## Special Section 2: Role of Microcredit in Poverty Alleviation

### 1. Introduction

Micro finance is recognized as an effective tool to fight poverty by providing financial services to those who do not have access to or are neglected by the commercial banks and financial institutions. Financial services provided by Micro Finance institutions (MFIs) generally include savings and credit. According to an estimate, currently 67.6[1] million people around the world have access to micro financing. This number is expected to grow steadily in the future since the target is to reach 100 million poor people with credit by the end of the year 2005 (see **Box 1**)

The main features of the microcredit institution which differentiate it from other commercial institutions are, it is (1) a substitute for informal credit; (2) generally requires no collateral; (3) have simple procedures and less documentation; (4) mostly group lending; (5) easy and flexible repayment schemes; (6) financial assistance of members of group in case of emergency; (7) the most deprived segments of population are efficiently targeted, and the last but not least is (8) groups interaction with each others.

The major objectives of microcredit schemes are: (1) to stop exploitation of the poor caused by expensive informal credit; (2) to provide small loans to poor people at relatively lower cost as compared to accessible informal loans; (3) to finance economically and socially viable projects those cannot be financed otherwise; (4) to empower women within households as decision makers and in society through active economic participation; (5) to create maximum employment opportunities; (6) to create self sufficient and self-employed people and the most importantly; and (7) to reduce poverty, accelerate growth and improve the living standards on sustainable basis.

### 2 Microfinance Sector in Pakistan

In Pakistan, microfinance is gaining importance as an effective tool of social mobilization and poverty alleviation. Currently in Pakistan, a variety of institutions ranging from NGOs to private and government sponsored rural support programmes are delivering microfinance services to the poor. Two Commercial banks i.e. First Women Bank and Bank of Khyber are also providing lines of credit for the microfinance sector.

This sector has the largest potential clientele base, comprising of 6.5 million poor

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[1] Report on the Asia/Pacific Region Microcredit Summit Meeting of Councils February 16-19, 2004

households[2]. However, the microfinance service market in Pakistan remains underdeveloped and serves only 7 to 8 percent of these potential clients. If microfinance is to serve a large share of the market, practitioners must improve their programs by enhancing their outreach access to the potential clients. The Pakistan Microfinance Network (PMN) is an effort to address these issues by arranging specialized trainings and creating awareness among policy makers (see **Box 2**).

In Pakistan, the poor usually acquire loans from informal sources. Lack of income and resources force them to take loans to meet basic necessities of life and the hurdle of collateral leave them at the mercy of the informal avenues. According to NHDR/PIDE Survey 2001, friends and relatives are the major sources of loan followed by shopkeepers and landlords (see **Table 1**). Thus, there remains a great need and potential for growth of microfinance sector in Pakistan.

Some initiatives have already been taken by the non-profit organizations to provide small loans to the poor to enable them to start small businesses. The Pakistan Poverty Alleviation Fund (PPAF) was also established in FY00 to provide credit and loan to partner organizations or NGOs for further lending to the poor individually or in groups (see **Box 3**).

The subsequent sections discuss the initiatives taken by non-profit organizations.

**Table 1:Sources of Loan by Economic Status( Percent)**

| | Extremely poor | Poor | Marginally non poor | Total |
|---|---|---|---|---|
| ADBP | 1 | 2.7 | 5.1 | 2.5 |
| Commercial banks | 0 | 0.2 | 3.2 | 0.7 |
| NGO | 0.3 | 0.7 | 1.9 | 0.8 |
| Input supplier | 1.9 | 3 | 4.5 | 2.9 |
| Landlord | 10.9 | 4.7 | 5.1 | 7 |
| Profit money lender | 2.2 | 0.5 | 1.9 | 1.4 |
| Shopkeeper | 39.1 | 37.2 | 26.1 | 35.9 |
| Factory/mill | 0.3 | 0.7 | 3.8 | 1.1 |
| Commission agent | 1 | 0.5 | 1.9 | 0.9 |
| Friends/relatives | 40.4 | 49.1 | 45.9 | 45.4 |
| Others | 2.9 | 0.5 | 0.6 | 1.4 |

