms of Highest Borrowers, & Loan Portfolio, Highest no. of Savers and Savings.

Active Borrower		Gross Loan Portfolio		Active Savers		Value of Savings	
Districts	#	Districts	Rupees	Districts	#	Districts	Rupees
Lahore	186,482	Lahore	1,998,861,801	Tharparkar	132,907	Karachi	1,667,841,373
Faisalabad	95,991	Bahawalpur	968,241,387	Bahawalpur	114,602	Hyderabad	287,984,387
Karachi	93,990	Karachi	951,528,925	Karachi	61,778	Islamabad	283,155,513
Bahawalpur	72,210	Faisalabad	850,887,724	Rawalpindi	58,606	Chitral	250,012,225
Multan	68,816	Gujranwala	731,597,906	Khushab	53,151	Bahawalpur	244,066,057
Gujranwala	59,980	Multan	727,439,287	Bhawalnagar	52,169	Gilgit	177,374,000
Kasur	58,082	Kasur	568,458,408	Attock	49,579	Multan	166,304,684
Rawalpindi	52,138	Rawalpindi	447,926,828	Faisalabad	48,776	Lahore	142,171,190
Sargodha	39,780	Rahimyar Kha	426,791,968	Badin	47,698	Tharparkar	112,194,801
Sahiwal	35,144	Bhawalnagar	364,788,464	Bhakkar	47,486	Skardu	99,644,163

Source: PMN

The tables below show top 10 districts in each province based on MF outreach levels. The Punjab province with largest presence of MFPs' branches/units continued to attract larger flows of microcredit in CY08. During the year the province's share in MF branches, GLP and total savings remained intact at 66%, 67% and 29% respectively; it improved by 1 percentage point in active borrowers to 67% and decreased by 1 percentage point in active savers to 54%. The intra province distribution of MF outreach suggests relatively better dispersion of MF outreach across Punjab than the other provinces. The top five districts of Punjab accounts for 41% of total MF borrowers in the province, whereas the top 10 districts have 60% of the MF borrowers.

Top Districts: Punjab

Borrowers		Active Savers		Policy Holders	
Cities	#	Cities	#	Cities	#
Lahore	186,482	Bahawalpur	114,602	Lahore	221,423
Faisalabad	95,991	Rawalpindi	58,606	Bahawalpur	159,150
Bahawalpur	72,210	Khushab	53,151	Faisalabad	93,093
Multan	68,816	Bhawalnagar	52,169	Multan	77,467
Gujranwala	59,980	Attock	49,579	Gujranwala	73,411
Kasur	58,082	Faisalabad	48,776	Kasur	68,839
Rawalpindi	52,138	Bhakkar	47,486	Rahimyar Khan	57,896
Sargodha	39,780	Lodhran	42,396	Sahiwal	56,938
Sahiwal	35,144	Chakwal	38,369	Bhawalnagar	56,509
Rahimyar Khan	32,293	D.G. Khan	31,253	Sargodha	55,165

Source: PMN

The Sindh province enhanced its share in GLP and total savings by 2 percentage points each to 21% and 51% respectively and by 1 percentage point in MF branches to 20% during CY08.

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[6] PMN's "Spotlight on Microfinance". Feb., 2009.

Its share in active borrowers and active savers remained intact at 20% and 27% respectively. The top five districts of Sindh accounts for 54% of total MF borrowers in the province, whereas the top 10 districts have 75% of the MF borrowers.

Despite the prevailing political unrest in the province, the share of NWFP in MF branches/units and active savers increased by 1 percentage point each to 11% and 10% respectively. Its share in GLP and active borrowers decreased by 2 and 1 percentage points respectively to 10% each. Its share in savings however, remained intact at 13%. The top five districts of MWFP accounts for 56% of total MF borrowers in the province, whereas the top 10 districts have 74% of the MF borrowers.

The MF outreach in the Balochistan province also remained intact with slight changes MF branches, active borrowers, GLP and Savings. The top five districts of Balochistan accounts for 74% of total MF borrowers in the province, whereas the top 10 districts have 99.7 % of the MF borrowers.

