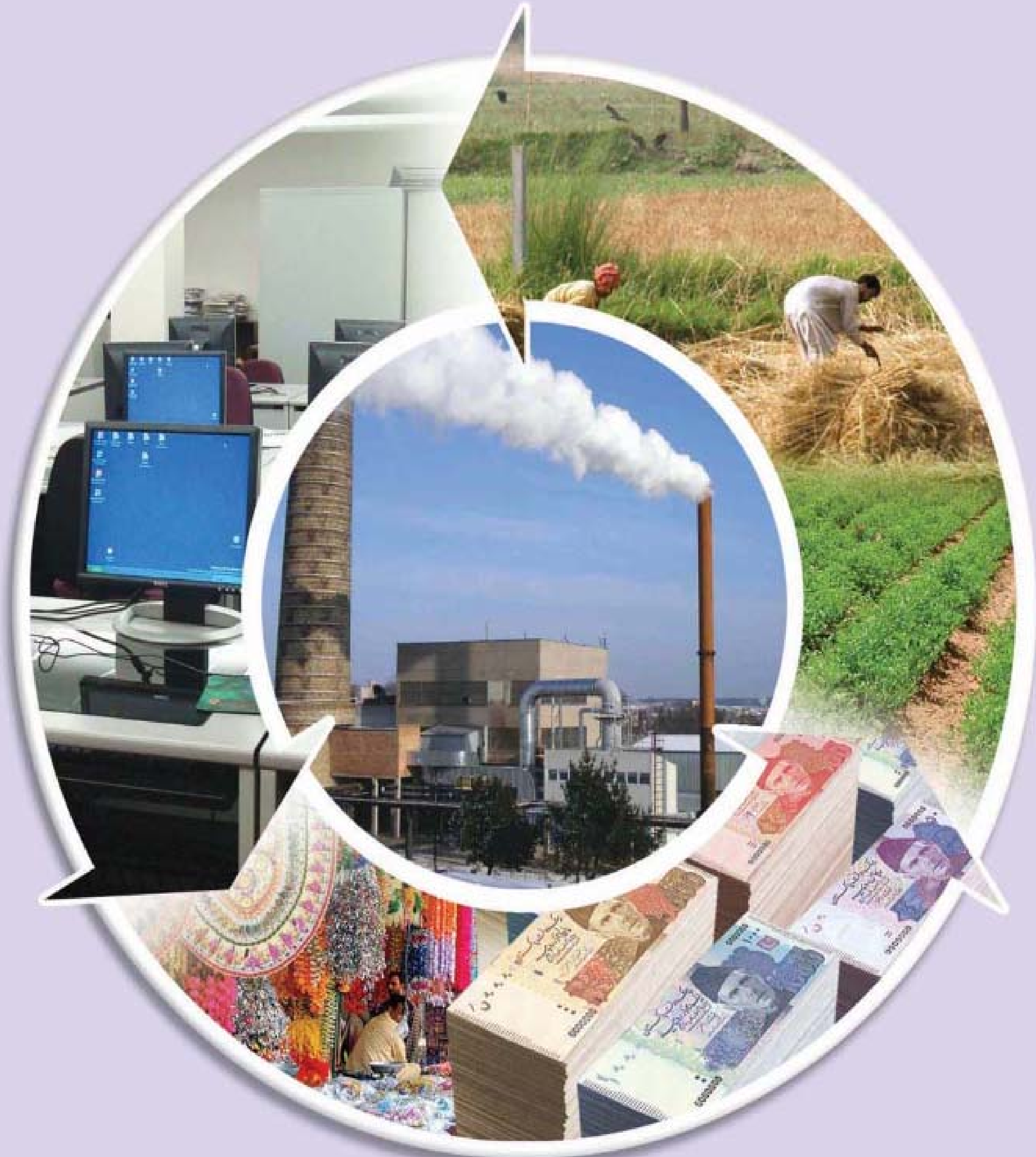
Development Finance Quarterly Review

June, 2010



SME FINANCE DEPARTMENT

STATE BANK OF PAKISTAN, KARACHI

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EXECUTIVE SUMMARY

SBP constituted the Development Finance Group (DFG) in 2006 to develop an exclusive focus for nurturing development finance areas in the country. In line with its mandate of promoting financial inclusion, the DFG steers the implementation of policy and strategic framework for SMEs, Micro enterprises, Agriculture & Rural Finance, and Housing & Infrastructure Finance. The recent initiatives taken under the DFG's umbrella have proved highly significant in generating employment and fostering entrepreneurship, thus contributing to the equitable economic growth in the country.

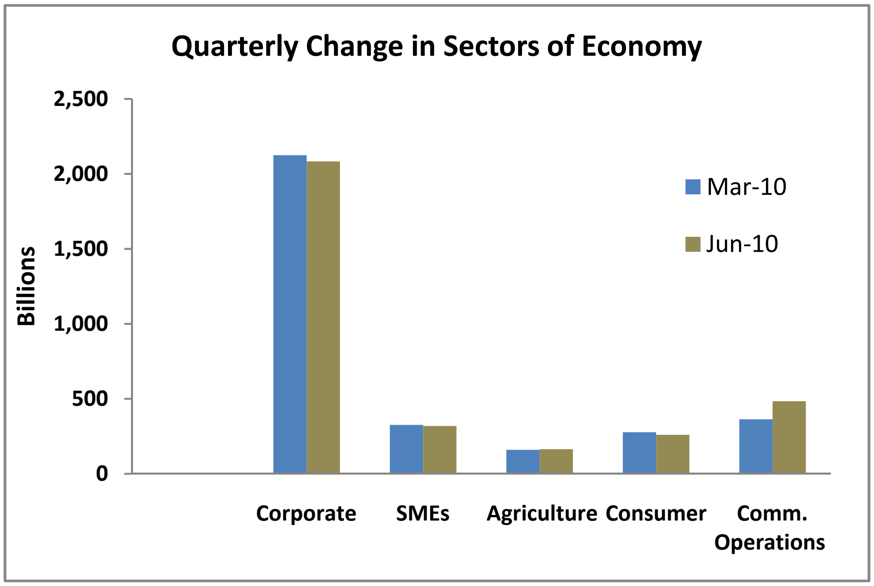
While Development Finance (DF) areas witnessed considerable growth in last few years, however, there has been a slow down in the last few quarters. At the end of June 2010, Development Finance (DF) outstanding portfolio (Rs. 823.4 Billion) witnessed a decrease of 2.3 percent YoY basis, while the quarterly decline recorded as of June-10 was 3.9 percent compared to the decline of 0.6 percent at the end of the corresponding period of 2009. Of this amount, the major share (38.7 percent) is that of SME sector followed by Infrastructure with 31.6 percent and the remaining 29.3 percent with other DF sectors.
The decline in DF portfolio may be attributed to the overall declining trend in various sectors of the economy. It also reflects the cautious lending approach of the banking industry towards the priority sectors of the economy compared to corporate and consumer sectors. Besides, DF could also not flourish due to a number of other factors like high interest rates, power outages, domestic law & order situation and overall shyness of the industry towards the mentioned sectors.

Non Performing Loans (NPLs) of DF sector stood at Rs. 140.7 Billion, recording a 20.7 percent increase YoY basis, while the quarterly rise recorded was 4.1 percent at the end of Jun-10. Of this amount, 63.2 percent was the share of SME NPLs and 19.3 percent that of Agri. Sector and the remaining 17.5 percent with other DF sectors. There has been a slight rise of 0.5 percent in NPLs of the whole banking industry at the end of Jun-10. As stated earlier, the rise in DF NPLs may be attributed to the prevailing economic conditions and the resulting effects on priority sectors of economy.

SBP's policy thrust is to encourage and persuade banks to enhance their outreach and deliver specialized services and the same would continue. SBP has taken a number of initiatives for financial innovations and development of Market Supporting Mechanisms for the development of priority sectors of the economy. In recent past, SBP has taken concrete steps to stimulate funding channels, allow alternative delivery channels, and support institutional strengthening for such financial institutions that are geared to reach out to financially excluded population, initiation of Credit Guarantee Schemes, Refinancing Schemes for Modernization of SMEs and Review of PRs for SMEs. Further, a new strategic framework for sustainable microfinance in Pakistan (2010-2015) has also been developed.
While these initiatives represent potential for great strides forward, their impact on improving the level of financing and socio-economic conditions is linked with the performance of broader political and macro-economic indicators. However, increased financial inclusiveness would provide people opportunities for developing entrepreneurship and meeting their financing needs with lesser difficulty.

1.0. STATE OF SME FINANCE

SME sector has been experiencing difficulties for the last few years mainly on account of economic and financial crises in the country and the resulting higher inflation and rising NPLs. Banks continued to adopt a cautious lending approach towards SME as well as other priority sectors of the economy; as a result, the financing to SMEs has not picked up significantly over the period.



The total outstanding amount of banking industry at the end of June, 2010 saw a minute quarterly growth of 1.7% (Rs 57.5 Billion). Here it is worth mentioning that except Commodity Financing (33%) and Agricultural financing (2.4%) all other sectors of economy witnessed a declining trend. (***See Figure)***

The end of June, 2010 shows that SME sector's outstanding credit stood at Rs. 318.8 Billion constituting approximately 10% of the total outstanding portfolio of the banking industry in Pakistan.

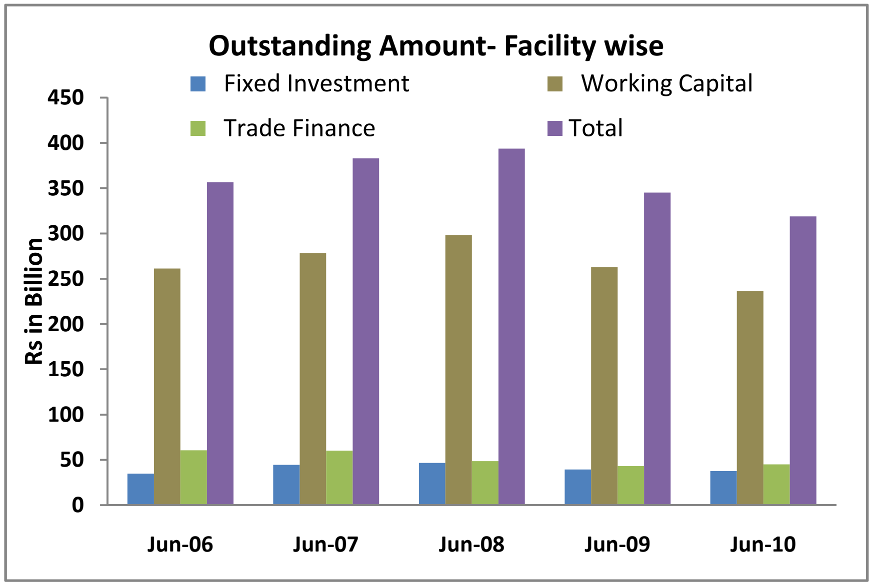
An analysis of the breakup of SME portfolio towards various sectors divulge that **Trading sector** took the lion's share of 44.1%, followed by Manufacturing SMEs with a share of 39.2%, and Services SMEs with a share of 16.7% at the end of the quarter under review. While duration-wise analysis reveal that ***Short term loans*** (upto one year) constitute about 75.3%, ***long term loans*** (exceeding 3 years) were about 16.8% and the rest was the share of ***Medium term Loans*** (1-3 years).

There has been a increase in the NPLs of Banking Industry for the last few years and this time recorded a quarterly growth of 0.5%, while SME Sector witnessed a quarterly increase of about 7.4%.

Despite declining trend in outstanding amount, the number of SME borrowers, however, witnessed an increase of about 0.6% at the end of the quarter under review. Whereas the total industry borrowers saw a decline of 1.8%

1.1. MAJOR TRENDS

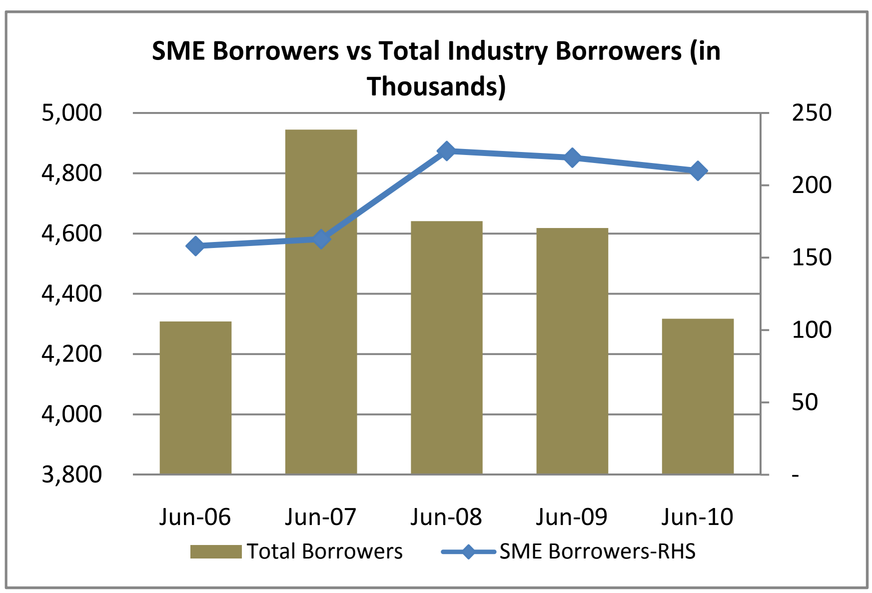
1.1.1. FACILITY WISE FINANCING



Facility wise Financing ***(See Figure)*** to SME sector reveals that major chunk of the outstanding amount is being utilized under Working Capital (WC) accounting for 74.1%, followed by Trade Finance (TF) with 14.1% and Fixed Investment Finance (FI) 11.8% of total SME portfolio at the end of June, 2010. Predominant portion of working capital finance since June 2006 to June, 2010 reflects the need of SMEs to get finance for inventory and day to day operations. This may also reflect on the fact that long term investment and development by the SMEs is not considered an important business development initiative. Further, the meagre share of fixed investment finance in total SME loan portfolio is a clear reflection as it has been hovering in the viccinity of 10% to 15% for the last few years. To cater the Fixed Investment needs of SMEs, SBP has introduced Refinancing facility for modernization of SMEs.

