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Micro Financing in Pakistan: A Historical Study

ABSTRACT

This study provides a historical analysis of the evolution of microfinancing in Pakistan, tracing its development as a means of poverty alleviation and financial inclusion. Microfinance in Pakistan has its roots in community-based financial support systems and has since grown into a formal sector that addresses the needs of low-income individuals and marginalized communities. The research examines key stages in the growth of Pakistan's microfinance sector, including the establishment of institutions.It is a great challenge for a country like Pakistan, where, according to the statistics of the United Nations World Urbanization Prospective the urban population is 37% of the total population in 2012 and rural population is 63% of the total population and the per capita income is average. The Islamic micro finance models are struggling to achieve their goal, which are solely developed to meet the gap between the SMEs and the financial institutions that are unable to address the need of the market.The study explores various microfinance models used within Pakistan. Additionally, it analyzes the instruments offered, including micro-loans, savings accounts, and micro-insurance, highlighting how these products enable individuals to manage financial risks, invest in small businesses, and improve their livelihoods. Challenges such as regulatory barriers, political instability, and cultural factors affecting the sector are also discussed, along with emerging opportunities through digital finance and fintech. By contextualizing the historical trajectory of microfinance in Pakistan, this study provides insights into its impact on poverty reduction and economic empowerment. The findings highlight the importance of continued support, innovation, and policy improvements to strengthen microfinance as a sustainable tool for socioeconomic development in Pakistan.

Keywords: *Pakistan, Micro Financing, Historical Study, NGOs*

AUTHORS

Dr. Syed Abrar Hussain Shah*
Assistant Professor, COMSATS University Islamabad, Vehari Campus, Punjab, Pakistan.
abrarhussain@cuivehari.edu.pk

Prof. Dr Altaf Hussain Langrial*
Professor & Director, Institute of Islamic Studies,Bahauddin Zakariya University, Multan, Punjab,Pakistan.
altaf.langrial@bzu.edu.pk

Dr. Hafiz Muhammad Hassan Mahmood **
Lecturer, University of Education Lahore, Vehari Campus, Punjab, Pakistan.
irhasan.mahmood@gmail.com

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E-mail: editor@al-marsoos.com

***Correspondence Author:**
Dr. Syed Abrar Hussain Shah*
Assistant Professor, COMSATS University Islamabad, Vehari Campus, Punjab, Pakistan.

Introduction

Almost all governments, administrative authorities, cooperative and social organizations, and NGOs support programmes providing credit and finance and policies for alleviating poverty in the relatively less developed communities and societies of their respective countries. In Pakistan too, since the establishment of the banking and financial institutions, the primary emphasis of economic planning and policies has been on the provision of the basic infrastructure needed for the development of Large Scale Enterprises (LSEs) and the development of Small & Medium Sized Enterprises (SMEs).[1]) Unfortunately, the initial efforts were unable to garner favourable results for SMEs, despite the fact that SMEs account for a significant part of the country's economy and provide employment for villagers, generate skilled labour for Large Scale Enterprises and retard the tendency of villagers to migrate to mega cities in search of a livelihood.

Latest studies indicate that rural credit institutions have not been successful enough, as was anticipated initially, in achieving their goals of social and economic growth and development as they are being plagued by various organizational structure and operational management constraints. Therefore, with the efficient implementation of the models of Islamic Microfinance and effective provision of skills and innovative ideas in the emerging financial market of today can assist in the development of the micro entrepreneurs of the rural areas who will then directly contribute towards the growth of the small and medium enterprises.

"Allah has permitted for you trade and prohibited interest"[2].

Islamic banking has gained separate entity recognition than conventional banking. For Islamic Finance to give out its support towards a sustainable growth of the countries' SMEs, it needs to regulate its products offering in the rural market. These products hold the nature of buying and selling of assets, investment management, partnership, leasing, Islamic bonds and insurance, agency and lastly contract of works. To evolve Islamic Finance in Pakistan, a regulatory framework has been synchronized as follows by the State Bank of Pakistan (2007):

1. Full fledge Islamic Banks,
2. Islamic banking subsidiaries of conventional banks and
3. Islamic banking branches (IBBs) of conventional banks

Numerous microfinance and Islamic banks as well as the conventional banks, with Islamic window, are working under such structure and have nurtured and developed over the past few years. However, their success will only be ensured if their product offerings and services are microfinance specific and their coordination with certain agencies like Islamic Internal Rating Agency (IIRA), as well as the Islamic Financial Services Board (IFSB), The Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI) and the General Council of Islamic Banks and Financial Institutions (GCIBFI) will develop a supportive outline to meet