Top Districts: Sindh

Borrowers		Active Savers		Policy Holders	
Cities	#	Cities	#	Cities	#
Karachi	93,990	Tharparkar	132,907	Karachi	93,762
Hyderabad	33,399	Karachi	61,778	Hyderabad	45,273
Khairpur	23,782	Badin	47,698	Khairpur	37,603
Sanghar	19,497	Mirpur Khas	42,163	Tharparkar	33,545
Larkana	18,589	Dadu	37,232	Umer Kot	22,906
Nawabshah	18,224	Umer Kot	37,096	Dadu	22,311
Mirpur Khas	15,722	Khairpur	26,804	Mirpur Khas	19,274
Dadu	14,472	Hyderabad	21,916	Larkana	18,589
Matyari	13,546	Thatta	15,177	Nawabshah	18,419
Jacobabad	11,940	Tando Allahyar	10,884	Sanghar	17,551

Source: PMN

Top Districts: NWFP

Borrowers		Active Savers		Policy Holders	
Cities	#	Cities	#	Cities	#
Mardan	29,282	Mardan	27,283	Mardan	48,552
Nowshera	16,944	Haripur	20,417	Peshwar	19,956
Peshwar	16,912	Malakand	16,684	Malakand	17,794
Charsadda	13,411	Gilgit	15,729	Nowshera	17,592
Malakand	10,267	Chitral	15,344	Charsadda	15,519
Swabi	10,015	Mansehra	14,641	Swabi	13,591
Chitral	8,631	Swabi	13,828	Chitral	7,977
Abbottabad	6,770	Charsadda	9,665	Abbottabad	6,029
D.I. Khan	6,226	Abbottabad	9,001	D.I. Khan	5,969
Haripur	5,323	Skardu	6,946	Gilgit	4,882

Source: PMN

Top Districts: Balochistan

Borrowers		Active Savers		Policy Holders	
Cities	#	Cities	#	Cities	#
Quetta	4,474	Kech (Turbat)	21,717	Quetta	4,418
Jafarabad	3,485	Gwadar	9,276	Jafarabad	3,485
Nasirabad	2,493	Quetta	1,097	Nasirabad	2,493
Gwadar	2,186			Gwadar	2,333
Loralai	2,088			Loralai	2,088
Sibi	1,878			Sibi	1,878
Pishin	1,334			Pishin	1,334
Barkhan	986			Barkhan	986
Zhob	717			Zhob	717
Mastung	336			Mastung	336

Source: PMN

Key Initiatives/Developments

Following were the steps/initiatives to facilitate the development of microfinance industry in the country during the year 2008:

<u>SBP/SBP BSC:</u>

- The State Bank of Pakistan issued license to Kashf *Microfinance Bank Limited* (KMFB) which plans to reach out to over one million savers and 350,000 borrowers through a network of 100 nationwide branches up to 2012.[7]

- As part of the efforts to strengthen institutional development through transformation of stronger MFIs/RSPs into regulated MFBs, SBP has also recently issued license to *NRSP Microfinance Bank* Limited though it has not started operations yet.

- The *Development Finance Conference* was held at the State Bank of Pakistan on 1st July, 2008 and 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.

- SBP issued Branchless Banking guidelines to promote banking in remote/rural areas[8].

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[7] http://www.sbp.org.pk/press/2008/KMB-25-OCT-08.pdf

[8] http://www.sbp.org.pk/press/2008/Rural_Financa-26-Dec-08.pdf

- SBP allowed MFBs to share their customers' data with pilot/private CIB(s) subject to development of comprehensive customer protection and confidentiality guidelines duly approved by their Board of Directors and with the customers' consent.

- The DFSUs in 13 SBP-BSC offices across the country organized a number of seminars, workshops and Microfinance Melas (fairs) to enhance the financial literacy of micro and small enterprises and low income population. These programs have also been instrumental in promoting linkages between MF stakeholders, which is a prerequisite for synergizing the stakeholders' efforts and initiatives for increasing outreach of microfinance.

- To ease the liquidity constraints of MFPs and to support of microfinance sector to promote financial inclusion, SBP announced following three facilities:[9]

    - The Microfinance Credit Guarantee Facility (MCGF)
    - The Institutional Strengthening Fund; and
    - The Improving Access to Finance Services Fund

Government:

- The Planning Commission of Pakistan organized a roundtable on the "State of Microfinance in Pakistan and Recommendations for the Future" on 12th March, 2009, in collaboration with PMN.

- Pakistan Poverty Alleviation Fund (PPAF) launched its five-year PRISM program on the 3rd of July 2008 which is financed mainly through a long-term concessionary loan of US$ 42.1 million to the GoP from IFAD. The program aims to promote sustainable microfinance in Pakistan.