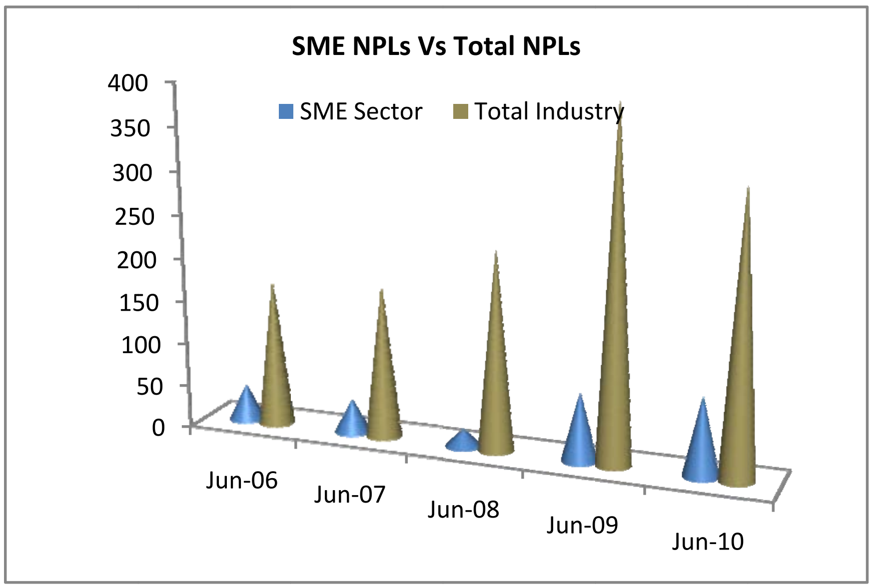
The absolute outstanding amount for working capital finance stood at Rs. 236.2 billion, recording a negative quarterly growth of 3.1%, outstanding amount under Trade Finance remained Rs. 45 billion registering a quarterly growth of 5.1% while Fixed Investment Finance got an amount of Rs. 37.6 billion recording a negative quarterly growth of 5.2% at the end of June, 2010.

1.1.2. BREAKUP OF BORROWERS



At the end of June, 2010, SME borrowers stood at 209,942 constituting about 4.9% of the total number of borrowers in the banking industry ***(See Figure)***. About 67.6% of the SME borrowers availed working capital finance, 28.7% Fixed Investment and the rest under Trade Finance. While the quarterly growth in the number of borrowers was 0.6% at the end of the period under review. The share of the borrowers categorized as ***Trading SMEs*** was 51.6%, followed by ***Services SMEs*** with 31.1% and ***Manufacturing SMEs*** with a share of 17.3% at the end of the quarter while their respective quarterly variation remained 8.0%, -0.3% and -15.3%. Further, a duration wise analysis of the borrowers reveal that the share of borrowers availing ***long term loans*** (exceeding 3 years) was 45.5% , ***Short Term loans*** (upto one year) was 48.6%, and ***Medium Term loans***(1 to 3 years) constituted about 5.9% of the total SME borrowers. Moreover, an analysis of SME Borrowers share in different brackets of ***Loan Size*** manifest that 71.0% of total SME Borrowers fell in the bracket size availing loans of ***upto Rs. 0.5 Million (M) , while*** borrowers against the bracket size of over ***Rs. 0.5 to 1 M, Rs. 1 to 2 M, Rs. 2 to 3M, and over Rs. 3 to 5M were*** had a share of 8.4*%, 6.3%, 3.1%, and 3.6%.*

1.1.3. NON PERFORMING LOANS



SME sector's Non Performing Loans (NPLs) have increased to Rs. 88.9 billion, constituting about 19.6% of total NPLs of the Banking industry at the end of June, 2010 ***(See Figure*** Moreover, the share of NPLs in total outstanding amount advanced towards SME Sector remained at 27.9%. Whereas the quarterly increase recorded was 7.4% as compared to a decline of 10.2% during the corresponding quarter of 2009, mainly due to the current wave of economic slump. Increase in SME NPLs is, however, consistent with the rise of total NPLs of banking industry which recorded a quarterly growth of 8.6% at the end of period under review.

1.1.4. BANKING SECTOR WISE DISTRIBUTION

The share of **Public Sector Banks** i.e. NBP, FWBL, BOP and BOK constituted about 12.1% of the total SME Finance portfolio at the end of the reporting period, recording a quarterly decline of 5.03%. Further, the share of these banks in total NPLs of SME Sector is 18.8% and their share in total SME Borrowers was 31.3%. The outstanding share recorded a decline of 25.2% YoY basis whereas the quarterly decline recorded was 5.0%.

Private Banks have been doing well in SME Finance arena for the last few years, recording consistent growth compared to other categories of Banks. The share of *Private Banks* stood at 82.8% (Rs. 263.9 Billion in absolute terms) of the total outstanding SME finance portfolio, and recorded a quarterly decline of 1.9%. Among *Private*

Banks, HBL has the highest share of 14.5% followed by NIB bank with 9.4%, Bank Alfalah with 8.2%, and MCB with 5.1% respectively in the total SME financing.

Islamic Bank's share has witnessed a quarterly decline of 6.3% at the end of June, 2010. The low share of Islamic Bank's is primarily due to the fact that the major chunk of their portfolio (87%) is diverted towards corporate and consumer finance.

AS OF JUNE 2010 (in Percentages)					
Category of Banks	Share in SME O/S	Share in SME NPLs	Share in SME Borrowers	YoY Change	QoQ Change
Pub. Sector	12.1	18.8	31.25	-25.2	-5.0
Specialized	3.0	8.9	18.39	-3.0	-0.3
Private	82.8	71.1	49.81	-4.5	-1.9
Islamic	1.4	0.8	0.39	-17.6	-6.3
Foreign	0.5	0.4	0.15	-1.3	5.8
DFIs	0.1	0.1	0.01	-15.5	-5.6
Total Banks/ DFIs	100.0	100.0	100.0	-7.7	-2.3

Specialized Banks category consists of SME Bank, ZTBL, PPCBL and IDBP. The outstanding amount of *Specialized Banks* towards SME sector was Rs. 9.66 billion constituting about 3.0% of total SME financing at the end of the reporting period. By having a closer 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 years and did not witness any significant improvement, mainly on account of the diversion of their major chunk (84.8%), contributed by ZTBL, towards Agricultural sector.

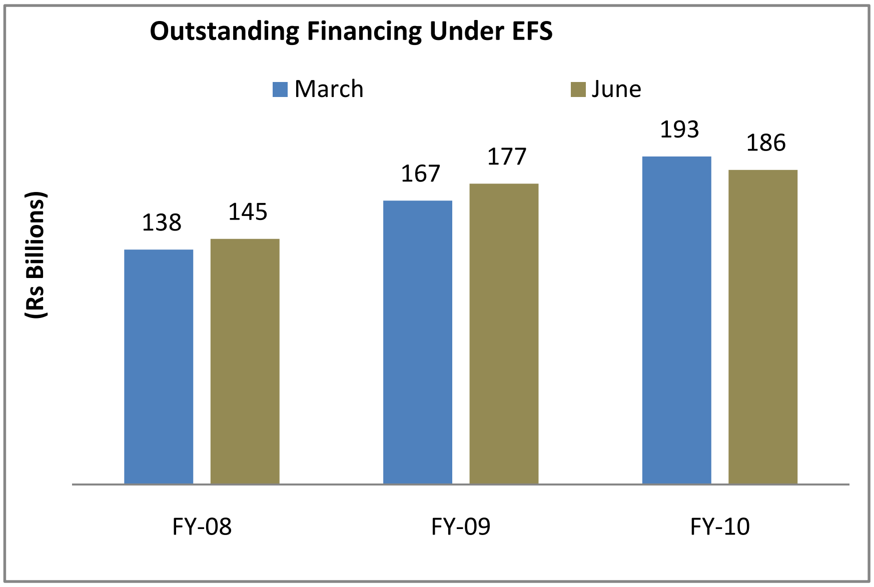
Foreign Banks' category comprises of Albaraka Islamic Bank, Deutsche Bank, Bank of Oman, HSBC, Bank of Tokyo Mitsubishi, and City Bank. At the end of the period under review their share was about Rs.1.71 billion forming 0.5% of the total SME finance. The share of foreign banks too did not see any significant improvement as the major chunk of their portfolio targets the corporate and consumer sectors.

The total outstanding amount of **DFIs** remained Rs. 0.32 Billion contributed only by the two DFIs namely ***Pak Oman Investment Company*** and ***Saudi Pak Industrial & Agricultural Investment Company.*** Moreover, the total number of borrowers served by them was 28 at the end of the period under review. The reason for lesser share towards SME sector is due to the fact that their 96.4% of the total outstanding portfolio targets corporate and consumer sectors of the economy.

1.2. SBP REFINANCE SCHEMES

In addition to traditional financing facilities for export promotion, State Bank of Pakistan introduced schemes during the quarter under review which will support the domestic economy and would have indirect impact on exports. Improper facilities for storage of agriculture cause significant post harvest losses. Therefore, in order to enhance storage capacity and develop agriculture produce marketing, SBP introduced a financing scheme for establishment of Silos, Warehouses and Cold Storages. Moreover, recognizing the importance of SMEs in creation of employment opportunities, economic growth, poverty reduction and equitable distribution of economic prosperity, SBP expanded the scope of Refinancing Facility for Modernization of SMEs by including almost all the SME sectors. This facility will greatly help in addressing the fixed investment issues of SMEs for technology up gradation.

To diversify the pool of borrowers under LTFF, SBP fixed a limit of Rs 1 billion exposure allowed to an individual borrower. Further, to rationalize the mark-up rates under the EFS, SBP increased the mark up rates by 0.5%. Further under Prime Minister's Fiscal Relief to Rehabilitate the Economic Life in Khyber-Pakhtoonkhwa, FATA and PATA, payment of mark-up rate subsidy on eligible business loans in war affected areas was implemented.



SBP continued to provide financing under Export Finance Scheme (EFS) for export promotion which witnessed a decline from its peak of Rs 198 billion in Dec'09 to Rs 193 billion in Mar'10 and Rs 186 billion at end Jun'10. Whereas Under Long Term Financing Facility the financing outstanding increased to Rs 17 billion from Rs 15 billion in previous quarters.

1.2.1. EXPORT FINANCE SCHEME (EFS)

The quarter under review witnessed decline in outstanding financing under EFS due to adjustments made under Part-II of the scheme. The primary reason is that exporters focus on the realization of export proceeds, to match the performance requirement against already availed loans. If the exporter avails additional financing in this quarter it becomes difficult to meet the additional performance requirement. During the quarter under review the EFS outstanding amount stood at Rs 186 billion as on June 30th, 2010. The EFS limits were increased to Rs 232 billion from Rs 228 billion as compared to previous quarter (Mar-2010). At the end of quarter under review EFS witnessed a decline of Rs 8 billion as compared to preceding quarter, but grew by 5% when compared to the same quarter of last year. The disbursements during the quarter declined by Rs 64 billion (Part-II Rs 62 billion) against Rs 150 billion in the previous quarter.

Banking Group Wise Outstanding Position of EFS

Banking Group	Jun-10	Mar-10	Jun-09	Δ YoY
	(Rs in Billions)			%
Public Sector Banks	11	11	14	-21%
Private Banks	163	168	155	5%
Islamic Banks	5	5	3	33%
Foreign Banks	8	9	6	31%
Total	**186**	**193**	**177**	**5%**

1.2.2. BANKING GROUP-WISE UTILIZATION OF EFS

The Private Sector Banks stand as a major banking group participating in the Export Finance Scheme with highest share in the outstanding EFS at Rs 163 billion (88%), followed by Public-sector Banks with Rs 11 billion (6%).

1.2.3. COMMODITY WISE DISTRIBUTION

The commodity-wise trend exhibits textile sector at the top with 115 billion (62%) of the total amount of Rs 186 billion followed by edible goods with Rs 27 billion (14%). Both the sectors showed a decline of 1% and 9%, compared to March-2010 quarter but on YoY basis increased 2% and 26% respectively. This decline is reflective of the overall decline in the amount outstanding under EFS and is due to adjustments of outstanding financing made under Part II of the EFS. The disbursements and the outstanding to the sectors are expected to increase as disbursements against the rolled over facility increase after the month of August. The maximum increase of 36% was attributed by the Machinery sector compared to Mar-10 position, whereas YoY basis Sports goods showed a highest decline to 19%.

Commodity Wise Outstanding Financing under EFS

Sector	Mar-10	Jun-09	Jun-10	% Change	
	Billion PKR			YoY	QoQ
Textile/Textile Products	116.0	112.6	115.0	2%	-1%
Edible Goods	29.5	21.2	26.7	26%	-9%
Leather/Leather Goods	10.9	10.2	10.8	5%	-1%
Machinery	1.0	1.0	1.4	45%	36%
Metal Products	2.9	2.6	3.0	16%	3%
Carpets	2.5	3.1	2.8	-10%	11%
Sports Goods	2.8	3.5	2.8	-19%	1%
Other Commodities	27.8	23.2	23.0	-1%	-17%
Total	**193.37**	**177.38**	**185.54**	**5%**	**-4%**

1.2.4. BORROWER WISE DISTRIBUTION

By the end of FY 10, the total number of borrowers under EFS stood at 1,830 with an average loan size of Rs. 102 million. A slight increase of almost 6% was recorded in total number of borrowers during the quarter under review as compared to previous quarter.