Source: NHDR/PIDE Survey 2001

### 2.1 Rural Support Programmes (RSPs)

Rural Support Programmes aim to modify the entire economic system in a way that the poverty alleviation becomes the focus of all development activities. RSPs create, promote and support effective and disciplined community organizations to manage rural development and work toward self-reliance and poverty alleviation. Rural support programmes in South Asia opted for the strategy of social

[2] Report of Committee on Rural Finance, State Bank of Pakistan,2002

mobilization and thus they not only provide financial support to the poor but also guide them towards the effective use of resources by including them in the decision making process. The participating groups in Pakistan like Aga khan Rural Support Programme (AKRSP), National Rural Support Programme (NRSP) and Sarhad Rural Support Programme (SRSC) have been using the same strategy and the results are quite encouraging towards the objective of poverty alleviation and sustainable development.

### 2.1.1 Aga Khan Rural Support Programme

The Aga Khan Rural Support Programme (AKRSP) was established for small farmers of northern areas of Pakistan living at subsistence level and having marginal access to financial and technical support. During 1980s such farmers required an average Rs 250 as a crop loan. But banks were unable to afford millions of such small loans and later recover them. However, AKRSP took an initiative by forming local institutions such as Village and Women's Organizations to facilitate provision of financial services to these poor farmers. This policy has been quite effective and there are now a thousand village organizations with around 90,000 members in the northern region. The pay back rate on the loans has been impressive at approximately 98 percent.

### 2.1.2 Sarhad Rural Support Programme (SRSP)

This programme was founded in 1989 with the assistance received from the provincial government of the North West Frontier Province, AKRSP and USAID. It follows the successful strategy of Aga Khan Rural Support Programme (AKRSP) by focusing on improving the quality of life of the most vulnerable social groups by providing them financial assistance in the form of micro-finance. Currently it operates in the rural regions of Peshawar, Abbottabad, Mansehra, and Kohat and covers 12 districts reaching 6,000 community organizations.

### 2.1.3 National Rural Support Programme (NRSP)

The NRSP was set up in November 1991 to undertake developmental activities in the rural areas of Pakistan. It is working in the Federal Capital Territory and in 27 districts of all the four provinces as well as Azad Jammu & Kashmir. NRSP is providing technical assistance to other Rural Support Programmes also. NRSP provides social guidance and technical assistance not only in rural credit, enterprise development and urban poverty alleviation project but also for social organization, human resource development, physical infrastructure & technology development, finance & accounts etc.

### 2.1.4 Punjab Rural Support Programme (PRSP)

The PRSP was founded in November 1997 in Punjab on the lines of other rural support programmes operating in the country. The bulk of its operations is related to microcredit along with providing assistance in the areas of business development, health and education etc. Presently, it covers the twenty major districts of Punjab through eight regional offices.

### 2.1.5 A Comparison between NRSP, SRSP and PRSP

**Table 2** indicates that the coverage of NRSP in terms of number of active borrowers and loans is the highest among all rural support programmes. SRSP is the most efficient of all as depicted by its operational efficiency (operational efficiency represents intermediation cost) but its number of borrowers is smaller as compared to the other two. The highest portfolio at risk for PRSP may be a cause for concern but the experience shows that bad debts tend to be high for such programmes, (PRSP is new as compared to other support programmes), and the social pressures on borrowers keeps default ratios lower in the long run.