Others (PMN, MFPs etc.):[10]

- To promote best practices and transparency in the MF sector, PMN launched *Code of Conduct for Consumer Protection* on 26th January, 2009.

- PMN has made significant progress in establishing the *Pilot Credit Bureau* for Microfinance industry in Lahore region. The proposed date of going live of this project is July, 2009.

- Khushhali Bank was converted into a public limited company in April 2008, licensed by SBP and started operations under MFI Ordinance, 2001 w.e.f. April 1, 2008.

- ASA-Pakistan started its operation in September, 08 in Karachi. ASA is internationally recognized as one of the leading MFIs of Bangladesh.

- FMFBL was ranked 7th out of 652 MFIs in the 2008 MIX Global 100 Composite Ranking announced on 22nd December, 2008. Its previous rating was 16th. The only other MFI from Pakistan in the top 100 ranking is KASHF, ranked 27th.

- Telenor Pakistan has acquired 51% share of Tameer Microfinance Bank (TMBL) for a foreign direct investment of US$12.5 million through a direct rights issue.

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[9] http://www.sbp.org.pk/MFD/initiatives.htm
[10] http://www.microfinanceconnect.info/user_industry_news_display.php

4. SME Finance

Small and Medium Enterprises (SMEs) are increasingly becoming a focal point of academic as well as policy makers' interest. As more data has become available in recent times, numerous studies have been undertaken to examine the characteristics of such enterprises and more importantly their contribution to important economic variables such as employment, GDP growth and poverty alleviation. The SME sector contributes 60% of GDP and over 70% of total employment in low-income countries; while they contribute over 95% of total employment and about 70% of GDP in middle-income countries[11]. Although there is some debate whether a vibrant and large SME sector has a causal relationship with GDP growth, there is sufficient consensus that such enterprises due to their labor intensive nature provide greater employment opportunities. Moreover, SMEs contribute towards more equitable income distribution. In addition, SMEs support the enrichment of systemic productive capacities as they help to utilize productive resources at all levels of the economy and thus contribute to a better integrated economic system.

For a large agrarian economy such as Pakistan, SMEs provide vertical and backward linkages and ensure that the produce is absorbed completely and at the local levels. The SMEs account for 30% of the country's GDP, 35% of the manufacturing value addition, 25% of the total export earnings and more than 70% of the total industrial labor force. Further, they constitute a dominant bulk, more than 90%, of industrial units in the country with smaller enterprises[12] constituting more than 98% of the SMEs. Similarly 84% of the SMEs have annual revenue of less than Rs. 0.5 million. This extremely large segment of the SMEs, however, has been largely out of the banking system and depends overwhelmingly on informal sources to meet their financing needs. The following section reviews the trends and developments in the country's SME finance sector during CY08.

SME Financing during CY08

The financing to SMEs during the year exhibited an unusual trend; the number of SME borrowers increased by 20.4% to 222,861 whereas the amount of loans outstanding against the SMEs reduced by 11.7% to 386 billion suggesting as if the banks have started down scaling and tapping the smaller enterprises(Table 1). The bank-wise analysis (Table 2), however, shed some light on this trend; the public sector banks registered significant growth in SME borrowers whereas the private and specialized banks registered negative growth, both in number of borrowers and the outstanding portfolio. Within the Public sector banks about two third of the growth came from NBP, the largest public sector bank, which had initiated the Federal Government sponsored self employment scheme (Karobar-auto rickshaw financing) in 2007 that continued during CY08, particularly during the first half. After adjusting the Auto rickshaw loans[13], which have no relevance with normal SME loans, the actual growth in SME outreach levels during the year was

Table 1: Penetration of SME finance

	2007	2008
Number of SME Borrowers	185,039	222,861
Penetration	6.2%	7.43%
Outstanding (Rs. in billion)	437.350	386.197
As % of GDP	8%	6.6%

Table -2: Bank Group wise Number of SME Borrowers

Name of Bank	No. of Borrowers		Change
	Dec-07	Dec-08	
Public Sector Banks	29,790	74,297	44,507
Specialized Banks	41,973	40,200	-1,773
Domestic Private Banks	113,028	108,083	-4,945
Foreign Banks	248	281	33
Total:	**185,039**	**222,861**	**37,822**

Source: BSD SBP

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[11] Ayyagari, Beck and Demirgüc-Kunt, 03).
[12] SMEs having up to 10 employees
[13] These loans have been classified under the category of SME loans on the instructions of SBP.

negative. The negative growth in SME portfolio however, was in line with the overall economic slowdown in the country generally and negative growth in large scale manufacturing particularly, which adversely affected the performance of manufacturing SMEs. Further, the bulk of banks' SME exposure is in manufacturing SMEs, which remained under stress during the year due to a number of negatives like depressed economic environment - both locally and internationally, long power outages, tight monetary conditions, political instability and fragile law and order situation that gripped the country throughout the year. The Box-1 on the next page highlights the issues faced by SMEs in accessing financial services.