1.2.5. REGIONAL ALLOCATION OF BORROWERS

Borrowers were found accumulated in four major cities i.e. Karachi, Sialkot, Lahore and Faisalabad as observed in the previous quarters. According to banks' data for the quarter under review up to 90% borrowers are from these four cities where only Karachi & Sialkot has almost 62% of total beneficiaries under the Scheme. Similarly, almost 94% EFS funds are accumulated in the said cities and almost 48% funds have been availed by only Karachi based exporters. The average loan size availed by borrowers under EFS varies from region to region. For instance, the average loan size is Rs. 464M at Rawalpindi, while at Sialkot the same is Rs. 19M. As such inconsistent patterns have been witnessed with regard to average loan size and number of borrowers across the regions. There were just 9 borrowers at Rawalpindi at the end of June 2010 as compared to 586 borrowers at

Karachi at the same period. Likewise, the number of borrowers and the borrowing capacity of borrower/exporter are different at different regions.

1.3. ISLAMIC EXPORT REFINANCE SCHEME (IERS)

During the quarter under review the total number of participating banks was 11 (4 Islamic Banks, 6 Conventional Banks' Islamic Banking Operations and 1 Foreign Islamic Bank). The limits assigned under the scheme were increased by 5.6% (to Rs. 19 billion from Rs 18 billion in Mar'10). The total IERS financing outstanding at the end of the quarter stood at Rs 11 billion, with no change compared to previous quarter.

1.4. LONG-TERM FINANCING FACILITIES (LTFF)

Under the Long Term Financing Facility for Plant and Machinery, limits remained same at Rs 19.5 billion. During the quarter Rs 2 billion were disbursed; the outstanding amount increased by 15% from Rs 14.66 billion in Mar'10 to Rs 16.85 billion as on 30th Jun'10.

Under LTFF major portion of financing was contributed towards Textile Sector with Rs. 9.8 Billion (58%), followed by engineering goods, with Rs 3 billion (17.8%). Within the Textile sector major financing was availed by weaving textiles. Whereas, during the quarter,

adjustments of Rs 3 billion were made under LTF-EOP (defunct scheme), and the outstanding position of LTF EOP as on June-10 stood at Rs 25.78 billion. Thus, the total long term financing outstanding under LTFF and LTF-EOP stood at Rs 42.63 billion.

2.0. STATE OF MICROFINANCE

The microfinance banks experienced slow growth in the quarter ending June 30 of 2010 with only 3% growth in borrowers and 8% growth in portfolio. Keeping in line with the last quarter, microfinance banks remained in consolidation phase in June quarter of 2010. In order to mature into an industry capable of reaching millions in Pakistan, the sector must produce with clients-responsive products and cost-effective channels while strengthening the industry fundamentals.

Overall, borrowers increased by 8% over the year and 3% over the quarter.

Snapshot of Microfinance Banks

	Jun'09	Mar'10	Jun'10	Growth%(Yo
Branches	271	284	289	7
Borrowers	615,189	646,982	667,268	8
Advances (Rs.'000)	8,254,426	9,388,299	10,113,502	23
Deposits (Rs. '000)	5,553,800	6,931,375	8,122,596	46
Depositors	343,065	582,193	673,070	96
Assets (Rs.'000)	15,932,411	17,653,259	18,754,256	18
Borrowings (Rs.'000)	4,781,837	4,811,416	4,669,846	-2
Equity (Rs.'000)	5,098,219	5,210,237	5,279,341	4
NPLs (Rs.'000)	256,978	214,323	260,787	1

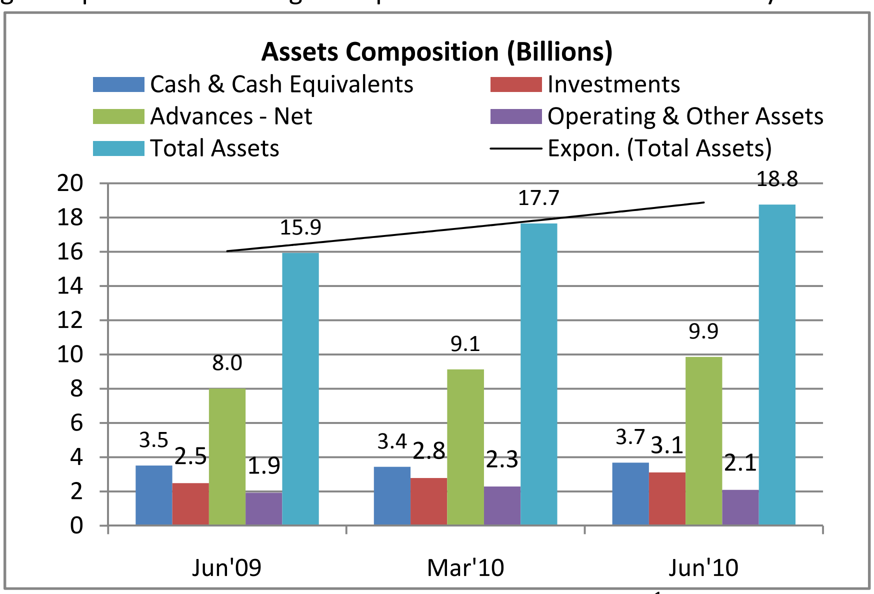
Correspondingly, advances grew up 23% over the Fiscal Year 2009-10 and branches by 7%. Quarterly growth in advances was 8%. The slow growth rate persists as the large microfinance banks continue to face funding constraints, and NRSP, the largest player, has not yet commenced its microfinance business operations.

While banks are consolidating their loan portfolios, the deposit base is growing. The volume of MFBs' deposits has increased by 46% on a yearly basis and 17% on a quarterly basis, owing to better deposit mobilization strategies. FMFBL and TMBL are the lead players in deposit mobilization and constitute 90% of the total volume of deposits. Moreover, average loan size over the year has grown from Rs. 13,420 to Rs.15,160. This implies that MFBs are now moving from household finance towards enterprise finance, yet they still have a long way to go. In addition, total assets of MFBs grew by 18% for the year from Rs. 15.93 billion to Rs.18.75 billion as did equity by 4% to Rs. 5.28 billion as of June end 2010. Lastly, the volume of non-performing loans of MFBs has slightly increased by 1% over the FY 2009-10, however, the overall NPL ratio remained at 2.58%.

2.1. MAJOR TRENDS

2.1.1. ASSETS

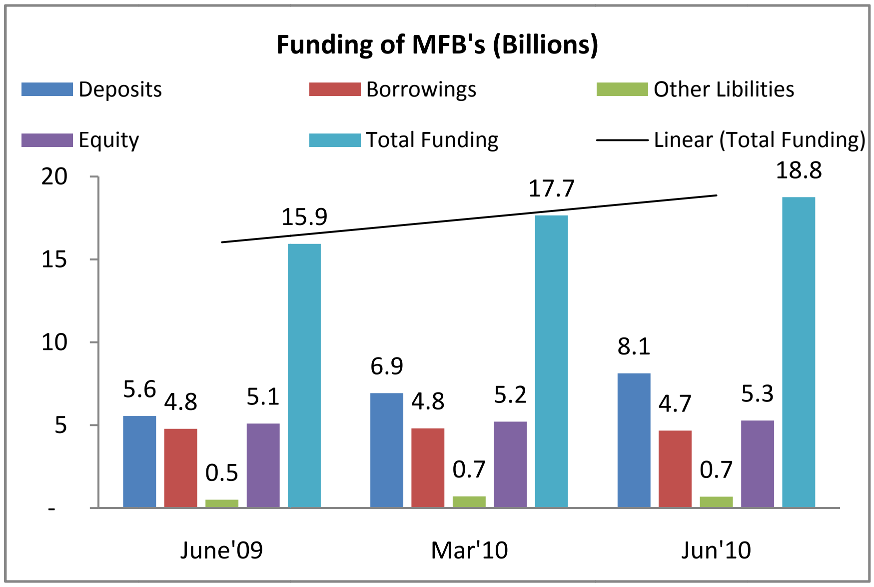
The asset base of MFBs has shown slight improvement during the quarter as its value increased by 6% to Rs.18.75 billion as of June 2010. However, this indicates a tremendous improvement in the asset base over the year, with an 18% increase. It shows that MFBs are gradually making more efficient use of their assets as advances are becoming a larger component of their asset base over the period of time. This proportion stands at 53% in June of 2010 which is showing a gradual increasing trend over the period of time. Compared to regional peers, it is still relatively lower as the average Gross Loan Portfolio to Total Assets for the year 2008 for Asian microfinance players was 72%[1]. *Ceteris paribus*, the ratio for Pakistan is expected to further improve in forthcoming quarters of 2010, with increased lending by MFBs to the underserved, especially by new MFBs in their bid to expand in low income urban and peri-urban markets.



2.1.2. FUNDING

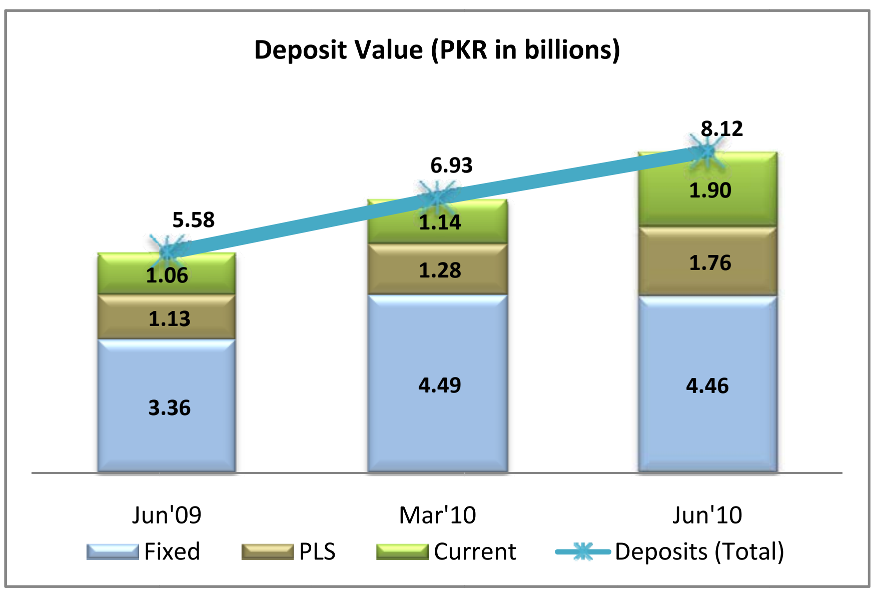
[1] 2008 MFI Benchmarks collected by Mix Market. http://www.themix.org/publications/2008-mfi-benchmarks

The funding structure of MFBs illustrates slight changes during the quarter under review. MFBs have managed to raise the level of deposits up to 39% of their funding as of quarter ended June 2010. In the corresponding quarter last year, deposits comprised of 30% of the funding structure. Correspondingly, share of borrowings and equity have reduced as proportion of total funding. The drive to collect deposits is mainly led by FMFBL. TMBL and FMFBL collectively constitute a 90% share of microfinance deposit mobilized by MFBs thus far. Khushhali Bank, the oldest MFB, has so far managed to capture only 3% of the total volume of deposits. Kashf Microfinance Bank although a new entrant is also making considerable progress in deposit mobilization from urban and peri-urban low income households.



2.1.3. DEPOSITS

Deposits escalated by 46% on yearly basis. This trigger in deposits is partly due to low deposit base of the sector, but also evident of the increased realization among MFBs for building self-funding mechanism. Importantly, similar kind of trend is witnessed in the deposits growth on quarterly basis which is recorded at 17%. Looking at the composition of deposits, fixed deposits hold the major chunk of deposits at 55% while, Profit and Loss Sharing (PLS) deposits and current deposits stood at 22% and 24% of overall deposits respectively as of quarter ended June 2010. Fixed deposits provide MFBs with flexibility at least in the short run as they are sticky, which explains the trend towards mobilization of fixed deposits. Moreover, the average deposit has significantly declined from Rs.22,000 in June 2009 to Rs.12,000 in June 2010. A decline in average

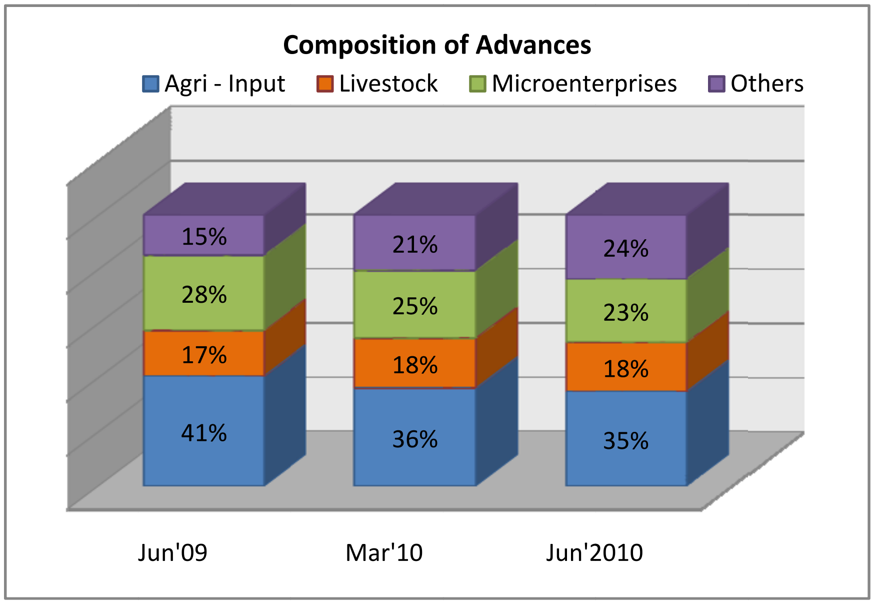


deposit size is good for overall economic growth especially sector's liquidity as small deposits tend to be less volatile than large deposits that have a greater impact on a bank's balance sheet.

SBP underscores the value of deposits as a critical source of funding for microfinance banks. Various measures have been taken to further improve the enabling environment for mobilization of local resources. Some of these steps include allowing schedule bank status to Tameer MFB, licensing new MFBs, encouraging partnerships, use of alternate delivery channels and branchless banking solutions to cater to the untapped market. It is imperative for MFBs to accelerate deposit mobilization to achieve their true potential.