1 There is no uniform definition of SMEs applicable across the whole territory of Pakistan. This paper follows the SMEDA (Small and Medium Enterprise Development Authority)'s definition approved in SME Policy 2007 (http://www.smeda.org. pk/). According to the SMEDA's definition, the employment size of SMEs is up to 250, the paid-up capital upper limit is Rs. 25 million, and annual sales are up to Rs. 250 million

2 Surah Al-Baqarah: 2:275

the challenges of attending the needs of micro credit holders. Besides, without the collaboration of the various stakeholders in the microfinance sector, they might face barriers to the development of micro finance services in the rural areas.

1. The History of Microfinance in Pakistan

There are three forms of Microfinance in Pakistan:

1. The informal Sector
2. Early Initiatives by Government
3. Microfinance Initiatives by NGOs

2. The Informal Sector

The poor of Pakistan have generally relied on informal sources for meeting most of their credit requirements. Informal providers serve a predominantly lower income group who are perceived by the financial institutions as “un-bankable” due to their inability to comply with conventional loan collateral requirements. The informal credit market is served by a wide variety of providers including predominantly family and friends, landlords, money lenders, traders, Art are commission agents. Large landlords usually provide credit to their tenants or sharecroppers for the purchase of agriculture inputs and consumption purposes. This is most common in Sindh and Southern Punjab. Art are commission agents favour interlinked transactions providing, for example, inputs to farmers and undertaking to sell their produce. It is difficult to properly assess the actual price of credit in these interlinked transactions. Suppliers’ credit is common in established markets such as textile, and informal finance is common in the transport sector as well as in the shoemaking, dairy and livestock industries. The Agriculture Census of 2000 estimated that 65% of outstanding debt of all rural households was provided by non-institutional or informal sources. A Financial Markets Survey found that 82% of individuals borrowed 69 percent of the total amount of funds at very low or no interest payments with flexible repayment schedules from friends and relatives.

Distinct advantages are offered by informal credit, as it imposes no restriction on the purpose of its use, can be provided in small amounts, is characterized by low transaction costs, high interest rates by commission agents but no interest rate when provided by friends and family and rapid disbursement of credit. Although, its share in total credit has declined, it still remains a major source of credit in rural areas. The close familiarity of borrowers with informal lenders, inability of formal institutions to reach the poor explain why there is a heavy dependency of the rural population especially farmers on the informal market. Most informal lenders have, however, limited loan portfolios and operate within a narrow area of their influence.

There is widespread use of Rotating Savings and Credit Associations at all levels in Pakistan. These are called Committees and are especially popular among women from all socio-economic backgrounds to establish private savings committees which people trust. The members of a committee know each other well and deposit a fixed amount in a pool which is then distributed by rotation to each member on a monthly basis. This helps to meet the savings need in an informal manner in a system which enjoys a high degree of trust. The funds are generally used for a large financial outlay such as a marriage, house building, consumer durables, education, etc.

3. Early Initiatives by Government

The Government has in the past made little distinction between agriculture and micro-lending. Its focus in the past has been on providing credit to small farmers. Prior to independence, institutional credit was available to the farmers either in the form of Taccavi loans which were initiated by the Government before cooperatives and commercial banks actively came into crop and other agriculture sector loans. Taccavi loans were given from the government's treasury and disbursed through revenue departments of the provincial governments. These were disbursed to needy farmers for seeds, fertilizers, etc., by revenue agencies. Taccavi loans were also given in the case of damage to crops in floods or famine conditions. Taccavi loans carried an element of interest, and in the case of a delay in repayment, penal interest was also levied. The formal sanction and regulation of Taccavi loans was established through the Land Improvement Loans Act of 1883 (LILA) and Agriculturists Loan Act 1884 (ALA), later on replaced by West Pakistan Agriculturists Loan Act of 1958 (ALA). Under ALA, loans were disbursed for sinking of irrigation wells/tube wells, land levelling, and land reclamation and development for agricultural purposes. The contribution of these loans towards total institutional credit declined overtime with the development of new institutional sources. Delays and procedural difficulties in sanctioning and disbursement of loans rendered the system of Taccavi inefficient and ultimately these loans were discontinued in 1993-94.[3]