Despite the net addition of about 38,000 SMEs in the banks' SME portfolio during the year, the number of SMEs reached by the banking industry by end CY08 was just over 7% of the total SMEs in the country. Further the SME loans portfolio was just 6.6% of GDP (8% in 2007), which is too low for a sector that contributes 30% to GDP. The position is however, largely in line with the trends in SMEs' access to finance across the globe generally and developing world particularly. A number of studies on SMEs suggest that SMEs have lesser access to formal sources of finance relative to larger firms[14]. For instance in South East Asia, financing from formal sources meets less than 25% of total financing requirement of the SME sector, and only 3% to 18% of the SMEs actually avail formal finance[15]. This is despite the empirically proved fact that the lack of finance from the formal sources has been one of the major impediments in development of the sector to its real potential in most of the developing economies. A detailed survey of more than 10,000 SMEs revealed that the probability that a firm rates financing as a major obstacle is 39% for small firms, 38% for medium-size firms, and 29% for large firms[16].

The table 3 exhibits similar trends for SMEs' access to finance in Pakistan. The corporate sector, which already had lion's share in banks' loan portfolio, further improved its share to 63% during the year from 56% in the preceding year. The SMEs' share however declined to 11% from 15% last year. This contraction in SME credit can be largely attributed to general economic slowdown as the SMEs by their very nature are more sensitive to economic cycles. The banks, which have been consistent in their negative bias and perception particularly for smaller enterprises, became more cautious in lending to SMEs due to the general economic slowdown as well as rising trend in Non Performing Loans in the sector.

Table 3. Sector wise Distribution of Credit

	Dec-07		Dec-08	
	Amount (000)	Share %	Amount (000)	Share %
Corporate Sector	1,622,570	56.4	2,154,547	62.7
SMEs	437,350	15.3	386,197	11. 2
Agriculture	150,789	5.2	155,506	4.5
Consumer Finance:	384,798	13.4	360,991	10.5
Commodity Financing	148,769	5.2	235,436	6.9
Staff Loans	52,326	1.8	64,783	1.9
Others	69,649	2.4	79,154	2.3
Total	2,866,251	100	3,436,614	100

Source: BSD SBP *The figures include domestic and foreign operations

[14] Beck, Demirgüç-Kunt, and Maksimovic 2005
[15] This number varies from country to country. Source ASEAN 2005
[16] Beck, T., Demirgüç-Kunt, A., Laeven, L., and Maksimovic, V., 2006. "The Determinants of Financing Obstacles", Journal of International Money and Finance 25, 932-952.

Text Box No. 1: SME Financing Issues

Supply-Side Issues of SME Financing:

- **Limited understanding of SME credit market; size and viability:** Only limited studies on estimation of total financing needs of the SMEs are available. Even worse is the situation in assessment of the sectoral credit market size and viability of SMEs operating in different sectors. Lack of proper financial figures severely curtail the ability to assess financial viability of the SME firms.
- **Lack of Industry benchmarks for SME financing**
- **SMEs perceived as high risk projects:** Lending to SMEs is perceived as a risky business venture due to the uncertainties facing small industries, the high mortality rates of such enterprises, vulnerability to market and economic changes etc.
- **Collateral issues:** most SMEs either lack the collaterals acceptable to banks or are reluctant to offer such collaterals to banks.
- **No mechanism for registering movable assets-**the absence of secured transaction regime in the country doesn't allow SMEs to use their plants and machinery as collaterals to secure bank loans
- **Lack of understanding of SME Business:** Some banks have not even developed the necessary infrastructure in terms of IT and human resource to handle large number of small loans
- **Fewer financing products/options for SMEs:** Financial Institutions are biased in favor of lending to large corporate borrowers and as such their financial products, lending procedures and financial analysis techniques are also highly skewed towards larger enterprises. SMEs being not in focus, banks have not developed appropriate products and lending procedures for them. Resultantly, their skill structures, product design and marketing and credit evaluation procedures are incompatible with the SMEs' dynamics.
- **Higher operational costs-** small ticket large volumes
- **Higher NPLs ratio for SMEs-** the industry average for NPLs in SME sector are higher than the overall average, which coupled with absence of credit guarantee schemes discourages banks to develop and expand SME finance portfolios.

