Development Finance Quarterly Review

Development Finance Group
State Bank of Pakistan

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PREAMBLE

Development Finance in broader terms may be described as an extended branch of development economics that explores strategies for providing financial resources to productive and priority sectors of economy with focus on under-served and un-served. The State Bank of Pakistan defines development finance as provision of financial services to SMEs, Agriculture & rural community, microenterprises, and to housing and Infrastructure projects/sectors. Lack of adequate financial resources has been one of the key impediments in the development and growth of these sectors to their real potential.

To achieve a sustainable growth and flow of financial services to the un-banked/under- banked sectors and regions a market oriented approach has been adopted by the SBP. The Financial Inclusion Strategy of SBP 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. A Development Finance Group (DFG) has been set up in SBP to spearhead all development finance related initiatives of SBP. Mandate of Agriculture Credit Department (ACD) has been broadened to facilitate development of a self sustainable rural finance sector. Separate departments have been set up to exclusively focus on improving flow of financial services to SMEs, microenterprises, and households. In addition to this, Creation of Development Finance Support Department (DFSD), within the SBP Banking Services Corporation in the second half of 2007, to provide field presence to DFG for continuous interaction with the stakeholders at grass roots level was another significant initiative. The DFSD since then has established units in 13 BSC offices and made them operational.

This publication reviews the developments in the sector at the end of the period September, 2008. More specifically, it presents reviews on SME Finance, Refinance Schemes, Infrastructure & Housing Finance, Agriculture and Micro Finance sectors in terms of the Borrowers, disbursements made to the respective sectors, outstanding amount, Non Performing Loans, Bank wise, sector wise and Segment wise distribution. Moreover, Key achievements by each department are also enlisted in this regard.

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EXECUTIVE SUMMARY

The State Bank has taken concrete measure for the promotion and development of key sectors of the economy specially underprivileged and underserved sectors which have received lesser attention from the formal financing institutions. The SME, Micro Finance, Housing and Agriculture sectors have not been able to get an easy and smooth access to finance from formal financing institutions. The measures taken by the State Bank has yielded fruitful results in terms of improved levels of formal financing to the above sectors, accompanied by changes in banks' strategic focus towards these sectors. SBP has also been encouraging banks to develop capacity in these development finance areas to tape the potential business opportunities offered by these sectors to the banking industry.

Over the past few years more funds have been channelized into the development finance area to boost the growth and performance of neglected sectors of the economy. Currently, due to certain factors including rising inflation and interest rates, economic instability, the effects of global financial and economic downturn, the growth of the formal financing to these four sectors declined slightly excluding the agriculture sector where the absolute amount increased by Rs. four billion. The following table shows the trends of last two quarters and their share in total bank advances.

Outstanding	Break up of Total Advances (domestic) in Billions			
	As of September, 2008		As of June, 2008	
	Amount	% age Share	Amount	% age Share
SMEs	361.6	11.8	393.6	13.5
Agriculture	157.7	5.2	154.2	5.3
Microfinance (MFBs Only)	5.9	0.2	6.7	0.2
IHFD	253.7	8.3	275.1	9.4
Total	**778.9**	**25.5**	**829.6**	**28.4**

The banking industry's exposure towards SME sector is the second largest after corporate finance. At the end of third quarter of the current year the SME sector's outstanding credit stood at Rs. 361.6 billion in absolute terms. This constitutes about 12 % of total credit of the banking industry. Though a negative quarterly growth of 8% has been recorded in advances to SME Sector by the end of third Quarter of current year; however, there has been a constant growth of about 50.3% when compared with the position of outstanding amount of September, 2004. The decrease in growth by 8% may be attributed to a variety of factors like higher inflation, increased interest rates, law & order situation, economic instability and to a great extent the effects of the global financial and economic crisis.

An overview of the facility wise financing to SME sector reveals that the major portion of the outstanding amount is utilized for working capital (WC) finance followed by trade finance (TF) and fixed investment (TF) respectively. The share of five big banks i.e. Habib Bank Ltd, Allied Bank Ltd, MCB Bank Ltd, National Bank of Pakistan, United Bank Ltd; constitute about 39.6% of the total SME finance portfolio at the end of the period under review. As far as utilization of SME loans by different sectors of the economy is concerned, Manufacturing Sector receives the largest share of SME finance forming about 41.3% of total sectoral distribution of SME finance by the end of September, 2008 followed by commerce and trade, construction, real estate and transport, with their share in the total SME finance as 33.4%, 3.5%, 6.6% and 3.4% respectively.

As part of its endeavor to promote priority sectors of the economy the SBP has also been running Refinance Schemes to meet funding needs of these sectors. These schemes are *Export Finance Scheme and Long Term Financing Facility (LTFF).*

Under the Export Finance Scheme banks were assigned limits of Rs 125 billion for the first Quarter of FY09, which, with the 30% share by banks' own resources, made the total amount available under EFS as Rs. 179 billion. The EFS limits were subsequently reviewed and increased by 35% for the second quarter of FY09 when SBP decided to take over the 30% financing provided by banks from their own sources. At the end of the quarter, Rs. 147 billion was outstanding under the scheme as compared to Rs.125 billion for same period of last year. The outstanding finance under EFS grew by 3% compared to the position on June 30, 2008.The commodity wise and borrower wise analysis under EFS financing show skewed distribution. Out of total credit extended under EFS, 64% was outstanding against the textile sector. The Top 8 beneficiaries/borrowers are availed more than 75% of the total financing under the scheme. While under the Long Term Financing Facility, the participating Financial Institutions (PFIs) were assigned limits of Rs. 9.5 billion in FY-09. As on September 30, 2008 Rs.1.2 billion was outstanding against the financing provided under the scheme. Although banks were providing 30 percent of financing from their own sources at subsidized rates; however, as a part of other measures to ease liquidity situation and facilitate exporters, SBP decided to provide 100% refinancing under EFS and LTFF schemes and take over the 30% financing which the banks had already provided.

Housing finance represents approximately 18% of total consumer financing in Pakistan. With outstanding (net of NPLs) at Rs.73.60 billion as on September 30, 2008, the housing finance sector has reported a growth of 2% during last twelve months, albeit, reflective of a slowing tend. This slow growth is primarily attributed to an increase in interest rates and tight monetary policy that has led to an overall squeeze in the private sector credit growth. However, the number of banks entering the mortgage market is increasing over time which is a sign of increasing competition and outreach. Sectoral analysis reveals that currently outright purchase constitutes 61% of total outstanding. Outright purchase and construction category has increased by 4% and 2% respectively over the last 12 months; renovation reports a decline in financing by 9%. Increase in construction costs including materials like cement and steel, are one of the contributing factors. Despite a slowing trend witnessed in the housing finance market, increased number of banks is seen to have entered the mortgage market. Banks/DFIs are now seen to be taking a strategic long term view of the housing finance in Pakistan and accordingly have formulated plans to expand their housing finance portfolio overtime, which is an encouraging sign.

Despite overall economic turbulence, a positive trend was experienced in infrastructure financing during July-September 2008 quarter. However, no seismic shift has been reported during the quarter under review as energy and telecom sectors remained the leading beneficiaries. However, positions of top sectors within the energy and telecom sectors have been shifted since the end of the corresponding quarter last year. This shows the lack of diversity as only some sectors are getting financing and other important sectors like Road, Construction, Water & Sanitation, and Ports etc. remain out of equation as far as their share in Infrastructure financing is concerned. One possible reason for this fact could be lower appetite of private sector in infrastructure projects due to higher risks associated with it and the availability of other viable financing opportunities.

Agriculture is an important sector of our economy, a dominant driving force for growth and the main source of livelihood for 66% of the country's population. Availability of credit to meet financial requirements of the farming community is one of the key factors that play a pivotal role in the development of agriculture sector of a country. Taking cognizance of the need for agri. credit and Government's declared priority of uplifting the agriculture sector, SBP has since its inception been endeavoring to make the much needed credit available for agriculture sector, and such endeavors have yielded fruit in the form of improved Agri Financing over the period. Under the *Indicative Target Mechanism*, the Agriculture Credit Advisory Committee (ACAC) had set indicative agri. credit target for banks of Rs

250 billion for FY 2008-09, out of which Rs 172 billion were allocated to commercial banks. Among the commercial banks, Rs 119.5 billion to five major banks and Rs 52.5 billion to Domestic Private Banks (DPBs). The target of remaining 78 billion was allocated to ZTBL and Punjab Provincial Cooperative Bank Limited with a share of Rs 72 billion and Rs 6.0 billion respectively. The target was 25 percent higher than previous year's target of Rs 200 billion and 18.5 percent higher than the disbursements of Rs 211.6 billion during FY 2007-08. Out of total Rs 250 billion, During July-September, 2008 banks disbursed Rs 46.6 billion showing an increase of 28.3 percent over the disbursements of Rs 36.3 billion made in the same period last year. Banks group wise disbursements during July-September, 2008 along with corresponding period of last year are given in Table 2.1.

The Microfinance (MF) Sector continues to increase outreach (branches, borrowers, depositors) at a steady pace. The number of active borrowers of MFBs now stands at 564,892 in the quarter ending September 2008, increasing by 10% over the quarter and 26% over the twelve month period beginning September 2007. Similarly, the number of depositors rose by 14% over the quarter under review. The number of branches reached to 252 compared to 185 in September of 2007, and 245 in June 2008. The two largest MFBs added significantly to expansion in outreach during 2008, while contribution to the sector by remaining MFBs remained trivial.

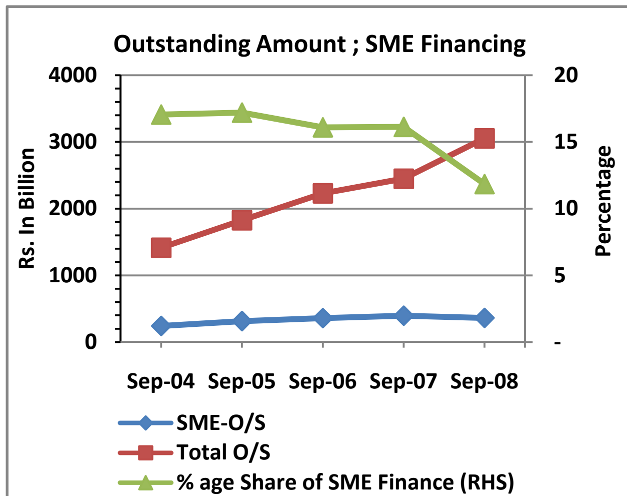
The Loans and Advances in the MF sector have witnessed growth in its share to 52% as of September of 2008 from 41% and 46% as of September 2007 and June 2008 respectively. The composition of loan portfolio illustrates a consistent pattern during the period under review. Agriculture financing constitutes major portion with share between 41 to 42% during the year. Microenterprise and livestock are second and third largest sectors being financed by MFBs. The share of microenterprise and livestock stood at 28% and 17% respectively. Examination of the financing structure indicates that borrowing continues to dominate the funding structure of MFBs, with a constant share of 43% over the year. MFBs are credit focused and savings mobilization has not taken off in Pakistan yet. The sector has not been able to develop and launch appropriate saving products due to a variety of reasons as banks lack effective product research, marketing, financial literacy, capacity of staff, institutional constraints, weak MIS and perhaps even scarcity of appropriate market competition among MFBs to induce deposit mobilization. Quarterly growth in deposits was minimal, around 2%, however, annualized growth, approximately 32%, is substantial.

The Male borrowers have dominant share in the loan portfolio of MFBs. In September of 2007, male borrowers had 79% share in loan portfolio. The share of male borrowers has now declined to 77% by the end of September of 2008. However, a recent rise in female borrowers is a healthy sign in the growth of the microfinance sector. Experience of South Asian region illustrates that lending to women has better results in terms of outreach and recovery. In order for banks to be significant players in the microfinance of the future, they must increase outreach of microfinance clients. Banks do seem to be moving in the right direction by allocating more assets to advances, increasing outreach and profitability. However, MFBs must capitalize on inherent advantage of the ability to mobilize deposits. Only then, will MFBs be able to increase outreach in the current scenario of financial markets. Furthermore, the ownership of identifying innovative ways to mobilize deposits must come from the private sector.

SME FINANCE

SME FINANCING PROFILE

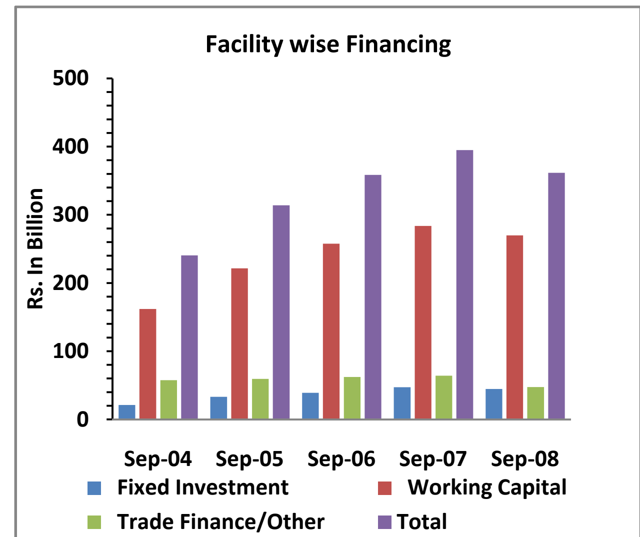
The banking industry's exposure towards SME sector is the second largest after corporate finance. At the end of third quarter of 2008, the SME sector's outstanding credit stood at Rs. 361.6 billion. SME exposure constitutes about 12% of total credit of banking industry. By the end of September, 2008 a negative quarterly growth of 8.4%, has been recorded in advances to SME Sector. However the relative decrease in growth of SME finance in the corresponding 3rd quarter of 2007 was 3.1%. Nevertheless, there has been an increase of about 50.3% in SME finance when compared with the position of outstanding amount as of September, 2004 with the current reporting period.



A decline of 8.4% in absolute outstanding amount towards SME sector can be witnessed when compared with Sep-07 and Sep-08. For the last couple of years SME finance has been witnessing a consistent low growth due to a variety of factors like higher inflation, tight monetary policy resulting in higher interest rates, law & order situations, economic instability, reluctance of the banking industry to penetrate in the market, capacity constraints of banks to tape the potential market, and major demand side obstacles, hindering the growth of SME sector in Pakistan.

FACILITY WISE FINANCING

An overview of the facility wise financing to SME sector reveals that the major portion of the outstanding amount is utilized for working capital (WC) finance followed by trade finance (TF) and fixed investment (TF) respectively. WC finance accounts for 74.6%, TF 13.1% and FI 12.3% of total SMEs portfolio at the end of September, 2008. Predominant portion of working capital finance displays the need of SMEs to get finance for inventory and day to day operations.

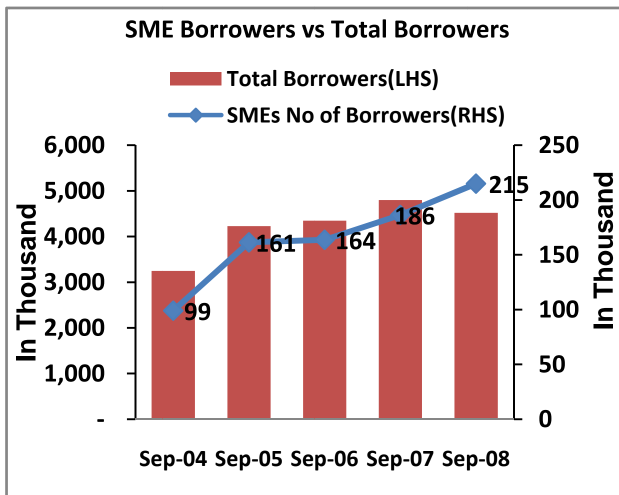


The absolute outstanding amount for working capital finance stands at Rs. 269.8 billion at end of the reporting period, recording a negative quarterly growth of 9.6%. Trade finance received an outstanding amount of Rs. 47.3 billion showing a negative quarterly growth of 2.7% followed by Fixed Investment of Rs. 44.5 billion having, also recorded a negative quarterly growth of 4.6% at the end of September, 2008. This deteriorating SME financing portfolio can be attributed to the wave of global financial and economic recession as well as local economic conditions.

NUMBER OF BORROWERS

The outreach of banking industry has increased considerably in the SME sector over the past five years showing a promising momentum during this span. At the end of September 2008, SME borrowers stood at

214,948 constituting about 4.8% of the total number of the borrowers in the banking industry. About 73.7% of the SME borrowers avail working capital finance, 24.5% Fixed Investment and the rest resort to Trade Finance. There has been a positive growth of 33.3% during the period September 2004 to September, 2008 in the SME number of borrowers. Also a significant growth of 15.4% in the number of SME borrowers was recorded during the period September, 2007 to September 2008.