**Table 2: Productivity Indicators (July-June2003)**

| | NRSP | SRSP | PRSP |
|---|---|---|---|
| No of Active Borrowers | 70,375 | 6,389 | 60,464 |
| Number of Active Loans | 70,375 | 6,389 | 60,464 |
| Borrowers per Loan Officer | 158 | 118 | 268 |
| No of Active Savers | 401,611 | 151,500 | 180,070 |
| Operational Efficiency (percent) | 16.10 | 13.40 | 16.50 |
| Cost per Borrower (Rupees) | 1,442 | 1,101 | 1,137 |
| Portfolio at Risk>90 days (000' Rupees) | 42,409.5 | 29,091.9 | 70,636.5 |

Source: PMN Performance Indicators Report 2003

Some non-governmental organizations are also extending microcredit along with these rural support programmes. Kashf, Sungi, Orangi Pilot Project (OPP) and Development Action for Mobilization and Emancipation (DAMEN) are a few of the known organizations working in this field (see **Box 4**)

### 2.3 Microfinance Institutions (MFIs)

Presently two specialized MFIs i.e. First Microfinance Bank Limited (FMFBL) and Khushali Bank (KB) are operating in the country. As awareness about the MFIs framework grows, microfinance banks are likely to be established in the foreseeable future. In this regard, licenses have already been issued to "Network Microfinance Bank Ltd" and "Rozgar Bank" by State Bank of Pakistan, which are expected to start their operations in the near future.

The operational growth of the MFIs is obvious from the fact that they have increased their outreach by increasing the number of branches in different geographical areas in addition to a considerable increase in their active client base (see **Table 3**).

The KB has a major share (95 percent) in loaning activity. KB has expanded its outreach vertically as well as horizontally across all the provinces of Pakistan & AJK. The network of Khushali Bank consists of 40 branches and 70 service Centers across 41 districts whereas FMFBL network consist of 20 branches in 12 districts as KB started its operation one and half year prior to FMFBL. There is more than 130 percent increase in the number of borrowers (0.13 million) during December 2002 to June 2004.

The advances by MFIs increased by Rs.389 million (52.8 percent) during the first half of the year 2004. A break up of advances shows that the loan portfolio of MFIs is relatively diversified. The major share of the advances belongs to the livestock sector followed by micro enterprises and agricultural inputs; the remaining consists of miscellaneous sectors (see **Figure 1**). However, an institutional breakup depicts a different picture. Khushali Bank has a higher exposure in livestock (50 percent), which is also reflected in the overall MFIs' loan portfolio

**Table 3: Outreach of MFIs**

| | Dec-02 | Dec-03 | Mar-04 | Jun-04 |
|---|---|---|---|---|
| No. of branches | 39 | 56 | 60 | 60 |
| Total No. of borrowers "000" | 57.0 | 96.4 | 102.1 | 133.56 |
| Total No. of depositors "000" | 2.8 | 10.1 | 12.1 | 14.3 |
| Advances (net) million Rupees | 493.1 | 736.3 | 796.2 | 1125.1 |
| Average loan size - Rupees | 9000.8 | 8093.9 | 8253.1 | 8905.4 |

**Figure 2.1: MFIs Advances Distribution -March 2004**

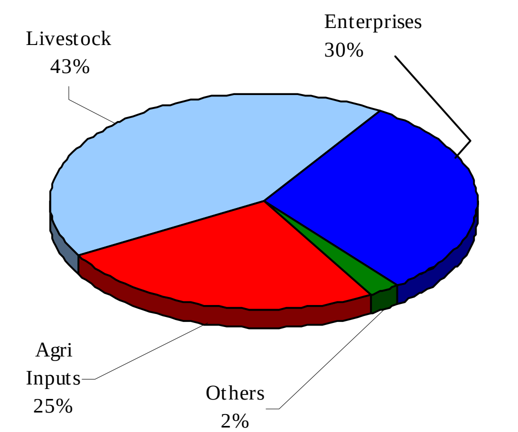
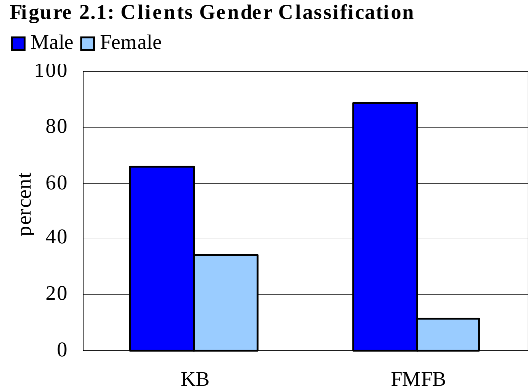



**Figure 2.1: Clients Gender Classification**



due to its dominating size. On the other hand, FMFBL' loan portfolio is highly skewed towards the micro enterprises (84 percent).