Demand-Side Issues of SME financing

- Reluctance on part of SMEs especially SEs to borrow from banks. This reluctance may be attributed to:
  - Inadequate and delayed credit, Cumbersome lending procedures, Insistence on collaterals and guarantees
  - Informal Accounts and Management System: SMEs seeking loans are unable or unwilling to provide accounting records and other documentation required by banks
- Proposal Formulation: SMEs especially the SEs do not have exposure of dealing with formal lending institutions. They generally fail to appropriately put their loan proposal in front of the commercial banks.
- Difficulties in managing loan documents (volume/language)
- Lack of credit history
- Low level of awareness about available financing options. SMEs often complain about lack of information on the services/products available through banking channels.

Source: SME Department SBP and various focus group meetings at field units of DFSD, BSC Bank

The Non Performing Loans

Table 4: Non Performing Loans		
Sector	Dec-07	Dec-08
	%	%
Corporate Sector	7.14	8.88
SMEs	9.25	15.79
Agriculture	18.68	15.77
Consumer Finance	4.37	6.93
Commodity Financing	1.01	1.4
Staff Loans	1.17	0.97
Others	13.99	10.03
Total	7.44	9.13

Source: Banking Surveillance Department , SBP

The Non-Performing Loans (NPLs) of SME sector increased significantly during the year to 16% as compared to 9% in the preceding year. The SMEs' NPLs to total loans ratio at 16% was in fact the highest in all the sectors. The second half of CY08 witnessed an overall slowdown in the expansion of bank credit as the concerns emanating from global financial meltdown started impacting the domestic financial markets albeit with lesser severity. The rather uncertain domestic environment and political instability also made the banks to shy away from giving credit to most segments except to their blue chip customers. As a result financing to sectors like SMEs and consumers dried significantly. Concomitantly, many SME borrowers found themselves unable to pay their financial obligations due to several reasons, namely: disruption in their production due to power shortages; rising cost of inputs; high financing rates; and loss of export orders due to problems at the buyers' end. Thus the rise in NPLs to Loans ratio for SME sector during the year was due to both reduction in SME portfolio and defaults by the SMEs. The ratio was adversely affected on both sides, i.e. rise in NPLs and decline in gross SME loans.

Sector and Bank Group wise Distribution

Table 5: Sector and Bank Group wise distribution of SME loans in 2008 (Rs. in million)					
Type of Banks	Trading	Manufacturin	Services	Total	Share %
Public Sector Banks	29,110	17,402	8,313	54,825	14
Specialized Banks	5,052	3,963	1,035	10,050	3
Domestic Private Bank	101,858	161,427	49,448	312,733	80
Islamic Banks	3,742	2,135	948	6,825	2
Foreign Banks	752	761	251	1,764	1
Total	**140,514**	**185,688**	**59,995**	**386,197**	**100**
Share%	**36**	**48**	**16**	**100**	

Source, Statistics Department, SBP

The table 5 gives sector and bank group wise distribution of SME loan portfolio. The manufacturing SMEs had the largest share of 48%, followed by 36% and 16% of Trading and Services SMEs respectively. Interestingly this credit distribution does not correspond to the sectoral distribution of SMEs; the manufacturing SMEs constitute only 20% of total SMEs but absorbed almost half of the lending to SME sector. On the other hand trading and services SMEs despite accounting for about 80% of the SMEs could fetch 52% of the SME loans. This distribution may be ascribed to relatively more organized nature, bigger size and larger financing needs of manufacturing SMEs. Most of the trading SMEs besides being small and less organized also have access to trade credit (credit purchases) from wholesalers and/or manufacturers. Although trade credit from wholesalers is expensive, it is readily and conveniently available and does not require any collateral and other formalities needed for bank loans.

The bank group-wise distribution of SME credit shows that the Domestic Private Banks with more than 80% share in the SME loans, are the largest financiers of the SME sector. This is however in line with their size and dominant share in the country's entire banking system. The privatization of 4 of the 5 big banks during last 5-6 years has made the DPBs the largest group with more than 80% share in banking assets.