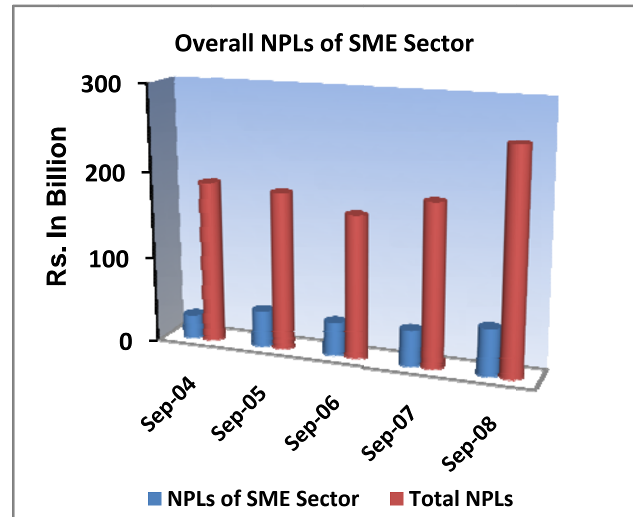


NPLS OF SME FINANCE

SME sector's NPLs stood at Rs. 53.7 billion constituting 21% of the total NPLs of Banking industry at the end of

September, 2008. A close look at the SME sector NPLs behavior reveals that it has been roaming in between the range of Rs. 20 billion to Rs. 40 billion during September, 2004 to September, 2007. However, it can be easily observed that the percentage change of the NPLs of SME Sector, from September 2007 to September 2008 has witnessed a growth of 30.8%. While NPLs of the whole industry increased by 36% during the same period.

In addition to this, a quarterly comparison of the respective quarters of September 2007 and September 2008 reveal that an increase of 10% was witnessed last year during the same quarter while a sharp rise of about 168% has been recorded in the corresponding quarter of 2008.



BANKWISE DISTRIBUTION

BIG FIVE BANKS

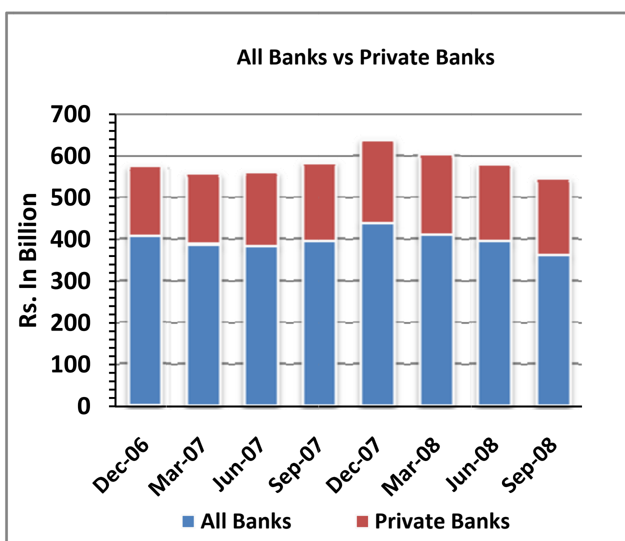
The share of five big banks i.e. Habib Bank Ltd, Allied Bank Ltd, MCB Bank Ltd, National Bank of Pakistan, United Bank Ltd; constitute about 39.6% of the total SME finance portfolio at the end of the period under review.

In absolute terms the outstanding amount of Big Five stood at Rs.143 billion of total Rs. 361.6 billion at the end of the same period. Of the Big Five banks HBL has the lion's share of about 12.6% of the total SME finance outstanding by the banking industry. While NBP, ABL, UBL and MCB each follow with a share of 8.1%, 6.1%, 6.3% and 6.5% respectively in total SME finance. The Share of Big five recorded a decrease of 15.2% towards SME Sector, during Sep-07 to Sep-08. While only ABL and NBP witnessed a positive growth of 39% and 20% respectively, for the mentioned period among others.

During third quarter of 2008 the Big Five have displayed a negative growth of 16.3 % compared to 0.4 % of corresponding period in 2007.

PRIVATE BANKS (EXCLUDING BIG FIVE BANKS)

Private Banks have been doing well in SME finance arena for the last two years, and they have recorded a consistent growth. The share of private banks stands at about 50.7% of total outstanding SME finance portfolio by the end of the reporting period. And the absolute outstanding amount of the private banks was Rs. 183.45 billion surpassing the absolute amount of big five banks. Among the private banks NIB bank has a share of 9% in total SME finance portfolio at the end of September, 2008. NIB has shown impressive performance by increasing its SME portfolio from Rs.17 billion to Rs. 32.4 billion during the period Sep-07 to Sep-08. In Private Banks category the share of Bank Alfalah, Standard Chartered, Faysal Bank, RBS, Askari and Habib Metropolitan is 8.7%, 4%, 4.4%, 3.4%, 4.6%, and 3.2% respectively of the total outstanding amount of SME sector, at the end of the period under review.

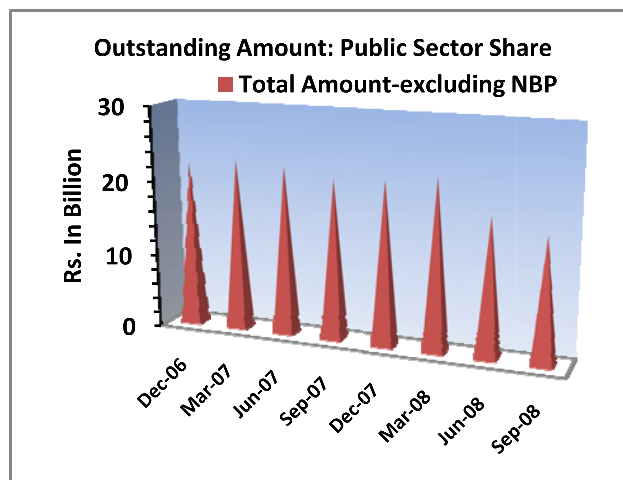


Private Banks category witnessed a decline of 3% during the period September 2007 to September 2008. While the quarterly change recorded negative growth of 1.1% in third quarter of 2008 as compared to 6.6% with the corresponding quarter in 2007.

PUBLIC SECTOR BANKS (EXCLUDING NBP):

Public sector banks have the third largest proportionate share in SME finance after Private Banks and Big Five Banks. Public sector banks constitute about 4.6% of total SME finance portfolio by the end of September, 2008. In absolute terms these banks had outstanding amount of Rs. 16.6 billion by the end of September, 2008. Of which 63.7% is the share of Bank of Punjab.

An analysis of this category reveals that the quarterly growth in 2007 was 2.4% while there has been a negative growth of 9.6% during the corresponding period of the current year at the end of September 2008. Further, public sector banks have witnessed a decline of 22.4% in their outstanding portfolio during the period September 2007- September 2008.



ISLAMIC BANKS:

Islamic bank's share has enhanced considerably from an outstanding amount of Rs. 1.4 Billion to Rs. 6.5 Billion during the period December 2005 to September 2008. While during the period Sept-07 to Sep-08 it has shown an impressive growth of 61.5%. The main contributors in this category were Meezan, Bank Islamic and Dubai Islamic Bank with 72.3%, 9.11% and 9.06% respectively. For the past two years no significant improvement has been made by Islamic banks towards capturing SME finance market as they have been hovering around 2% of the total SME finance portfolio.

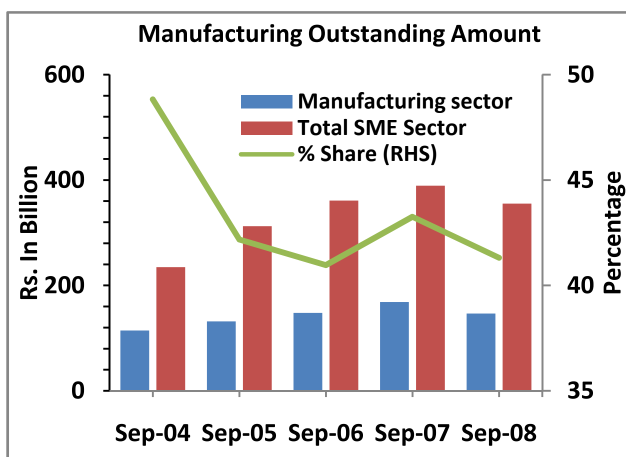
SPECIALIZED BANKS:

This category of Banks consists of SME Bank, ZTBL, PPCBL and IDBP. The absolute amount outstanding of the specialized banks towards SME sector has mounted to Rs. 9.99 billion by the end of the reporting period. This constitutes about 2.8% of the total portfolio of the banking industry extended under the head of SME finance. The main contributors in this category of Banks are SME Bank (75.4%) and IDBP (24.6%). Having a close look at SME finance performance of the specialized banks it is evident that their portfolio has been hovering around Rs. 10 billion for the last few quarters. SME Bank has the largest portfolio of Rs.7.5 billion constituting about 2.1% of total SME finance outstanding credit by the end of the reporting period. Specialized banks outstanding amount has witnessed a slight increase of 0.66% during the period September 2007 to September 2008.

SECTORAL DISTRIBUTION

MANUFACTURING SECTOR

A sub-sector wise analysis reveals that the Manufacturing Sector receives the largest share of SME finance forming about 41.3% of total sectoral distribution of SME finance by the end of September, 2008; in absolute terms it amounts to Rs. 147 billion. Manufacturing SMEs have been the top credit availing entities over the last four to five years. Out of total manufacturing sector SME credit Big Five banks have advanced Rs. 63.2 billion, Private Banks Rs. 70.7 billion, Public sector Banks (Excluding National Bank) Rs.5.4 billion, Islamic Banks Rs.2.7 Billion, specialized Banks Rs. 3.9 Billion and Foreign Banks approximately Rs. 0.93 Billion by the end of the reporting period.



During Sep-04 to Sep-08 period, a 28% growth of SME Finance in this sector has been recorded. However, a negative growth of 15% during has been witnessed from Sep-07 to Sep-08. In third quarterly of 2008 a growth a negative growth of 7.7% has been recorded compared to positive growth of 5.12% in third quarter of 2007.

COMMERCE & TRADE

Commerce & trade is the second largest sector receiving the major portion of SME finance. In aggregate this sector has availed Rs.118.6 billion out of total outstanding amount of SME finance by the end of September, 2008. This constitutes 33.4% of the total sectoral credit availed by the SMEs. In this category the private sector banks lead with a portfolio of Rs.58.9 billion followed by Big Five banks with Rs.44.5 billion by the end of September, 2008.There was a negative quarterly growth of 3.3% in 2007. Commerce and trade sector recorded a negative growth of 12.7% during the third quarter of 2008 compared to 3.3% in corresponding period of 2007.

Moreover, the growth of commerce & trade sector has enhanced considerably by 62.4% during the period Sep-04 to Sep-08. However a decline of 2.6% during the period Sep-07 to Sep-08 has been observed.

OTHER MAJOR SECTORS

Construction sector constitutes about 3.5% of the total SME Finance. While in absolute terms this sector has Rs. 12.5 billion outstanding amount during period of analysis. Similarly, ***Real Estate, renting and business activities*** has an outstanding amount of Rs. 23.4 billion constituting about 6.6% of the total sectoral credit distribution by the end of third quarter of 2008. ***Transport, storage and communication*** sector has a share of 3.4% by the end of the period under review. And total outstanding amount towards this sector was recorded as Rs.12.2 billion.

Table 1		Sep-04		Sep-05		Sep-06		Sep-07		Sep-08	
S.N	**SECTORS**	**Amount**	**% Share**	**Amount**	**% Share**	**Amount**	**% Share**	**Amount**	**% Share**	**Amount**	**% Share**
1	**Fishing, and related activities**	871	0.37	886	0.28	1,028	0.28	801	0.21	-	-
2	**Mining and Quarrying**	448	0.19	764	0.24	861	0.24	1,414	0.36	1,453	0.41
3	**Manufacturing**	114,640	48.83	131,759	42.17	147,846	40.96	168,425	43.25	146,729	41.31
4	**Ship breaking and waste / scrape etc.**	783	0.33	464	0.15	1,394	0.39	431	0.11	281	0.08
5	**Electricity, gas and water supply**	1,168	0.50	1,440	0.46	2,169	0.60	3,173	0.81	6,252	1.76
6	**Construction**	9,831	4.19	12,038	3.85	13,187	3.65	19,085	4.90	12,463	3.51
7	**Commerce and Trade**	73,044	31.11	114,338	36.60	126,274	34.98	121,766	31.27	118,618	33.40
8	**Hotels, restaurants and clubs etc**	735	0.31	1,679	0.54	2,840	0.79	3,599	0.92	2,819	0.79
9	**Transport, storage /communications**	**6,225**	**2.65**	**7,810**	2.50	8,889	2.46	9,996	2.57	12,225	3.44
10	**Real estate, renting related activities**	9,089	3.87	9,215	2.95	11,676	3.23	11,920	3.06	23,423	6.59
11	**Education**	858	0.37	1,196	0.38	2,249	0.62	1,893	0.49	2,803	0.79
12	**Health and social work**	1,301	0.55	1,575	0.50	2,071	0.57	2,714	0.70	3,740	1.05
13	**Other community, social activities**	2,904	1.24	5,748	1.84	8,890	2.46	10,455	2.69	7,849	2.21
14	**Other private business n.e.c**	12,873	5.48	23,524	7.53	31,588	8.75	33,709	8.66	16,529	4.65
	TOTAL	**234,769**		**312,436**		**360,962**		**389,382**		**355,183**	

Source : Statistics & Data ware House, SBP

MAJOR ACHIEVEMENTS/INITIATIVES:

⇒ SMEFD has completed an ADB funded project for strengthening Secured Transactions Framework. The project is aimed at enhancing SME and entrepreneurs access to formal source of finance by establishing a system of charge creation on moveable & Immovable assets of small borrowers in urban and rural areas. Based on the study, the necessary amendment in the legal Framework has been suggested to the Government.

⇒ Introduction of SME Independent Credit Ratings through existing credit rating agencies, So that an independent opinion of the capability and willingness of an SME Borrower to repay its debts is made.

⇒ Launching of SME Finance Cluster Training Program at different SME hubs throughout the country. And Introduction of Financial Awareness campaign at main SME Clusters, as a part of Capacity Development measures for the stakeholders.

⇒ Working on establishing SME Credit Guarantee Agency for Pakistan, to share risk with the lending institution, so that when borrowers default on a loan and thus incur a loss for the lender, the lending institution will be compensated for all, or part, of the loss involved. Such schemes seek to help to overcome the problem of loan applicants who have good projects, and are in every respect credit worthy, but cannot offer adequate collateral to satisfy the normal requirements of a lending bank. A successful credit guarantee scheme, apart from reducing the risk, (or possibly the perceived risk), must contribute to lowering the transaction costs of such loans.

⇒ Publication of a Booklet on SME Financing Products by Banks as part of Awareness Building measures.

⇒ Formation of SME Credit Advisory Committee/Core Group to provide a forum for the resolution of SME Finance related issues.

⇒ Introduction of Credit Scoring Mechanism in Pakistan.

COUNTRY IN FOCUS: THAILAND

Thailand has been experiencing a sustained growth since 2002 but the activity slackened in 2005. Annual GDP growth rate was 6.9% in 2003, 6.1% in 2004 and 3.5% in 2005. Growth is mainly driven by the manufacturing sector. The share of SMEs in GDP was 39.4% and in exports of the country it was about 29.1% in 2006. Out of the total number of enterprises in Thailand, approximately 96% of them are SMEs and are therefore the driving force behind the expanding economy.

In 2000, an Act designed to promote SMEs was legislated by the government. Its major objective was to assist, promote and develop SMEs. Several financial institutions, including state owned and commercial banks have also rendered their support by providing credit facilities and advice to SMEs. Supporting SMEs to survive and grow at the same time is vital for the sustained economic growth as it boosts competitiveness.

Some of the major initiatives/measures taken by the Thai Government for the promotion and development of SME sector are as under

ESTABLISHING SMES VENTURE CAPITAL FUND

In order to enhance competitiveness of Thai business, the Venture Capital (VC) Fund of 5,000 million baht for investment in SMEs was founded in 2003. The target groups for the fund were identified as fashion & Design Based, Software and IT, Food & Herbs, Automotive Parts, Tourism, Export Oriented Business, Business which supports the aforementioned groups and Projects which involve or support SMEs according to government policies.

SMALL INDUSTRY CREDIT GUARANTEE CORPORATION

The Small Business Credit Guarantee Corporation (SBCG) is a state-owned specialized financial institution, with objectives as follows:

⇒ To increase credit extension from financial institutions to small industries

⇒ To strengthen the confidence of financial institutions in providing credit to small industries

⇒ To accelerate the dispersal of credit extension to small industries throughout the Country

⇒ To promote industrial development to achieve the target of the National Economic and Social Development Plan

ESTABLISHING THE OFFICE OF SMALL & MEDIUM ENTERPRISES PROMOTION

Office of Small and Medium Enterprises Promotion (OSMEP) was established under the Small and Medium Enterprises Promotion Act 2000 as a juristic entity and governmental office, not an official agency or state enterprise.