Cooperatives have been another source of credit from the formal sector. Credit cooperatives have existed in this region since their introduction in India under the Cooperative Credit Societies Act of 1904. The objective was to provide loans to small farmers through their own local associations on relatively easy terms and free them from the exorbitant rates offered by moneylenders and grain merchants.[4] At the time of independence, the co-operative banks were engaged in financing commercial activities mainly and had neglected the financing of co-operative societies. To further enhance the level of rural credit and to promote the cooperative societies and cooperative movement in the country, the Government established the Federal Bank for Cooperatives (FBC) and Provincial Cooperative Banks (PCBs) in the late 1970s. This was undertaken through an Ordinance in 1976 entitled the "Establishment of Federal Bank for Co-operatives and Regulation of Co-operative Banking Ordinance" was promulgated. The Federal Bank for Cooperatives (FBC) was designed as an apex body to meet the credit needs of cooperative banks and societies. It was designed as a development bank and served as a tool for the State Bank of Pakistan to regulate the Provincial Cooperative Banks. The SBP would lend to the Federal Co-operative Bank at just 0.5 percent. The Federal Bank would keep a percentage-based fee and pass on the subsidized funds to Provincial Co-operative Banks. These would then on-lend to the Co-operative Societies established in the provinces and registered and regulated under the aegis of the Provincial Co-operative Societies Department at a profit (8 percent – 10 percent).

The FBC along with PCBs played a positive role in the development of cooperatives and extension of rural credit in the initial years. However, it could not sustain this effort despite the development of 66,000 primary societies, primarily due to misuse of subsidized funds and incapacity of FBC to effectively monitor and regulate the activities of PCBs and the Societies. The Cooperatives suffered from uneven coverage, with no presence in two thirds of the villages; lack of accountability and professional management; poor portfolio management;

3 Iqbal, Muhammad, Ahmad, Munir and Abbas, Kalbe. The Impact of Institutional Credit on Agricultural Production in Pakistan. The Pakistan Development Review. Pakistan Institute of Development Economics. 2003.

4 Qureshi and Shah. 1992

and weak supervisory capacity of the provincial cooperative departments. Cooperatives met with little success and have been mired in financial misappropriations due to politicization and domination by the rural elite. The Punjab Economic Research Institute (PERI) conducted an evaluation of the Cooperative Credit Programme in Punjab in August 1986. One of its main findings was that only four percent of the cooperative societies were genuine. An estimation of the Subsidy Dependence Index (SDI) which measures the percentage increase in the financial institution's average on-lending interest rate required to fully compensate for the elimination of subsidy, revealed that the Punjab Provincial Bank was heavily subsidy dependent. It would have to increase its on-lending interest rate to 25 percent instead of 14 percent to fully eliminate the subsidy in 1994-95. Provisioning for reserve requirements would have entailed an even higher increase in on lending rates.[5]

In the 1950s two specialized institutions namely the Agricultural Development Finance Corporation and the Agricultural Bank were established in Pakistan. These were merged to form the Agricultural Development Bank of Pakistan (ADBP) in 1961. Historically, ADBP has been used as a subsidy delivery vehicle by successive governments, lending to its clients at below market interest rates. The Bank introduced a village and client centred approach through the expansion of its supervised credit scheme by bringing credit services to the farmers through Mobile Credit Officers (MCOs). To provide access in rural areas, a country wide network of branches and MCOs was developed. ADBP also introduced services for women through female credit officers.[6] There was relaxation in lending conditions which had previously been based on mortgaging land and as a result had excluded tenants, landless and women from accessing most credit lines.

The directed agricultural credit programmes of the Government proved to be subsidy dependent and ineffective in helping to achieve important goals. Instead of building a sustainable financial infrastructure, many of the directed credit programmes undermined the development of a viable financial market. Cheap credit was ineffective in alleviating rural poverty, in stimulating agricultural investments and in spurring agricultural production. Support for these traditional directed agricultural credit efforts began to wane in the 1980sand by the end of the decade most donors and some governments sharply reduced their support for agricultural credit. In part, this decline in support was due to the unsatisfactory performance of these efforts. Critics increasingly argued that relatively few of the credit subsidies were captured by poor people and that subsidized and directed credit had a weak effect on farm production and investment. Serious and chronic loan recovery problems, dependency on outside funding, and overall costs eroded the support for these efforts. Poor performance and the lessening of donor and government support led to the collapse of many public agricultural development banks and rural (government directed) co-operatives in the 1980s.