Loan type wise Distribution of SME Loans

Another way of looking at the bank credit distribution is by loan purpose. The share of working capital loans in the total SME loan portfolio though improved by 6 percentage points to 77% during the year, however decreased in absolute terms to Rs.295 billion from Rs.309 billion as at close of CY07 (Table 6). The contraction is attributable to general economic slowdown etc as explained earlier. The overwhelming dominance of working capital loans in SME loan portfolio is largely in line with the banks' risk perception about SMEs and their collateral focused products. Most working capital loans are of short term nature and are usually secured/collateralized by personal assets of the owners, or stocks, which are relatively more easily available with the SME owners. The Fixed investment loans, which were already quite low further lost their share and reduced to 12% of total SME loans during the year from 14% in the preceding year. In absolute terms also there was a net retirement of about Rs.16 billion by the sector, which would have repercussions on the long term growth of SMEs. Another interesting feature of banks' SME loan portfolio is that about half of the total loans are in manufacturing sector; however most of the loans to the manufacturing SMEs were for working capital and only a small proportion for fixed investment. Thus the banks' shyness to fund fixed investment by SMEs, particularly the new SMEs, is even acute than the short term working capital requirements. While banks may gradually develop a comfort level for financing fixed investment by the existing reputed SMEs, the new entrepreneurs would hardly be able to convince banks to finance their untested ideas and fixed investment proposals. This signifies the need for venture capital and equity participation funds to encourage fresh investment in the sector.

Table 6: Type wise break up of loans to SME

Loan type	2007 Amount* (000)	2007 Share%	2008 Amount (000)	2008 Share %
Fixed Investment	60,272	13.8	44,509	11.7
Working Capital	309,148	70.7	294,651	77.0
Trade Finance	67,930	15.5	47,036	11.3
Total	437,350	100	386,197	100

Source: SMEFD, SBP *Domestic operations only

SME Size wise distribution of SME loan portfolio

As SBP started collecting SME size wise data of SME loan portfolio during CY08, the comparative data for earlier periods is not available. However as the smaller enterprises are more vulnerable to economic shocks being experienced by the country since the recent past, it is highly likely that the share of low end SMEs in the SME loan portfolio would have reduced further during CY08. The Table-7 gives SME size-wise breakup of SME loan portfolio as at close of CY08 which suggests that around 25% of the portfolio was outstanding against small and micro level SMEs having up to 10 employees. This ratio on the face of it is pretty encouraging and negates the general perception (rather consensus) that smaller enterprises are largely excluded from the banking system. However a clearer picture emerges in table 8, which gives break –up

Table 7: Size and Bank wise break up of SME Credit in 2008 (%)

SMEs Size (based on employees)	Public Sector Banks	Specialized Banks	Domestic Private Bank	Islamic Banks	Foreign Banks	Overall Share
Up to 10	51.6	57.1	19.2	37.7	23.2	25.2
11 to 20	15.6	6.4	12.9	11.2	12.4	13.1
21 to 30	9.5	2.0	9.8	13.4	13.8	9.6
31 to 50	14.3	6.1	30.5	15.3	19.3	27.2
51 to 100	1.7	3.8	8.1	16.9	12.8	7.2
101 to 150	0.6	24.5	7.4	2.5	13.5	6.8
151 to 250	6.9	0.0	12.1	2.8	5	10.8
	100	**100**	**100**	**100**	**100**	**100**

Source: Statistics Department, SBP

Table 8: Size and Category wise break up (%)

SMEs Size (# Employees)	Manufacturing	Services	Trading	Overall Share
Up to 10	6.6	36.0	45.2	25.2
11 to 20	8.0	17.8	17.8	13.1
21 to 30	7.7	7.7	13.0	9.6
31 to 50	33.9	13.7	24.0	27.2
51 to 100	12.9	6.6	0.0	7.2
101 to 150	12.6	5.1	0.0	6.8
151 to 250	18.3	13.2	0.0	10.8
	100	**100**	**100**	**100**
Share in total SME loans	**48**	**16**	**36**	**100**

Source: Statistics Department, SBP

of SME size and type wise breakup of SME loan portfolio. A bulk of SME portfolio outstanding against smaller enterprises (having up to 10 employees) was with Trading and Services SMEs whereas the small manufacturing SMEs had less than 7% share in total credit outstanding against manufacturing SMEs. The trading and services SMEs by their very nature employ less number of people. A small trading or services SME employing a fewer number of employees may not be that small in terms of assets or sales revenue. Thus the number of employees based criterion to determine the size of trading and services concerns is not very relevant and may be misleading if used without the assets size and sales volume criteria. The SME size and type wise analysis thus confirms the general perception about large scale financial exclusion of smaller firms, either manufacturing or trading.