2.1.4. ADVANCES

Advances are gradually increasing and have registered a value of Rs. 10.11 billion by June of 2010, with slight variations in concentration of loan portfolio of MFBs. The composition of advances has not changed drastically except a slight change in its different components. Agriculture fi nancing continues to dominate with 35% of share in total advances by MFBs. Microenterprise is the second largest sector financed by MFBs and stood at 23% as of the June 2010 quarter. Financing for agricultural inputs has particularly increased over the year from Rs. 3.35 billion as of corresponding quarter last year to Rs. 3.53 billion as of June 2010, similarly advances to agricultural inputs increased by 5.0% over the quarter.



2.1.5. NON PERFORMING LOANS

Given the situation in June of 2009, Non-Performing Loans (NPLs) have slightly increased by 1% over the year as they have gone up from Rs. 0.256 Billion to Rs. 0.260 Billion. During the current quarter NPLs also increased marginally from 2.30% to 2.58 % of total advances.

2.1.6. GENDER

MFBs lending continues to be dominated by the male clients. However, there is a gradual shift in favor of female borrowers as their fraction is steadily increasing. The male to female ratio was 74 to 26 in corresponding quarter last year whereas; currently it is 70 to 30 by the end of June 2010. The trend is obvious as microfinance banks are increasingly encouraging female clients.

2.2. LESSONS FROM INDONESIAN MICROFINANCE

Indonesia has a multitude of institutions that focus exclusively or partially on microfinance, which serves the various segments and vast geographical areas of Indonesia. Some of the most successful examples of microfinance in the world come from Indonesia. BRI (Bank Rakyat Indonesia), one of the largest commercial bank in the country has a highly successful microfinance business, which in fact contributes to 60% of the bank's profits. What is more unusual is that BRI is largely a government owned institution with few problems typically associated with state-run enterprises. BRI transformed internally as a result of the government-led reforms in the aftermath of the financial crisis in Indonesia in 1997, BRI's transformation was fueled primarily by the "privatization" of its internal operations (decentralized decision-making, making employees responsible for their work, a profit orientation, giving employees a stake in performance, and incentives), the improved professionalism of its staff, increased flexibility, and the targeting of its services to rural activities in general rather than to purely agricultural undertakings. Furthermore, strong leadership steered the effort of transformation of BRI, as well as complete operational autonomy from the government as far as lending targets were concerned as the government was in the overall liberalization of the financial sector.

In addition to the presence of BRI, Indonesia has a wealth of formal institutions some of which are governed by the central bank and informal institutions that provide services to the typically unbanked. These include cooperatives, rural banks, pawnshop companies and many other institutions. Each institution has a separate mandate, with a unique approach that focuses on different segments of the market providing a wealth of financial services. While these institutions have different approaches, technology and an extensive network is an important source of tremendous success. Users of financial services have access through ATMs and kiosks, which has not only reduced costs for institutions but also helped achieve scale.

Indonesian experience offers a few valuable lessons to policymakers around globe:

- A variety of institutional models are required to reach considerable scale in delivering low-cost financial services.
- Different institutions can be successfully supervised by different entities
- Use of technology is critical in ensuring service delivery
- A mix of the public-private partnerships requires a orientation towards profit-making

While benefiting from the above lessons, policymakers must consider their own unique economic circumstances.

3.0. STATE OF AGRI FINANCE

The role of **Agriculture** in Pakistan's economy is of pivotal nature. Pakistan has tremendous potential for growth and development in agriculture due to its diverse geographic and climatic conditions. However, adequate and timely financial assistance to the farming community may improve production potential of agriculture sector.

The Agricultural Credit Advisory Committee (ACAC) had set an agricultural credit target of Rs. 260 billion for 2009-10. The target was 11.6% higher than the disbursement of Rs 233 billion in 2008-09. Out of the total target, Rs 174 billion were allocated to commercial banks, Rs 80 billion to ZTBL and Rs 6 billion to Punjab Provincial Cooperative Bank Limited.

During the April-June-2010 quarter, banks disbursed Rs 81.7 billion compared to disbursement of Rs 60.1 billion in January-March, 2010 and Rs 81.2 billion in the same quarter last year. Quarter wise & annual agri. credit targets and actual disbursements by banks during 2009-10 and corresponding period last year are given in Bank-wise break up of agri. credit disbursements reveals that during July-June 2009-10 five major banks as a group disbursed Rs 119.6 billion or 96.5% of their whole year targets, ZTBL disbursed Rs 79.0 billion or 98.8% of its targets, Domestic Private Banks (DPBs) disbursed Rs 43.8 billion or 87.5% of their targets and PPCBL disbursed Rs 5.7 billion or 95.4% of its allocated targets. Performance of 5 major commercial banks, ZTBL and DPBs showed some improvement compared with last year disbursement, whereas, PPCBL's disbursement remained in line with its last year disbursement trends.

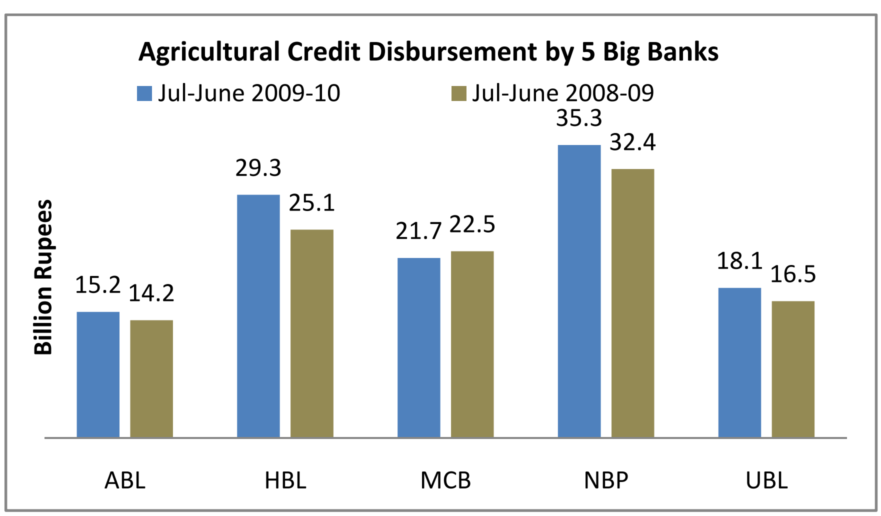
Agricultural Credit Targets and Disbursement (Billion Rupees)

Banks		Disbursement						Disbursement				
	Target 09-10	**Jul-Sep 09**	**Oct-Dec 09**	**Jan-Mar 10**	**Jan-Mar 10**	**Jul-Jun 09-10**	**Target 08-09**	**Jul-Sep-08**	**Oct-Dec-08**	**Jan-Mar-09**	**Apr-Jun-09**	**Jul-Jun 08-09**
5 Big Comm. Banks	124.0	25.8	29.6	29.8	34.4	119.6	119.5	25.6	23.0	25.7	36.4	110.7
ZTBL	80.0	9.9	20.5	18.5	30.1	79.0	72.0	8.7	18.9	17.7	29.8	75.1
DPBs	50.0	7.8	10.4	10.5	15.1	43.8	52.5	11.4	9.5	7.6	13.1	41.6
PPCBL	6.0	0.6	1.7	1.3	2.1	5.7	6.0	0.8	1.4	1.4	2.0	5.6
Total	**260.0**	**44.1**	**62.2**	**60.1**	**81.7**	**248.1**	**250.0**	**46.6**	**52.8**	**52.4**	**81.2**	**233.0**

3.1. MAJOR TRENDS

3.1.1. PROVINCE-WISE DISBURSEMENTS

The major portion of agricultural credit to the tune of Rs 213.5 billion was disbursed in Punjab during 2009-10 and its share in total agri. credit disbursement has increased to 86 percent from last year's 84 percent. Banks disbursed Rs 26.7 billion in Sindh and its share has declined from 11.9 percent to 10.8



percent mainly due to ban on mutation in the province. The share of other provinces and regions is negligible in agri. credit due to weak demand, law and order situation and inadequate supply. Details of province-wise disbursements, vis-à-vis targets achieved during 2009-10- and 2008-09 are given in Table.

Province-wise Indicative Agri. Credit Targets and Disbursement (Billions)

Province	Target 2009-10	Disbursement					Target 2008-09	Disbursement				
		Jul-Sep 2009	Oct-Dec 2009	Jan-Mar 2010	Apr-Jun 2010	Jul-Jun 2009-10		Jul-Sep 2008	Oct-Dec 2008	Jan-Mar 2009	Apr-Jun 2009	Jul-Jun 2008-09
Punjab	202.8	36.6	54.4	51.5	71.0	213.5	195.0	40.1	46.1	40.8	69.1	196.1
Sindh	36.4	5.8	6.0	6.4	8.5	26.7	35.0	4.4	4.6	9.1	9.5	27.6
Khyber Pakhtoonkhwa	15.6	1.3	1.5	1.9	1.8	6.5	15.0	1.7	1.8	2.2	2.2	7.9
Baluchistan	3.9	0.1	0.1	0.1	0.3	0.6	3.8	0.1	0.1	0.1	0.3	0.6
AJK & Gilgit-Baltistan	1.3	0.2	0.2	0.2	0.2	0.8	1.3	0.2	0.2	0.2	0.2	0.8
Total	**260.0**	**44.1**	**62.2**	**60.1**	**81.7**	**248.1**	**250.0**	**46.6**	**52.8**	**52.4**	**81.2**	**233.0**

Sector-wise classification reveals that out of total disbursements of Rs 248.1 billion, an amount of Rs 171.7 billion or 69.2 percent was disbursed to farm- sector and Rs 76.4 billion or 30.8 percent to non-farm sector. Last year, an amount of Rs 169.8 billion or 72.9 percent was extended to farm sector and Rs 63.2 billion or 27.1 percent was disbursed to non-farm sector. The share of non-farm sector shows continuous increasing trend and its share in total credit disbursements increased from 17.4 percent in 2006-07 to 30.8 percent in 2009-10. Major sources of sustained rise in disbursement in this sector are livestock and fisheries sub-sectors with Rs 29.1 billion and Rs1.6 billion credit absorption respectively. High prices of meat, fish and export of livestock attracted investment in non-farm sector. Financing to poultry sector also increased by Rs 43.9 billion on account of record prices of poultry amid strong domestic demand.

3.1.2. AGRICULTURAL CREDIT RECOVERY

During 2009-10, banks recovered Rs 244.5 billion or 90.7 percent of recoverable amount of agri. loans compared with Rs 217.1 billion or 89.6 percent recovered of recoverable amount during 2008-09. The five major banks recovered Rs 123.6 billion or 90.6 percent of the recoverable amount compared with Rs 99.5 billion or 87.9 percent of amount recoverable last year. ZTBL recovered Rs 73.2 billion or 85.3 percent of the recoverable amount compared with Rs 69.9 billion or 86.2 percent of amount recoverable last year. DPBs continues to give concentration on recovery derive and recovered 42.9 billion or 109.7 percent of recoverable amount compared with Rs 42.2 billion or 110.3 percent of recoverable amount last year. PPCBL recovered only Rs 4.8 billion or 57.7 of recoverable amount.

Credit Disbursement to Farm & Non-Farm Sectors (Billions)											
Sector		2009-10					2008-09				
		Jul	Oct	Jan	Apr	Jul-	Jul	Oct	Jan	Apr	Jul-Jun
A	**Farm Credit**	**29.7**	**44.1**	**41.0**	**56.9**	**171.7**	**29.8**	**39.5**	**37.0**	**63.6**	**169.9**
1	**Subsistence Holding**	**18.5**	**26.4**	**24.0**	**34.4**	**103.3**	**18.3**	**25.3**	**23.5**	**40.6**	**107.7**
i	*Production*	16.0	23.5	21.2	31.8	92.6	16.5	23.5	21.6	37.4	99.0
ii	*Development*	2.5	2.9	2.8	2.5	10.7	1.8	1.8	1.9	3.2	8.7
2	**Economic Holding**	**6.9**	**11.1**	**10.9**	**16.1**	**45.0**	**6.3**	**9.4**	**9.3**	**16.1**	**41.1**
i	*Production*	6.8	9.8	10.3	15.4	42.3	5.8	9.1	8.9	15.2	39.0
ii	*Development*	0.1	1.3	0.6	0.7	2.7	0.5	0.3	0.4	0.9	2.1
3	**Above Economic Holding**	**4.3**	**6.6**	**6.1**	**6.4**	**23.4**	**5.2**	**4.8**	**4.2**	**6.9**	**21.1**
i	*Production*	4.1	6.1	5.8	6.2	22.2	5.0	4.4	4.1	6.6	20.1
ii	*Development*	0.2	0.5	0.3	0.2	1.2	0.2	0.4	0.1	0.3	1.0
B	**Non-Farm Credit**	**14.4**	**18.1**	**19.0**	**24.9**	**76.4**	**16.8**	**13.3**	**15.5**	**17.5**	**63.1**
1	Small Farms	2.5	4.6	4.0	6.4	17.5	2.9	3.2	2.7	4.1	12.9
2	Large Farms	11.9	13.5	15.0	18.5	58.9	13.9	10.1	12.8	13.4	50.2
	Total (A+B)	**44.1**	**62.2**	**60.0**	**81.7**	**248.1**	**46.6**	**52.8**	**52.5**	**81.1**	**233.0**

3.1.3. AGRI. NON-PERFORMING LOANS

Non-performing loans in agri. financing stood at Rs 27.5 billion or 16.0 percent of the outstanding loans as on 30th June, 2010 compared with Rs 25.9 billion or 16.0 percent of the outstanding loans as on 30th June, 2009.

3.1.4. NUMBER OF AGRI. LOAN BORROWERS

Agri. Loan borrowers were 1.813 million as on 30th June, 2010 as against 1.906 million as on 30th June, 2009. Bank-wise position of outstanding number of borrowers reveals that decrease in number of borrowers was witnessed in all categories of banks. High mark up, increasing NPLs and defaults in repayment resulted in decline in outstanding number of borrowers over the period.