The Agriculture Development Bank of Pakistan (ADBP) was converted into a public limited company and renamed the Zarai Taraqiati Bank Limited (ZTBL) in 2002. The ZTBL was allowed enhanced paid up capital and a clean balance sheet with a leaner structure. The restructuring included its process, system and product reengineering, with major emphasis being laid on reorientation of existing employees with specific focus on their capacity building, induction of a professional management team. ZTBL restructuring was undertaken

5 Report of the Committee on Rural Finance. SBP. 2002.

6 PCR, Gujranwala Agriculture Development Project, Operations Monitoring & Evaluation Department, ADBP, October 1994

as part of the reform agenda of the ADB-funded Rural Finance Sector Development Programme. At the same time the Government liquidated the Federal Bank for Cooperatives (FBC). The Punjab Provincial Cooperative Bank is now the only scheduled cooperative bank which still has operations on the ground. The other Provincial Cooperative Banks may also be liquidated as they currently exist only on paper. At this time a host of private sector institutions were also established to enhance the accountability and transparency of the private sector institutions.

4. Specialized Microfinance Institutions

Microfinance Institutions (MFIs) are non-bank microfinance providers that specialize in provision of microfinance services. Currently, five MFIs are operating in Pakistan and collectively, they reach 386,000 active borrowers. These organizations are registered with the SECP under the Companies Ordinance 1984 as non-profit associations or under the Societies Registration Act 1860, or as trusts under the Trusts Act 1882, which fall under provincial governments' jurisdiction. Given their non-bank status, they cannot 'intermediate' deposits, although some do 'mobilize' savings from their clients. With the exception of one (SAFWCO), all others originated in Punjab and most of their operations are concentrated in this province. The flagship service of these institutions is microcredit but some basic insurance services (mostly credit-life) are also provided to the credit clients. Group lending remains the dominant lending methodology but some of the MFIs, such as Kashf and Asasah who are diversifying into larger loan sizes, are beginning to deal with individual clients as well. At the end of December 2008, these MFIs had a market share of 27% in terms of active borrowers. Some like Akhuwat as explained earlier have an unusual strategy which is not to charge any interest on the loans but raise funds for operations through philanthropic contributions.

5. Microfinance Banks

Microfinance banks are relatively new players in the microfinance market in Pakistan, but have gained importance relatively quickly. All MFBs are established under the Microfinance Institutions Ordinance 2001 and a reregulated by the State Bank of Pakistan. To date, six MFBs – four national level and two district level (in Karachi district) – are operating in the country and two others; Kashf Micro Finance Bank and NRSP Bank have recently obtained licenses from the SBP. The largest, in terms of market share and geographic network is the Khushhali Bank (KB)[7] and the First Micro-Finance Bank which between them have 90% of the share of active clients of this peer group. Most of the banks are currently using the same group-based lending methodology as non-bank MFIs, except for Tameer MFB, which deals with individual clients and offers larger loans compared to the market average. Although banks can offer their clients services other than credit such as savings, remittance, etc., these products remain under developed, and with the exception of one or two institutions, not a lot of focus is placed on developing deposit or insurance services. The Khushhali Bank which was the first bank to enter the market has had little or no incentive to develop a savings product as it was provided funds by the Asian Development Bank and commercial Banks which were required to buy its shares by the Government of Pakistan. The First Micro Finance Bank Ltd is also diversifying into products and has undertaken some innovative arrangements for extending its outreach in rural areas through partnership with Pakistan Post Office.

7 While this Bank was initially established under s special Ordinance it is now being brought under the purview of the main Microfinance Ordinance 2001

6. Commercial Banks and Commercial Financial Institutions in Micro-Finance

Commercial banks in Pakistan have generally gotten into micro-finance as a result of a stipulation from the government. At one point, banks were directed to provide loans to the agriculture sector and they were given a rebate on the lending they provided. Despite the incentive, very few banks provided the requisite quota. Some banks like the Khyber Bank have established a special micro-finance department inspired more by a social welfare orientation than by a belief that micro finance was a profitable venture. Khyber Banks participation in the microfinance sector was also encouraged by donors such as the Asian Development Bank and the International Fund for Agriculture Development (IFAD) which envisioned that the credit component in their development interventions would be provided by the Bank of Khyber. However, this experience was positive only sporadically when there was committed leadership at the top. At the operational level, the Khyber Bank found that its existing staff and systems were not well suited to conducting micro-finance operations. The First Women's Bank also established a micro-finance lending operation but this lacked outreach and a true understanding and commitment. More recently, the Government has persuaded commercial banks to enter the sector through equity contributions to the Khushhali Bank. However, the Government has now decided to privatize the KB and plans to offer its shares on the market.