OSMEP acts as a central planning office and coordinates the action plans of all relevant offices in promoting SMEs in Thailand. OSMEP works as coordinator, facilitator, promoter and supporter for all SMEs Promotional agencies.

SETTING & IMPLEMENTING THE NATIONAL PLANS FOR SMES PROMOTION

The first SMEs Promotion plan was implemented during the period 2002-2006. The focus and strategies adopted during the period were as under:-

⇒ Build and develop new entrepreneurs.

⇒ Rehabilitate SMEs to become key economic and social mechanisms.

⇒ Build and improve infrastructure and eradicate business obstacles.

⇒ Reinforce SMEs to attain sustainable growth

⇒ Reinforce SMEs Export potentials at international standards.

⇒ Enhance the potentials of community enterprises to regional areas.

The second SME Promotion Plan, to be implemented from 2007 to 2011 consists of strategies; (a) to create new entrepreneurs & develop the capability of existing entrepreneurs, (b) upgrade productivity & innovative capability in manufacturing sector, (c) enhance efficiency and reduce disadvantage of trading sectors, (d) promote value creation and value addition in service sector, (e) promote SMEs in regional and local areas, and (f) develop enabling factors and favorable business environment.

ESTABLISHING THE SMES BANK

In 2002, Small and Medium Enterprise Development Bank of Thailand or SME Bank was formed. The Bank's mandate was "to conduct business with the aim of developing, promoting and assisting small and medium enterprises to start-up expand or improve their businesses by providing loans, guarantees, venture capital, counseling and other necessary services.

SME Bank has restructured its business in 10 clusters (Food, High tech & energy, wholesale and retail, packaging & logistic, Franchise, Manufacturing, Tourism, Services, Automotive, and Fashion). SME Bank's next five year plan is aimed at building an entrepreneurial society in Thailand.

ENTREPRENEURIAL SOCIETY

Key Findings from GEM (Global Entrepreneurship Monitor) 2005 research confirms that in Thailand entrepreneurs constitute a large proportion of the

adult workforce. The activities of entrepreneurs provide a major impetus to commercial activity. Some 86 percent of adults aged between 18-64 years are willing to start new businesses. In Thailand most entrepreneurial activity is opportunistic with 13.9 percent of the population claiming to engage in this type of entrepreneurial activity. Sixty-nine percent of entrepreneurial activity in Thailand takes the form of small business ventures. Government policies such as the One Tambon, One Product (OTOP) initiative encouraged people to engage in entrepreneurship. Some Thai social and cultural norms, worth particular mention is the positive attitude of Thai people that entrepreneurship is a valid choice for individuals who wish to engage in commerce. The prevailing business climate in Thailand also contributes to high levels of entrepreneurship.

ASSETS CAPITALIZATION POLICY

In order to help people of all strata the Government came up with the asset capitalization policy to offer poor people wider opportunities for funding sources. Under the policy, documents are issued to guarantee all assets owned by the poor, such as machines, product stalls, old houses, and hire contracts, so that they would be able to use them as collateral to obtain loans from banks at fair interest rates.

The organization set up for implementing this policy comprises two Committees. The first is the Assets Capitalization Policy Committee chaired by the Prime Minister. The second Committee is the Assets Capitalization Operation Committee. The Operation itself is executed by the Assets Capitalization Bureau, a public sector organization

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EXPORT FINANCE SCHEME (EFS)

State Bank of Pakistan has, at various times, launched credit financing schemes to promote priority sectors of the economy. These schemes are periodically reviewed to gauge both the effectiveness of the procedures as well as to monitor the credit utilization under the schemes and related issues.

SBP introduced the Export Finance Scheme in 1973, with the objective of encouraging the export of nontraditional, value added products. Over the years, EFS has been revised with the objective of making the scheme more borrower-friendly and to encourage the export of value added products. SBP continually monitors the credit disbursement under the scheme to ensure that its objectives are accomplished.

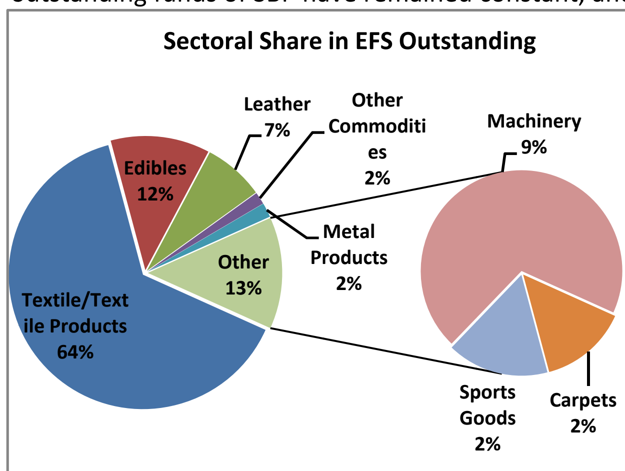
LIMITS UNDER EFS FOR FY09

To ensure availability of adequate refinancing to the commercial banks under Export Finance Scheme, the overall quantum of limits for banks under EFS for FY 2008-09 was increased by 25% of the amount outstanding as on 30th June 2008. Accordingly, on an overall basis, SBP allowed limits to the extent of Rs 125 billion to banks under the Scheme during FY 09 up from Rs 100 billion during FY 08.However, in November 2008 SBP decided to take over the 30% financing provided by the banks and the limits of banks have been enhanced to Rs. 169 billion accordingly.

OUTSTANDING FINANCING UNDER EFS

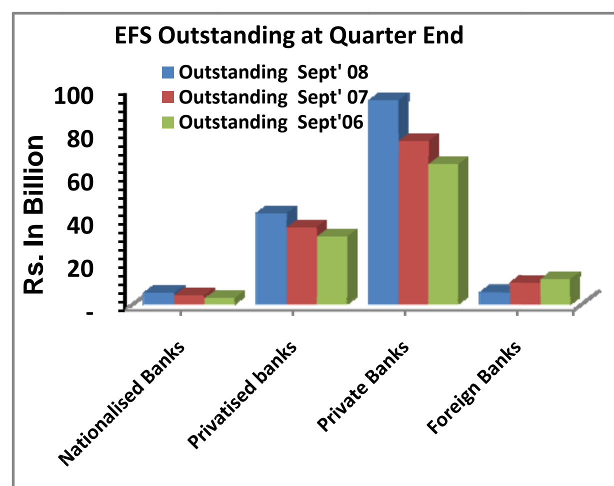
At the end of the first quarter of FY09, Rs. 147 billion was outstanding under the EFS as compared Rs. 125 billion on September 30, 2007 and Rs.110 billion on September 30, 2006. A look at the trend of amount outstanding under the Export Finance Scheme clearly suggests that the quantum of outstanding financing increased by 33% over Sept'06 position. The amount outstanding against foreign banks has reduced by 53 % when compared with first quarter of 2006 and 37% when compared to the first quarter of 2007; however, this decrease is off-set by the increase in private banks outstanding position resulting in a net increase of 20%

over Sept'06 position. A closer look at the outstanding position reflects SBP's monetary stance as the outstanding funds of SBP have remained constant, and



in fact have declined by 9% when compared to Sept'06 due to sharing of 30% financing by banks. A comparative position of the amounts outstanding under EFS for the quarters ended Sept'08, Sept'07 and Sept'06 is presented in Graph.

The growth of financing under EFS since July 1, 2008 shows increase of Rs. 1.5 billion during the quarter under review, with the maximum increase in private banks. The decrease in outstanding position of foreign banks is corroborated by the negative flows, reflecting greater repayments compared to disbursements.



COMMODITY-WISE POSITION

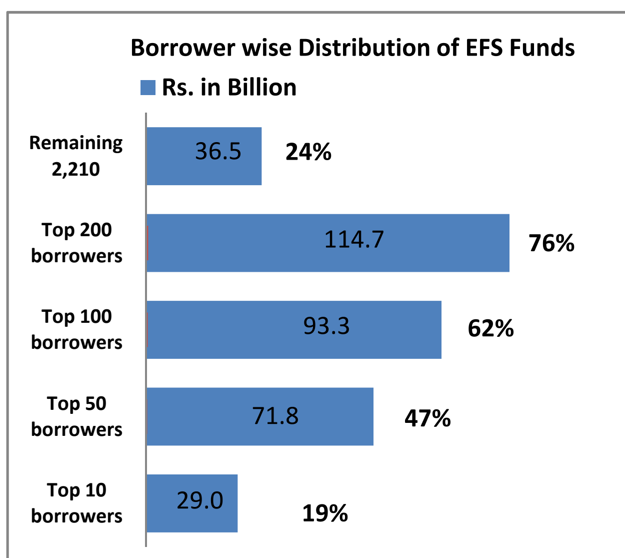
A distribution of the EFS funds along different sectors of the economy is shown in Graph. The Textile Sector continues to dominate share of financing, which is 64%. Other sectors such as edibles (dominated by rice), leather and leather goods also received a significant share. The details of sector-wise utilization of EFS financing are given in the table 1.

BORROWER WISE DISTRIBUTION OF EFS FINANCING

The distribution of EFS funds has been concentrated in

Table 1: Commodity-Wise EFS outstanding as on September 30, 2008

	Sept' 08		Sept' 07		Sept' 06	
	Billion PKR	%	Billion PKR	%	Billion PKR	%
Textile/Textile	91.53	64%	85.51	68%	75.06	68%
Edibles	17.06	12%	14.17	11%	11.77	11%
Leather	10.42	7%	8.11	6%	8.22	7%
Other	2.11	1%	0.66	1%	0.57	1%
Metal Products	2.46	2%	2.99	2%	2.33	2%
Carpets	2.71	2%	2.41	2%	2.27	2%
Sports Goods	3.14	2%	4.66	4%	3.66	3%
Machinery	13.38	9%	7.17	6%	6.84	6%
Total	142.82 *	100%	125.68	100%	110.71	100%



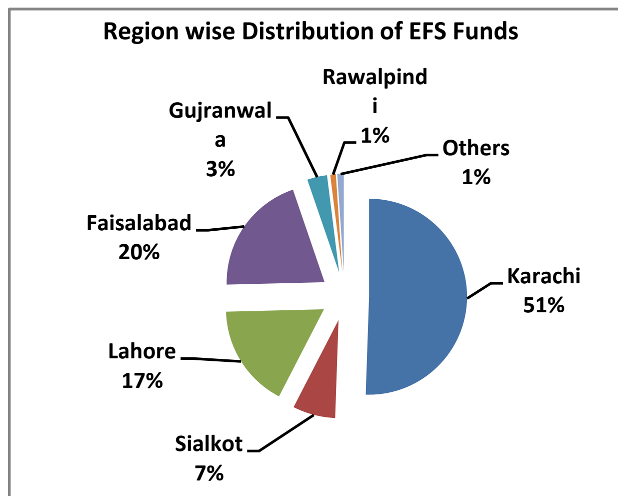
the top big borrowers. Top 100 beneficiaries have availed about 62% of total financing under EFS, while the Top 200 availed 76 % of the total financing under EFS which reflects that only a small segment (i.e. 8%) of total borrowers have availed more than 75% of EFS funds.

The total number of beneficiaries under EFS reported by all banks stood at 2,410, decreased by 20% from 3,030 as on June 30, 2008. One important reason for this decline was the use of different reporting formats of BD Form used by banks as we curtailed the BD Form for FY09 by excluding from it the finance provided by banks from their own sources at other than EFS rates.

REGIONAL ALLOCATION OF BORROWERS

Region wise borrowers of EFS are unevenly allocated. According to banks' data for the quarter under review, up to 90% borrowers are from four major cities i.e. Karachi, Sialkot, Lahore and Faisalabad. Similarly, more than 90% EFS funds are accumulated in these four cities and more than 50% funds have been availed by only Karachi based exporters.

The number of borrowers and the borrowing capacity of borrower/exporter are different at different regions. The average loan size is Rs. 122.83 M at Faisalabad while at Sialkot the same is Rs. 14.59 M. and there were 250 borrowers at Faisalabad at the end of September 2008 as compared to 736 borrowers at Sialkot at the same period.



ISLAMIC EXPORT REFINANCE SCHEME (IERS)

The Islamic Export Refinance Scheme was initiated in 2002 with only one Islamic bank participating in the scheme. The scheme has been designed as a Musharaka between SBP and a participating Bank. The participating bank at its end may provide IERS funds through products approved by SBP, to its clients under the conditions of the Musharaka stated in the scheme.

With the growth in Islamic Banking that number has consistently been increasing, and at present four Islamic banks and four conventional banks are availing financing under the scheme. The scheme has been developed such that the Shariah Principles of financing are followed, but that the exporters should not be disadvantaged under the scheme compared to the conventional EFS as the rates of profit charged to them have been maintained at par with the EFS.

The IERS was started with an initial limit of Rs. 500 million assigned to Meezan Bank Ltd in 2002. The limits assigned under IERS for the quarter ended Sept'08 were Rs. 9.5 billion and shared by 7 banks. These limits have been revised to Rs. 10 billion for the second quarter of FY09. Islamic banks were assigned a limit of Rs 5.9 billion while the Islamic Banking

Branches of conventional banks were assigned Rs 1.2 billion.

During the quarter Rs. 4 billion were disbursed compared to Rs.3 billion during the comparative quarter of FY08 registering an increase of Rs. 1 billion (32%). However when compared to the respective Quarter of FY07, the increase is marginal 6%. The increase is attributed to an increase of Rs 1 billion by a single bank. The amount outstanding at the end of the quarter under IERS was Rs.7 billion, 30% higher than the comparative quarter of FY08.

LONG TERM FINANCING FACILITY FOR PLANT & MACHINERY (LTFF)

In January 2008, SBP introduced a new refinance scheme; Long Term Financing Facility for Plant and Machinery (LTFF) to promote export led industrial growth in the country. The facility is aimed at providing necessary finance to exporters for adoption of new technologies and modernizing their plant and machinery in line with the international competitive environment. Sectors eligible for availing financing for importing machinery under the scheme are, Textiles, rice processing, Leather Goods, Surgical instruments, Sports Goods, carpets & wools, fisheries, engineering goods, Poultry & meat (hatching, preservation, packaging, canning etc), fruits & vegetable (preservation, canning etc), IT services & equipment, marble & granite, gems and jewelry.

The facility is available to the export oriented projects only if their annual export is equivalent to US $5 million or at least 50% of the sales whichever is lower. The rate of service charge at which SBP will provide refinance to the Participating Financial Institutions (PFIs) will be determined on the basis of the average of weighted average yields of last two auctions of 3, 5 and 10 years PIBs, and shall remain effective for one year, however, rate of service charges once fixed remains locked-in for the entire duration of a loan.

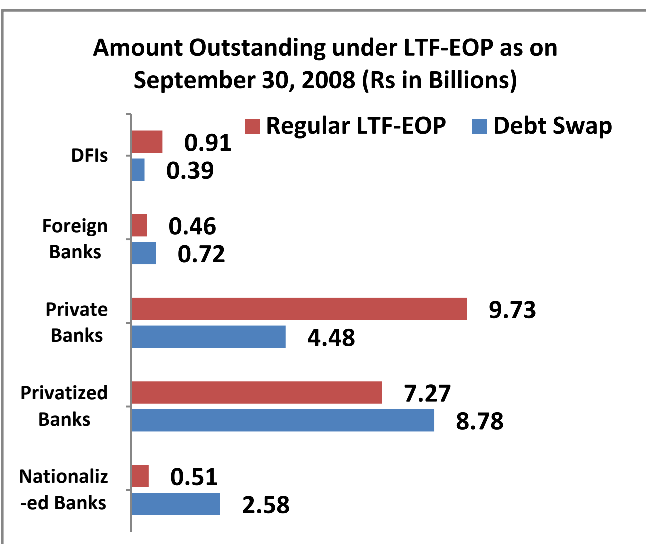
For the current fiscal year, a limit of Rs. 9.5 billion has been allocated to the financial institutions, with privatized banks (MCB, ABL,UBL & HBL) being assigned the biggest share of Rs. 4.4 billion, followed by private banks at Rs 4 billion, DFIs at Rs. 0.6 billion, nationalized banks at Rs. 0.4 billion and foreign banks with Rs. 100 million.

The disbursements under the scheme for the first quarter were merely Rs 660 million. The banks have, however, already established LCs worth Rs. 3.675 billion against which the funds shall be availed during the current fiscal year. The total disbursements under the scheme since inception are Rs. 1.7 billion.

The low utilization may be attributed to the fact that the textile sector (which is the single largest manufacturing sector of the Pakistan economy) had imported substantial machinery for up-gradation and expansion during the past few years. Other reasons which may contribute to lower import of machinery are increasing exchange rate, general increase in the cost of doing business and 30% share of financing to be provided by PFIs till November 12, 2008.

