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Growth and Productivity Analysis of Micro Finance Sector: A Case Study of Pakistan

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Abstract

This study reviews growth strategies and their effect on the efficiency and productivity of the microfinance sector of Pakistan. The sector needs to have an adopted intensive growth strategy instead of extensive strategies of wide expansion in terms of physical infrastructure and human resources, which have increased the financial sustainability risks for the credit constrain institutions. The six-dimensional model of outreach used in this study also shows that the sector does not achieve the targets set forth for these micro finance institutes with respect to its active borrowers' outreach. The sector has mainly focused on the big cities and urban areas whereas the poverty levels are higher in rural areas. The government has also shown its interest by launching two different types of loan schemes. Among the three different types of institution, the microfinance banks dominate the sector.

Key Words
Micro Finance, Growth Strategies, efficiency, six-dimension model.

Introduction

Almost half of the seven billion people in the world get less than two dollars of earnings a day. Moreover, one out of five children do not even reach their fifth birthday (WDI, 2001). These poor people try to earn their living by working in small organizations and firms (small and medium-size enterprises SMEs)). However, SMEs require finances to run their operations and to have capital expenditure. SMEs help such poor households to start a small business and change their financial conditions using microfinance (Gallardo et al., 2003; Hubka & Zaidi, 2005).

Microfinance is a broad term that refers to the provision of microfinance services to the typically poor segment of the community and small-entrepreneurs to support them in developing self-employment chances and income-generating activities (Abbas et al., 2014). Extending this definition refers to the provision of small loans, savings accounts, and other necessary financial services to the poor households to enhance their self-employment opportunities and earnings capacity and to decrease their vulnerability (Schreiner & Colombet, 2001).Morduch (1999) argues that getting finance from banks requires many documents that restrict access to these financial services. Microfinance provides such a lending facility at a much lower interest rate than commercial banks (Ghazal, 2013). Moreover, financial services are provided by the microfinance institutions (MFIs) to those low-income households who lack access to formal financial institutions (Naeem, 2014).

MFIs serve as mediators between the international funds and donors who provide subsidized financial capital to the MFIs and to the poor recipients. The purpose of the microfinance institutions is not only the provision of credit facilities but also self-employment of the deprived and social welfare of the society (Thente & Sofia, 2003). Similarly, Lidgerwood (1999) argues that MFIs work as development organizations because their basic objective is to reduce poverty through employment generation for the poor, helping in the development of the existing businesses. Moreover, it helps the extremely deprived section of the community and targets such family circles in both rural and urban areas. Mordoch and Haley (2002) report that the poorest can benefit from these microfinance efforts.

History of Micro-Finance

Microfinance started in the 1970s in Bangladesh to help the rural villagers (Yunus, 1999). The main aim was to help society poor people. In addition, MFIs play their role to eradicate poverty from societies. Moreover, suggested that these projects are operationalized through social development tools (Hermes & Sink, 2007).

Furthermore, the World Bank estimated that more than 7000 microfinance institutions are involved in providing services to over 16 million poor people in the developing world at an estimated cash turnover at US$2.5 billion. The International Microcredit Summit approximates microfinance to facilitate poor families of about 100 million poor families and allocated US$ 21.6 billion for this purpose. Studies report 723 MFIs with a clientele of amount of 190 million out of which a proportion of 74 are women entrepreneurs (Harris, 2009). These facilities are provided to people who are otherwise unable to meet the requirements for loans from conventional credit institutions (Schreiner, 2000).

Micro-Finance in Pakistan

It is reported that about 32.6% of the population live below the poverty line. The poor have a higher dependency ratio on a single bread earner. Prior literature reports quite some work in this sector in countries like Pakistan, India, and Bangladesh for the eradication of poverty and income diversification. For example, Hasan and Raza (2011) report that mostly the microfinance is based on the deposition of payment on a very small scale.

Microfinance started in 1982 in Pakistan. Initially, the government used to provide microcredit to SMEs but in the 1990s, with the growth in the sector, many non-governmental organizations (NGOs) started work in microcredit to SMEs with a diversity of financial and non-financial services. In addition, in Pakistan microfinance institutions have been initiated such as the first microfinance institute such as the Orangi Pilot project established in Karachi. The basic aim of such institutions was poverty alleviation (Hasan & Raza 2011; Rauf & Mahmood 2009). Others followed suit and started different rural support programs (RSPs). There are now around 11 RSPs and all of them offer microfinance services (RSPN2011). To date, around 80% of the microcredit active customers are dealt with by RSPs (Rasmussen et al., 2004).