Several interactions between the commercial sector and the micro-finance sector in Pakistan have materialized in the past due to MFIs search for funds. This has led them to forge a range of arrangements with commercial banks. Some of them have been fairly standard type of arrangements while others have been more innovative. The restriction on commercial banks in Pakistan not to provide unsecured loans above Rs 5 million has worked as a constraint in forging some of these partnerships. MFI-NGOs which have been able to provide collateral have benefited more from these arrangements. The National Rural Support Programme has pledged its government securities to secure loans from a host of commercial banks such the Habib Bank, Al-Falah Bank, Soneri Bank and First Women's Bank. Kashf and Asasah have been able to secure funds from the Muslim Commercial Bank and others, etc. However, the sector has been less entrepreneurial than in most countries in securing such arrangements.

The mainstream commercial banking sector believes that micro-finance poses excessive risk and there are no added incentives for them to enter a market when existing operations have yielded annual profits of between 60 to 100% in the last few years. However, some banks are exploring other models, such as the service company model, which reduces their direct risk exposure. The commercial sector has been enamoured with consumer lending and feels that a loan product which helps them secure loans against salaries and spread their risk offers a good path for growth. Without access to specific credit technologies for the microfinance sector, the commercial banks have been reluctant to enter the sector. As a result of the current tight liquidity conditions in the inter-bank market and rising yields on government paper and corporate debt, the commercial banks have little incentive to venture into this new area. The financial crisis is likely to further limit commercial appetite for microfinance.

The micro-finance practitioners in Pakistan have a strong view about the direct entry of commercial banks into the micro-finance sector. While micro-finance NGOs feel that commercial banks will be unable to undertake micro-finance due to their very different orientation and it is best that they stay out of the sector. In this context, the government has taken a liberalized approach and rather than pursue the old approach of directed lending for priority sectors it has issued guidelines which list the various options for commercial banks to enter into the micro-finance sector through partnerships with NGOs and through downscaling their products. In view of the current financial crisis the commercial banks entry into the microfinance sector appears somewhat unlikely.

7. Microfinance Initiatives by NGOs

The provision of microfinance services was initiated on a small scale by several NGOs running development programmes when they realized that credit was an essential input for enhancing productivity and incomes. The Aga Khan Rural Support Programme (AKRSP) in the Northern Areas and the Orangi Pilot Programme in urban Karachi were among the first to Initiate a Micro-Finance Programme. When AKRSP first started its operations, loans were not part of its portfolio. At this stage, savings was the only component of the AKRSP model due to its basic premise that social capital, human capital development and capital formation constituted key elements for rural development. Its strategy for capital formation was to insist that its members save during their weekly Village Organization meetings. The savings programme generated considerable interest among both men and women and, in fact, provided the main motivation for the first women's organizations established in the Northern Areas. AKRSP's savings programme provided the first opportunity to small savers to save with the formal sector through its intermediation with the banks. The savings were deposited with commercial banks as the NGO was not allowed to take deposits.

When AKRSP first initiated its operations, it had not systematically planned a credit programme for its clients. AKRSP entered the credit market when it realized that its clients needed loans for investment purposes and that the loans available from the formal sector could not be easily tapped due to cumbersome disbursement procedures and high transactions costs. AKRSP's credit chronology illustrates its dynamic nature and the inexperience of its financial managers. AKRSP has experimented with many types of different loan products since its inception in 1982. In designing its loan products, AKRSP appears to have struggled with balancing several different motivations such as social cohesion, access to inexpensive source of funds for its clients, investment in village development and sustainability. AKRSP experimented with short and long-term loan products and individual and group loans as well as developing a village banking model. In later years, AKRSP developed a package of Village Banking which allowed the VOs and WOs to assume much of the responsibility for micro-level banking operations and laid the cornerstone for the financial autonomy which the VOs and WOs later wrested for themselves and initiated a programme of internal lending under which the members on- lent their members money from their own savings on terms and conditions determined by them. Finally, AKRSP separated microfinance from its operations and transferred all its resources and staff to the First Microfinance Bank and completely divested itself of microfinance operations. However, some of its stronger VOs and WOs continue the village banking operations on their own even today.