4.0. STATE OF HOUSING FINANCE

In Pakistan rapid urbanization has become a challenge for increasing number of people. Studies indicate that lack of finance from a formal source is primarily a supply-side problem. Most of the housing finance is arranged through personal resources. The formal financial sector caters to only 1 to 2 percent of all housing transactions in the country, whereas the informal lending caters up to 10-12% of such transactions. Presently, the formal financial sector provides housing support through two major sources namely the Government owned House Building Finance Corporation (HBFC) and private commercial banks.

The property development industry suffers from low public confidence. Financial weaknesses and the absence of clear, uniform and fair business practices have affected its credibility contributing to the reluctance of financial institutions in providing development and construction finance. There is a strong need to strengthen the property titling and land administrative procedures including improvements of the legal provisions, standardization of processes, and computerization of all relevant revenue record. These steps will enhance the financing by the formal sector. Weaknesses in the existing legal framework also impede the financing opportunities of the formal financial sector. Though the Financial Institution Recovery Ordinance, 2001 empowers the financial institutions to foreclose a mortgage property without recourse to the court of law, lack of full implementation of the recovery law in its letter and spirit dilutes its effectiveness in protection of rights of the respective parties, i.e., the financial institutions, mortgagors, landlords and tenants, thus needing a major improvement.

Although the regulatory framework for land registration and transfer regime exists in Pakistan, the process by which land is acquired and registered is cumbersome at times, because of number of institutions and registration procedures required to execute property transactions. Land records are manually maintained leading to errors and omissions and resultantly they have modest commercial value for the mortgagee financial institutions especially in rural and some urban areas. The lack of efficient and reliable system of ascertaining the bona-fide of property titles has forced banks to limit the access of housing finance to a certain number of urban localities within the urban centers.

National and local master plans for town planning and housing facilities are either inadequate or poorly enforced, which lead to inefficient allocation of land and uncontrolled urban development. Lack of transparency and accountability in the planning process also give opportunities to land grabbers/mafias to have valuable inside information as to future infrastructure developments or to be able to influence such plans so that value of its land increases. Over-restrictive building codes and laws on subdivision limit the efficient use of urban land and increase the price to consumers, especially in zones having relatively higher prices of lands in high land price zones. Moreover, the large scale projects often get delayed due to failure of utility companies in connecting new housing developments in time.

The “property valuers” have professional conduct requirements that were established by SBP and the Pakistan Banks’ Association (PBA), whereas majority of real estate builders and developers are working as sole proprietorships or partnerships with limited capital and informal corporate governance structures. Absence of sound governance structure within the housing developer industry creates lack of good practices, illegal construction, unreliable building permits, and legally unprotected advance purchase of units that are required to be built in future. The unstructured and unsupervised nature of business of real estate brokers/ agencies, which could serve as natural arrangers for the provision of financial services, is also a significant constraint to the provision of housing and housing finance. Consequently, it is difficult for financial institutions to verify the character, capital, and capacity of potential clients. Risk assessment and portfolio valuation is also fragile, which is another factor for the lenders' extreme caution for transaction initiated by these venture. As a result, financial institutions are reluctant to enter in this market, which in turn causes scarcity of finance and constraints in the supply of housing. In the absence of the formal arrangements between the housing developers/real estate agents etc and financial institutions, the protection of individual purchasers remains limited as the market is dominated by cash transactions with limited availability of systematic information in a transparent manner. Without using a strong regulatory authority to enforce corporate governance and allied standards for this stratum of business entrepreneurship, the quality of availability of housing facilities across population spectrum will not improve.

At present, almost 29 commercial banks, House Building Finance Company (HBFC) and one DFI is catering to housing finance needs. HBFC is the only specialized housing bank in the country, which has been providing housing finance to public since 1952. Commercial banks entered the mortgage business during 2003 contributing very small share in the housing finance system. Only few commercial banks extended housing loans during 2003. Although HBFC's share in the total housing finance has reduced in absolute terms, it is still the only institution that continues to cater to the lower-middle and low-income groups and enjoys the largest customer base.

After demonstrating a promising growth trend during previous five years, the housing finance sector reported a decline of 12% in outstanding portfolio over the last year. The total outstanding reported by banks and DFIs as on June 30, 2010 was Rs. 70.34 billion compared to Rs. 80 billion as on June 30, 2009. The total number of outstanding borrowers has decreased from 117,535 to 101,632 since June 2009; showing a fall of 13.53%.

Non-performing loans have increased from Rs. 13.87 billion (June 2009) to Rs. 17.38 billion (June 2010); a 25.31% increase over the year. However, this rise in NPLs is not unique to housing finance and is only depicting the overall increase in NPLs of all sectors witnessed in the banking industry during the past year.

Approximately 673 new borrowers were extended house loans during the quarter, accounting for Rs. 1.94 billion of new disbursements. HBFC accounted for 17.23% of these new borrowers and contributed 44.32% of the new disbursements equivalent to Rs. 86 million.

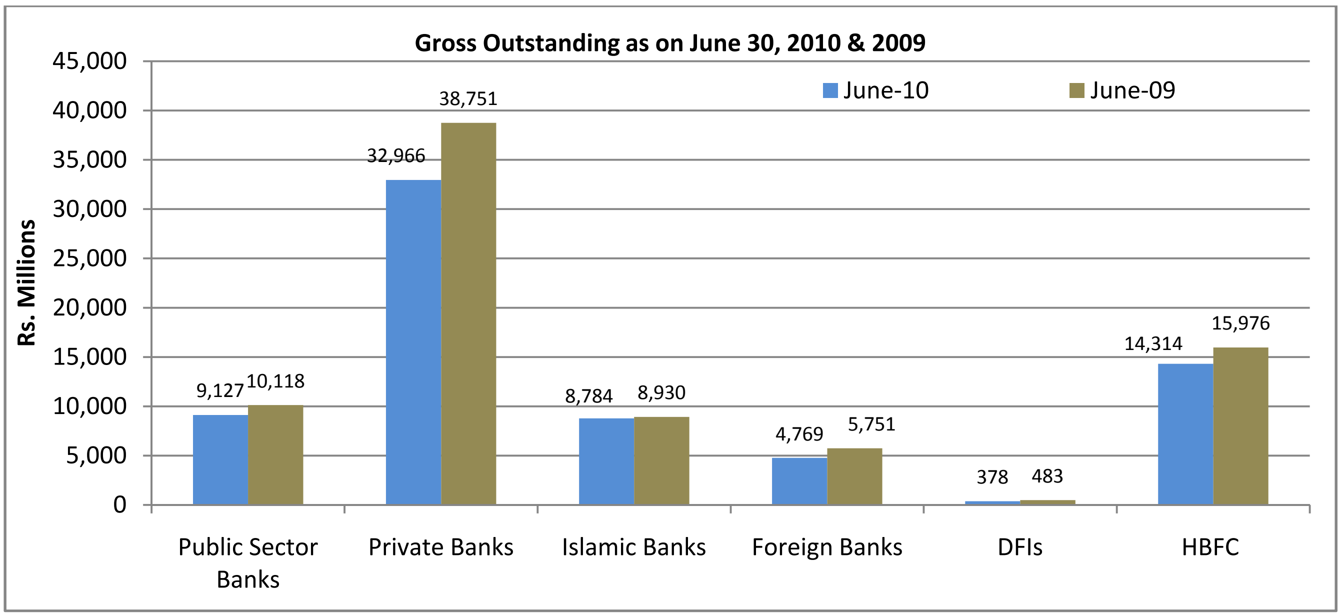
Financing for outright purchase continued to dominate other sectors (construction and renovation) by comprising almost 58% share in gross outstanding portfolio. Outstanding portfolio for construction and renovation was 31% and 11% respectively.

4.1. MAJOR TRENDS

4.1.1. GROSS OUTSTANDING

The total outstanding finance as on June 30, 2010 of all banks and DFIs stood at Rs. 70.34 billion compared to Rs. 80 billion on quarter ending June 30, 2009, outstanding of all commercial banks and DFIs collectively decreased by 12%.

Banking sector-wise total outstanding on quarters ending June 30, 2009 & 2010 are shown in Figure. Of the total outstanding, commercial banks accounted for Rs. 55.65 billion with private banks posting Rs. 32.97 billion; a 14.93% decline since quarter ending June 30, 2009. Public sector banks reported an outstanding of Rs. 9.12 billion followed by Islamic banks of Rs. 8.78 billion and foreign banks with Rs. 4.77 billion. Excluding DFIs, all commercial banks collectively posted a 12.44% decline when compared to quarter ending June 30, 2009. The outstanding loans of HBFC were Rs. 14.31 billion; down by 10.40% over the last year. Other DFIs have a meager share of Rs. 0.378 billion in outstanding loans.



4.1.2. NON-PERFORMING LOANS

NPLs have increased from Rs. 13.86 billion (June 2009) to Rs. 17.38 billion (June 2010); a 25.31% increase during the year. Figure shows comparison of existing NPLs of different banking sectors with last year. NPLs as a proportion of total outstanding have witnessed an increasing trend over the last fifteen months. This overall rise in NPLs is primarily due to rising inflation, high interest rates and the prevailing economic scenario.

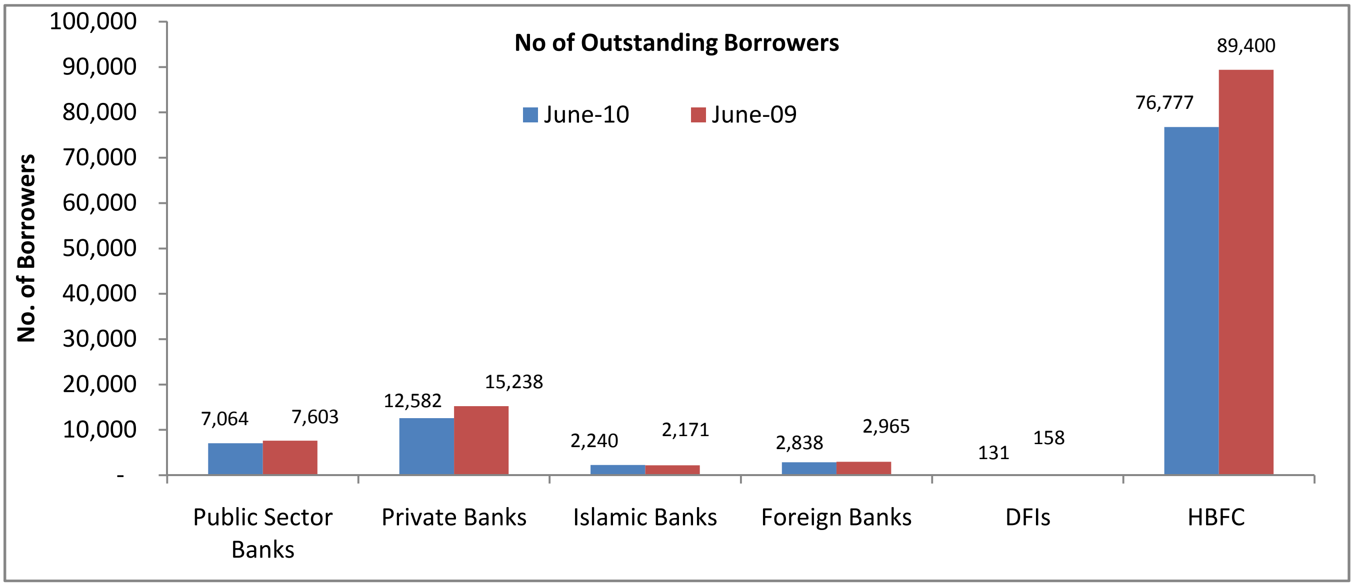
HBFC's NPLs have increased from Rs. 6.14 billion to Rs. 6.42 billion during the year; a 4.41% increase. Although growth of its NPLs remains relatively low in absolute terms when compared to some of the other banking sectors, its percentage share in its total outstanding, however, is the greatest, as 44.82% of its total outstanding constitutes NPLs.

Excluding HBFC, NPLs for all banks and other DFIs have increased by 41.94% over the year from Rs. 7.72 billion to Rs. 10.96 billion. The percentage share of NPLs that all banks and other DFIs (excluding HBFC) constitute is 19.57% of their total outstanding portfolio, compared to a 12.06% as on June 30, 2009.

4.1.3. NUMBER OF BORROWERS

Total number of outstanding borrowers has decreased from 117,535 to 101,632 since June 2009; a decline of 13.53%. As shown in Figure, there is a decrease in no. of borrowers in each category except Islamic banks, where numbers increased from 2171 to 2240.

Approximately 53.52% of total borrowers of housing loans have been classified as non-performing. However, this is primarily due to HBFC's number (51,317) of non-active borrowers that have been classified as non-performing, which comes to 66.84% of total borrowers of HBFC. Thus, excluding HBFC in such an analysis will be important as it caters to 76% of the total borrowers in housing finance sector which accounts for only 20% of



total outstanding portfolio. Thus, by excluding HBFC, 12% of total borrowers of housing loans have been classified as non-performing.

4.1.4. SHARE OF BANKS

The overall market share (based on gross outstanding) of commercial banks (excluding DFIs) remained the same since the end of last year, as 79%. Within commercial banks, the share of private banks in the total outstanding decreased marginally from 48% to 47%. Share of public sector banks, foreign banks and HBFC remained stagnant at 13%, 7% and 20% respectively. While share of Islamic increased from 11% to 12%

4.1.5. DISBURSEMENTS

Fresh disbursements to the tune of Rs. 1.94 billion were made to 673 borrowers during the quarter ending June 30, 2010 (Table 1). Private Banks extended new disbursements of Rs. 1069 million followed by Islamic banks with Rs. 657 million, public sector banks with Rs. 65 million and foreign banks with Rs. 57 million. HBFC's fresh disbursements for the quarter were reported to be Rs. 86 million only. Among commercial banks, the number of new borrowers totaled 557, with private banks serving 333 borrowers and Islamic banks 158 borrowers. HBFC extended loans to only 116 new borrowers during the reporting quarter.