Loan Size wise Distribution

The loan size wise distribution of the SME loan portfolio shows that 12% of the portfolio comprised loans of up to Rs.1.0 million (Table 9). These loans however accounted for about 74% of the total SME borrowers. This seemingly suggests that a large majority of banks' SME borrowers are small. The ratio however would stand substantially reduced after adjusting for about 40,000 auto rickshaw loans of NBP included in the SME portfolio during the year. The remaining bulk of the small loans also largely came from SME bank, the specialized bank with focus on relatively smaller enterprises. The rest of the banks however, hardly have any presence in low end SMEs. About 76% of the SME loan portfolio comprised loans of Rs.3 million or more and was outstanding against 17% of the SME borrowers. Although further breakup of this portfolio is not available, the overall trend suggests that most of the loans would be larger in size, Rs.10 million and above. The mind set, the business model, the loan products and the HR and systems' capacity of the banking industry as a whole, are incompatible with the dynamics of the low end SMEs. The anecdotal evidence collected by BSC offices during interaction with the banks' regional and branch managers, suggests that most of the banks don't target the SMEs with financing needs of less than Rs.5 million. This signifies the need for incentivizing the banks to develop capacity for tapping this largely unserved/underserved segment of our economy. The proposed SME Credit Guarantee Facility may prove effective for the purpose if targeted towards the low end SMEs. Further collaborative efforts by banks, chambers of commerce, government industrial and commerce departments, SMEDA etc will also have to be made to address the demand side issues like information asymmetries to attract banks investment in the low end SMEs. There is also a need for collecting more details about flow of funds to low end SMEs; for instance the loan size of Rs.3 million and above could be broken into brackets like Rs.3.1 to 5 million, Rs.5.1 to 10 million and more than Rs.10 million to have a better picture of the flow of funds to various sized SMEs.

Table-9:Loan size wise distribution of SME portfolion-2008

Loan size	Credit %	Cumulative Credit %	Borrowers %	Cumulative borrower %
Up to 0.5 million	8.1	8.1	65	65
0.5 to 1 million	3.8	11.9	9	74
1 to 2 million	4.8	16.7	6	80
2 to 3 million	7.4	24.1	3	83
Over 3 million	75.9	100	17	100

Source: Statistics Department, SBP

Regional Distribution in 2008

The regional distribution of banks' SME loan portfolio suggests that the SMEs in Punjab have been absorbing about two third of the total SME credit which is almost equal to the province's share in total SMEs. Almost similar is the position in Baluchistan which accounted for 2% of SME borrowers and 1.5% of the SME credit against its

Table 10: Regional Distribution

Province Name	Share in Credit (%)	Share in No. of borrowers (%)	Share in SMEs (%)
Balochistan	1.48	2.0	2.09
Sindh	27.16	26.0	17.82
Punjab	66.98	61.0	65.26
NWFP & AJK	4.38	11.0	14.21

Source: Banks' regional plans submitted to DFSD share of about 2% in total SMEs. The SMEs in Sindh province however absorbed more than 27% of the SME credit, which is much higher than the province's share of 18% in total SMEs. This shows that the financial inclusion levels of SMEs in Sindh are much better than the other provinces. However within Sindh most of the SME credit is concentrated in Karachi, which accounts for 83% of the SME credit in the province. On the other hand in Punjab the distribution is more even with regions like Multan (10.2%), Faisalabad (10.69%), Gujranwala (8.34%), Lahore (22.50%) accounting for a substantial share in overall credit to SME sector. The province of NWFP remained relatively underpenetrated as it absorbed just over 4% of the SME credit compared to its share (14%) in total SMEs. Moreover NWFP has 11% of the borrowers while accounting for merely 4.38% of the outstanding credit, which suggests that the SME loans in the province are generally small in size being availed by relatively smaller enterprises.

