International Journal of Economics, Commerce and Management
United Kingdom Vol. II, Issue 3, 2014
http://ijecm.co.uk/ ISSN 2348 0386

CAN COMMERCIAL BANKS DO MICRO FINANCE IN PAKISTAN? FRAME WORK & LESSONS

Bugvi, Sahibzada Ahmad Muneeb
Global Institute, Lahore, Pakistan
muneeb.bugvi@gmail.com

Abstract

For Poverty alleviation, different organiations are working with a common goal. There is a common problem of sustainability in operations of microfinance institutions. This paper emphasis on the need of Fund transfer from Pakistan Commercial Banking System to Microfinance sector. Commercial Banks no doubt have infrastructure and more finances to dominate the financial markets. If they change their mind set and attitude in the direction and needs of microfinance market, they can become important actors. In 1990s two commercial banks in Zimbabwe and Kenya have started microfinance operations. Experience of both CBZ and CBK shows that if commercial banks have to move critically, seriously and successfully into microfinance, they need a champion with in bank. We have discussed a real example of successful 100 year old Sri Lankan Commercial Bank namely Hatton National Bank doing microfinance. The initial result shows in terms of profitability after some time of inception. In the preceding section of this paper Pakistan microfinance sector is discussed with constraints and emphasis is made on the vigorous guide lines issued by State Bank of Pakistan

Keywords: Microfinance, Commercial Banks, Commercial Microfinance System, Microfinance in Pakistan

INTRODUCTION

Poverty reduction is the millennium goal of countries of the world. Microfinance is an effective and appropriate tool to reach the millennium goal. In Analysis of the effects of Microfinance on Poverty Reduction (Morduch & Haley, 2002) Micro finance Institution / Bank has the ability to reach poor people. Evidence proves the positive impact of microfinance on poverty elimination. Not everyone is fit for Microfinance, impoverished people who are extremely ill, mentally unfit or highly indebted are not suitable for microfinance. Business abilities at micro level should be judged for effective poverty reduction. Microfinace has the potential to effect a range of Poverty reduction targets in income, health, nutrition, education and agriculture. Poor's income smoothing and increase of income is possible through Microfinance. It is an instrument for poverty reduction of under developed population of the world.

Commercial Banks no doubt have infrastructure and more finances to dominate the financial markets. If they change their attitude towards the direction and needs of microfinance market, they will become important actors. The demand for micro finance services are high, commercial banks can provide funds to microfinance market. For a commercial bank it is enormously costly to manage small loans. The organizational structures, procedures, products and methodologies of commercial banks are not suited to microfinance and changing them can be difficult, time consuming and expensive.

Eusebius (2010) projected Latin American banks as benchmark profitable institutions. eg. BancoSol Bolivia Commercial banks are now more interested in microfinance market as a diversification strategy. They are involved in microfinance in a number of ways. In some cases commercial banks are in partnership with MFIs. They provide loan funds and on the other hand MFI undertake the monitoring, origination and collection of the loan. Commercial banks distribute microfinance Investment vehicles MFIVs which are run by professional managers to provide funding for MFIs.

Baydas, Graham, & Valenzuela (1998) discussed obstacles for larger commercial banks in micro finance; these are lack of commitment from commercial bank top management and low financial confidence in providing loans to MFI. Microfinance is expensive due to small size of loans and commercial banks cannot operate them with their mechanics and overhead structure. Prudential Regulations of Commercial Microfinance takes into account the specialized nature of microfinance programs.

Large commercial bank may manage fully independent micro enterprise retail center operations which have their own lending policies, staff and information system, reporting to the commercial bank. This is an Independent structure of MFI administration. This study attempts to answer following research questions:

1. Can commercial bank provide microfinance services profitably?
2. Design a system which shows how Commercial Banks can do Microfinance?

LITERATURE REVIEW & FRAMEWORK

In 1990s two commercial banks in Zimbabwe and Kenya started microfinance operations. Commercial Banks down scaling occurred. New loan and saving products were introduced. A successful Example of MFI becoming Commercial Bank is BancoSol Bolivia. Another commercial bank, doing only microfinance is Centenary Rural Development Bank, Uganda. Most of the Commercial banks that have stimulated into microfinance are state banks like Bank Rakyat Indonesia (Bell, Harper, & Mandivenga, 2002). Liberalization has increased competition in banking sector of Africa. Commercial Bank of Zimbabwe (CBZ) and Co-opeartive bank of Kenya (CBK), as a result of diversification, entered into the microfinance operations.