Overall, one third of the total clients are female. However an institutional breakup of male-females clients shows that Khushali bank is ahead of FMFB catering to the needs of poor females; KB female clients were 34 percent of the total compared to 11 percent female clients of FMFB (see **Figure 2**). It should be noted however that 34 percent share of female clients is still substantially lower than the average of 79 percent for MFIs worldwide.

## 2.4 Microcredit Role in Poverty alleviation

"*Money, says the proverb, makes money. When you have got a little, it is often easy to get more. The great difficulty is to get that little"*

*Adam Smith*[*]

Today, the world faces the major challenge of reducing poverty. Of the world's 6 billion[3] people, 2.8 billion live on less than 2 dollar a day and 1.2 billion live on less than 1 dollar a day. Of these 1.2 billion, 500 million live in South Asia. General Assembly of the United Nations has recognized the positive impact of microcredit in poverty reduction. Microfinance impact studies have demonstrated that:

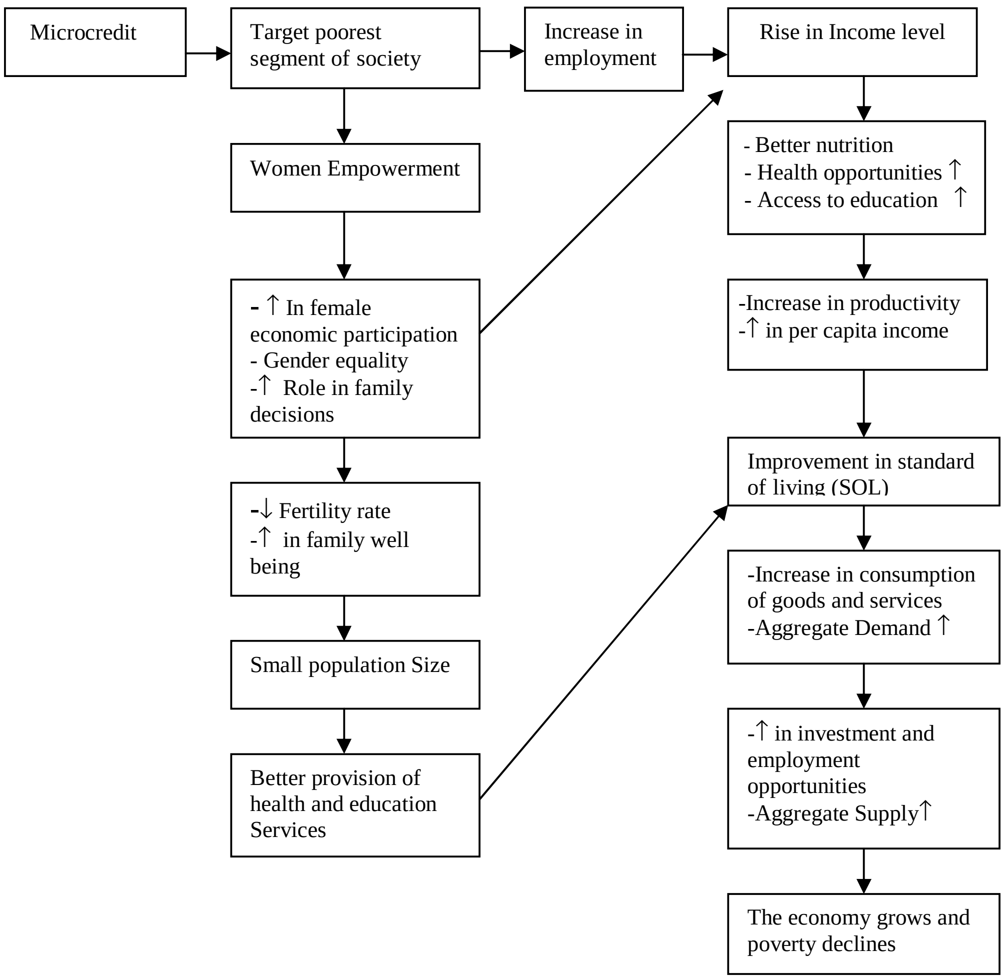
- microfinance helps poor households meet basic needs and protects them against risks.
- the use of financial services by low-income households leads to improvements in household economic welfare and enterprise stability and growth.
- by supporting women's economic participation, microfinance empowers women, thereby promoting gender-equity and improving household well being.
- the level of impact relates to the length of time clients have had access to financial services.