In the recent past, the government launched many schemes and established many MFIs through the projects of the World Bank during 2000. The establishment of the Microfinance Bank Ordinance in 2000 and subsequently the Micro Finance Banks (MFBs) changed the dynamics of the MFIs. Currently, there are 11 MFBs and 24 MFIs registered with the Pakistan Microfinance Network (PMN), the national association of microfinance institutions and banks, accounting for 2.43 million micro borrowers (Micro Watch, 2013). Similarly, Khushhali Bank was established and it initiated a number of microfinance products. Since the rate of return is higher at a low level of risk in micro-financing scheme of this Bank and in addition, people are attracted to invest their money in these schemes *(Khushhali Bank's Annual Report, 2007)*.

The network and number of branches of a large number of microfinance institutions are expended. Hence, the aggregate level of 2.4 million poor households facilitated by microfinance programs. In addition, the government planned to reduce the poverty level by 2015 (Adnan & Ahsan, 2010). These MFIs offer many products but are not limited to Prime Minister Youth Load Scheme (loan limit up to Rs. 2 million), and Prime Minister Interest-Free Loan Scheme. Moreover, NGOs offer different schemes for SMEs to eradicate poverty.

Adnan and Ahsan (2010) argue that due to low levels of education and less experience, poor people have limited access to credit or gets loans on terms more suitable to credit providers which leads to more poverty. They suggest that such circumstances result in the demand for a new market for MFIs. Similarly, Cletus and Oney (2014) report that MFIs are the new and main source of credit to small businesses (SMEs).

In the recent past, micro-financing has become a debatable topic in the development sector. One of the main recipients are the women who get a share of almost 70% of all the micro-credit provided to SMEs. Thenste and Sofia (2003) report that many programs were launched by different NGOs to empower women. Such a move has reversed the conservative top to bottom approach.

Earlier research emphasizes the importance of MFIs, such as El-Shabrawy (2011) who argues that microfinance during its preliminary stage offered only a single product. For example, these products include but are not limited to microcredit, micro-housing loans, micro-insurance, micro-education, micro-health safety system and many more. The demand for microfinance products and services is also increasing globally. Initially the microfinance sector was dominated by small non-profit organizations, however, at the moment it is led by proper financial institutions.

Theain issues debated include whether those MFIs with either no donors or with very modest donors are only interested in their own financial sustainability and hence are more focused about financial performance. However, those MFIs having donors are more worried about the social indicators and accomplishments of their organizations rather than financial performance. However, both believe that they are contributing to eradicating poverty. This has led to aggressive competition amongst the MFIs and their lending policies have created a debt burden on their clients.

Earlier literature reports a need for an accurate rating system for assessing and evaluating MFIs. The majority of these evaluation models help donors and sponsors in this microfinancing to weight these institutions.

Using data from 2013-17 (5 years), this study finds that MFIs have grown over the years in terms of both personnel and as well as branches and advances. For example, human resource growth is recorded at almost 30% and in physical infrastructure, it is almost around 50% from 2013-17. The total number of branches also increased to more than 1700 showing a growth strategy for the sector. Similarly, the growth pattern is also observed for all the three sets of institutions that are MFBs, MFIs and RSPs, along with their intensity of development and maturity.

Methodology

The study uses a model called the Six Dimension Model. It is based on input and output of financial and human resources (Schreiner, 2002). The study is based on the criterion of low cost and maximum output reporting a synergetic effect. These different aspects are interchangeably used and are related to each other. The first four measures estimate different aspects of MIFs such as breadth, depth, scope, and worth. The rest of the two indicators are measures of efficiency and performance.

Breadth

Breadth explains how many borrowers are taking loans from all the MFIs.

Depth

The depth is the ratio of the number of females to total number of borrowers for an MFI in both urban and rural areas.

Scope

This indicator is measured as how many different products an MFI offer to its customers and is measured as how many different savings accounts are maintained by females against the total number of savings account.

Worth

It represents how difficult are the terms and conditions such as duration, installment, size etc. of a loan agreement. It is measured as the average loan of the market.

Cost

One of the aspects of an MFI is the suitability factor, which is represented by whether it covers its costs and is self-sufficient. Moreover, one of the aspects of MFI performance is a return on assets it generates as well as return on equity.

Length

How much an MFI produces revenue to be resourceful enough for a long period of time. It is how much they produce revenue and does not rely on external sources to be sustainable.