4.1.6. SECTORAL SHARE

The biggest share of housing finance continued to be attracted towards outright purchase. The outstanding for outright purchase stood at Rs. 31.65 billion as on June 30, 2010; a 60% share in total outstanding of Rs. 52.96 billion. This is followed by the construction category where outstanding reported at quarter-end stood at Rs. 15.38 billion and that of renovation stood at Rs. 5.93 billion. Active portfolio shows that private banks have taken a lead in financing for all three sectors; construction 42%, outright purchase 52% and renovation 38%.

4.2. ANALYSIS OF LOAN VARIABLES ADOPTED BY BANKS/DFIS & HBFC

A summary analysis of loan variables across all banking sectors including weighted average interest rate, Loan-to-Value ratio (% financing by banks), average maturity period, average loan size and average time for loan processing is given below

Weighted average interest rate

The overall weighted average interest rate comes to 15.7%; at the end of the current quarter; an increase of 0.1 percentage points when compared to quarter ending June 30, 2009. Highest weighted average profit rate was reported by foreign banks 16.9%, followed by Islamic banks 16.3%, HBFC 16.1%, private banks 15.1% while public sector banks average came to 13.7%.

Average maturity periods

Average maturity period for the quarter ending June 30, 2010 came to 13 years, which is higher as compared to quarter ending June 30, 2009 when it was 11.9 years. HBFC's average maturity period is reported to be 13.6 years, while that of Islamic banks is 11.6 years. Among commercial banks, private sector banks have extended housing loans for an average tenure 13 years followed by foreign banks with 12.6 years and public sector banks with 11.3 years.

Loan to Value ratio

The percentage of financing (Loan to Value ratio) extended by banks decreased during last year. The LTV ratio for housing finance decrease from 57.1% (during quarter ending June 2009) to 49.8% (during quarter ending June 2010). Average LTVs of commercial banks have decreased from 58% to 42% which demonstrates their cautious approach towards fresh lending. The LTVs for HBFC have increased from 54.2% to 57.2% during the last year.

Average time for loan processing

The reported average time for loan processing is approx. 38 days for all banks and DFIs, which was 26 days in June 30, 2009. This increase is predominantly due to HBFC. Currently, the application processing of most of the banks is a centralized process, where branches forward applications to central branches/head offices for assessment and approvals. Moreover, the processing time can be considerably reduced if land titling issues are resolved and institutional inefficiencies removed.

Average loan size

Average loan size for disbursements made during the quarter ending June 30, 2010 is Rs. 3.5 million for all banks, except HBFC. The average loan size for HBFC is reported to be Rs. 1.2 million for the reporting quarter. Islamic banks have financed with an average financing size of Rs. 2.1 million. Private Banks reported an average loan size of Rs. 4.9 million, foreign banks Rs. 3.1 million and public sector banks reported Rs. 1.3 million. The housing finance market is still inclined towards lending to high income groups.

Conclusion

The quarter ending June 30, 2010 depicted a decrease in overall portfolio. NPLs of the housing finance portfolio display a rising trend and banks continue to show signs of cautious lending amidst decreased affordability of the borrowers. LTVs have decreased and maturity periods increased. The lack of conducive institutional framework and secondary mortgage market still pose as a major constraint towards the growth of housing and housing finance sector which is one of the potential key drivers of the economy.

5.0. STATE OF INFRASTRUCTURE FINANCE

Pakistan's infrastructural situation is relatively poor by international standards and this has a significant impact on the lives of every Pakistani in the country. Acute shortage of electricity has turned this necessity into a luxury. Large portion of population do not have access to proper drinking water and sanitation facilities. The Government of Pakistan and its people face an uphill battle against poor infrastructure and it seems like the latter is winning as the country is going through the worst power crisis in its history, with electricity shortage of around 4000 MW. With an estimated 5% annual growth in demand, the country would need additional capacity of approximately 10,000 MW by 2016. The improvement and expansion of infrastructure is a pre-requisite for sustaining and accelerating economic growth and social development in a country. Improving quality and service coverage in crucial sectors like power, water supply and sewerage treatment, transport and logistics is critical for Pakistan's economy and to improve the quality of life of its citizens.

It is estimated that due to insufficient infrastructure, Pakistan looses about 4 to 6 percent of its GDP (approximately $6 billion). Logistical bottlenecks increase the cost of production by about 30%. This has a significant impact, as Pakistan is facing stiff competition from the likes of India and China in the export markets. To improve and expand infrastructure, Pakistan's needs are massive and its resources are limited. Not only there is limited fiscal space, there are also huge gaps in public sector capacity to build and operate infrastructure. Tight fiscal indicators such as fiscal deficit, trade deficit and current account deficit do not permit to spare sufficient public sector resources for infrastructure development. A study suggests that to sustain a 7% GDP growth would require an investment about 7 % of GDP.

In the last three decades, Pakistan has been facing a high rate of urbanization and population growth. The consequences of such unprecedented changes are seen in the form of unplanned, unregulated and uncontrolled urbanization which pose a major problem to the city dwellers. Provision of adequate infrastructure facilities is a perpetual problem, which is needed to be tackled on urgent basis.

The stock of infrastructure finance hovered around Rs. 260 billon throughout the year. Though there was no major shift in total outstanding portfolio of infrastructure project finance but some internal shifts within different infrastructure sectors were observed. The outstanding stock of Power Generation sector escalated significantly from Rs. 115 billion in June 2009 to Rs. 146.5 billion in June 2010. The 27.4% increase in Power Generation sector is, however, much lower than staggering 116% increase witnessed in the volume of Power Generation from June 2008 to June 2009. The quantum of overall disbursement was Rs. 10.3 billion in this quarter which was Rs. 9.1 billion during the previous quarter while the same was Rs. 21.9 billion during April-June, 2009. There is around 53% downfall in volume of disbursement on YoY basis. As in the previous quarters, Power Generation sector remained principal contributor with disbursement of about Rs. 6.3 billion. Total NPLs stood at Rs. 7 billion for this quarter while same were Rs. 7.8 billion during previous quarter.

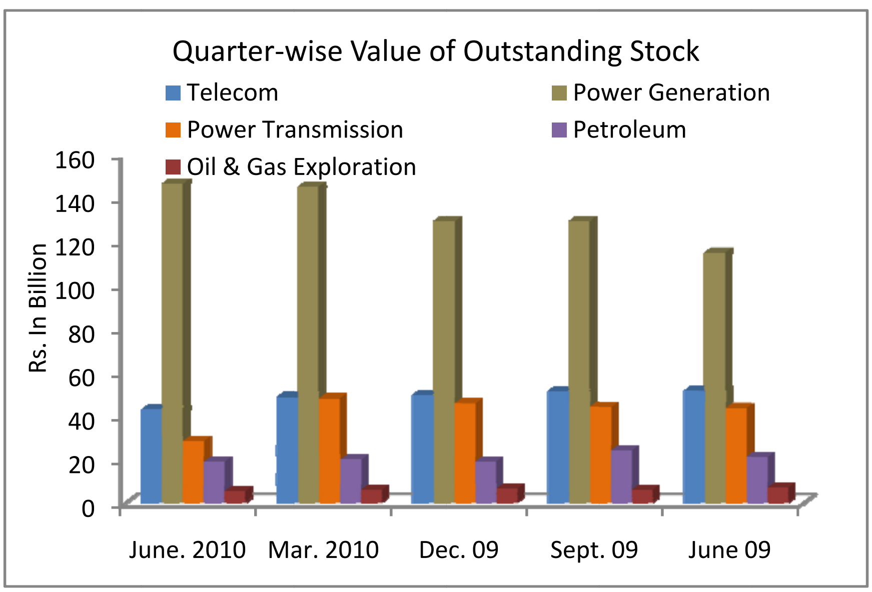
One important signifier of infrastructure development is the number of new projects which get financial close and the figures pointed towards a worrying fact that during FY 10, only 10 new projects got financial close against 53 projects in FY 09. Majority of new initiatives were taken in power generation sector. The international and indigenous experience shows that private sector only participates when there is clear assurance of project's viability and government's support, wherever required. The role of DFIs is very disappointing as they have only around 2% share in total outstanding portfolio of infrastructure project finance.

5.1. MAJOR TRENDS

5.1.1. OUTSTANDING PORTFOLIO

Total financing outstanding at close of June, 2010 was Rs. 260 billion against Rs. 283.7 billion at the end of previous quarter of March 2010. The volume of outstanding portfolio was same at the end of June 2009 and June 2010 peaking in March 2010 with Rs 283.7. The analysis shows, that power generation sector stood out among all the sectors of infrastructure, but the growth became stagnant this quarter. A number of factors like power policy, expertise of financial sector in this sector and demand of energy were the main reasons of its solid growth until March 2010, but the pace has slowed down as no new initiative is reported and the issue of circular debt is persistently hounding this sector for quite some time.

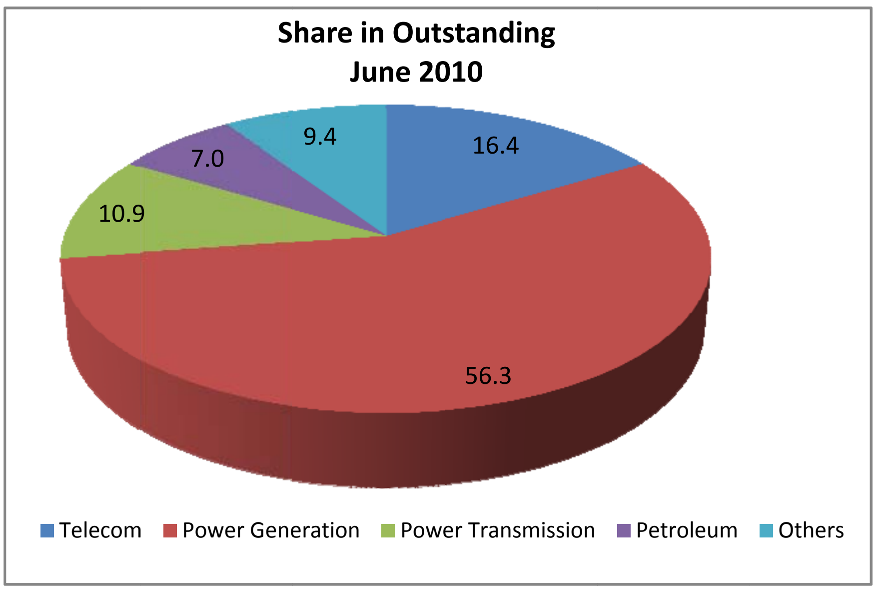
Figure shows the quarterly position of top five sectors from June 2009 to June 2010. All the top five sectors, except Power Generation, are showing a decline in their respective volume of outstanding since the end of last quarter. However, the steep decline was witnessed in Power Transmission and Distribution sector. The outstanding volume in this sector was Rs. 47.9 billion at the end of March 2010 which reduced to Rs. 28.3 billion at the end of the quarter under review.



5.1.2. DISBURSEMENTS

Total Rs. 10.3 billion were disbursed during Apr-June 2010 quarter in all infrastructure sectors against Rs. 9.6 billion in the previous quarter. The disbursement during Apr-June 2009 quarter was Rs. 38 billion. Power generation sector received Rs. 6.3 billion (61.2%), which is significantly higher than other sectors. Share of power generation sector in disbursement was also significantly higher in previous quarter at 69.7% (Rs. 6.7 billion) whereas it was 53.3% (Rs. 11.7 billion) during Mar-June 2009 which shows that there was a relatively more active scenario in infrastructure sectors a year ago. Telecommunication sector was conspicuous by its absence in this quarter while both Power Transmission and Petroleum received only Rs. 759 million and Rs. 264 million respectively in this quarter. The absence of oil & gas sector has been a real concern considering its important role in the economic activity of the country, while Port & Shipping sector saw, for the first time in last two years, any meaningful activity.

5.1.3. ANALYSIS OF SECTORAL SHARE IN INFRASTRUCTURE PORTFOLIO



At the end of June 2009, power generation sector had 44.6% of the total stock followed by telecommunication sector with 19.8%. After a year, the top slot continues to be held by power generation sector with a substantial 56.3% share in the pie. Since the overall outstanding portfolio of infrastructure was more or less same over the year so the declining market share of different sectors is due to the declining volume of outstanding stock of these sectors. The telecommunication sector remained at second place with 16.4% share followed by power transmission sector at 10.9%. Petroleum sector, despite having huge potential, had been on the downside from 8.2% to 7% in a year.

5.1.4. BANKING SECTOR-WISE DISBURSEMENTS

Private sector commercial banks have disbursed Rs. 9.05 billion (87.9%) out of total Rs. 10.3 billion financing in infrastructure sectors during the quarter. Public sector banks disbursed Rs. 1.07 billion (10.4%), while DFIs have miniscule Rs. 148 million (1.4%) despite having a mandate of development finance. In Mar-June 2009 quarter, private sector banks disbursed Rs. 20.5 billion (93.6%) while public sector banks and DFIs disbursed less than one billion rupees.

5.1.5. BANKING SECTOR-WISE SHARE IN OUTSTANDING

The trend is predominantly in private sector banks' way. The stock share of private sector banks is hovering around 83% at the end of June 2010. Public sector banks slowed down a bit from 14.5% to 13.8% while DFI's didn't post any major shift during the year. Though private banks enjoy a major share, portfolio diversification beyond limited infrastructure sectors is highly desirable.

5.1.6. NEW INITIATIVES IN THE QUARTER

Only one new initiative was reported in this quarter in Ports & Shipping sector. This project is an expansion of container handling on port, which seeks an enhanced capacity of more than one million TEU (Twenty-foot equivalent unit) by the end of 2017 from existing 850,000 TEU. This project has the estimated cost of Rs 16.6 billion on a 63:37 debt equity ratio.