The Orangi Pilot Programme which had used the improvement of sanitation in one of the urban slums in Karachi initiated a credit programme when it realized a critical need for financial services. However, OPP did not have a model either and under the guidance of Dr Akhtar Hameed Khan experimented with several different approaches. These programmes continued to grow gradually and spawn other rural development initiatives across the country such as the National Rural Support Programme in Islamabad, the Punjab Rural Support Programme in Lahore and the Sarhad Rural Support programme in Peshawar. These were all patterned on the line of AKRSP. These programmes were not designed to run as sustainable programmes and were managed by Social Organizers with no experience of managing such programmes. In fact, in the early years there was no estimation of how much it cost to actually deliver these credit services and the interest rates were fixed on an ad hoc basis to reflect what the programme managers felt the poor could afford to pay.[8]

In the early 1990s most NGOs were running their micro-finance programmes from outright donor grants. The sector was not at a stage where it was considering loans to finance its programmes. There was little consideration given to the source of funds that would fuel future growth. None of the NGOs, apart from the Sarhad Rural Support Corporation (now SRSP) which had been given a loan from Khyber Bank as part of a donor project, was reporting any financial cost on borrowings because they did not incur any cost on this account. The year 1996 is viewed as a turning point in the history of the microfinance sector in Pakistan.18 This was the year that Kashf Foundation was initiated as the first specialized microfinance organization in the country with a grant from Grameen Foundation, AKRSP realized the need to separate its microfinance operations and created a separate unit to track financial performance, and the National Rural Support Programme initiated its Urban Poverty Alleviation Programme (UPAP) in Rawalpindi to help develop a pilot programme on a sustainable pattern. Some of the NGOs decided to collaborate and form an association of microfinance providers in Pakistan in 1998, called the Microfinance Group-Pakistan, which later evolved into a formal organization in 2001 in the form of the Pakistan Microfinance Network (PMN). The establishment of PMN spurred a focus on transparency, performance reporting, capacity building and tracking progress in the microfinance sector.

At the government level, concerted efforts for the promotion of the sector began in the year 2000 when an apex funding body, the Pakistan Poverty Alleviation Fund (PPAF) was established for poverty alleviation. As an apex organization, the role of PPAF is to act as a wholesaler and intermediary of funds, while its Partner Organizations (POs) perform the actual retailing function of loaning funds and implementation of projects on the ground. PPAF provides its partner NGOs three types of facilities which consist of (i) extending lines of credit for expansion of poverty targeted micro credit programmes (ii) grants for Community Physical Infrastructure (CPI) schemes and social sector services on a cost sharing basis and (iii) grants to strengthen the human and institutional capacity of POs.

The establishment of PPAF and its financing of NGOs provided a real impetus to the growth of the sector. In the last eight years from 2000 to 2008, PPAF has established itself as one of the main players in the development sector in Pakistan. From the initiation of its activities in 2000 to the end of December 2007, PPAF had disbursed a cumulative total of US$ 457 million to 71 Partner Organizations. On a cumulative basis it has disbursed US$ 348 million for credit, US$ 75 million for community infrastructure schemes and US$ 34 million for capacity building. It has developed itself as a professional and highly credible apex institution with a strong and efficient corporate culture. It is today one of the largest social funds in the world. While its Partner Organizations may hold a wide range of views regarding PPAF, they all agree that it has been the main catalyst which has led to the exponential growth in the microfinance sector, enabled a more integrated approach to rural development and allowed a long-term perspective to social mobilization and community empowerment. They also agree that it has transformed them from charity driven organizations dependent upon donor financing to organizations with a clear business plan for becoming sustainable development

8 Haq, Aban. Ed. Edited by Minerva John. Microfinance Industry Assessment: A Report on Pakistan. Pakistan Microfinance Network. September 2008

partners.

There was little conception of working towards sustainability in the micro-finance operations when PPAF first started its operations. For many years the main providers in the sector were micro-finance NGOs which started micro-finance as one of their many activities. They initiated micro-finance more as a tool for social mobilization than as a sustainable financial product. Some of the leading organizations had not properly separated out their micro-finance operations from their other operations and assigned notional costs to their micro-finance operations. The Pakistan Poverty Alleviation Fund (PPAF) was the first organization which was able to change the expectation that NGOs could only operate with grants. Prior to PPAF, none of the NGOs had ever taken loans to finance their operations. PPAF thus brought about a significant shift in the institutional mindset of these organizations. This change entailed a complete transformation in organizational culture, appraisal criteria, staffing pattern, financial management and monitoring and evaluation criteria.