The methods reported in the earlier paras regarding the six-dimensional model, though the length of outreach is the main objective representing an expansion of outreach which is one of the conditions of financial stability of MFIs (Brand, 2000). The average cost of an MFI will be the lowest if its outreach increases to about 12000 customers (Farrington, 2000) beyond which if the costs do not cover the sustainability, then that MFI is not effective in covering its cost. Thus, to be effective, MFIs charge higher interest rates on loans offered and even sometimes fail to recover operating costs and be sustainable over a longer period of time (Brand & Gearstick, 2000).

The above methods are used to analyze the growth of these credit institutions, MFIs. Moreover, this six-dimensional model is also used to investigate the performance of these MFIs. Thus, the performance, long term survival, and expansion of the overall microfinance sector, its three different types of institutions and the top few leading institutions of the sector can be judged. The analysis of this paper is based on the Pakistani microfinance sector and SBP data sources for the period 2013-17.

Findings and Results

This section reports the results of the paper. As stated above, the six dimensions of the outreach model are used to evaluate the growth and sustainability of the MFIs. The results are shown in Table 1. They show that the growth of the microfinance sector in terms of its human resources is almost 30% and in physical infrastructure, it is almost around 50% from 2013-17. As shown in table 1, the total number of branches has increased from 1,221 to 1,606 and the total staff serving in the MFIs has increased from 11,557 to 17,456. This growth in the branches and staff is greater than the increase in the number of active debtors and the gross loan amount indicating extensive growth strategies. The same pattern of growth is reported in the case of all the institutions, where despite their intensity of development and maturity, the increase in the number of branches and induction of new human resources has been reported during the fiscal year 2013-17.

Table 1. Length of Outreach

	Personnel					Branches				
	2013	**2014**	**2015**	**2016**	**2017**	**2013**	**2014**	**2015**	**2016**	**2017**
MFBS	5,038	5,203	5,470	6,126	8,298	289	345	374	295	378
MFIS	3,229	3,161	3,476	5,319	5,613	424	384	435	697	602
RSPS	3,290	3,641	5,256	3,708	3,545	666	676	741	638	626
Total	11,557	12,005	14,20	14,648	17,45	1,221	1,405	1,550	1,460	1,606

Sources: PMN

In addition, despite this extensive growth strategy of increase in branches and staffing, the operational expenses have also increased. Moreover, table 2 shows that the total assets of all MFIs recorded a rapid increase wherein MFBs and RSPs' assets have grown by 19% and 8%, respectively in 2013-14, while the assets of MFIs have shown a decline of 59% during the same year. The overall growth in assets of all the three type of institution during the year 2013-17 is 211%, 53%, and 43%, respectively. On the other hand, the analysis reveals that the debts are still high at around 80%.

The Breadth of the Microfinance Sector

Breadth is the assessment of the number of borrowers. The results show that the number of borrowers has increased from 1.4 million to 2.6 million. However, as per the targets, the relative increase is still low, reaching 3.5 million by 2016. The breadth of the outreach of the sector has increased by 14% in 2013-14 and in 2014-15 has shown an increase of around 6% and a further increase of 23% and 17% in the year 2016 and 2017. Additionally, the gross loan portfolio has shown an increase of 22% in the year 2014-15 and it has further increased by 36% in 2015-16 and by 38 % in 2016-17.

Table 2. Financial Structure

		MFBs					**MFIs**				**RSPs**	
	2013	2014	2015	2016	2017	2014	2015	2016	2017	2014	2015	2016	2017
TA		(19%)	(41%)	(30%)	(43%)	(-41%)	(23%)	(88%)	(13%)	(8%)	(30%)	(-9%)	(12%)
TE		(6%)	(14%)	(13%)	(53%)	(-30%)	(40%)	(11%)	(52%)	(15%)	(45%)	(14%)	(25%)
		26%	21%	19%	20%	18%	20%	25%	28%	18%	20%	25%	28%

TD	(24%)	(51%)	(34%)	(41%)	(-44%)	(18%)	(112)	(7%)	(6%)	(27%)	(14%)	(7%)
	74%	79%	81%	80%	79%	76%	86%	81%	82%	80%	75%	72%

Sources: PMN. 2013 is taken as the base year. TA: total assets, TE: total equity, TD: total debts, Percentage shown in ( ) is the total increased or decreased in total assets, total equity and the total debts. Whereas those without ( ) shows the percentage of total equity and total debts in the total assets

Table 2 also shows a group comparison of the whole sector. The total share of MFBs inactive borrower served by the sector has increased from 30% to 25% in the year 2013-17 whereas the MFIs have not shown any significant increase or decrease and stood at around 34% during the same period and the share of RSPs has recorded an increase of 4% and has risen from 36% to 40% in the share of total number of active borrowers.