CARE an International NGO provides partnership and technical assistance to CBZ in microfinance programme implementation. CBZ initially was not prepared to provide funds to the microfinance unit, but agreed to implement the program because of availability of funds by British Government Department for International Development (DFID). In 1995 DFID funding covered start up and operational cost, and it also provided a Loan Guarantee Fund (LFD). CBZ took on 20% risk for initial loan and 40% for second loan and full risk thereafter.

In 1998 British Government Department for International Development (DFID) provides funds for CBK. CBZ micofinance program was implemented by Community Banking Unit (CBU) housed within CBZ Credit division. It has its own dedicated loan officers. CBU uses administration of CBZ. In December 2000 four branch level CBUs were opened in the existing branches of CBZ. CBZ personnel were employed from within as mangers at CBU. CBU staff (ex-teachers) are responsible for the entire CBU Loan cycle. CBK decided to launch microfinance program using its entire physical structure. Program was set up in its existing department. This integration posed many challenges due to organization culture. But due to good administration, training and bank staff motivation, CBK overcame these issues. CBZ lends through the group lending model of loan size $85 to $1,290 taken for 6-18 months. Loans are priced 5 % over prime lending rate. (Year 2000 prime lending rate was 64.5% per annum). CBU offers an obligatory saving product.

In Co-operative Bank of Kenya individual loan product and saving product both are modeled along the lines of Bank Rakyat Indonesia loan range from $75 to $ 3,800 for 6 months.

Table 1: The Commercial Bank of Zimbabwe

Community Banking Unit loans Portfolio	
Total Amount Disbursed	US$1,690,000
Total No. Loans Disbursed	8,205
Average Loan Amount	US$175
Portfolio Outstanding	US$569,000
Total No. Loans Outstanding	3,194
Average Portfolio at Risk (>30days due)	7%
Community Banking Unit Savings	
Total No. Savings Accounts	9,519
Total Amount Deposited	US$983,000

Table 2: The Cooperative Bank of Kenya

Cooperative Bank of Kenya Biashara Plus loans	
Total Amount Disbursed	US$4,170,000
Total No. Loans Disbursed	3,861
Average Loan Amount	US$1,080
Total Amount Disbursed (during 2001)	US$2,916,000
Total No. Loans Disbursed (during 2001)	2,256
Average Loan Amount (during 2001)	US$1,292
Portfolio Outstanding	US$1,219,000
Total No. Loans Outstanding	1,451
Average Portfolio at Risk (>7days due)	3%

Experience of both CBZ and CBK shows that if commercial banks have to move critically, seriously and successfully into microfinance, they need a champion with in bank. Commercial banks are reluctant to provide funds. The micro finance program of both these banks was funded by DFID. This transition of funds was a lengthy process. The adjustment of microfinance in commercial bank environment is a difficult proposition. The microfinance operations suffer because of political and external environment.

We can quote few examples of successful commercial banks doing microfinance. There are cultural issues in this transformation and once a Commercial bank decides to step in microfinance then it should implement this program within a reasonable time frame.

METHODOLOGY

For study purpose, a case study design is adopted where commercial bank included was Hatton National Bank Sri Lanka. Hatton National bank was Bench marked and analysis was done to reach at important conclusion for the Pakistani commercial banking sector.

Hatton National Bank Sri Lanka

Hatton National Bank has a 100 years history of commercial banking in Sri Lanka. HNB is one of the successful Commercial Bank of Sri Lanka which is involved in microfinance program. From its inception profitability was not the issue but the long term goal was commitment to economic and social development. There is recognition of social issues prevailing in Sri Lanka like poverty reduction. Hatton National Bank started its micro loan program in 1989. They termed their micro loan program in local language as Gami Pubuduwa (GP) which means village awakening through self reliance.

The case of HNB involvement in microfinance focuses on corporate social responsibility of a commercial bank. This responsibility is strongly connected with the dedication and commitment of the senior banks officials. Commercial Bank consistency in organizing the microfinance program is dependent on the presence of visionary company board members.

HNB profitability was a secondary issue in the early years of launch. Micro Finance Institutions financial statements showed that Micro finance can be profitable after some years of launch and subsidies. Literature and data on profitability of commercial banks in microfinance is very limited and in most cases nonexistent. It is due to difficulty in costing and presence of limited number of commercial banks in microfinance.