LONG TERM FINANCE FOR EXPORT ORIENTED PROJECTS (LTF-EOP)

In May 2004, SBP introduced a long term financing scheme specifically for the value added export oriented projects in order to facilitate import of machinery for up-gradation of existing technology and enhancement in the quality of industrial production. Banks / DFIs, approved as Participating Financial



Institution (PFI) under the Scheme, are allowed to

provide financing facilities to borrowers for import of machinery, plant, equipment and accessories thereof by export-oriented entities. An important feature of the scheme was that it was also intended to facilitate Pakistani exporters to access foreign markets, and also allows financing for acquisition of brand name/franchise, for a maximum period of five years inclusive of grace period. The Scheme stands abolished on 31.12.2007.

DEBT SWAP OPTION ALLOWED

During 2003-2005, textile sector imported substantial machinery to replace, upgrade and expand their existing plants taking advantage of the prevalent low interest rates. However, interest rates rose steadily during 2006 making the floating rate debt for the sector expensive and adding to the cost of production.

To prevent loss of export markets, in terms of orders lost to other competing countries, a relief package in the shape of a debt swap option was structured for the sector by SBP in September 2006. The main objective of the option was to replace the expensive floating rate debts of the textile sector by a less costly fixed rate debt.

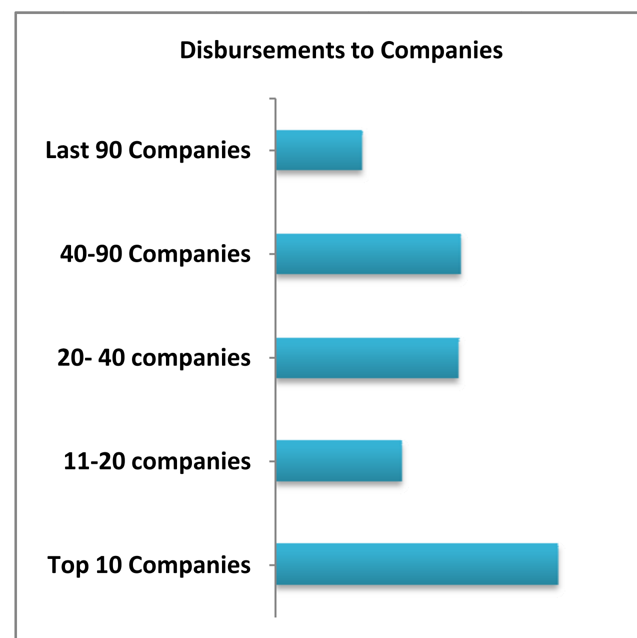
Commercial loans amounting to Rs. 34 billion taken against machinery imported by the textiles sector for up-gradation, replacement, expansion etc from January 1, 2003 to December 31, 2006 was allowed to be swapped by SBP refinance under the scheme for providing Long Term Finance-Export Oriented Projects (LTF-EOP). As on September 30, 2008 50% of the finances provided under the debt swap has been repaid, while the entire amount of the debt swap option is expected to be repaid by 2014. As on 30th September, Rs36 billion was outstanding against the disbursement of the previous years, of which Rs. 17 billion is against the debt swap option and Rs. 19 billion against regular financing. Bank wise distribution of outstanding funds under LTF-EOP can be seen in Graph.

BANK-WISE POSITION

The highest amount of refinance availed under the debt swap option was by the privatized banks (inclusive of NBP) amounting to Rs.22 billion, while the Local Private banks availed Rs 6 billion and the foreign banks availed Rs 4 billion. The share of DFIs was a marginal Rs 1.6 billion.

COMPANY-WISE POSITION

A company-wise analysis of the debt swap option shows that the top 10 companies received nearly a third (33%) of the amount disbursed under the option, with more than 65% going to 20% of the total borrowing companies. Graph shows the distribution of funds amongst the 180 debt swap borrowers.



SUBSIDY TO EXPORTERS

The Funds available to exporters, through their banks, under the various SBP refinance schemes carry service charges which are below the market rates. Given the tight monetary policy that SBP has been following during the past 3 years, these rates have been significantly below the market, thus allowing borrowers mark-up savings of about 7percent given present KIBOR rates.

It is estimated that Rs. 2.3 billion have been saved by exporters in mark-up payments under EFS during the

1st quarter of FY09, compared to Rs. 860 million during the 1st quarter of FY08 due to rising market rates and fixed EFS rates. It is also estimated that almost Rs. 5 billion was saved in mark up for the whole year of FY08.

The textile sector has saved approx. Rs.2.2 billion in mark up from the debt swap option (with an average relief in mark up of 7% from dec'06 to Sept 08). These savings are expected to increase, given the present tight monetary policy and the rising interest rate trend. For the quarter ended September 2008, the outstanding debt swap stood at Rs.17 billion while the mark up savings amounted to Rs 408 million (compared to Rs. 385 million for Sept' 07), an approximate subsidy of 9 percent in markup paid compared to the commercial loan.

POLICY CHANGES

In the Monetary Policy announced on July 31, 2007, as a part of the tight monetary stance required to check the rising inflation, it was decided that the SBP shall provide 70% refinance against loans for its various refinance schemes. However, due to the difficult economic conditions not only domestically but also internationally, it was decided to revert to 100% financing in order to ensure that the exporters had ready access to financing and the economy does not suffer due lack of funds.

Further, banks shall also not be entitled to deduct the funds provided under both parts of the Scheme from their Time and Demand Liabilities determined for the purpose of computation of both Cash Reserve Requirement and Statutory Liquidity Requirement.

CURTAILING FINANCE TO EXPORTERS

Banks have been advised to ensure that the over-due amount of export proceeds is repatriated before issuance of fresh export finance under the Export Finance Scheme to concerned borrower. This restriction was imposed on the banks in order to curtail misuse/willful default in export proceeds realization because Export finance facility is provided under the Scheme to banks/exporters at a very low rate for the purpose of promoting export of our country as well as to earn foreign exchange.

RELAXATION TO EXPORTERS

In October 2008, vide SMEFD Circular Letter No 2, it was decided to enhance the entitlement of limit from existing 50% to 67% in the case of exporters of hand knotted carpets for the monitoring year 2008-09 on the basis of export proceeds realized during monitoring year 2007-08.

REVIEW OF BANKS LIMITS

It was decided that rather than monitoring and assigning bank limits for export finance once a year, the limits shall be reviewed on a quarterly basis and adjustments shall be made accordingly. This is expected to ensure that banks put in efforts to ensure that the limits sanctioned to them are better utilized, thus they would be prompted to market the scheme more aggressively than they were before. It would also enable SBP to reallocate the limits from banks which have cushion available to those which have exhausted their limits. The aim is to ensure that the exporters have ample financing available and thus banks are not turning down their request for EFS funds on the pretext that their limits have been exhausted.

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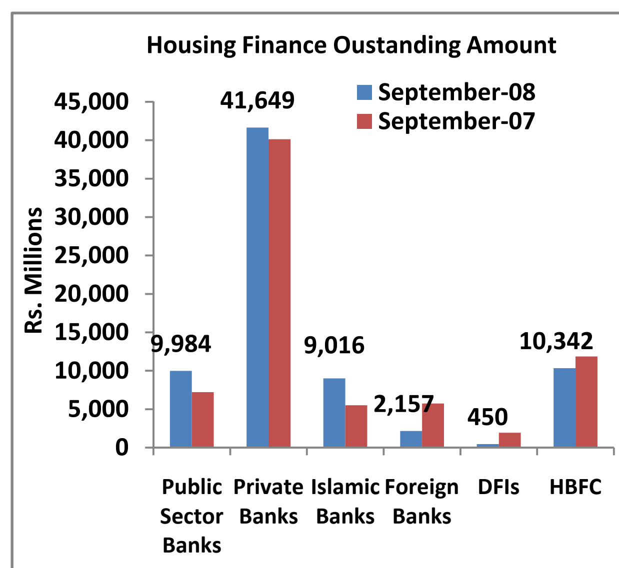
INFRASTRUCTURE & HOUSING FINANCE

HOUSING FINANCE

Housing finance represents approximately 18% of total consumer financing in Pakistan. With outstanding (net of NPLs) at Rs.73.60 billion as on September 30, 2008, the housing finance sector has reported a growth of 2% during last twelve months, albeit, reflective of a slowing tend. This slowing growth is primarily attributed to an increase in interest rates and tight monetary policy that has led to an overall squeeze in the private sector credit growth. However, the number of banks entering the mortgage market is increasing over time which is a sign of increasing competition and outreach.

OUTSTANDING

The total outstanding finance (net of NPLs) as on September 30, 2008, of all banks and DFIs stood at Rs.73.6 billion. Compared to quarter ended September 2007, outstanding amount of all commercial banks and DFIs increased by 2%. Of the total outstanding finance, commercial banks accounted for Rs.62.8 billion with private banks posting an outstanding of Rs.41.7 billion. Excluding DFIs, all commercial banks (public sector banks, private banks, Islamic banks and foreign banks) together posted a 7% increase when compared to quarter ended September 2007.[1] Impressive growth was posted by Islamic banks recording a 63% increase in outstanding amount, from Rs.5.5 billion in September 2007 to Rs.9.02 billion in September 2008. This was followed by a 38% increase in outstanding of public sector banks; from Rs.7.2 billion in September 2007 to Rs.9.98 billion in September 2008. The outstanding of foreign banks and DFIs (excluding HBFC) fell by 62% and 77%, respectively over the year. This was primarily due to mergers and change in status of individual banks. The outstanding of HBFC stood at Rs.10.34 billion; a 13% decrease compared to outstanding of Rs.11.8 billion, as on September 30, 2007.



Compared to the quarter ended June 2008, the outstanding (net of NPLs) of all banks and DFIs (including HBFC) posted a growth of only 1%. Public sector banks and Islamic banks posted a growth of 12%, each. This was followed by a 6% increase in outstanding of HBFC and a 5% increase posted by foreign banks. On the other hand, private banks and DFIs (excluding HBFC) witnessed a 6% and 17% decline respectively.

NUMBER OF BORROWERS

Outstanding no. of borrowers has increased from 51,555 to 61,512 since September 2007; a 19% increase (Figure 2). Islamic banks have shown a sharp increase (of 39%) with numbers increasing from 1,556 to 2,178 over the year, followed by private banks (27%), HBFC (26%) and public sector banks (18%). Foreign banks and DFIs reported a decline of 61% and 87%, respectively.

[1] Due to a change in reporting requirements since March 2008, the outstanding figures reported for the quarter ended September 2008 are now exclusive of NPLs and therefore present an approximate comparison to the outstanding figures reported for the quarter September 2007

NON-PERFORMING LOANS

The NPL figures have increased from Rs.9.7 billion (June 2008) to Rs.10.5 billion (September 2008); a 9% increase over the reporting quarter.

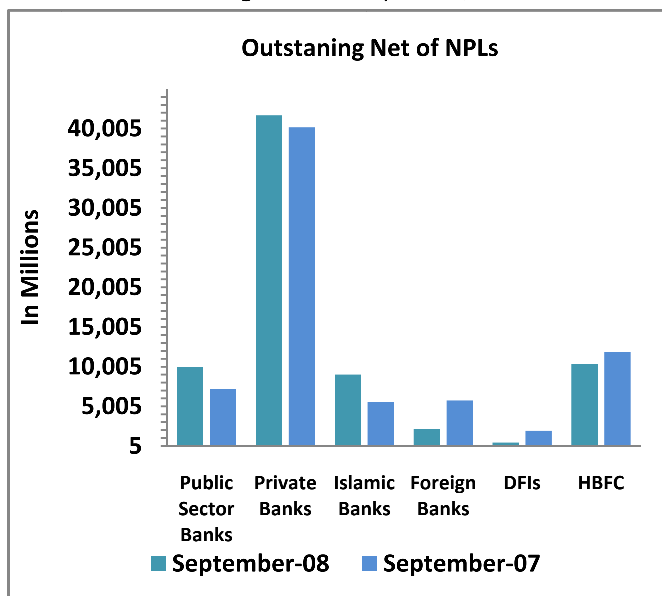
An increase in NPLs of 47% has been witnessed among foreign banks (from Rs.66 million to Rs.97 million) followed by 31% among private banks (from Rs.2.88 billion to Rs.3.76 billion). NPLs for Islamic banks have increased from Rs.84 million to Rs.103 million; a 23% increase. Public sector banks have reported a decline in NPLs from Rs. 744 million (June 2008) to Rs. 651 million (September 2008); a 13% fall. NPLs of HBFC have remained approximately the same.

NPLs as a percentage of total outstanding for the entire housing finance sector (commercial banks and DFIs) are reported to be 12.5%. Commercial banks (excluding DFIs) collectively have NPLs constituting 6.89% of their total outstanding. HBFC reports NPLs to be 36.13% of their total outstanding, whereas other DFIs stood at 12.85%. All banks and DFIs are facing serious problems of loan default as it has added Rs.37 billion NPLs during July-September 2008 and the total figure reaching close to Rs.290 billion. This rise in NPLs is due to rising inflation and interest rates and this may further escalate the problem in coming quarters. The high interest rate policy also reduced the demand for housing which has caused the growth of mortgage sector to slow down.

SHARE OF BANKS

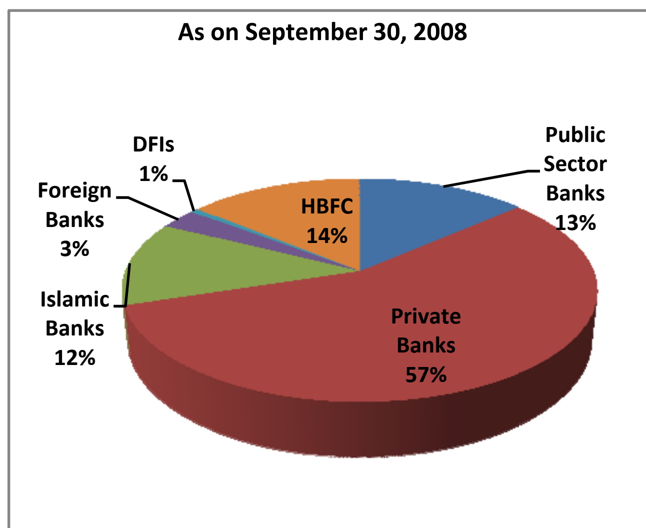
The overall market share of commercial banks has increased from almost 81% to 85% since quarter ended September 2007 (Figure 4). Within commercial banks, the share of private banks increased from 55% to 57% with Islamic banks showing resilient growth with their share increasing from and 8% to 12% by the reporting period. Share of public sector banks has also increased from 10% to 13% and that of foreign banks has decreased from 8% to 3%, since September 2007. The fall in the share of foreign banks and the rise in private banks can partially be attributed to mergers and conversion of foreign banks into local private banks. The share of HBFC has declined from 16% to 14% of the total outstanding.

It can be seen in Figure 4 that private, Islamic banks



and public sector banks are main players in the housing finance sector, while DFIs and Foreign banks are reducing their share in the market. These figures confirm that the commercial banks still consider mortgage as a profitable business and are expanding their portfolio despite high interest rates and lack of enabling environment.

DISBURSEMENTS



A total of Rs.4.9 billion worth additional disbursements were made during the quarter September 2008 (Table 1). Private Banks extended fresh disbursements of Rs. 2.2 billion followed by Islamic banks with Rs.1.07 billion. HBFC's additional disbursements for the quarter were reported to be Rs. 1.04 billion. Among commercial banks the number of new borrowers totaled 1,636, with private banks contributing 1,191 borrowers. HBFC extended loans to 1,761 new borrowers during the reporting quarter.

Table 1 Disbursements during the Quarter September 2008

	Amount (Rs. Millions)	No. of Borrowers
Public Sector Banks	**255**	**152**
Private Banks	**2,219**	**1,191**
Islamic Banks	**1,066**	**232**
Foreign Banks	**313**	**61**
All Banks	**3,855**	**1,636**
DFIs	**3**	**1**
All Banks & DFIs	**3,858**	**1,637**
HBFC	**1,046**	**1,761**
Total	**4,904**	**3,398**

SECTORAL SHARE

The greatest share of housing finance is currently being attracted towards outright purchase. The total outstanding (net of NPLs) for outright purchases stood at Rs.45.2 billion as on September 30, 2008; a 61% share in total outstanding of Rs.73.6 billion. This is followed by the construction category where outstanding reported at quarter end stood at Rs.19.9 billion and that of renovation stood at Rs.8.5 billion. While financing for outright purchase and construction category has increased by 4% and 2%, respectively, over the last 12 months, renovation reports a decline in financing by 9%. Public sector banks have taken a lead in financing for outright purchase (76% increase) and renovation (38% increase) since September 2007. Islamic banks are seen to be taking an aggressive approach in financing construction by taking their portfolio from Rs. 338 million to Rs.2.30 billion, a 580% increase since September 2007.