Depth of Outreached

It is an important dimension of the outreach. In the last five years, the active borrower number increased. The depth of outreach basically measures the number of male and female active borrowers based on their location. From the year 2013-17, the MFIs have shown an increase of more than 50% in the number of active women borrowers. The group-wise study shows that MFBs and RSPs have shown an increase of around 43% and 68%, respectively.

Table 3. Depth of Outreached on the basis of Gender

		2013	2014	2015	2016	2017
MFBs	WB /AB	28%	33%	28%	27%	26%
	MB	72%	67%	72	73%	74%
MFIs	WB /AB	89%	80%	82%	91%	90%
	MB	11%	20%	18%	09%	10%
RSPs	WB	51%	52%	71%	75%	74%
	MB	49%	48%	29%	25%	26%

Source: PMN annual reports WB: Women Borrowers/total active borrowers, MB: Bale B

Alternatively, the group-wise results show a low proportion of female borrowers for MFBs while a steep increase of 89% and 51% for MFIs and RSPs, respectively. Keeping these statistics in line, the results show that there is an increase in active women borrowers for the SMEs. One of the objectives of the government as well as for profit organizations is to actively involve the deprived sector of our society in the economic wellbeing of not only their own families but to also involve them in the growth of the overall economy. These results indicate that the target of the government and other supporting organizations to support this deprived section of the society is well on its course of achievement. The share of women borrowers is more for MFIs than the other two credit providers showing that MFIs are the most active institutions in providing microfinance services to the female borrowers. Based on the geographical location of these credit providers, the results show that there is not much difference in the number of credits provided to the borrowers. These are almost the same for both urban and rural areas for all the credit providing institutions showing that these institutions are equally accessible to both areas.

Another aspect of the sectoral analysis ishow much credit has been given to which sector. Sectoral results show that trade and small business is the highest recipient of this microcredit, which represents one-third of the total borrowers followed by the agriculture section having one-fourth of the sectoral share. These results indicate that the trade industry is the major contributor to the welfare and uplift society and also to the economy.

Worth of the Outreached

The average loan size represents the worth of the outreached in microfinance credit. In Pakistan, a person is eligible for microcredit if his or her income is below the taxable income. The MFB has increased its loan limit from Rs 300,000 to Rs. 500,000. If we look into the average loan size, all three types of the institution have increased their loan size. The MFBs has raised their loan size from Rs. 16,400 to Rs. 33,500; the MFIs have raised their loan size from Rs. 14,600 to Rs. 27, 700 in year 2013-17 and the RSPs have increased their loan size from Rs. 15,100 to Rs. 21,100 during the time period. This increase in the average loan size represents a higher demand and importance of microcredit.

Table 4. Sector Served by Microfinance Institution

Sectors	2013	2014	2015	2016	2017
Agriculture	29%	23%	23%	22%	22%
Poultry/Livestock	15%	14%	15%	16%	16%
Trade	36%	36%	38%	35%	30%
Services	9%	11%	7%	9%	8%
Manufacturing	6%	7%	9%	9%	9%
Housing	0	0	0	0	0%
Others	5%	8%	8%	9%	15%
Total	100%	100%	100%	100%	100%

Sources: PMN annual report

Moreover, this rise in loan size shows that these institutions are moving from their social objective towards the commercial. This increased in the loan size may be due to the increased in the number of depositors, which have increased from 0.46 million depositors to around 3 million depositors during the study time period with also an increase in the gross loan portfolio.

Scope of Outreached

Table 5. Depth of Outreached on The Basis of Location

		2013	2014	2015	2016	2017
MFBs	RURAL	55%	52%	46%	56%	58%
	URBAN	45%	48%	54%	44%	42%
MFIs	RURAL	55%	52%	46%	56%	58%
	URBAN	45%	48%	54%	44%	42%
RSPs	RURAL	55%	52%	46%	56%	58%
	URBAN	45%	48%	54%	44%	42%

Sources: PMN Annual Reports

Table 6. Average Loan Size

	2013	2014	2015	2016	2017
MFIs	16,400	20,200	23,300	29,100	33,500
MFIs	14,600	17,200	20,800	20,600	27,700
RSPs	15,100	17,600	17,500	18,600	21,100