GP microloan program was fully integrated into Hatton National Bank products in 1989. It is a part of Development Banking Unit. Total 72 GP field officers were positioned in different branches. Mainly these branches are in rural areas and these loan officers' report to the branch manager.

Table 3: Hatton National Bank Micro Loan Program

Borrowers	11,000
Male	80%
Portfolio	SLR 743 Million (US $ 7.4 Million)
Saving Deposits	SLR 900 Million (US $ 8.8 Million)

As on 30th June 2004

The main focus of GP was on community skills development and training. Management did not calculate profitability of GP micro loan program of Hatton National Bank Sri Lanka till 2003. They decided to calculate profitability first time in 2003 when new deputy General Manger took the charge. HNB micro loan program represent only 0.55 % of total bank assets. Portfolio of micro finance program is only 0.93 % of the bank total loan portfolio as of 30th June 2004.

In 2003 bank MIS system could not calculate product wise profitability. At that time management calculated manual profitability figures. GP had not incorporated head office expenses and direct cost of GP field loan officers.

GP program of microloan had a net profit of SLR 1.0 million (US $ 9,761) for the period ended 30th June 2004. These results are not significant but according to Hatton National Bank it is their long term commitment to economic and social development.

According to author of this paper, corporate social responsibility can be truly fulfilled by thinking and acting in the alleviation of poverty by the commercial banks. Commercial banks should not think about the profitability of their enterprise which they are generating from microfinance program. They have already earned trillions and trillions dollars from the corporate world. They have the infra structure, plenty of funds, but if they stress on the profitability of micro lending program right from the beginning they will not be successful.

As in case of Hatton National Bank, Sri Lanka results of GP after fourteen years of inception are not significant. If we look in more detail at the factors, the study clearly shows top management commitment to their long term objective is that Hatton National Bank charges interest rate ranging from 9-14 % compared with 20% of other MFI in Sri Lanka.

HNB operates GP micro loan program as a bank internal Unit. Micro loan program operates inside the existing bank arrangement as a division and all loans are on Bank books.

Table 5: List of commercial banks operating microfinance program as an internal unit

Bank Name	Country
Bank Rakyat	Indonesia
Banco do Nordeste	Brazil
Banco Salvadoreno	Salvador
Banco Agricola	Salvador

Management of Hatton National Bank calculated profitability of its microloan program based on Activity based costing technique. Despite the low or negligible profitability figure, the GP loan officers not only mobilize savings, they cross-sell other bank products. They also provide assistance in branch operations and graduate clients, promoting them to the bank small and medium sized (SME) division for further extended loan products. HNB gives great value to these loan officers and the clients of microloan program.

According to Sri Lankan department of census and statistics poverty line is described as earning SLR 1,423/- per person per month and taking 2,030 kilocalories. The government of Sri Lanka took positive actions to keep interest rate low, offered by commercial banks on micro lending. As a result HNB and other state owned commercial banks like Bank of Ceylon and Peoples Bank offered micro finance loans at lower rates than its NGO competitors.

HNB was the first commercial bank of Sri Lanka which hires agriculture experts as banking officers. GP loan range from SLR 25,000/- to SLR 750,000/- (US $ 244 to US $7,320) the HNB principle is one of graduation i.e. bankable clients. It is mandatory for GP clients to open a saving account. These loans are for working capital or purchase of long lived asset for business.

GP loan is an individual loan product; this loan is often backed by cross guarantee of group members. In Hatton National Bank, Development Banking Unit staff is responsible for GP loan administration as well as rural loan product. *Rural credit interest rate is lower than micro lending program.* Maximum rural credit limit is US $ 300,000/- compared with GP loan, which is only US $ 7,500/- as on 30th April 2004.

GP loan officers handled 34% of micro loan products portfolio and 66% rural credit portfolio.

Table 6: Total time distribution

GP lending	40 percent
Rural lending	20 percent
Other Branch Business	40 percent

As discussed above Hatton National Bank management perspective is to fulfill corporate social responsibility by alleviating poverty. This is due to the visionary thoughts of Managing Director and Chairman Board of Directors HNB. Since Micro lending program inception, profitability was not an issue rather rural entrepreneur and rural infra structure development was the point of focus.