The leading microfinance practitioners are all beginning to transform their microfinance programmes in Pakistan. They have all either already separated their microfinance programmes from other services or are in the process of doing so. PPAF now requires its Partner Organizations to prepare separate audited accounts for their microfinance operations.[9]

In 2000 the government under a separate ordinance and with financial assistance from the Asian Development Bank established the Khushhali Bank for providing microfinance to un-served and underserved areas of the country. In 2001 the State Bank of Pakistan formulated the Microfinance Institutions Ordinance 2001 which opened the way for the private sector to establish microfinance banks with much lower levels of reserve requirements and equity financing. This heralded the beginning of the ‘commercial’ era for microfinance when microfinance was not viewed as just a ‘social’ service but rather a sustainable financial enterprise as well. To date, eight MFBs have been established in Pakistan (NRSP and Kashf have recently been provided microfinance banking licenses). The sector consists of a diverse range of players today. It includes development NGOs, specialized MFI, Microfinance Banks, development finance banks with microfinance operations, commercial banks also attempting to develop a range of products, post office branches with some linkages with the microfinance sector, insurance companies and private sector leasing firms with products especially designed for the microfinance sector.

8. Rural Support Programmes and Broad-Based Development NGOs

Rural Support Programmes originated in Pakistan during the 1980s when the first RSP - the AKRSP – was established in the Northern Areas of Pakistan. In subsequent years, the RSP model based on community organization and mobilization was replicated across the country. There are currently over 10 RSPs operating across Pakistan. The Rural Support Programmes and broad-based development NGOs provide microfinance services as well as grants for community level infrastructure projects, education and health services at the village level. While some of the rural support programmes have received initial endowments from the Government such as the National Rural Support Programme, the Punjab Rural Support Programme and the Sindh Rural Support Programme and are therefore known as Government-sponsored Non-Governmental Organizations (GoNGOs) most others have received no support from the Government but rely almost exclusively on donor support such

9 Haq, Aban. Ed. Edited by Minerva John. Microfinance Industry Assessment: A Report on Pakistan. Pakistan Microfinance Network. September 2008.

as the Sarhad Rural Support Programme, the Baluchistan Rural Support Programme and the Thardeep Rural Development Programme. A few other organizations are also included in this category such as the Development Action for Mobilization and Emancipation (DAMEN), Sungi Development Foundation and Centre for Women Cooperative Development (CWCD). International NGOs have also entered the sector, with Bangladesh Rural Advancement Committee (BRAC) beginning operations in 2007 and ASA expected to start its operations soon in Pakistan. Table 7 below provides some basic details about some of the leading RSPs and other NGOs.

With respect to microfinance, the RSPS and broad-based NGOs are the largest peer group, accounting for 39 percent of active borrowers at the end of December 2008. However, this large share can mostly be attributed to the National Rural Support Programme (NRSP), which accounts for 80 percent of this peer group's outreach. Again, due to their multidimensional nature, the microfinance services offered by most RSPs are limited to one or two basic credit products. RSPs also mobilize savings from their members but since they are not allowed to take deposits these are deposited in commercial banks in the name of the community organizations. There is a wide variation in these organizations in terms of their financial management and sustainability. While two of these organizations are operationally self-sufficient, the others subsidize their microfinance operations from grants received through donor support or income earned from other development activities. The Punjab Rural Support programme and the Sarhad Rural Support programme have had particular problems with their microfinance programmes. As a result, PRSP has considerably slowed down its activities in the sector while SRSP and the Baluchistan Rural Support programme have conducted a complete review of their earlier programmes and have initiated new programmes with a clear assessment of costs and sustainability.

9. Other Financial Service Providers

The first foray into microfinance by a regulated financial institution was made by a leasing company – Network Leasing Corporation Limited (NLCL), established in 1995, specifically for providing micro leasing services to small businesses throughout Pakistan. The latest annual report of NLCL shows credit lines from Deutsche Bank Microfinance Fund, Swiss Agency for Development and Cooperation (SDC), and Pakistan Poverty Alleviation Fund (PPAF). This company is now facing serious problems due to internal fraud and poor management systems. ORIX Leasing Pakistan (OLP) is a leading financial service company with an array of products. Established in 1986, OLP is a listed Pakistani leasing company sponsored by ORIX Corporation Japan – an integrated financial service company with over $50 billion assets spread over 23 countries. It has also been providing services to the micro-finance sector through arrangements with ASASAH and other intermediary MFIs.