Microcredit helps in reducing poverty by providing the poor with credit facility to start a small business. It not only supports the economic condition of the poor people but also has positive impacts on their social life through better standard of living with greater access to education and health facilities and empowerment to participate in decisions of the society (see **Flow Chart 1**).

[*] "The Wealth of Nations" 1937, p.93

[3] Report on the Asia/Pacific Region Microcredit Summit Meeting of Councils February 16-19, 2004

**Flow Chart 1: Transmission Mechanism of Microcredit to Poverty Alleviation**



## 2.5 Microcredit –Success Stories

Microfinance in Pakistan is a relatively new and emerging discipline but it is gaining importance fast as a tool of social mobilization and poverty alleviation. Though impact of microfinance sector in Pakistan is yet to be evaluated, but globally it has shown a positive impact on poverty reduction that is significant enough to be recognized.

While talking about its role in poverty reduction, two questions arise in mind. First, whether microcredit increases earning capacity of the poor families that is sufficient enough to move them out of the poverty trap. Second, whether the poverty alleviation is on sustainable basis or is it a temporary phenomenon. While majority of studies answer the first question, there is a need to explore the answer of the second question to assess the sustainability of microcredit impact on the poverty eradication. However some of the findings of the studies related to impact analysis of the microcredit programmes on poverty alleviation are discussed here:

- A World Bank study[4] found that percentage of **Grameen Bank, Bangladesh** borrowers living in extreme poverty was reduced by 70 percent within 4.2 years of joining. The study also revealed that profit from Grameen financed businesses increased borrowers' consumption by 18 percent per year. Another study revealed that more than 91 percent of the borrowers reported positive impact of Grameen on their living standards.

- An impact study[5] of **KASHF foundation, Pakistan** revealed that 94 percent of its borrowers have experienced positive economic and social changes in their households and 75 percent of them feel that without this loan it would have not been possible for them to undertake business activities and to generate employment and income.

- Research conducted by the Consultative Group for the Poor in **Indonesia**, found that microcredit borrowers increased their incomes by 12.9 percent compared to 3.0 percent by the incomes of non-clients.

- An impact study conducted on Bunyad Literacy Community Council **(BLCC), Pakistan** by the Research team of SBP, found that its clients have increased their income by 63 percent. Beneficiaries of microcredit

[4] See Latifee .H.I (2000), Microcredit and poverty reduction: Experiences of Grameen operation in Asia", Grameen Trust.
[5] See Latifee (2000)

were not only able to increase their earnings, but more importantly, were able to spend more on the education of their children.

- In another study conducted by Freedom from Hunger, its clients in **Ghana** were found to have increased their incomes by US $36 per annum compared to US $18 per annum for non-clients. Beneficiaries of microcredit were not only able to increase their earnings, but also to diversify their incomes. Eighty percent reported secondary sources of income versus the 50 percent of non-clients.

- Another study of **Bank Rakyat Indonesia** borrowers of the island of Lombok reported that the incomes of clients had, on average, increased by 112 percent. Consequently, 90 percent of households had moved out of poverty.