MICRO FINANCE INDUSTRY IN PAKISTAN

Pakistan Micro finance industry is in its early ages, despite the fact it has been growing worldwide for the last thirty years. It is considered to be the most vital, powerful and effective tool for poverty alleviation. In Pakistan Microfinance and Financial sector Diagnostic study by International Finance Corporation, World Bank Group and Kfw BANKENGRUPPE (IFC; Kfw;, April 2008) the authors discuss, Pakistan has very few interested commercial banks who supply funds to the micro finance sector. Pakistan microfinance industry relies significantly on international donor funds. Microfinance is considered as a social service in Pakistan and banks lack a Socio-Commercial approach.

Pakistan political government environment is unstable and direction is not towards poverty alleviation in country. All government energies, financial resources are deployed against terrorism in Pakistan. Government spends more financial resources on security issues as a result; country development projects like poverty alleviation, education, health and agriculture are suffering. The allocated amount for these development projects are curtailed to a minimum level in the annual budgets of Pakistan. These allocated funds are transferred to meet the expenses of Pakistan armed forces for requirements of security and counter terrorism.

The focus of commercial banks operating in Pakistan is mainly on corporate sector with US $ 21,159 million compared with MFI loan disbursement of US $ 179 million as on 31st December 2006. Commercial Banks provide less than 6 % funds to the total financing requirements of small and medium enterprise, SME sector. State Bank of Pakistan has given some guide lines for Islamic micro finance by the Islamic commercial banks and other financial institutions. For Islamic Micro finance there are four types of guide lines:

- A full- fledged Islamic Microfinance Bank
- Islamic micro finance service offered by a Islamic bank
- Islamic micro finance services offered by commercial bank
- Islamic microfinance by Micro finance Bank.

Right now in Pakistan, only National Rural Support Program NRSP is offering Islamic Micro lending products on pilot basis. There is a lack of effective force full policy by SBP on involvement of Commercial financial institution which curtails steady growth in microfinance sector.

Pakistan financial sector comprises of commercial banks, DFIs, Micro Finance Banks, NBFIs and Modarabas. Financial Institutions of Pakistan are hesitant to offer financial services to the down market, as information of small borrowers is inadequate. This is due to lack of maintenance of data bases. Commercial Banks follow the methodology of acquiring collateral which is a mismatch with principles of microfinance.

Pakistan financial sector is dominated with commercial banks, as in most of developing countries. Both of the Conventional commercial banks and microfinance sector are monitored and controlled by State Bank of Pakistan. The SBP is an autonomous institution and in a position to make integrated change in prudential regulations for MFB and Commercial banks. These regulations should have the effect of funds availability to micro finance banks from commercial banks at nominal interest rates for running sustainably poverty alleviation programs.

As on 30th June 2007 there were 47 commercial banks in service with a total of 7,746 operational branches. Unfortunately very small number of commercial banks provides microfinance facility. Some reasons behind this low involvement by commercial banks are

- Lack of vigorous prudential regulations by State Bank of Pakistan.
- Instability of political Governments
- 30 out of 60 years of Military rule in Pakistan
- Lack of commitment, consistency and corporate social responsibility from top management of Commercial Banks.

As commercial banks have the infrastructure for rapid expansion of microfinance in the five provinces of Pakistan, they have already earned a substantial amount in dollars from the corporate/household sector. There is a need to channel some these funds towards the micro enterprises considering them bankable according to Prudential Regulations of State Bank of Pakistan. This fund transfer towards micro business and low income population will ultimately reduce poverty in Pakistan.

First Women Bank and SME Bank are exceptions, but their role in microfinance is almost negligible. Citibank International provides some percentage of loan funds to micro lending programs and considers it as their corporate social responsibility rather as a long term strategic investment. Standard Chartered Bank Pakistan had a deal with Kashaf Foundation Pakistan to provide US $ 4.2 million for micro finance.

Standard Chartered Bank Pakistan Ltd, a subsidiary of Standard Chartered PLC, has closed its first microfinance deal, a two-year term loan to Kashf Foundation worth PKR 350 million (USD

4.2 million). The deal is supported by the Program for Increasing Sustainable Microfinance (PRISM), a project launched by the Pakistan Poverty Alleviation Fund (PPAF) to assist microfinance institutions (MFIs) forge partnerships with commercial funders.