Currently, the greatest growth witnessed since September 2007 in the construction category is being led by Islamic banks and Private Banks. For the outright purchase category, public sector banks and Islamic banks have taken a lead while in the renovation category public sector banks and HBFC are playing a more dominant role.

ANALYSIS OF LOAN VARIABLES

Table 2 and 3 summarizes loan variables across all banking sectors including weighted average interest rate, Loan-to-Value ratio (% financing by banks), average maturity, average time for loan processing and number of cases classified as foreclosures. With the exception of weighted average interest rate and average maturity periods, comparisons with September 2007 for other loan variables are not made due to unavailability of data over the entire 12 month period.

The overall weighted average interest rate for the quarter ended September 2008 was estimated to be 13.7%; 0.26 percentage point increase from June 2008 and a 2.94 percentage point increase when compared to September 2007. Highest weighted average interest rate was reported by DFIs (excluding HBFC) at 16%, followed by foreign banks at 15.05%, Islamic banks at 14.86%, and private banks at 13.6% and public sector banks at 13.3%. The weighted average interest rate reported by HBFC is 13.7%; a 4.57 percentage point increase compared to quarter ended September 2007.

Average maturity periods have declined from 13.14 years (September 2007) to 11.76 years (September 2008). Table 2 shows that foreign banks have extended housing loans for an average tenure of 8 years followed by public sector banks with 9.43 years, private sector banks with 11.9 years, DFIs (excluding

Table 2	Wt Av. Interest Rate			Av. Maturity Period		
	Sep-08	Jun-08	Sep-07	Sep-08	Jun-08	Sep-07
Public Sector Banks	13.33	13.13	11.46	9.43	11.06	10.50
Private Banks	13.61	12.94	11.91	11.92	12.11	11.66
Islamic Banks	14.86	13.22	11.59	15.00	16.58	12.31
Foreign Banks	15.05	14.67	13.85	8.07	12.27	11.36
All Banks	13.94	13.23	12.17	11.57	12.67	11.49
DFIs	16.01	14.84	12.21	12.38	14.71	13.87
All Banks & DFIs	14.02	13.29	12.41	11.60	12.75	11.85
HBFC	13.71	13.71	9.14	15.10	16.67	14.42
Total Average	13.71	13.45	10.77	11.76	12.92	13.14

HBFC) with 12.4 years and Islamic banks for 15 years. HBFC's average maturity period for the quarter is reported to be 15 years; a slight increase from 14.42 years when compared to September 2007 figures. Islamic banks and HBFC are offering loans for longer terms, albeit, less than the maximum tenure limit of 20 years set by SBP. The percentage of financing (Loan to Value ratio) extended by banks has declined during the quarter ended September 2008 (Table 3). The LTV ratios for housing finance fell from 58.12 during quarter June 2008 to 52.68 during quarter ended September 2008. The sharpest decline was witnessed among foreign banks where the LTV ratios fell from 59.75 to 36.12 during quarter ended September 2008. The LTVs for HBFC remained 55% for the quarters June and September 2008. Decline in LTV ratios and increasing interest rates reflects that housing finance is becoming more unaffordable, especially for the salaried class and lower income groups.

The reported average time for loan processing is 26 days for all banks and DFIs. The processing time can be considerably reduced if land titling issues are resolved; documentation is standardized and institutional inefficiencies removed. Moreover, application processing is a centralized process, where branches forward applications to central branches/head offices for assessment and approvals.

Average loan size for disbursements made during the quarter ended September 2008 is estimated to be Rs. 2.41 million for all banks, except HBFC. The average loan size for HBFC is reported to be Rs. 860,000 for the reporting quarter. Islamic banks have disbursed loans with an average loan size of Rs. 3.63 millions. This is an increase of 27.8% in size (in Rs.) compared to June 2008 when average loan size was reported at Rs. 2.84 million. On the contrary, other banks report a fall in their average loan sizes. DFIs other than HBFC report an average loan size of Rs. 2.47 million followed by private banks with Rs. 2.38 million, foreign banks with Rs. 1.97 million and public sector banks with Rs. 1.8 million. HBFC's average loan size has remained relatively constant. The housing finance market is still inclined towards lending to high income group.

No. of cases intended to be settled through foreclosures have increased by 60 new cases during the quarter September 2008, for banks/DFIs (excluding HBFC). HBFC reported the highest number of cases currently subjected to foreclosure proceedings.

Table 3	Loan to Value Ratio (%)		Average Time for Loan Processing (days)		Average Loan Size (Rs. Millions)		No. of Foreclosures[2]	
	Sep-08	Jun-08	Sep-08	Jun-08	Sep-08	Jun-08	Sep-08	Jun-08
Public Sector Banks	58.32	63.74	38.57	39.23	1.80	2.08	0	0
Private Banks	52.68	57.32	22.75	22.61	2.38	4.01	173	114
Islamic Banks	56.71	59.12	33.59	21.46	3.63	2.84	8	8
Foreign Banks	36.12	59.75	18.82	23.82	1.97	2.48	0	0
All Banks	52.79	58.88	25.70	24.49	2.41	3.41	182	122
DFIs	49.11	45.40	30.00	30.00	2.47	2.73	1	1
All Banks & DFIs	52.68	58.28	25.91	24.72	2.41	3.38	183	123
HBFC	55.00	55.00	30.00	30.00	0.86	0.89	2,658	N.A
Total Average	52.68	58.12	26.10	24.98	2.35	3.32	2,841	123

CONCLUSIONS

Overall, statistics for the quarter depict positive growth, albeit to a very small extent. This can be attributable to interest rates, macroeconomic conditions and an institutional framework that needs to be made conducive for a well structured mortgage market. This quarter suggest that banks remain very cautious in their lending strategy to the housing sector. Housing-related risk is presently manageable due to the relatively small size of the housing finance portfolio. The limited exposure allows banks to manage the liquidity risk by leveraging their stable deposit base, but this is not sustainable in the long term due to the relatively short maturities of bank deposits (the bulk of banks' deposits are less than one year in duration). In addition, the active lenders are typically the smaller private commercial banks with limited branch networks that compete with large nationalized banks for securing deposits. As a result, banks are currently forced to restrict their housing loans to 10–15 years. The solution to this issue is the development of a secondary mortgage market which is under consideration. This would help banks off load their mortgage loans, ease liquidity problems, rationalize the interest rate and develop innovative mortgage products. In part, the banks' cautious approach to lending is because they are still in the process of attracting the requisite expertise and resources required to exploit this business area and manage its associated risks. Nevertheless, there is clear indication that in this relatively new product development phase, there is great potential for larger portfolios and for more institutions to enter into the market for the provision of affordable housing, especially to cater middle income and salaried class.

KEY INITIATIVES AND ACHIEVEMENTS

Following key initiatives have been taken by SBP to further develop market based mechanisms and enhance the flow of credit to this priority sector.

As part of its earlier efforts, SBP had established a ***Housing Advisory Group (HAG).*** The HAG was established with an intention to conduct a thorough analysis on the existing regulatory and policy framework affecting housing finance. The HAG made number of recommendations. These include reforms in legal and regulatory framework, establishment of secondary mortgage market, development of market intelligence, provision of affordable/ low income housing finance products.

[2] The no. of Foreclosure cases are cumulative figures, i.e., cases classified as foreclosures since inception.

SBP and World Bank have agreed to work together for implementing key recommendations of HAG by focusing on: restructuring of HBFC, establishment of Mortgage Refinance Company, low cost housing finance, establishment of an observatory for real estate market and capacity building of professionals engaged in housing finance.

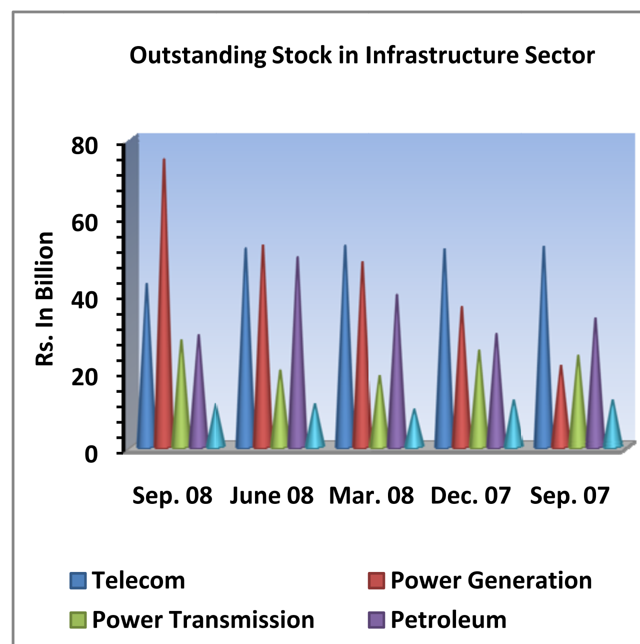
A Cooperation Agreement was signed between International Finance Corporation, the private sector arm of the World Bank Group, and SBP to launch a ***housing finance training program in Pakistan***. The training intends to cover all aspects of housing finance.

INFRASTRUCTURE FINANCE

Despite overall economic turbulence, a positive trend was experienced in infrastructure financing during July-September 2008 quarter. However, no seismic shift has been reported during the quarter under review as energy and telecom sectors remained the leading beneficiaries. However, positions of top sectors within the energy and telecom sectors have been shifted since the end of the corresponding quarter last year.

OUTSTANDING PORTFOLIO

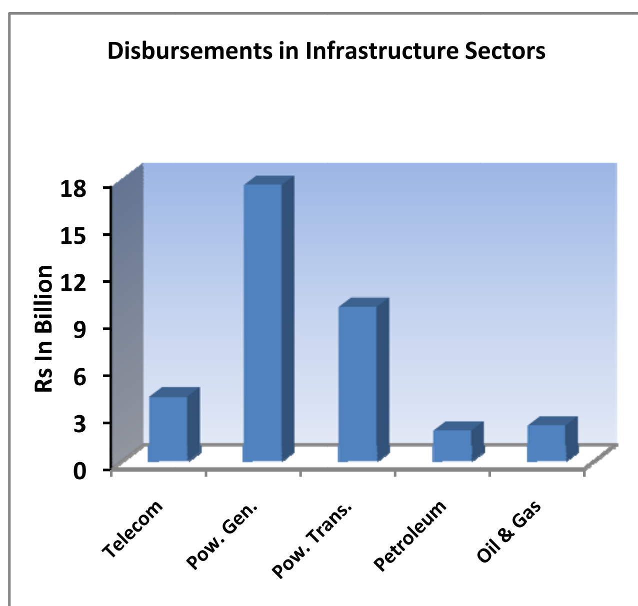
Total outstanding financing at close of September 2008 was Rs. 204.13 billion as against Rs. 159 billion at the end of September 2007. This 28% increase in outstanding stock of infrastructure financing during last twelve months and the trough experienced in consumer financing during the same period reveal growing confidence of banking sector for infrastructure financing. The persistent energy crisis in the country impels the power generation sector to enhance the generation capacity and financial sector is responding to this SOS call by channeling huge funds in power sector. The outstanding stock of Power Generation sector swelled up significantly from September 2007 to September 2008. Figure shows the position of top five sectors from September 2007 to September 2008. Telecom sector remained the top sector during three quarters of last year i.e. September 2007, December 2007 and March 2008 as



its value remained above Rs. 50 billion in each quarter. In June 2008 its value started decreasing which further declined in September 2008 quarter. During this period its value decreased by Rs. 10 billion. On the other hand, Power Generation sector grew by leaps and bounds during mentioned quarters. The trajectory of Power Generation is steep and a lot of funding has been witnessed in it. Its value was around Rs. 20 billion in September 2007 quarter which stands at more than Rs. 70 billion exactly after a year with phenomenal 254% growth rate. Petroleum sector remained in rollercoaster as trajectory of its value follows a cyclical path. Value of Petroleum sector decreased from Rs. 49 billion in June 2008 to Rs 29 billion in September 2008. There was 70% decrease in value during the quarter. One possible reason for higher value in Petroleum during preceding quarters could be attributed to international hike in petroleum products which started declining of late. Performance of Oil & Gas Exploration sector remained dismal in all quarters. This important sector must be allowed to realize its potential in current energy-crisis scenario. Federal Ministry of Petroleum is working to finalize new Petroleum Policy to attract new investment in this sector.

DISBURSEMENTS:-

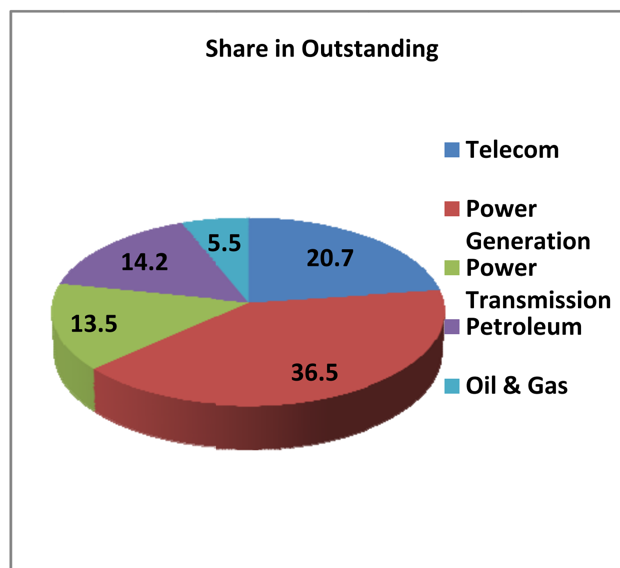
Total Rs. 38.8 billion disbursed during July-September 2008 quarter in all infrastructure sectors. Figure show the amount disbursed and share of each sector during the quarter under review. Power Generation sector received over Rs. 17 billion (45.5%) which is significantly higher than other sectors. Power Transmission sector occupied second place with approximately Rs. 10 billion (25.4%). Thus, Power Generation and Transmission sectors together received more than Rs. 27 billion which represents more than 70% share in total disbursement. This



demonstrates the efforts initiated to overcome the power shortage crisis in the country. More than 80% of the total disbursement is directed in three sectors which calls for a diversified approach by the financial institutions to boost other key sectors also.

SECTORAL SHARE IN INFRASTRUCTURE:-

In September 2007 Telecommunication sector was at the top as far as share in total outstanding is concerned with 32.5%, followed by Petroleum sector which has almost 21% in the total pie of outstanding. After a year the top slot has been secured by power generation sector which nudged the Telecommunication sector at second place with sizable 36.5% share. Telecommunication sector's share reduced to 20.7% by the end of September 2008. Power transmission sector saw a dip in its share of outstanding and relegated to third position at the



end of September 2008 with 14.2% share. The recent trend shows that power sector will figure prominently in coming quarters as well.

BANK-WISE DISBURSEMENTS:-

This segment reveals a significant contribution of the private sector commercial banks in infrastructure project financing. Private sector commercial banks disbursed Rs. 35 billion during the quarter out of total Rs. 38 billion financing in infrastructure sectors during the quarter. Public sector banks disbursed meager Rs. 3.5 billion and DFIs remained almost quiet with Rs. 0.75 billion.

BANK-WISE OUTSTANDING SHARE:-

The stock share of private sector banks rose from 78% to 85% from September 2007 to September 2008. Public Sector banks saw a decline in their share from 19.6% in September 2007 to 12.8% in September 2008.

Analysis shows that it is the enterprising private sector which takes interest in infrastructure financing and sees this sector attractive while public sector is

becoming more and more conventionalized with the passage of time. A policy and strategic shift is desired in public sector banks and DFIs who has the potential to contribute much more in infrastructure development.

NEW INITIATIVES IN THE QUARTER:-

Table 1 shows that during the quarter total 15 projects have been finalized to the tune of Rs. 114.9 billion. Banking Sector is financing Rs. 84.06 billion which is 73.2% of the total project cost. Power Generation figures prominently as far the financing by banking sector is concerned as 63.4% financing for new projects is directed towards five power projects which are expected to add 1090 MW of power to the national grid. Telecommunication and Water and Sanitation sectors come next in terms of project cost (Rs. 17.85 billion and Rs. 15.4 billion respectively) and financing by banks (Rs. 10.2 billion and Rs. 11.56 billion respectively). Telecom companies are investing to enhance their network coverage across the country while new investment in Water and Sanitation sector will provide 33 million gallon clean water per day to the metropolis. In Oil and Gas Exploration sector Sui Southern Gas Company is expanding its distribution network to the tune of 1800 mmcfd with project cost Rs. 14.52 billion.

Table 1: New Projects in July-September 2008 Quarter (Rs. In Billion)

Sectors	No. of Projects	Estimated Project Cost	Banks' Financing
Power Generation	5	65.47	53.28
Telecommunication	5	17.85	10.2
Water and Sanitation	2	15.4	11.56
Oil & Gas Exploration	1	14.5	8.13
Petroleum	1	1.35	0.74
Any Other	1	0.29	0.15
Total	15	114.86	84.06

KEY INITIATIVES AND ACHIEVEMENTS:-

Appreciating the critical role of infrastructure and housing sectors in propelling the domestic economy following key initiatives have been taken by SBP to further develop market based mechanisms and enhance the flow of credit to these priority sectors.