6.0. KEY DEVELOPMENT FINANCE INITIATIVES – POLICY AND INDUSTRY

The following were the key Development Finance initiatives

SBP reviewing Prudential Regulations for SME Financing

In order to further strengthen the existing regulatory framework for SMEs, a thorough review of existing Prudential Regulations (PRs) for SME Financing is being undertaken in consultation with relevant stakeholders. The Review proposes separate definition and regulations for Small and Medium Enterprises that will greatly facilitate SMEs' access to bank credit and consequently raise their share in banks' loans.

Credit Guarantee Scheme

State Bank launched the Credit Guarantee Scheme (CGS) for Small and Rural Enterprises with support from UK's Department for International Development (DFID). The objective of the scheme is to ensure repayment of loans of Small and Rural Enterprises which normally do not fall under the coveted customer list of banks and thus the Scheme attempts to resolve the issue of severe credit rationing to them. The Scheme is split in two components viz Component-1 for Khyber-Pakhtoonkhwa, Gilgit-Baltistan & FATA and Component-2 for targeted priority clusters in other parts of country. Further, it shares 60% loss of banks arising from their lending to Small and Rural Enterprises.

Awareness Seminars

SME Finance Department launched a series of Awareness Seminars in collaboration with Development Finance Support Department (DFSD) of SBP-BSC to disseminate the salient features of CGS/SBP Schemes. The seminars were attended by members of trade associations, chambers, farmers association, SMEDA and regional SME & agriculture heads of banks and officials posted in the DFSU. The discussions and interactions proved quite useful as these Seminars not only created the desired atmosphere in each region for effective utilization of the Scheme but also provided opportunity to the SMEFD officials to listen to the view points of end-users of these facilities.

So far, these seminars have been organized in cities having concentrated presence of SMEs like Karachi, Peshawar, Sialkot, Faisalabad, Multan and Lahore.

Capacity Building of Banks in SME Financing

Under the second phase of SME Finance Grass Root Cluster Training Program, Multan, Rawalpindi, Gujranwala and Lahore have been covered and more than 120 credit officer from different commercial banks have benefited from the second phase of the program.

Financing Facility for Storage of Agricultural Produce

In order to develop the agricultural produce marketing and enhance storage capacity SBP issued a Scheme for "Financing Facility for Storage of Agricultural Produce (FFSAP)" to encourage Private Sector to establish Silos, Warehouses and Cold Storages through SMEFD Circular No. 08 dated June 4, 2010. The financing shall be available on long term basis for establishment, expansion and balancing, modernization & replacement (BMR) of Steel/Metal/Concrete Silos, Warehouses & Cold Storage facilities for storing agricultural produce.

Expansion in Scope of Scheme for Modernization of SMEs

In order to improve the access to finance for SMEs, the scope of the Scheme for Modernization of SMEs (issued through SMEFD Circular No.14 of 2009 and SMEFD Circular No. 17 of 2009) was expanded to cover a wide range of SME Clusters/Sectors, through SMEFD Circular No. 07 dated May 6, 2010. The financing will be available for purchase of new imported/local Plant & Machinery for BMR of existing and setting up of new units. Further, financing for import/ local purchase of new generators up-to a maximum capacity of 500 KVA shall also be eligible under the Scheme. The tenor for financing under the scheme has also been enhanced from 7 years to 10 years.

Long Term Financing Facility (LTFF) for Plant & Machinery

It was decided through SMEFD Circular Letter No. 03 of 2010, dated April 6, 2010 that LCs established for import of Second Hand Machinery upto June 30, 2010 shall be eligible for availing refinance under LTFF. Previously, LCs for import of second hand machinery established upto December 31, 2009 were made eligible through SMEFD Circular Letter No. 3 dated March 11, 2009. Through SMEFD Circular Letter No. 4 of 2010 dated April 12, 2010, it was decided that a maximum financing to a single export oriented project under LTFF Scheme will not exceed Rs 1,000 million. However, banks/DFIs may provide financing facilities as per their credit policies over and above the said maximum limit from their own sources subject to adherence of Prudential Regulations.

Reduction in Export Performance Requirements

The required performance for financing facilities availed under Part II of EFS during FY 2009-10 be fixed at 1.50 times as against existing performance requirements of 2.0 times for ***Hand knotted Carpets*** through SMEFD Circular No. 9 dated June 28, 2010. The entitlement of limits for FY 2010-11 shall, however, continue to be fixed as per existing criteria / instructions.

Revision of Financing Rates under the Export Finance Scheme (EFS)

The refinance rates under the Export Finance Scheme were increased by 0.5% through SMEFD Circular No. 10 dated June 30, 2010. Effective July 1, 2010 the end user rate increased to 9.5% from 9% and simultaneously the benefit allowed under SMEFD Circular No. 15 of 2009 will also be adjusted in view of the revision.

Amendments in Prudential Regulation for Microfinance Banks

SBP amended Prudential Regulation No. 12 for microfinance banks (MFBs) pertaining to classification of Assets and Provisioning Requirements. According to the MFD circular No. 3 it has been decided that in addition to cash collateral, gold (ornaments and bullion) shall also be considered for specific provisioning against nonperforming loans. After this amendment gold would be treated at par with cash collateral for specific provisioning requirements against non performing loans. This amendment will ease pressure on the capital adequacy ratio of MFBs.

MFBs' time deposits exempted by SBP

The State Bank of Pakistan, in MFD Circular No. 2 of 2010, amended its Prudential Regulation No. 6 and 27 for microfinance banks regarding maintenance of Cash Reserve Requirement (CRR) and Statutory Liquidity Requirement (SLR). MFBs shall now maintain CRR equivalent to not less than 5% of its deposits. These include demand deposits and time deposits with tenors of less than one year. Likewise, time liabilities of tenors of a year and above will not require any SLR. This significant move has been geared towards creating more working space for MFBs, and to encourage them to mobilize long term deposits.

Exposure Visit Program for National Bank of Ethiopia

The Microfinance Department of SBP organized a one week exposure visit for a delegation of the central bank of Ethiopia, the National Bank of Ethiopia to facilitate them in re-engineering and re-organization of their supervisory systems and Processes. The National Bank of Ethiopia's team visited SBP from 12 to 16 of July of 2010. During the week SBP officials from various departments shared their experience in the area of regulations and supervision of microfinance as well as commercial banking.

SBP's Gross Root Level Training Program for Microfinance Credit officers

In order to address human resource challenges and capacity building of microfinance credit officers, SBP conducted a series of gross root level training programs. These programs will be conducted in different cities across Pakistan to train nearly 1000 loan officers in a year.

Launch of pilot MF-CIB

In a significant step towards enhancing risk management practices of MFPs, a pilot Microfinance Credit Information Bureau (CIB) was launched through a partnership between the SBP, PMN, PPAF and 11 microfinance providers from the Lahore district (in the current pilot phase). This pilot CIB has been set up with support from the UK's Department for International Development (DFID) and Citi Foundation.

PMN roundtable on rural finance in Pakistan

PMN hosted a roundtable discussion on the rural finance market in Pakistan, specifically focusing on challenges faced and potential opportunities that exist in the market. The PMN has been focusing on rural finance research since 2008 to raise awareness and provide policy direction on the issue; and has commissioned and published two reports on the subject to date. These include a research study on rural finance policy in Pakistan, and another one that profiles Pakistan's rural economy for microfinance. The roundtable was attended by participants from various fields, such as practitioners of rural finance, apex institutions, donors, the media, researchers and academia.

Agri Commodities Physical Trade & Market Development:

Pakistan's agri. sector suffers from a compounded problem of lack of infrastructure & market structure. Infrastructure side includes a lack of proper warehousing, whereas on market side, there is a lack of grading & testing, collateral management, post harvest financing and trading. To develop the storage, marketing & post harvest financing, SBP is leading a Committee of key stakeholders including Karachi Stock Exchange, National Commodities Exchange (NCEL), Pakistan Banks Association (PBA), Competitiveness Support Fund (CSF) & Pakistan Farmers Association, towards an initiative which will evolve proper storage, fair & transparent price mechanism & post harvest financing system. Electronic Warehouse Rceipts (EWR) will be integrated with trading, clearing & settlements system of NCEL. CSF & USAID is providing Technical Assistance to fund study to develop blueprint which would include operational structure, legal & regulatory framework and financials. In order to encourage private sector participation in infrastructure development, SBP has also launched a refinance scheme for agri product storage (silos, warehouses & cold storage), at subsidized rates.

In this connection, a meeting of Commodities Physical Trade and Market Development (CPTMD) Committee about the consultant and legal & regulatory framework was held at State Bank of Pakistan under the chairmanship of Mr. Muhammad Ashraf Khan, Executive Director, DFG – SBP, on 10th, June 2010.

Introduction of Pilot Project Phase III for deepening Agri Credit outreach

After successful implementation of Sindh Pilot Project and Pilot Project Phase II, Phase III (PP-III) has been launched in 51 agri. intensive districts of the country in collaboration with 12 SBP-BSC offices from Kharif Season 2010 for deepening of agri. credit outreach and creating linkages among stakeholders. The scope of the Pilot Projects has been enhanced under PP-III by including 23 new districts including 13 in Punjab, 4 in Sindh, 3 in Khyber Pakhtoonkhwa and 3 in Baluchistan.

In the first phase, meetings with the local representatives of participating banks and revenue officials of 17 districts at SBP-BSC offices of Peshawar, Rawalpindi, Lahore, Gujranwala and Sialkot were held to sensitize them with the importance of the project besides review of the strategy for outreach, awareness, one window operation facility, data reporting formats, etc. So far up to 30th June, 2010 banks have disbursed Rs 29.54 billion as against a target of Rs 53.52 billion or 55% of the target. Number of borrowers served is around 233,976 against target of 409,248 borrowers (57% achievement). Fresh disbursed borrowers were 79,490 against target of 130,175 while amount disbursed to them remained 10 billion against the target of Rs. 18 billion. It is expected that banks will achieve their overall targets for the project till September, 2010 as they are already upto their targets in the initial two months.

Training workshop for CAD/Risk management officials about Agri. lending

In order to develop the understanding of CAD & RMD officials about the dynamics of agri. lending, SBP developed two days training workshop on important topics such as overview of agri. sector, SBP regulations regarding agri. finance, agri. credit risk management tools and techniques, loan appraisal and documentation, agri. passbook and other documents of revenue department and so forth in consultation with banks. In this connection, four training workshops have so far been arranged at Karachi, Lahore, Multan and Islamabad during 2010, which were attended by around 170 senior officials of agri. lending banks, SBP and DFSD, SBP-BSC.

Implementation of Housing Advisory Group's Recommendations

As part of its earlier efforts, SBP had established a Housing Advisory Group (HAG) with an intention to conduct a thorough analysis on the existing regulatory and policy framework affecting housing finance. The HAG made number of recommendations stressing on the need to enhance access of financial services for the development of housing sector. 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. SBP had already disseminated the recommendations to the concerned stakeholders and is currently coordinating with the Ministry of Housing & Works, Pakistan Banks' Association (PBA), Association of Mortgage Bankers (AMB) and Association of Builders and Developers (ABAD) for implementation of some of the key recommendations.

Mortgage Refinance Company

SBP and World Bank Group have agreed to work together for implementing key recommendation of HAG for creating financing environment conducive to growth of housing sector by focusing on: establishment of Mortgage Refinance Company, availability of low cost housing finance and establishment of an observatory for real estate market. Work on the establishment of Mortgage Refinance Company is now being pursued aggressively. IFC developed a detailed business plan and feasibility for the Mortgage Refinance Company. Principal buy-in of the Ministry of Finance has been elicited and equity commitments from the GoP, few banks and HBFC have been received, while remaining banks are being pursued.

Capacity building Program on Housing Finance

In addition to initiatives taken to institutionalize housing finance, SBP realizes that a simultaneous development of human capital will play a critical role in ensuring sustainability of housing finance. In accordance with the Cooperation Agreement signed between International Finance Corporation (private sector arm of the World Bank Group) and SBP, a comprehensive housing finance training program was launched. The training covered all aspects of housing finance from product development, loan marketing/distribution and origination to loan underwriting, servicing and risk management. Till date, approximately 250 bankers from over 20 banks have been trained in the mortgage business. More capacity building programs would be conducted in future.

Creation of Web Portal on Housing Finance

In a drive to provide different stake-holders with reliable and needed information on various factors of housing/mortgage finance industry, as also recommended by HAG, SBP is working in coordination with the

Association of Mortgage Bankers (AMB) for developing a web portal. As an initial step, AMB's website has been created which contains information on basic housing parameters.

Development of Housing Finance Guidelines

Infrastructure & Housing Finance Department of SBP is in process of developing guidelines of housing finance to increase the efficiency of mortgage bankers by adopting best international practices.

Infrastructure Development and Financing Institution (IDFI)

SBP is pursuing a very significant objective of establishing a dedicated Infrastructure Development and Financing Institution (IDFI), with the blessings of Government of Pakistan. IDFI would be mandated with broad scope of identifying, developing, structuring and financing projects in key areas of infrastructure. Key multilaterals like World Bank, IFC, ADB and IDB are on board with keen interest to participate in the form of either technical assistance or financial participation. Negotiations with consultant are being finalized to prepare business model and feasibility report of IDFI, which is expected to be completed in second quarter of fiscal year 2010-11.

Capacity Building Program on Infrastructure Finance

A comprehensive Training Program on Infrastructure Project Finance was conducted with the assistance of the World Bank Group from 12 to 16 July 2010 at SBP's Learning Resource Centre in Karachi. This was for the first time that such a high level massive training program on Infrastructure Project Finance was held in Pakistan. This SBP-World Bank joint initiative was taken to address the issue of lack of expertise in the financial sector on project development and financing. Cambridge Economic Policy Associates (CEPA), a very renowned organization for working in infrastructure development and training sector, prepared the course manual and delivered the training. Around sixty professionals associated with infrastructure development and financing from banks, DFIs and federal and provincial governments participated in the training program. IHFD will continue similar training program in different cities of Pakistan to spread international best practices and enhance the capacity building of financial institutions and infrastructure units and divisions of federal and provincial governments.