SBP and BSC initiatives for SMEs

Realizing the importance of SME finance, SBP created a separate SME Finance Department (SMEFD) to exclusively focus and steer all SBP initiatives, particularly policy formulation, for increasing banks' exposure and penetration in SME sector. To provide field presence to SMEFD and other DFG departments a specialized department "Development Finance Support Department" (DFSD) was also established in SBP-BSC. The DFSD with its presence in 14 important regions across the country has proved an effective platform for dissemination of the policies and initiatives at the grass root level and for collection of grass roots feedback on the policies. Following key initiatives were taken during CY08 to promote SME finance:

1. Set up the SME Credit Advisory Committee to institutionalize the consultative mechanism for policy formulation on SME finance;
2. Launched a comprehensive Capacity Development Program for banks' SME Credit Officers across the country;
3. Introduced the concept of Indicative SME Credit Targets for Banks;
4. Constituted SME Core Group to develop recommendations on Financial Innovation and Capacity Development
5. Setting up of a Credit Guarantee Fund for SMEs in Pakistan under DFID Financial Inclusion Program;
6. Introduced Credit Ratings for SMEs in Pakistan; PACRA and JCR-VIS have already submitted their detailed methodologies for SME ratings. A concept paper on Specialized SME Credit Rating Agency for Pakistan has also been developed;
7. Developed a concept paper on Credit Scoring of SMEs to facilitate banks in adopting best practices in SME finance area.
8. Organized a number of seminars, workshops, fairs etc across the country to enhance financial literacy of the SMEs and thus increase their access to financial services being extended by banks.
9. To improve the stakeholders understanding about various SME clusters, the cluster studies have been initiated. The studies would give detailed info about the cluster size (based on assets, number of employees, sales volumes etc), historical growth trends and future growth potential, key business dynamics, cash flow patterns, existing sources of finance, existing and potential demand for financial services from banks etc.

Future Outlook

Despite the recent slowdown in credit, SMEs still promise a huge potential in Pakistan. World Bank in a recent report has actually tried to quantify the potential untapped market of such enterprises. According to this study, the untapped additional SME credit demand can exceed

Rs 300 billion[17]. The global banking industry has also started viewing SME finance a viable business option. A very recent study on SME financing by Beck, Asli Demirgüç-Kunt, María Soledad Martínez Pería reveals that a large majority of banks have started considering SME sector as viable and potentially hugely profitable sector[18]. The shrinking margins in the corporate markets due to intensifying competition have been steadily increasing the relative attractiveness of the still under penetrated SME sector. Owing to the localized nature of SME financing, most of the countries in the world have decentralized sales and loan initiation coupled with centralization of risk management, approval and credit administration. This separation is more pronounced in developed countries and also in more sophisticated banks of the developing countries.

The increasing acceptability of SME finance a viable business option by global banking may allay the local banks negative bias and perception towards the SMEs. The international trends like decentralization of sales and loan initiation and centralization of risk management and credit approval and administration may also make some inroads in the local financial market with necessary adaptation and customizing. The ongoing work on credit scoring, if successfully implemented would render SMEs the same kind of credit approval process which is adopted for consumer finance. This in turn would encourage the banks to venture out more in this field as it would bifurcate marketing, loan initiation and risk management and can improve the scale. However, to fully exploit the SMEs' growth potential, the issues like lack of collateral, cumbersome legal procedure, information asymmetries, no or limited credit history particularly of smaller enterprises etc will have to be addressed.

Another area where serious work needs to be done is bringing improvement in secured transaction regime. As the cash flows of the SMEs are unpredictable, therefore such a regime can prove critical for removal of supply side constraints. The recent World Bank study advocates development of such a secured transactions regime for Pakistan as it would lead to improvement of the pool of assets that can be offered as collateral and help bring those under formal financial scope who previously had limited or no access[19]. Further some support mechanism like SME credit guarantee schemes would also be critical for providing some degree of insulation to banks against risk of defaults by SMEs.

Thus although the SME financing has taken a hit during the year and this trend may continue during CY09 due to overall pessimism in the country's economic and political environment, however as the situation starts improving on the economic and political front, the financing to SMEs would start improving. The increased realization of the SMEs' role in equitable economic development, the gradually improving acceptance of the sector as a viable business avenue by banks, the innovations in SME finance business models etc give optimism about the future of SME finance in the country. The recent decrease in interest rates in April 2009 will also provide an incentive to SME borrowers to access the bank credit. The SMEs on their part will have to offer better disclosures, improve efficiency in operations, and introduce professionalism in their enterprises to reap benefits of the likely positive developments in SME finance.

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[17] World Bank, "Bringing finance to Pakistan's Poor" 2009
[18] "Bank Financing for SMEs around the World", Beck, Asli Demirgüç-Kunt, María Soledad Martínez Pería, 2008
[19] World Bank, "Bringing finance to Pakistan's Poor" 2009