- A Task Force on Infrastructure Finance established and delegated with a mandate to asses' country's infrastructure need has made a set of recommendations. These recommendations primarily focus on development of long-term funding mechanism through establishment of dedicated Infrastructure Lending Organization.

- As Part of Capacity Building measure; a training program titled 'Frontiers in Infrastructure Financing' is planned to be conducted in the first half of 2009 with World Bank.

- The department also undertook research initiatives ; The Review of Project financing, Quarterly Review for Infrastructure Finance and Credit Enhancement for Project Financing. A detailed analysis on the price trends of international crude oil prices and domestic oil products was also undertaken.

- Made efforts to improve the quality of data reported by banks/ DFIs on project financing.

AGRICULTURE FINANCE

AGRICULTURE FINANCE

Agriculture is an important sector of our economy, a dominant driving force for growth and the main source of livelihood for 66% of the country's population. It accounts for 21% of the GDP and employs 42% of the total work force. As such, agriculture is the center of national economic policies and has been designated by the Government as an engine of national economic growth and source of poverty reduction. Agriculture contributes to growth as a supplier of raw materials to industry as well as a market for industrial products and also contributes substantially to exports earnings.

With the liberalization of financial sector, there was a paradigm shift in the roles of SBP and banks. Under the new paradigm, SBP was committed to creating an enabling environment for banks to adopt agri/rural finance as a viable business line. Various initiatives were taken in the last 6-7 years to facilitate banks in innovative product development, capacity building and developing linkages with stakeholders. These initiatives have paid dividend in the form of rise in agri. credit disbursement to Rs 212 billion in FY 2007-08 from Rs 39 billion in FY 1999-2000.

DISBURSEMENTS:-

ACAC had set indicative agri. credit target for banks of Rs 250 billion for FY 2008-09, out of which Rs 172 billion were allocated to commercial banks, Rs 119.5 billion to five major banks and Rs 52.5 billion to Domestic Private Banks (DPBs), whereas target of Rs 72 billion and Rs 6.0 billion were assigned to ZTBL and Punjab Provincial Cooperative Bank Limited. The target was 25 percent higher than previous year's target of Rs 200 billion and 18.5 percent higher than the disbursements of Rs 211.6 billion during FY 2007-08. During July-September, 2008 banks disbursed Rs 46.6 billion showing an increase of 28.3 percent over

2.1 Indicative Agri Credit Targets and Disbursements (Source: ACD, SBP)

(Amount in billion Rupees)

Banks	2008-09 (July- September)				2007-08 (July-September)			
	Targets	Disbur.	Targets Achieved	Share in Total Disbur.	Targets	Disbur.	Targets Achieved	Share in Total Disbur.
5 Big Comm. Banks	119.5	25.6	21.5%	55.0%	96.5	19.5	20.2%	53.7%
ZTBL	72.0	8.7	12.1%	18.8%	60.0	7.2	12.0%	19.9%
DPBs	52.5	11.4	21.8%	24.5%	35.5	8.3	23.5%	23.0%
PPCBL	6.0	0.8	13.7%	1.8%	8.0	1.3	15.8%	3.5%
Total	250.0	46.6	18.6%	100.0%	200.0	36.3	18.2%	100.0%

2.2 Credit Disbursement to Farm and Non-Farm Sector (Source: ACD, SBP)					
					(Rupees in billions)
Sector		**July-September, 2008**		**July-September, 2007**	
		Disbursement	**% Share**	**Disbursement**	**% Share**
A	**Farm Credit**	**29.8**	**100.0**	**27.1**	**100.0**
1	**Subsistence Holding**	**18.3**	**61.5**	**16.9**	**62.5**
i	***Production***	***16.5***	***55.3***	***15.5***	***57.3***
ii	***Development***	***1.8***	***6.2***	***1.4***	***5.1***
2	**Economic Holding**	**6.3**	**21.0**	**5.6**	**20.7**
i	***Production***	***5.8***	***19.4***	***5.2***	***19.2***
ii	***Development***	***0.5***	***1.6***	***0.4***	***1.5***
3	**Above Eco. Holding**	**5.2**	**17.5**	**4.6**	**16.9**
i	***Production***	***5.0***	***16.7***	***4.4***	***16.3***
ii	***Development***	***0.2***	***0.8***	***0.2***	***0.6***
B	**Non-farm Credit**	**16.8**	**100.0**	**9.1**	**100.0**
1	**Small Farms**	**2.9**	**17.3**	**1.7**	**18.5**
2	**Large Farms**	**13.9**	**82.7**	**7.4**	**81.5**

the disbursements of Rs 36.3 billion made in the same period last year. Banks group wise disbursements during July-September, 2008 along with corresponding period of last year are given in Table 2.1.

Purpose-wise classification reveals that during the first quarter of FY 2008-09 an amount of Rs 40.1 billion (86 percent) was disbursed for production purposes and Rs 6.5 billion (14 percent) were extended for developmental purposes. During the same period last year, an amount of Rs 33.1 billion (91 percent) was extended for production purposes and Rs 3.2 billion (9 percent) was disbursed for developmental purposes.

Sector-wise classification of agri. credit disbursements reveals that during July-September, 2008, out of total disbursements of Rs 46.6 billion an amount of Rs 29.8

2.3 Province-wise Indicative Targets and Disbursements

(Amount in billion Rupees)

Region	2008-09 (July- September)				2007-08 (July-September)			
	Targets	Disbur.	Targets Achieved	Share in Total Disbur.	Targets	Disbur.	Targets Achieved	Share in Total Disbur.
Punjab	195.0	40.1	20.6%	86.0%	156.0	30.2	19.4%	83.2%
Sindh	35.0	4.4	12.6%	9.5%	28.0	3.6	13.0%	10.0%
NWFP	15.0	1.7	11.6%	3.7%	12.0	2.2	18.5%	6.1%
Balochistan	3.8	0.1	3.1%	0.2%	3.0	0.1	3.3%	0.3%
AJK/N.As	1.3	0.2	17.8%	0.5%	1.0	0.2	16.0%	0.4%
Total	250.0	46.6	18.6%	100.0%	200.0	36.3	18.2%	100.0%

billion (64 percent) was disbursed to farm sector and Rs 16.8 billion (36 percent) to non farm sector.

The province-wise agri. credit disbursements during the period under review show that Punjab received Rs 40.1 billion (86 percent) higher by Rs 9.9 billion as compared with disbursements of Rs 30.2 billion (83 percent) during the same period last year. Disbursements in Sindh were Rs.4.4 billion and its share in total Disbursements in NWFP, Baluchistan and AJK/N.As were Rs 1.7 billion, Rs 0.1 billion in Baluchistan and Rs 0.2 billion in AJK/N.As. Details are given in Table 2.3.

NON-PERFORMING LOAN

Traditionally, ratio of non-performing loans in agri. financing always remains higher within overall NPL of banking sector. However, in last few years agri. NPL have shown improvement and stock of NPL has reduced from Rs 38.2 billion in September, 2007 to Rs 34.8 billion in September, 2008. Banks' group- wise details indicate that out of total NPL of Rs 34.8 billion the share of ZTBL stood at Rs 19.3 billion (56 percent), five large banks Rs 7.3 billion (21 percent), DPBs Rs 6.0 billion (17 percent) and PPCBL Rs 2.2 billion (6 percent).

NUMBER OF BORROWERS

Agri. loan borrowers have reached to 2.0 million as on end September, 2008 as compared with 1.76 million at end September, 2007. Out of total agri borrowers, 1.44 million borrowers (72 percent) were from Punjab, 0.35 million (17.56 percent) from Sindh, 0.15 million (7.5 percent) from N.W.F.P, 0.02 million (1.0 percent) from Baluchistan and 0.04 million (2.0 percent) from AJK/N.As. ZTBL has the largest share of 60.5 percent followed by 30 percent of five major banks, 6.4 percent of PPCBL and 3.1 percent of DPBs.

SBP'S INITIATIVES FOR PROMOTION OF AGRI. CREDIT

Major initiatives taken for the promotion of Agri finance by SBP during July-September, 2008 are as under:

⇒ ***Enhanced indicative per acre credit limits*** on an average of 70% for major & minor crops, orchards and forestry. The enhancement in limit has been made on the basis of current prices of inputs like seed, fertilizer, pesticides, fuel, electricity, etc.

⇒ In order to mitigate the risk of banks and farming community against losses caused by the natural calamities, SBP has developed a ***Crop Loan Insurance Framework*** with the help of a Task Force comprising of representatives of banks, leading insurance companies, farming community and other stakeholders. Based on SBP framework, mandatory crop loan insurance scheme has been introduced from Rabi crop 2008-09 for major crops, viz. wheat, cotton, rice, sugarcane and maize The government has decided to bear the cost of premium of subsistence farmers up to a maximum of 2% per crop.

⇒ To facilitate banks in ***capacity building and training*** of their agri. credit officers, SBP has launched one-week Crash Training Program in May 2008 on cost recovery basis after consultation with banks and Development Finance Support Department, SBP-BSC. The training is offered at the offices of SBP-BSC and /or regional offices of commercial banks.

⇒ SBP has joined ***Asia Pacific Rural Agricultural Credit Association (APRACA***), a regional forum, for sharing of knowledge of international best practices of the region in agri. /rural finance. Using the network of APRACA, SBP arranged training visits of its officers and agri. heads of banks to the Bank for Agriculture and Agricultural Cooperatives (BAAC) in August 2008. The objectives were to study the working of BAAC and learn from its experiences in the field of agri/ rural finance.

⇒ Keeping in view the great potential and demand for Islamic Banking products for Agriculture, SBP formulated a ***Task Force on "Islamic Agricultural Finance"*** for development of guidelines comprising of representatives of SBP, Shariah Advisors of Islamic banks and Agri Heads of banks. The Task Force has developed draft Guidelines on Islamic Financing aimed at facilitating banks in developing Shariah compliant products for agriculture financing.

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MICROFINANCE

MICROFINANCE

The first microfinance bank in Pakistan, Khushhali Bank, was established under the Khushhali Bank Ordinance of 2000. In the following, MFIs Ordinance 2001 was promulgated, which paved the way for creation of more private sector MFBs. At present, seven MFBs are operating in the country, of which five have licenses to operate country wide and two licensed to operate at the district level. In order to provide fair treatment to MFBs, the legal status of Khushhali Bank was brought under Microfinance Ordinance 2001. Besides the existing seven MFBs, applications of proposed MFBs are under review at SBP. Hence, given the increasing number of players in the market, MFBs seem to be poised for accelerating growth, thereby increasing competition in the sector.

OUTREACH	3Q'07	2Q'08	3Q'08 Rs in '000'
MFBs	**6**	**6**	**7**
Branches	**185**	**245**	**252**
Borrowers	**448,470**	**511,615**	**564,892**
Advances	**4,654,520**	**5,878,183**	**6,712,961**
Deposits	**2,633,269**	**3,408,920**	**3,481,158**
Depositors	**131,860**	**197,439**	**226,043**
Assets	**11,318,672**	**12,522,013**	**12,598,234**
Borrowings	**4,859,250**	**5,359,984**	**5,391,837**
Equity	**3,590,774**	**3,420,930**	**3,349,052**

Licensed MFBs	Year	Status	Key Sponsors
Khushhali Bank Ltd.	**2000**	**Country-wide**	**Commercial Banks**
The First Microfinance Bank	**2001**	**Country-wide**	**AKAM, & IFC**
Rozgar Microfinance Bank	**2004**	**District–wide**	**Arif Habib Group**
Network Microfinance Bank	**2004**	**District–wide**	**JS & KASB Group**
Tameer Microfinance Bank	**2005**	**Country-wide**	**EMCL & IFC**
Pak Oman Microfinance Bank	**2006**	**Country-wide**	**Pak Oman Investment**
Kashf Bank	**2008**	**Country-wide**	**Kashf Holding**

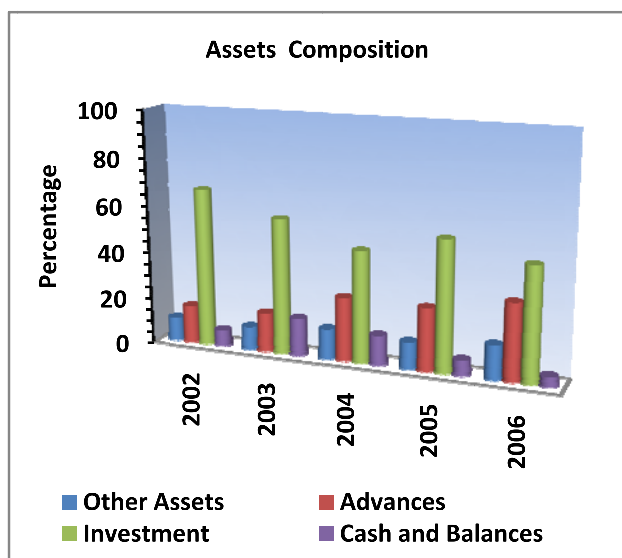
SECTOR AT A GLANCE:

The sector continues to increase outreach (branches, borrowers, depositors) at a steady pace. The number of active borrowers of MFBs now stands at 564,892 in the quarter ending September 2008, increasing by 10% over the quarter and 26% over the twelve month period beginning September 2007. Similarly, the number of depositors rose by 14% over the quarter under review. The number of branches reached to 252 compared to 185 in September of 2007, and 245 in June 2008. The two largest MFBs added significantly to expansion in outreach during 2008, while contribution to the sector by remaining MFBs remained trivial. On a positive note, total assets of the sector grew to Rs. 12.6 billion from Rs. 11.3 billion over the year September 2007 to 2008. While, the equity base of

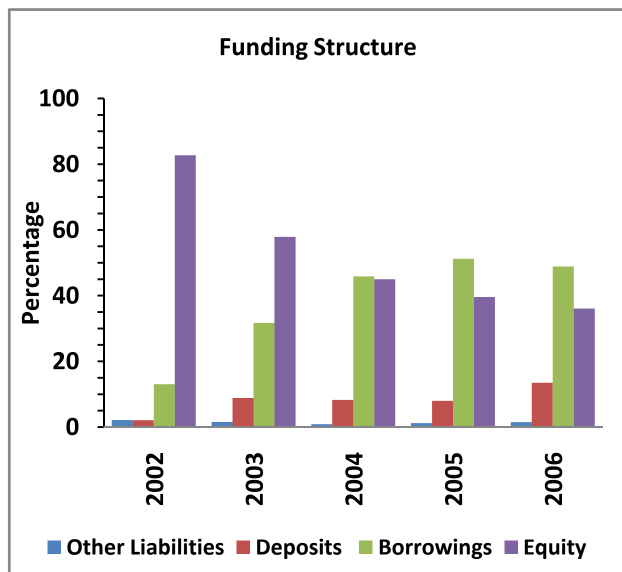
the sector declined from Rs.3.6 billion to Rs. 3.5 billion.

ASSETS:

Loans and Advances, a core earning asset, has witnessed growth in its share to 52% as of September



of 2008 from 41% and 46% as of September 2007 and June 2008 respectively. However, both Cash and Investments witnessed a decrease in their proportions



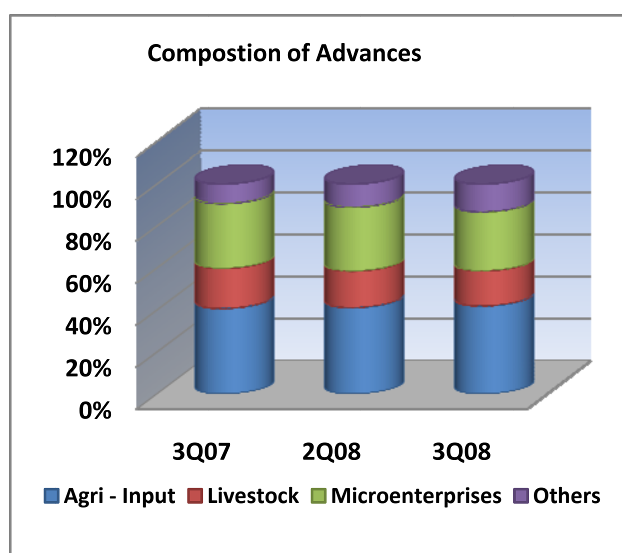
of the asset base. Cash and Cash equivalent decreased to 21% in September 2008 compared to 27% in the corresponding period of last year. The share of Investment also dropped to 12% from 16% during the same period. The share of fixed and other assets remained constant at 15-16% during the year. Reallocation of assets towards loans and advance implies that more are being used efficiently in microfinance services.

FUNDING:

Examination of the financing structure indicates that borrowing continues to dominate the funding structure of MFBs, with a constant share of 43% over the year. On a positive note, the share of deposits has increased to 28% in September of 2008 from 23% as of September 2007. However, the rise in share of deposits was offset by a decline in the share of equity to 27% in September of the current year from 32% in the same month of last year. While such a rise is positive, banks need to further strengthen deposit mobilization in order to lower future cost of funds.