Revised Guidelines for Infrastructure Project Finance

The issuance of revised guidelines for Infrastructure Project Finance is going through the process of approval and expected to be notified during second quarter of fiscal year 2010-11. The revised guidelines intend to facilitate the financial institutions to structure their lending mechanism in line with international best practices of assessing and mitigating risk inherent in large infrastructure projects.

6.1. DEVELOPMENT FINANCE NEWS FROM AROUND THE WORLD

The following are important news concerning Development Finance across the globe

The G-20 SME Finance Challenge

The Group of 20 and Ashoka's Changemakers, with support from the Rockefeller Foundation, are looking for the best models worldwide that catalyze finance for small and medium enterprises (SMEs). This challenge is open to all private sector participants, including private financial institutions, private investors and companies, socially responsible investors, foundations, and civil society organizations. The theme of the challenge is how public finance can unlock private finance to small and medium enterprises on a sustainable and scalable basis. The goal of the Challenge is to identify catalytic and well-targeted public interventions to unlock private finance for SMEs. Maximizing leverage of scarce public resources is at the core of the Challenge. *Up to 15 winners* will be invited to the November 2010 G-20 Summit in Korea to be recognized for their innovative ideas. Winners will then be connected with donors and investors at an SME conference in Germany following the Korea Summit. Further details can be seen at the site http://www.changemakers.com/SME-Finance

FC, GTZ provide assistance to spur Philippines Central Bank's SME lending

International Finance Corporation (IFC) and German government development agency (GTZ) are providing technical assistance to the Philippines' central bank to strengthen its supervisory and regulatory capacity for lending to small and medium enterprises. Deutsche Bank Risk Management Advisory has been chosen to provide advisory services on risk management best practices. Greater support from central bank supervisors for commercial banks specializing in lending to small and medium enterprises is expected to increase much needed credit flow to the sector. The Filipino central bank has successfully trained their supervisors to specialize in supporting microfinance institutions, and is looking at similar training to support commercial banks' small and medium enterprise lending operations.

This program is supported by the Canadian International Development Agency and the Australian Agency for International Development. GTZ supports the program through its Private Sector Promotion Program.

Introduction of Legal Framework for Separate Stock Exchange for SMEs in India

To ensure SMEs' access on capital markets, SEBI (Securities & Exchange Board of India) has recently established separate legal framework for promotion of dedicated platforms of Exchanges for listing and trading of securities issued by SMEs. The initiative has been welcomed by the stakeholders as they hope it will potentially create financing avenues for SMEs and also a separate market for investors keen to target that segment of the economy.

Introduction of Accessing Credit information of SME Borrower/Entrepreneurs in China

People's Bank of China set-up PBC-CRC in 2006. Later on, CRC developed two databases i.e. **National unified enterprise** and **Individual credit information** with joint efforts of banking institutions. Databases have strong social functions and help commercial banks to prevent and manage credit risks; help government to strengthen enforcement, improve the administrative management and enhance the credit awareness of enterprises and individuals in other fields. Since the information of enterprises' irregularities on environmental protection is included in the databases, some banks have refused to issue loans to such enterprises, which is of great significance to prevent credit risks and improve China's environmental protection.

Publication of SME & Entrepreneurship Magazine

SME & Entrepreneurship Magazine is a regional business magazine published in Malaysia, Singapore, Indonesia and Brunei by Business Media International. The magazine's main focus is on small and medium enterprises as well as entrepreneurs. SME Magazine features current news and in-depth analysis and practical articles and features in everyday language and is assumed, the most authoritative publication for SMEs.

SME Banking Knowledge Guide by IFC

IFC produced Guide based on their world-wide experience/learning in SME Banking sphere. Being a technical publication, it provides a useful reference and guidance to many FIs/Financial Services Providers and other organizations, dealing with SMEs in developing and expanding their SME operations.

Young Entrepreneurs Competition 2010 in Dubai

With the support of Sheikh Hamdan Bin Mohammed Bin Rashid Al Maktoum, Crown Prince of Dubai, the Mohammed Bin Rashid Establishment for SME Development has launched the Young Entrepreneur Competition 2010. The four day event brings together students from different private and public High schools, Colleges & Universities across the UAE, who will set up their stands and sell their products in a competitive environment. The competition aims at educating students on the basic principles of starting and operating a private business, and to inspire the students to become entrepreneurs in future by creating a simple entrepreneurial environment.

OECD: The Impact of the Global Crisis on SME and Entrepreneurship Financing and Policy Responses

The report "The Impact of Global Crisis on SME and Entrepreneurship Financing and Policy Responses", published by the Organization for Economic Co-operation and Development, within the framework of OECD Working Party on SMEs and Entrepreneurship (WPSMEE). It includes recommendations to national governments on how to tackle the long-standing deficiencies in the SME financial environment, as well as to prepare SMEs and entrepreneurs for a phase of innovation-led growth.

6.2. SPECIAL SECTION - BRANCHLESS BANKING TECHNOLOGY

Branchless Banking offers diversity and a wide range of operational models based on different characteristics, innovations and technology. Out of this vast variety of models, only the cell phone branchless banking could dramatically lower the cost of banking and more effectively reach the mass markets using technology. Cell phone banking or mobile banking (m-banking) is the delivery of financial services outside conventional bank branches using mobile phones and retail agents. M-banking allows the banks to serve its existing customers better, improve its outreach and capture new niches of market.

Participation of four primary players is required to deliver the services of banking through m-banking. These are bank itself, mobile network operator (MNO), m-banking technology vendors and the customers / consumers. Technologically, the m-banking channel can be delivered to the consumer through two bearer or application environments i.e. client-side applications and server-side applications. Client-side applications reside on the consumer SIM card or on their actual mobile phone device like J2ME (JAVA 2 Micro Edition) and S@T (SAT). Server-side applications are developed on a server away from the consumer mobile phone or SIM card. Server-side technologies include USSD, IVR, SSMS and WAP. The bank would only need to select one of these bearer channels for implementation. However, in some markets it would be wise to implement more than one bearer channel in order to manage consumer take up and the risk associated with non-take up of a specific technology.

Developing an m-banking system in a country without any existing m-banking infrastructure is quite expensive, time consuming and complex. Very few microfinance institutes (MFIs) have the significant financial, technical and managerial capacity that is required. MFIs mostly use existing m-banking systems of MNOs to not only utilize these technical capacities of MNOs but also to reduce transaction costs, facilitate greater outreach to hard to reach areas and increase consumer convenience. Different technology providers are offering particular technology which is shaping the offerings and their abilities to reach a particular market. On the basis of these particular technologies, m-banking is offering different models like bank driven, joint-ventures, non-bank led or non-bank driven. Selecting the right technology for a market depends on who is the target market and which mobile devices do they have; what kind of user experience and value proposition would be sufficient/appropriate in servicing the target market; what are the bearer channel costs related to this transaction and is it affordable to the target market; does the target market have access to the bearer channel; is it possible to get the application onto consumer's phone or handset without requiring the consumer to have an in-depth knowledge of the technology; is the bearer channel selected secure enough for the risk profile of the targeted customer, is it secure enough to protect the bank from any reputation risk if security is breached; are there sufficient means to manage the risk around the bearer channel chosen; does the channel comply with any financial processing rules and regulations relating to the method of processing, authentication of the customer, transfer of data, and levels of encryption, yet still deliver on the business requirement

In Pakistan five different models of branchless banking are growing. Most innovative and fast growing branchless banking is offered by Tameer Microfinance Bank (TMFB) called *Easypaisa* (an m-banking service). The bank started its m-banking process on its own without an existing m-banking infrastructure. Instead of spending heavy cost on arranging infrastructure, TMFB invited an MNO to invest in company and leveraged its customers, retailers, franchisees as well as its national advertising and marketing reach. Telenor, the second largest MNO in Pakistan with a customer base over 30 million purchased 51 percent shares in TMFB and then both organizations worked together to create Easypaisa brand for their m-banking services. Second successful branchless banking is recently offered by United Bank Limited (UBL) by launching *UBL Omni Dukaans*. Their retail agent for branchless bank is someone who is running a small shop and is looking to earn additional income by capitalizing on the existing foot traffic into his outlet as well as generating additional foot traffic. A typical agent includes bakeries, general stores, medical stores, computer and mobile services shops, electronics shops, boutiques, PCOs, super stores, travel agents etc. Channels for customers / agents are agent system (PC and Mobile Front End), SMS, WAP, Internet on PC, Call Centre (IVR & Agent based), ATM (associated Visa Debit Card), branch network (integrated with Core banking), USSD (in progress). Last year, United Nation's World Food Program (WFP) selected UBL for a solution to disburse Cash in lieu of physical food items to the Internally Displaced People (IDPs). UBL had distributed cash aid using "Visa Debit" cards. Since the branch network was not large enough to handle this kind of influx, hence UBL used "Branchless Banking" solution using a combination of mobile / web based PC front end and retailers as cash distributing agents. Recently, Government has selected UBL to disburse funds under Benazir Income Support Program (BISP) to the BISP beneficiaries through smart card – a three way collaboration between UBL, BISP and NADRA. In addition to above two successful models, First Microfinance Bank is using customer centers of Pakistan Post Office (PPO) to provide its banking services through PPO sub offices. KASHF Microfinance Bank has introduced *KIOSK Model* for branchless banking. MCB Bank Limited is providing branchless banking services to its existing clients through "*MCB Mobile*". The notable development as a result of these initiatives is the escalation in the agents' network in Pakistan that has already crossed 10,000.

There are a number of innovative models of branchless banking and m-banking operating around the globe. Kenya is the first country in the world to offer m-banking services at large scale, which is offered in partnership between Safaricom and Vodafone. M-PESA is available to all Safaricom subscribers (Prepay and Post-pay), even if they do not have a bank account. The M-PESA application is installed on SIM cards offered by Safaricom and works on all makes of handsets. Safaricom's M-PESA system allows users to add value to their "mobile wallet" at a Safaricom store or participating M-PESA agent (such as a top-up vendor or local village store) and they can use that electronic value to purchase goods, buy top-up, or transfer funds immediately to another Safaricom user anywhere across Kenya.

In Philippine, sixty small rural banks were organized in a group through USAID assisted program in Philippines to serve as resellers for GCash, a mobile payments solution developed by GXI, a subsidiary of Globe Telecom. Although GCash already existed, it was not present in rural communities in the Philippines. A network of GCash resellers (similar to check cashing businesses) was built up in these communities. In addition, several thousand employees of rural banks and other businesses use these merchants to cash-out their salaries. On its own, each rural bank was too small to be attractive to GXI. But as a collective association with over 2,000 branches and millions of potential customers, the small banks provided a significant business proposition for GXI. This Rural Bankers Association of the Philippines– Microenterprise Access to Banking Services (MABS) program sets a good example of cooperation among organizations.

The interesting feature of branchless banking is the diversity that has emerged over recent time. The diversity can be seen both in the ways banks/MFIs have planned to use m-banking and in the benefits they hope to receive. Several MFIs (such as Faulu and KWFT in Kenya) are using m-banking services in the expected way - to allow clients to make loan repayments and deposits. Beyond this, some MFIs are acting as agents for m-banking services (such as Vision Fund for WING in Cambodia), others are entering into close partnerships with MNOs to develop new services together (such as easy paisa and M-Kesho) and others are trying to build an m-banking system from scratch (such as Opportunity Bank in Malawi). It is still too early to know the results of all these initiatives but the diversity and creativity is encouraging.

A continuous effort on the part of capacity building to improve the ability of both vendors and banks/MFIs is required to coup with changing technologies, complexities involved and to implement and use back end system more effectively. In addition to capacity building, there is need for solution-oriented thinking at all levels considering the available resources and infrastructure to set up a model to create more diversity, to enhance outreach of the sector and to propel the use of technology at banks/MFIs.

Given the situation of economy, general level of literacy and available infrastructure, wider outreach of financial services is critical for economic stability, sustainability and growth. Hence, getting benefit from the flexibility of branchless banking to offer diversity through technology transformation and financial innovation could be a big step towards inclusive growth in financial inclusion through access to financial services, affordability of financial services and actual utilization of these services.

6.3. DF SECTOR - FUTURE OUTLOOK

The Development Finance (DF) sectors have witnessed slowdown in the last few quarters, i.e. the total DF portfolio at the end of June 2010, is Rs. 823.4 Billion, showing a decrease of 2.3% YoY basis. Similarly, Non Performing Loans (NPLs) of DF sector stood at Rs. 140.7 Billion, recording a 20.7% increase YoY basis, while the quarterly rise recorded was 4.1% at the end of Jun-10.The decline in DF portfolio and rising NPLs may be attributed to the high interest rates, power outages, domestic law & order situation and overall shyness of the industry towards the mentioned sectors.

Going forward, it would be unrealistic to expect a change that could bring drastic improvement in the overall economic situation in general and DF Sectors in special; as rising inflation, law and order situation and many other economic imbalances will continue to restrain positive growth in the DF sectors of SMEs, Micro, Agriculture and Infrastructure and Housing.

However, despite the prevailing adverse conditions, there still exists a strong reason for a positive course of action to take place, as a result of greater realization on the part of SBP, GOP, the banking industry and other stakeholders, to play a more effective role for the development of the subject sectors. Further, the huge potential of the DF Sectors itself is a highly motivating factor to incite the stakeholders to tap on, and consequently develop it for the benefit of economy and their own business interests. Thus, going forward, a positive turnaround is very much probable provided the relevant stakeholders play their role in a more meaningful and effective manner.

The State Bank, on its part, has taken various important initiatives for the development of the DF Sector, that will cause positive impact on the availability of funds for the sector and its overall development in the long run. Some important initiatives include launching of Credit Guarantee Scheme for Small & Rural enterprises, Refinance Scheme for Revitalization of SMEs of Khyber-Pakhtoonkhwa, FATA & Gilgit-Baltistan, Scheme for modernization of SMEs, Cluster specific surveys, introduction of Branchless Banking, Launch of Pilot MF-CIB, Infrastructure Development & Financing Institution, Mortgage Refinance Company and Capacity Building Programs for the bankers.