According to a statement released by Standard Chartered, this loan “will allow Kashf to meet its funding requirements and expand its customer base to increase access to finance… It also promotes commercial lending to microfinance institutions and encourages them to further improve operationally and to become self sustainable” (Rubin 2010).

Commercial Banks in Pakistan has shown very little interest in providing services to the poor community due to reservations about profitability figures. According to commercial Banks it is very expensive to run a micro finance program. Right now the focus of commercial banks is towards SME sector. They find potential in it due to margins of profitability.

State Bank of Pakistan had issued regulations allowing commercial banks to open window for micro finance services but no bank has demonstrated long term, consistent micro lending program.

In 1990s Micro Finance started in Pakistan, with the origination of Aga Khan Rural Support program. Microfinance providers in the country are classified into following working groups,

- Microfinance Banks. The specialized institutions which operate as micro finance banks.
- Rural Support Program: these programs are operating for rural development
- NGO-MFI: these nongovernmental organizations and Microfinance institutions run microfinance as part of development programs.
- Commercial Financial institutions involvement in micro finance.

Microfinance banks get license form State bank of Pakistan under the micro finance ordinance issued in year 2001. Khushhali bank is the largest microfinance bank in terms of loan portfolio. Rural Support programs have the largest infra structure network of micro lending. There are certain NGO-MFI like Aukhwat providing micro finance loans on interest free basis to the poor communities of Pakistan. The borrower is supposed to return only the principle amount and no interest is charged.

ORIX Leasing is one of the commercial financial institutions providing micro finance facility through different branches. ORIX is a Multi National Corporation working in Pakistan. As on December 2006 there is a network of 1,343 branches by micro finance providers in country. The mean loan size ranges between US $ 100 to US $ 500 and disbursed mainly through group lending model.

Micro finance providers in Pakistan are heavily dependent on international donor sources of funds. MF providers view microfinance as a social service to the community. Application and use of commercial sources of funds are lacking in micro finance sector resulting in slower outreach. Micro finance is considered to be socially driven business resulting in very low number of university graduates interested in studying it as a subject. At the same time very few universities offers this subject in curriculum. Corporate managers in a well established profit making companies are hardly interested to get a job in microfinance sector. This is due to low salary structure and no indications of career path development. There is a rapid growth in micro insurance, main providers of micro insurance are: EFU General Insurance, Admjee Insurance and the New Jubilee Insurance Company. Rural Support Program is the star player in insured clients.

CONCLUSION

Pakistan Microfinance Industry has not achieved sustainability. The solution lies with the commercial banks. In view of profitability made by Hatton National Bank, Sri Lanka commercial banks can venture into microfinance sector. A sustainable microfinance sector in Pakistan can be possible by Corporate Commercial Banks involvement, considering it to be at least their corporate social responsibility. State Bank of Pakistan SBP can issue vigorous guide lines for commercial banks to extend micro lending to poor through different channels already discussed in the prudential regulations for microfinance.

REFERENCES

Abeywickrema, C., & Jayaratne, L.USAID (2004). Case Study on Profitability of Microfiance in Commercial Banks:Hatton National Bank. United States Agency for International Development.

Baydas, M. M., Graham, D. H., & Valenzuela, L. (1997). Commercial Banks in Microfinance: New Actors in the Microfinance World. Ohio State University. US Agency for International Development.

Bell, R., Harper, A., & Mandivenga, D. (December 2002). Can Commercial Banks do Micrfinance?

Eusebius, K. (2010). Commercial Banks of Tanzania and Poverty Alleviation through Microfinance. pp. 1-17.

IFC; Kfw;. (April 2008). PAKISTAN: MICROFINANCE AND FINANCIAL SECTOR DIAGNOSTIC STUDY. Washington DC USA: International Finance Corporation and KFW Bankengruppe.

Lessons from the Commercial Bank of Zimbabwe and the Co-operative Bank of Kenya. Small Enterprise Development Journal (SED), vol.13(4), 1-13.

Morduch, J., & Haley, B. (2002). Analysis of the effects of Microfinance on Poverty Reduction. New York University, School of Public Service. New York: NYU Wagner Working Paper Series.

Rubin, S (2010). MicroCapital Brief. (Online) http://www.microcapital.org/microcapital-brief-standard-chartered-bank-pakistan-closes-first-microfinance-deal-42m-to-kashf-foundation/