- A study of Society for Helping Awakening Rural Poor through Education (**SHARE), India** reported that 85 percent of its clients constituted the bottom 20 percent of the individuals living below the poverty line. An impact study on women who have been borrowing from it showed very positive results of SHARE operation on the life of its borrowers in terms of increase in income, improved nutrition, increased expenditure on non-food basic needs, increased employment, enhanced savings, better housing and women empowerment. The study indicates that about 50 percent of borrowers rose above the poverty line.

- In **Bolivia**, the incomes of CRECER (Credito con Educacion Rural) clients increased by two-thirds after joining the program. Moreover, 80 percent of clients said that their savings have increased, whereas 78 percent have not had any savings prior to program participation.

- In **Bangladesh**, a study revealed that basic education competency among 11-14 year-old children in Bangladesh Rural Advancement Committee (**BRAC**) client households doubled to 24 percent in three years, overtaking children in non-client households by 14 percent.

- An evaluation study on, **Center for Agriculture and Rural Development (CARD), Philippines** suggest that it has succeeded in reaching very low-income households, generating self-employment and significantly increasing their income. At the time of joining, 100 percent of CARD members belonged to the bottom 50 percent of the population living below poverty line. As per CARD impact study, 50 percent of its borrowers have already crossed the poverty line.

The findings of the above studies also confirm the positive role of microcredit in poverty alleviation. In PRSP (Poverty Reduction Strategy Paper) of Pakistan, microcredit is indicated as an important tool for creating employment opportunities for poor. Due to the higher demand for microfinance, the branch network of existing MFIs is expanding together with entry of the new banks and NGOs in this sector.

Although MFIs are emerging as an important player in the country's banking and financial system, a substantial segment of the poor population remained underserved. In Pakistan, only 0.5 million (or 7.5 percent of the poor households) were provided with loans out of 6.67 million poor[6] households through the existing microcredit schemes to date. On the other hand, in Bangladesh 9.79 million (or 95 percent of the poor household) out of 10.2 million poor households were provided loans through such schemes so far which seems to have reduced poverty[7] significantly. Thus, if government aims to reduce poverty, it should also focus on the expansion of microcredit schemes to poor since economic growth alone is not enough for poverty reduction. Along with expansion of the microcredit services to the poor, the need to monitor and examine the impact of its existing schemes on the living standards of the poor cannot be overlooked.

[6] Derived from the official poverty estimates that indicate that 32.1 percent individuals in Pakistan were poor in 2001-02 (see **Economic Survey 2002-03**).
[7] As per Cost of Basic Needs method, the level of rural absolute poverty declined to 53 percent in 1991-92 from 71 percent in 1973-74.

**Box 1: International Year of Microcredit 2005**

The period 1997-2006 is being observed as the first United Nations Decade for the eradication of poverty by the international community. It was in this context that in 1998, United Nation General Assembly proclaimed 2005 as the international year of microcredit to recognize its contribution to poverty alleviation.

In order to commemorate 2005 as microcredit year, a resolution that targets **"to reach 100 million of the world poorest families, especially women of those families, with credit for self-employment and other financial and business services"** was passed by the end of the year.

The resolution also stressed on the fact that people living in poverty in rural and urban areas need access to microcredit and microfinance to enhance their ability to increase income, build assets and mitigates vulnerability in times of hardship. The resolution invited the member states, relevant organizations of the United Nations system, non-governmental organizations, the private sector and civil society to collaborate in the preparation and observance of the year and to raise public awareness and knowledge about microcredit and microfinance.

The year of microcredit provides an opportunity to the international community to raise awareness about the importance of microcredit in eradicating poverty by enabling people below the poverty line to undertake micro-enterprises so as to generate self employment and contribute to achieving empowerment, especially for women.

**Box 2: Pakistan Microfinance Network (PMN)**

The Pakistan Microfinance Network (PMN) is a network of organizations engaged in microfinance and committed to improving the outreach and sustainability of microfinance in Pakistan. PMN was established to resolve the issues and problems related to the microfinance sector, which prevent micro financing from achieving its true potential.