Sources: PMN annual reports

Table 7. Lending Methodology

Lending	2013	2014	2015	2016	2017
Group Lending	90.02%	88.03%	77.97%	77.31%	73%
Individual Lending	9.98%	11.97%	22.03%	22.69%	27%
Total	100.00%	100.00%	100.00%	100.00%	100.00%

Sources: PMN annual report

The scope of outreached basically measure the mobilization of saving the number of depositors. The deposit amount has shown a considerable increase during the last five years. The deposits have increased from Rs. 7.1 billion to around Rs. 32.9 billion while the number of depositors has increased from 0.46 million depositors to more than 3 million. One of the reasons for this increase is the addition of institutions and that the microcredit sector has introduced new products.

Cost and Length of Outreached

The first four dimensions of outreached provide a view about the performance of the sector. The length and cost of outreached give us the information about the financial performance, financial efficiency and the financial sustainability of the sector. The average AROA and the AROE of the sector are negative while the operational and the financial self-sufficiency of the sector has decreased for the MFIs and MFBs. However, for RSPs it has shown an increase of 30% during the year 2014.

The nominal and the real yield have also slightly increased for the sector. The AROA and the AROE of the sector are positive for the sector during the years 2016 and 2017, which shows the proper utilization of assets by the sector. The operational and financial self-sufficiency for the sector has also improved during the same years. This indicates that the sector is appropriately utilizing its assets.

Table 8. Productivity

MFB						**MFI**					**RSP**				
	2013	2014	2015	2016	2017	2013	2014	2015	2016	2017	2013	2014	2015	2016	2017
B/S	124	119	134	127	130	139	129	134	138	145	123	149	88	143	171
B/LO	250	280	318	339	398	276	246	231	301	304	174	421	163	189	278
L/O	124	119	134	127	130	139	129	134	138	145	123	149	88	143	171

Sources: PMN Annual Reports

Table 9. Financial Indicators

MFB						**MFI**					**RSP**				
	2013	**2014**	**2015**	**2016**	**2017**	**2013**	**2014**	**2015**	**2016**	**2017**	**2013**	**2014**	**2015**	**2016**	**2017**
AROA	1%	-2%	0%	0%	3%	-14%	2%	1%	1%	6%	-6%	-1%	-1%	2%	2%
AROE	9%	-10%	2%	-2%	21%	-62%	10%	4%	6%	23%	-19%	-2%	-3%	7%	9%
OSS	122%	94%	110%	107%	118%	71%	109%	124%	109%	141%	99%	98%	102%	111%	114%
FSS	107%	77%	106%	102%	115%	65%	92%	104%	109%	140%	79%	79%	98%	109%	113%
NY	32%	31%	34%	33%	36%	22%	29%	32%	28%	29%	28%	36%	38%	36%	34%

FY	9%	14%	20%	21%	25%	1%	12%	19%	16%	18%	6%	19%	24%	23%	23%

Sources: PMN Annual Report

Group-wise study of the sector shows that the RSPs are the most sustainable institutions both in term of their operational and the financial self-sufficiency while the MFIs are the less sustainable institutions among the group. Similarly, the productivity level of the sector is lower than that of the average level for the overall South Asian average productivity level of 149. The average productivity level for MFBs is 127; for MFIs and RSPs the average productivity levels are 137 and 108, respectively. MFIs have the highest productivity level among the group. This shows that the MFIs are rapidly expanding.

Conclusion

This study examines the growth strategies of the microfinance sector of Pakistan. Using data from the microfinance sector for the period 2013-17, the study finds an overall expansion of the microfinance sector. The results conclude that the microfinance sector has adopted an extensive growth strategy. The government is playing a positive role in the betterment of the sector and another addition as a new scheme. Although the sector of microfinance has shown significant growth, it fails to meet the target. The microfinance sector has increased its services from a single product of microcredit to multiple products. The number of institutions has also increased but still a lot is needed to eradicate poverty. Moreover, it is reported that the sustainability level of financial and operational aspects of the microfinance sector is weak, hence it is an issue which remains to be addressed. Similarly, increasing the level of overall cost per borrower and ratios of productivity are low. Finally, it is concluded that the prominent reason for this weak financial position of the microfinance sector is the expansion of a costly and inappropriate strategy of growth. Hence, these strategies adversely affect overall cost and productivity. The findings recommend that to reduce the level of trade-off between the commercial and social aim of microfinance focus should be more on utilizing the available human and financial resources and less on concentrating on the extensive growth strategy.

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