ADVANCES:

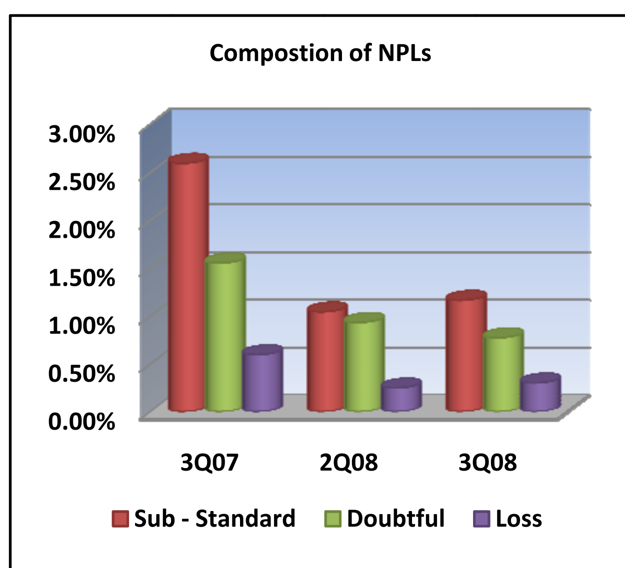
Composition of loan portfolio illustrates a fixed pattern during the period under review. Agriculture financing constitutes major portion with share between 41% to 42% during the year. Microenterprise and livestock are second and third largest sector being financed by MFBs. The share of microenterprise and



livestock stood at 28% and 17% respectively.

NON-PERFORMING LOANS:

A significant improvement occurred in the composition of Non-Performing Loans (NPLs). Overall, the level of NPLs dropped from 4.8% from September 2007 to 2.3% in September 2008. During the third quarter of 2007, substandard loans were at 2.6% which now have declined to 1.2%. There was a similar decline in other categories.



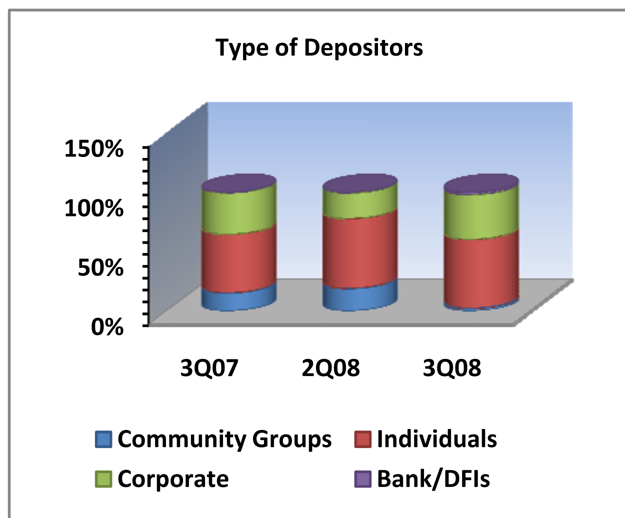
GROWTH IN DEPOSITS:

MFBs are credit focused and savings mobilization has not taken off in Pakistan yet. The sector has not been able to develop and launch appropriate saving products due to a variety of reasons as banks lack effective product research, marketing, financial literacy, capacity of staff, institutional constraints, weak MIS and perhaps even scarcity of appropriate market competition among MFBs to induce deposit mobilization. Quarterly growth in deposits was minimal, around 2%, however, annualized growth, approximately 32%, is substantial. As mentioned before, potential for mobilizing deposits is immense. On one hand, significant changes have been observed in different deposits categories during the period. Fixed deposits have increased significantly by 15% and 10% on quarterly and annual basis respectively. On the other hand, PLS and current deposits have declined by 13% and 5% respectively in the current quarter, while registering annual increases in both categories. The negative trend in the quarterly growth in deposits may be attributed to sharp increase in food and energy prices, and celebration of Eid during the quarter, when depositors tend to utilize savings to meet expenses.

MFBs Growth during July-Sept (%)

	Q1 FY08		Q1 FY09	
	Gross Loan Portfolio	Deposits	Gross Loan Portfolio	Deposits
FMFB	10.6	11.9	20.6	2.6
POMBL	-0.8	38.4	19.2	1.7
RMBL	-7.4	6.4	-25.1	-36.6
KBL	9.3	172.6	6.4	60.8
NMBL	-20.9	497.5	7.5	0.9
TMBL	-7.8	21.1	36.4	3.0
Total	7.0	17.6	14.2	2.1

An important concern in the pattern of deposits relates to disproportionate growth in the different

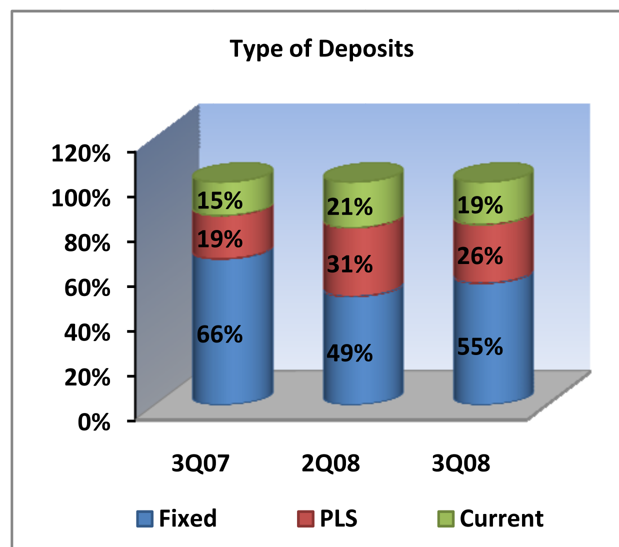


categories of depositors as evident from the graph. Growth in community or individual deposits remained negative whereas deposits of corporate and financial Institutions registered significant increase. These trends show that existing deposit base of MFBs is not only thin but also becoming increasingly vulnerable to depletion due to increasing contribution of large depositors.

In terms of number of depositors, corporate depositors have led growth followed by the growth in individual depositors. The overall number of depositors increased by 71% and 14% on annual and quarterly basis respectively. However, high growth in corporate depositors is also due to low base of numbers.

COMPOSITION OF DEPOSITS

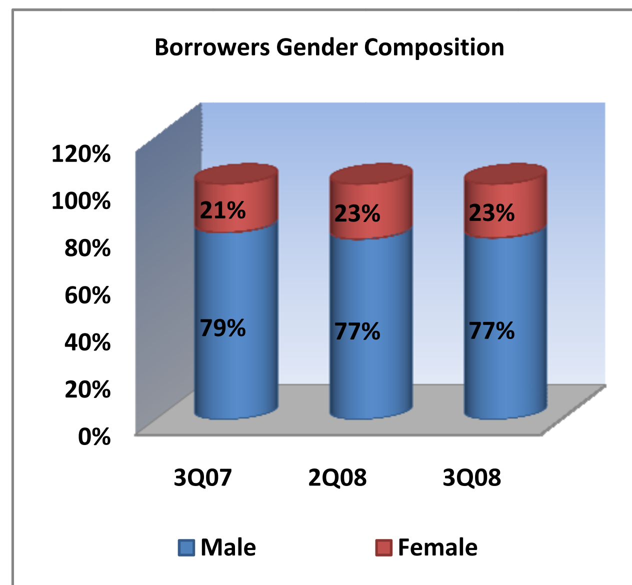
As visible, see Figure 9, share of community or group deposits has significantly dropped from 15% in the third quarter in 2007 and 19% in the second quarter of 2008 to 2% in the third quarter of 2008. However, this decrease is compensated by growth in deposits of corporate clients. Moreover, the fluctuating trend in corporate deposits also shows that MFBs seek to obtain corporate deposits whenever there is decline in the deposit base of their core customers.



In terms of type of deposits, fixed deposits continue to dominate the deposit base. During the year its share in overall deposits moved in the range of 49% to 66%. In contrast, current account deposits constitute the smaller part as its share remained in the range of 15% to 21%. Moreover, quarterly growth is mainly a result of growth in fixed deposits whereas the share of both current and PLS deposits has declined.

GENDER COMPOSITION

Male borrowers have dominant share in the loan portfolio of MFBs. In September of 2007, male



borrowers had 79% share in loan portfolio. The share of male borrowers has now declined to 77% by the end of September of 2008. However, a recent rise in female borrowers is a healthy sign in the growth of the microfinance sector. Experience of South Asian region illustrates that lending to women has better results in terms of outreach and recovery.

CONCLUSION

In order for banks to be significant players in the microfinance of the future, they must increase outreach of microfinance clients. Banks do seem to be moving in the right direction by allocating more assets to advances, increasing outreach and profitability. However, MFBs must capitalize on inherent advantage of the ability to mobilize deposits. Only then, will MFBs be able to increase outreach in the current scenario of financial markets. Furthermore, the ownership of identifying innovative ways to mobilize deposits must come from the private sector.

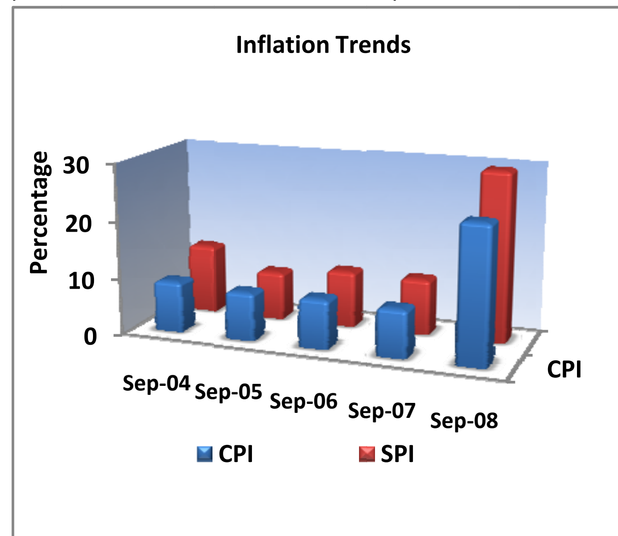
IMPACT OF INFLATION AND MICROFINANCE

The headline inflation crossed 25% in October 2008. In September 2008, CPI rose to 23.9% Year to Year (YoY) average with a 29.9% YoY increase registered in the food-group of CPI. Non-food inflation maintained its upward trend and reached 19.2% in September of 2008. Figure 12, indicates movements in both CPI and SPI.

Economic theory postulates that those with fixed and limited incomes will be more severely impacted by a rapid rise in prices as wages tend to be sticky in the short-term. Furthermore, burden is particularly acute on those who spend a greater proportion of their budgets on essentials especially on food. The impact appears to be more severe on those earning up to Rs.3000. who have experienced the greatest rise in inflation.

It is important to examine the impact of inflation on microfinance. Typically, microfinance services are meant for the two income bands, earning between Rs.3,000 to Rs.5,000 and those earning between Rs.5,000 to Rs.12,000. People in both these income segments have experienced between 24 to 26% inflation for September of 2008 (YoY).

We seek to examine the cost of doing business for these micro entrepreneurs and the impact on households as inflation increases. Existing literature predicts that microfinance entrepreneurs are able to charge high profit margins. This implies that they are able to bear the impact of rising prices. The extent to which this assumption holds true in the face of worrisome inflation remains unclear. Anecdotal evidence does exist to suggest that microfinance clients and their businesses may not be able to keep up with the impact of rising prices. Kashf Foundation recently carried out an unscientific study of its existing 100 clients to note that food consumption of its clients has declined since 2007, when food prices surged dramatically. The study also reports that clients are now spending a greater proportion of their incomes on food[1]. Furthermore, high inflation may have also reversed the positive effects of microfinance on clients as a recent World Bank report, **Global Financial Crisis and Challenges for Developing Countries** suggests. The report concludes that a surge in prices have increased extreme poverty by 100 million, reversing efforts made thus far to combat it.



[1] Food Security Study, September 2008, Kashf Foundation

Considering that we have little direct information on the impact of inflation on microfinance borrowers, we have relied on three sources of analysis to derive appropriate conclusions. These include:

- ⇒ Interest rates charged to borrowers, which accurately approximate the transaction cost incurred by them.
- ⇒ Movement of average savings and loan balances in a high inflationary environment.
- ⇒ Changes in Portfolio-At-Risk to indicate if clients are burdened by high inflationary rates, affecting micro businesses that may be unable to generate loan repayments.

A. INTEREST RATES OF MFIS/MFBS:

Annual interest rates charged by MFBs are in 20 to 30% range for their services and have increased slightly. However, interest rates of MFIs are much higher, around 30 to 40% and have stayed constant. MFIs tend to depend largely on subsidized funding from the Pakistan Poverty Alleviation Fund, which remains well below market rates. PPAF lends to its partner organizations at a rate of 8 percent and it takes collateral in the form of the loan portfolio and the other assets that are created by the loan itself[2]. MFBs, which have not raised deposits on a significant scale, may be financing their lending operations from equity and may not have yet borne the effect of rising rates. Moreover, higher cost of commercial funds provides an added incentive for MFBs to develop innovative mechanisms to mobilize deposits. Surprisingly, deposits grew by 17.6% in the quarter ending September 2007 and by only 2.1% in the quarter ending September 2008[3].

B. AVERAGE BALANCES:

Both real and nominal average loan sizes declined slightly between 2006 and 2007, which may be due to several possibilities. First, it is likely that as the industry expands, demand of both old and new clients cannot be met in entirety. Second, rapid increase in inflation may have in reality reduced the demand for credit as adverse selection forces people to stay away from microfinance services as the group lending model dynamics especially play out. While average loans have reduced in size, average savings balances have increased, which may be due to the efforts of MFBs to raise deposits. However, saving balances of clients with MFBs is not the only way clients may save, which may still continue to rely on informal mechanisms and illiquid forms of saving. Hence, industry analysts remain unclear about the real impact of inflation on household savings.

Average Loan and Savings Balances

2005		2006		2007	
Nominal	Real	Nominal	Real	Nominal	Real
9,001	8,164*	10,108	9,310*	10,062	9,317**
1,100	998	1,700	1,566	3,200	2,963

*General CPI for end of fiscal year/**Based on 12 Month Average Consumer Price Index of 2008

C. STABLE REPAYMENT RATES:

As the diagram below suggests that a surge in prices, portfolio at risk of the industry has stayed constant. The graph below depicts the industry's PAR with breakdown for MFIs and MFBs during the period of 2005 to 2007. This may imply that the end-beneficiary is resilient and that the informal economy has developed coping mechanisms to make repayments on time.

Portfolio at Risk Greater than 30 Days (Source: PMN & SBP)

	2005	2006	2007
MFIs	0.86%	0.81%	0.92%
MFBs	4.40%	2.10%	4.46%
Industry	2.70%	1.40%	2.27%

Micro-entrepreneurs, have not felt the pinch in terms of higher cost of lending and many are still paying the

[2] CLEAR report, Pakistan 2007, CGAP

[3] OSED, State Bank of Pakistan

prevailing rates. Much of the literature indicates that micro-entrepreneurs can afford to pay high interest rates. However, new literature has emerged that suggests that credit demand is elastic when a change in interest rate occurs[4], the poorest clients may be pushed out of microfinance market and others respond to increasing rates by smaller loans for shorter periods. Hence, if rates increase in Pakistan, potential demand for microfinance may decline.

GLOBAL TRENDS IN INFLATION AND MICROFINANCE:

Meanwhile India has reported that a surge in microfinance demand has been fuelled by inflation as more and more people look for ways to fight inflation by expanding and opening new microenterprises. A cluster of large and mature MFIs appear set for over 100% growth this fiscal year as inflationary trends have triggered higher working capital needs for their clients[5]. No information exists within Pakistan to confirm or reject a similar trend. Some literature supports that microfinance sector development best occurs in a low inflationary environment. According to Rhyne (2001), the process towards a more stable economy and especially lower inflation rates, attracts more microfinance clients. Vander Weele and Markovich (2001)[6] provide evidence on the devastating effects of inflation especially hyper inflation on microfinance institutions. Moreover, for borrowers high inflation rates means high interest rates increasing repayment problems. However, some literature points out the exact opposite. Pattern et al. (2001) have shown that the microfinance institutions can play a countercyclical role in times of crisis. During the Indonesian crisis, the microfinance sector performed much better than traditional financial institutions. Moreover, Marconi and Mosely (2005), point that certain types of microfinance institutions played as a shock absorber during the Bolivian macro-economic crisis of 1999-2001[7]. Experience of Latin American illustrates that microfinance tends to exists in high-inflation countries[8]. Thus, it can be safely assumed that macro-economic indicators including inflation have a mixed impact on the development of the microfinance industry.