The mission of PMN is "*to support the microfinance sector to provide financial services to the poor with particular focus on retail microfinance institutions"*.
PMN pursues its mission through three broader objectives.

- *Enhancing the capacity of retail MFIs* through specialized trainings and strategic planning.
- *Establishing a use of performance measures and promotes financial transparency*.
  For this purpose, PMN members self report their performance indicators that is published biannually as a performance indicator report.
- *Helping to create a policy environment that is conducive for retail MFIs.*
  To achieve above objective, PMN is actively involved in arranging policy seminars and conferences, which provides an opportunity for a range of stakeholders to present their views at a common platform. Moreover, PMN has representation on the SBP consultative group in order to participate in the development of a regulatory framework for microfinance.

PMN activities was initially financed through grants from the Asia Foundation and Aga Khan Foundation, but now it supports its operations not only through grants but also revenues earned through training courses and thus increasing its sustainability.

**Box 3: Pakistan Poverty Alleviation Fund (PPAF)**
The Pakistan Poverty Alleviation Fund (PPAF) Project was established in FY 00 to alleviate poverty and empower the rural and urban poor, by providing them with access to resources and services. There are five project components. 1) Micro-credit; 2) Community infrastructure; 3) Capacity building of partner organizations; 4) Capacity building of the PPAF and; 5) Endowment from the Government of Pakistan

*PPAF& micro-credit*: The credit and enterprise development unit of PPAF has been focusing on the identification of credible and capable partner organizations to expand its facility of loan disbursement and guidance of the deprived group for utilization of their resources over the time period of almost four years; it has maintained a diversified portfolio giving special consideration to gender. Under its mandate it can finance any legally established entity in government or private sector and its criterion for selection is based on the strength of the organization by analysing its past trends and the proposal submitted by the organization. Partner organizations are disbursed credit on quarterly basis subject to satisfactory performance that is evaluated through periodic on-site visits. By end FY 03, PPAF funding had been disbursed in 72 districts of the country, to 37-partner organization, of which ten are catering exclusively to women. Almost 300,000 individuals had availed of PPAF financing by end of FY04 with an average loan size of Rs 8,816 with 44 percent of the loans going to women. PPAF has recently extended lines of credit to three years instead of the previous one-year facility.

**Box 4: Comparison of NGOs**
These four organizations are not similar in their age. ***Kashf*** seems to be the most efficient as its client base is the largest along with the lowest operational efficiency ratio. It is working with a network of 30 branches and more than 50,000 clients. Its major lending products are general loan and emergency loan, along with flexible, open access savings products and accidental and life insurance products.

**Table 3: Productivity Indicators (Jan-Dec03)**

| | **Kashf** | **Sungi** | **OPP** | **DAMEN** |
|---|---|---|---|---|
| Age(years) | 8 | 10 | 8 | 8 |
| No of Borrowers | 59,389 | 1,033 | 2,481 | 10,140 |
| Number of Loans | 87,668 | 1,033 | 2,481 | 10,140 |
| Borrowers per Loan Officer | 345 | 172 | 226 | 307 |
| Operational Efficiency (percent) | 21.80 | 69.80 | 56.30 | 28 |
| Cost per Borrower (rupees) | 1,186 | 3532 | 4,287 | 949 |
| Portfolio at Risk>90 days (rupees) | 397,537 | 3,00,8142 | 741,322 | 527,474 |

Source: PMN Performance Indicators Report 2003

**Kashf** is followed by **DAMEN** but its portfolio risk is greater. **Orangi Pilot Project (OPP)** borrows from commercial banks without any concession and lends it to asset- less families on trust basis rather than collateral. At the beginning, bad debts were high but in third year the recovery rates began to rise. About 11-20 percent operations of **Sungi** are related to empowerment people through micro-credit though it was not basically aimed at microcredit to the poor.