MITIGATING NEGATIVE IMPACTS

In all likelihood, microfinance clients directly feel the pinch of rising prices, especially those who have borrowed for smoothening consumption. However, much of the sector remains protected from the immediate impact of inflation due to the government's support mechanisms in place such as PPAF funding leading to a lagged effect on microfinance vis-à-vis securing lines of credit especially at market rates. Such likelihood increases the necessity of mobilizing deposits by MFBs and development of partnership between NGO MFIs and licensed institution to mobilize small deposits. Such a step will ensure long-term viability of the sector and reduce the negative impact of inflation on microfinance clients. Institutions must also be encouraged to introduce some levels of flexibility to cope with the changing environment. Flexibility in the system especially for re-scheduling, rates and improving risk-sharing mechanisms with clients that were introduced in Russia and Bulgaria's microfinance industry in times of hyper-inflation[9]. Admittedly, Pakistan's economy is not suffering from hyper-inflation, but the industry could adapt itself to a changing environment.

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[4] "Do interest rates matter? Credit demand in the Dakha slums" Dehejia, Montgomery and Murdouch (2005)

[5] Microcredit booms as poor look to combat inflation: July 16, 2008. *The Economic Times*

[6] Weele, Ken Vander and Markovich, Patricia "Managing High and Hyper Inflation in Microfinance: Opportunity International's in Bulgaria and Russia" August 2001. *Microenterprise Best Practices, Development Alternatives*

[7] Though they highlighted in the fact that countercyclical role depended much on the kind of institution.

[8] Vanroose, A "The Uneven Development of Microfinance: A Latin American Perspective". CEB N06/021, June 2007, Solvay Business School, University of Brussels

[9] Weele, Ken Vander and Markovich, Patricia "Managing High and Hyper Inflation in Microfinance: Opportunity International's in Bulgaria and Russia" August 2001. *Microenterprise Best Practices, Development Alternatives*

In addition, the size of the microfinance market must be reexamined as inflation may have pushed many households in Pakistan into abject poverty are not viable microfinance clients. At the same time, vulnerable households earning more than $2 per day may have not become potential microfinance clients as they look for coping mechanisms and expand businesses. However, these impacts need to be critically analyzed by undertaking field research by microfinance organizations and other institutional bodies.

CHANGE IN LIQUIDITY CONDITIONS IN PAKISTAN:

In Pakistan, the current liquidity position exists due to tight monetary measures, which resulted in rising prices of oil and commodities. These conditions accompanied by the global recession and slow down

in the domestic capital market activities are posing grave challenges not only to local financial markets but also to the broader economy of the country.

In January of 2008, both the discount rate and KIBOR (6 months) stood at 10% and touched to 15% and 16.3% respectively in November of 2008. Especially, in the second half of the current year witnessed much of the volatility in interest rates.

MICROFINANCE GROWTH PRIOR TO THE CRISIS

Before the beginning of the recent liquidity crisis, the microfinance industry seemed well-poised to accelerate growth to target three million borrowers by the year 2010 and 10 million by 2015. One of the major constraints to growth is that the national strategy is mobilization of location capital resources. Recognizing this limitation, the national strategy planned to raise funding from local banking market to fund the growth of the sector in the medium-term of 2007 to 2010.

ARE LIQUIDITY CONDITIONS HURTING MICROFINANCE INDUSTRY

Until mid-2008, commercial debt through local banks was considered as the most likely source of financing for the short- to medium-term needs of the sector. This choice was opted because of the favorable liquidity conditions in the banking sector. The only challenge was to assure banks about the viability of MFB/Is. The volume of initial level financing needs of the sector was also within the comfortable range of banks. However, the prospective lenders (banks) and borrowers (MFB/Is) were negotiating to settle the cost of financing by the margin of 1-2 percentage in their favor.

Interest Rate Movement in year 2008

Dates	Discount Rate	KIBOR 6 month
1-Jan-08	**10%**	**10%**
31-Jan-08	**10.50%**	**10.4%**
22-May-08	**12%**	**13.8%**
29-Jul-08	**13%**	**14%**
12-Nov-08	**15%**	**16.28%**

Financing Sources	Dec 2006		Dec 2010 (Rs. In Billions)			
	Amount	%AGE	Low End Scenario		High Scenario	
			Amount	%AGE	Amount	%AGE
Savings	**1**	**7**	**12**	**26**	**22**	**25**
Debt	**9**	**64**	**24**	**52**	**47**	**55**
Equity	**4**	**29**	**10**	**22**	**17**	**20**
Total Financing	**14**	**100**	**46**	**100**	**86**	**100**

The process of bridging local banks and microfinance sector started with SBP guidelines for banks to undertake microfinance followed by a landmark deal between Kashf a consortium of commercial banks. To facilitate the process further, State Bank and PPAF have also arranged a credit enhancement facility to support an appropriate funding model at an appropriate cost. However, due to the emerging liquidity crisis, some of fundamentals of the model are under review.

Reliance on local funding is evident from projections of the national MF strategy. For a time horizon 2007 to 2010, the national microfinance strategy recognized the need of external debt at Rs. 24 Billion of the total financing need of Rs. 46 billion to 86 billion depending on the scenario. While the external debt constituted 64% of the total financing as of December of 2006, the projection of 2010 shows share of debt between 52 and 55%.

Growth projections of four Pakistani MFIs and MFBs illustrates, institutions heavily relying on commercial lending to fund their growth. Moreover, dependence on commercial lending in time frame (2008-2010) has been found increasing.

ANALYZING LIQUIDITY-RELATED RISKS

Following are specific risks that the industry is currently facing due to liquidity problems:

⇒ Increasing cost of funds: In the existing situation, the cost of funds for debt of MFB/Is will increase significantly as banks would like to charge additional liquidity premium and credit spreads from borrowing MFB/Is. The increased cost of funds may hit hard the already weak financial sustainability of MFB/Is.

⇒ Securing Funding: Only large and well-performing MFB/Is will be able to find the commercial debt from banks. The smaller and new players will be deeply affected by the current challenges.

⇒ FCY liabilities risk: In contrast to many other developing countries, Pakistan is least vulnerable to foreign currency payment related risk. SBP has pursued a policy of minimum reliance on foreign currency

exposure either through lending or guarantees for MF sector.

⇒ Rising operational cost: Current inflationary trends would also add to the cost of operations of MFB/Is, and thus would impact commercial viability of these institutions.

⇒ Confidence Risk: If MFB/Is slow down their growth and minimize their exposure to existing clients, this may result in lowering the confidence of both employees and clients.

COMMON SOURCES OF FUNDING FOR DEBT & EQUITY

As evident, the current conditions have raised challenges in exploring the debt and equity funds for MFB/Is. Below is given an analysis of few sources of financing for Microfinance Banks & Institutions:

⇒ Commercial Banks: Unlike many other countries, commercial banks in Pakistan have sufficient exposure to the microfinance industry. First, many commercial banks have an ownership stake in microfinance banks which provides commercial bankers a chance to serve as board members of MFBs. Second, a few large commercial banks also undertook important lending deals with few MFIs in the recent past. Third, another positive aspect is that management of leading Microfinance banks has prior experience of commercial banking. Finally, some commercial banks (especially Islamic Banks) have demonstrated interest in microfinance operations.

⇒ Capital Markets: Microfinance industry is still in earlier stage of its development, and the financial sustainability of its top institutions (barring a few) is also not satisfactory. In such situation, it will be hard to raise funds at economical cost either through debt or equity instruments of capital markets.

⇒ Apex institutions: Pakistan Poverty Alleviation Fund (PPAF) is an apex fund that provides government and donor sponsored funding for microfinance. Thus far, PPAF mainly funds MFIs and legal constraints prevent PPAF from funding MFBs. To improve continuity and sustainability of its whole-lending operations, PPAF has recently developed a credit enhancement program, PRISM, of $30 million in partnership with IFAD.

⇒ Social Responsible Investments/Donors/ Development agencies: Until now, donors have played a key role in providing assistance and funding especially to MFIs for onward lending. However, there have been concerns that the current global turmoil may result in donors shrinking their assistance package for the development sector.

⇒ Innovative Funding Strategies: In the recent times, the emergence of innovative funding strategies created hopes for long-term funding of the microfinance sector. Modern funding strategies included securitization of portfolio, emergence of hedge funds, investment vehicles. However, the recent jolts in larger financial markets are likely to have negative impacts on the continuation of these innovative and sophisticated fund generating strategies in near future.

In the existing environment, the MFB/Is would require to tailor their current business approaches and models. Specifically, changes will be required in the following areas:

Table 2. MFBs Growth during July-Sept (%)

	Q1 FY08		Q1 FY09	
	Gross Loan Portfolio	Deposits	Gross Loan Portfolio	Deposits
FMFB	10.6	11.9	20.6	2.6
POMBL	-0.8	38.4	19.2	1.7
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NMBL	-20.9	497.5	7.5	0.9
TMBL	-7.8	21.1	36.4	3.0
Total	7.0	17.6	14.2	2.1

Raising Deposits: In order to avert a future liquidity crisis, MFBs must raise deposits. Moreover, the contribution is from institutional and corporate depositors. The present liquidity-related risks have created a sense of urgency for MFBs to revisit their existing business strategies by shifting their focus on deposit-mobilization. Similarly, all MFIs, which have an established track record and reasonable client's base, would need to explore seriously for the transformation into MFBs.

Engaging partners: Since 2002 to 2003, the developments in Pakistani microfinance sector are a result of joint efforts of all stakeholders. At this time when the sector is facing funding challenges, it will be useful if all stakeholders sit together, jointly analyze the current conditions, and formulate recommendations for the future strategy.

Creating alliances & Institutional branding: Some large institutions such as Pakistan Post can be identified, which will not only provide support in the delivery channels but can also be a source of funding. However, only sound MFB/Is can benefit from such strategy.

Enhance risk management processes: Managing 'risks' is critical to the development of MFB/Is. Considering the recent cases of default risks of microfinance clients, MFB/Is need to review their loans appraisal standards to ensure their effectiveness especially in terms of assessment of repayment capacity of borrowers. This risk will be better checked once the existing efforts for developing a credit bureau system serving the whole microfinance sector are also materialized.

Improving Asset-Liability (AL) Management: MFB/Is should develop appropriate processes for managing AL on a regular basis. Global microfinance experiences indicate that AL management has not been given its due importance in many microfinance organizations. This negligence has been cited as one of the frequent reasons for the closure of microfinance organizations worldwide.

Emergency relief for liquidity: Since liquidity risk has potential of transforming into a systemic risk, a contingency plan for easing off the liquidity should be prepared in advance. The plan should define the broad principles, role of each player, mechanism of lending as the last resort, source of funds, cost, and other terms and conditions.

Building stability in the financial markets: In the last two decades, microfinance has seen a visible shift from social sector initiative to become an important component of financial sector strategy. Globally, microfinance is being considered as a tool to broaden access of poor to financial services. One of the important dimensions of this development is that microfinance now more than ever depends upon the stability of financial system at large. If overall financial system faces systemic risk, microfinance would have potential of getting affected.

CONCLUSION

The inability of MFBs to raise sufficient deposits and the current tight conditions of banks' liquidity show that growth prospects in microfinance outreach are significantly constrained by the current liquidity 'crisis'. This liquidity challenge has reemphasized that the expansion of financial services net to poor is though laudable but a complex phenomenon for financial sector development. The prudent way to move forward is to keep close watch on how microfinance as a business/industry is growing, and take appropriate responsive policy measures. The larger responsibility lies on the shoulders of the leaders of MFB/Is is to build institutions on fundamental principles of growth and sustainability. The government, regulators and policy making institutions in collaboration with key stakeholders should keep on developing enabling environment and supporting infrastructure for facilitating the sector. It is expected that positive development emanating from these difficult conditions would include efficiency of operations and deposit mobilization.

MICROFINANE NEWS

⇒ SBP has launched the UK Department for International Development sponsored ***Financial Inclusion Program*** (FIP), a GBP50 million program. FIP has been launched with a view to make the

microfinance sector of Pakistan robust in order to provide financial services to the poor and marginalized groups using market based approaches.

⇒ ***BRAC*** is one of the largest NGOs in the world and also considered to be a self-financed institution today. BRAC currently focuses on credit, it offers two products: group-based microloans exclusively for women and individual micro-enterprise loans both for men and women. Efficient and skilled operational management and a well-designed MIS structure will be one of the greatest strengths of BRAC's microfinance program.

⇒ Rated by Forbes magazine in 2007 as the best microfinance institution based in Bangladesh, ***ASA established operations in Pakistan***. The primary objective of ASA's program is to address huge market demand for small credit in Pakistan especially for women entrepreneurs situated in rural areas.

⇒ ***Health insurance*** has been devised on a partner-agent model where Kashf works with an insurance company in providing hospitalization coverage to all clients. The pilot was opened to three branches for a period of six months and the target enrollments for the health insurance product was 10,000 against which the target realized was 8,343. The product has yet to complete one year and yet to produce concrete lessons learned for Kashf. However, the foundation is in process for refining and improving the product before it is considered for complete launch.

⇒ ***HSBC Amanah, the global Islamic finance service***s arm of the HSBC Group, has partnered with Islamic Relief, a major international relief and development charity, to offer a pilot Islamic microfinance scheme in Pakistan. HSBC Amanah will provide funding towards Islamic Relief's microfinance projects in Rawalpindi, Pakistan. It will also assist Islamic Relief in developing Shariah structure for financing models and contracts and providing Islamic finance training to Islamic Relief staff.

DEVELOPMENT FINANCE SUPPORT DEPARTMENT (DFSD)

SBP is not only engaged in development of an enabling policy and regulatory environment for achieving a sustained rise in flow of financial services to un-banked/under-banked areas/sectors like SMEs, Agriculture and low income segments of the society but also taking steps to ensure dissemination and implementation of these policies at grassroots level. To achieve this purpose, a separate *Development Finance Support Department* (***DFSD***) has been established in SBP-BSC, which is an operational arm of SBP and has presence in 15 strategically important regions of the country. The DFSD has established its units in 13 regions across the country for continuous interaction with the stakeholders at grassroots level. The units are focal points in their respective region for implementation and dissemination of SBP policies and initiatives for strengthening and promotion of Development Finance (DF).

For further strengthening and institutionalizing the consultative mechanism with grassroots stakeholders, separate Focus Groups for Micro, SME and Agriculture finance has been constituted in all the 13 regions to discuss and 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 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. During quarter ended Sept.08 about 17 such meetings were held across BSC network.

MAJOR INITIATIVES/ACHIEVEMENTS

The other key initiatives taken by DFSD and its units during the last two quarters include:

⇒ **Awareness programs-** Apart from programs arranged by SBP, the DFSD also arranged awareness programs for farmers, traders and small enterprises for: a) enhancing their understanding about SBP policies and initiatives for increasing their access to financial services and b) introducing the bank products and services. The programs include Agri Melas, farmers' meetings and seminars and workshops for SMEs and Micro enterprises. The Melas held by Hyderabad, Multan, Lahore, Sialkot, and Faisalabad offices were quite successful and attracted significant media coverage and hence contributed to the awareness of banking products among large number of stakeholders.

⇒ **Help Desks-** In order to assist the SMEs in accessing financial services from banks, Help Desks are being established at local Chambers of Commerce and Industry. A Help Desk at Multan Chamber became functional during the quarter wherein the SBP-BSC staff and the banks' officials guide the SMEs in matters pertaining to banks' loan products etc.

⇒ **Regional/District profiles-** Preparation of Regional/District profiles is another initiative of DFSD to enhance the stakeholders understanding of the local/regional markets. As a pilot project detailed profiles of two districts viz. Sukkur in interior Sindh and Gujranwala in Central Punjab were prepared. The profiles also included surveys of SMEs and agriculture sectors of the two districts, which explored in detail the SMEs and Agriculture sector of the two districts. The Gujranwala District surveys have already been released and placed on SBP website for wider dissemination, the Sukkur district surveys are likely to be released in the next quarter. The

survey of Cotton Belt comprising 7-8 districts of southern Punjab and exploring the potential of Livestock sector of Baluchistan are two important projects to be completed by the close of current fiscal year.

⇒ **Linkages with Educational and Research Institutions-** The DFSU units have also started developing linkages with educational institutions to sensitize them about the emerging DF market. This would increase the demand for DF related courses in the educational institutions and would be instrumental in improving the supply of suitably qualified HR for the fast emerging DF market. Similar linkages are also being developed with reputed Research Institutes for wider dissemination of their research finding s particularly amongst the farming community. About 12 meetings with prominent researchers and Agri universities/ institutes have so far been held which proved useful in enhancing stakeholders' understanding about their functions and latest research.

⇒ **Coordination with provincial Governments**- DFSD also coordinates with provincial agricultural, livestock and revenue departments to share and disseminate the provincial governments' initiatives for facilitating the farming community. In this respect an Interprovincial Agricultural Workshop was held in the last week of June 2008 to bring the banks and the relevant government departments closer to each other and share their respective initiatives for farmers' facilitation.

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