Although not considered mainstream institutions, some public sector organizations also provide financial services to the public. Amongst these are the National Savings Organization (NSO) and Pakistan Post Savings Bank (PPSB). The NSO acts as an agent for the Ministry of Finance (MoF) and mobilizes savings through various types of deposits and savings instruments. Its products are available through its own network of 368 centres, as well as in post offices and branches of commercial banks across the country. Some of the products offered by the organization are of interest to small depositors, as the minimum deposit is now low (Rs. 100 for a savings account, Rs. 500 for some savings certificates and the special savings account). Prize Bonds sold by the NSO also come in small denominations and are relatively popular with the urban poor. Besides its core function of handling mail, Pakistan

Post performs various agency functions for the government, including providing deposit services to the general public through half of the 13,000 PPSB branches. According to estimates, the PPSB holds deposits worth Rs. 56.6 billion in approximately 3.8 million accounts, of which an estimated 70 percent are below Rs. 10,000. In October 2007, Pakistan Post entered into a public-private partnership with FMFB which will allow FMFB to use 4000 of the Post's sub offices for expanding its own microfinance operations.

10. Support Organizations

The Pakistan Microfinance Network (PMN) has provided critical support to the sector in terms of establishing industry standards, transparency, performance indicators, capacity building, research and advocacy for policy support. It is the only national level network for microfinance practitioners in the country. It emerged after the first Microcredit Summit held in 1997 as an informal effort by some practitioners, and was formally registered with the SECP as a non-profit company in 2001. Its membership currently includes 20 organizations from the various MFI peer groups who collectively account for over 95 percent of the sector. The network's vision and mission revolve around expanding access of formal financial services and supporting retail institutions in achieving this objective. Its efforts towards promoting transparency and creating an enabling environment for microfinance in Pakistan have been widely recognized. A few provincial level networks are also operating in the country but except for the Sindh Microfinance Network that was established through the efforts of the local NGOs, others have failed to move forward. Microfinance banks are also members of the Pakistan Bankers' Association (PBA), which was established in 1953 to coordinate the efforts of the banking industry in Pakistan.

The JCR-VIS Credit Rating Company is one of the two local institutions providing ratings for financial institutions in Pakistan. It is also the only company that provides ratings for MFBs and MFIs. MFBs are required to be rated annually as per SBP's requirements, but some MFIs have also had themselves rated in order to ascertain 'where they stand,' or as part of their strategies to access commercial funding in the future.

Currently, there is no credit bureau in Pakistan that covers the entire microfinance sector. The largest credit bureau is the CIB, housed in and run by the central bank, and all banks are required to submit information on all outstanding loans to the CIB. Microfinance banks are also required to report to the CIB. In addition to SBP's CIB, a few private sector credit bureaus also exist but they mainly serve the banking sector. However, efforts are underway to establish a credit bureau for the microfinance sector. Due to the strong interest of its members, PMN has begun working on setting up a pilot credit bureau in Lahore, covering all MFIs working in the district. Initially, this will house negative information only and is mostly intended to be a test run for a full-fledged, country-wide CIB for the sector. In addition to the PMN, the ADB has also undertaken a feasibility study for the establishment of a CIB for the sector and their report is expected soon.

11. Key Principles of Microfinance

The following principles of microfinance can be defined as follow:

1. Deprived segment of the society needs a diversity of financial services, not only loans
2. It is powerful instrument to fight against the poverty

3. It is a source to build financial systems may be useful to serve poor.
4. It must pay for itself to accomplish large numbers of poor people.
5. It is about building perpetual domestic financial institutions.
6. Micro credit is not the suitable instrument for everyone or in every situation.
7. Mark up ceilings making it difficult for poor people to get credit.
8. The task of government is to enable financial services, not to provide them.
9. The funds of the donor should be supported to private capital not to compete with private capital.
10. The shortage of organized institutions and managers are the main obstacles are microfinance.
11. It is performed well while it is measured and opened

The common mistakes or misconception are found among the people is that the microfinance is the modern shape of charity. But there is an apparent difference between microfinance and charity. Normally charity is given for fulfilment of needs while microfinance facilities is given to the poor to start business and generate own source of income and became economically independent Microfinance and micro credit is firstly used in 1970 and it is an innovation in the field of finance. According to Robinson (2001)

"*Prior to then, from the 1950s through to the 1970s, the provision of financial services by donors or governments was mainly in the form of subsidized rural credit programmes"*.[10]

"These often resulted in high loan defaults, high loses and an inability to reach poor rural households The difference between microcredit and the subsidized rural credit programmes of the 1950s and 1960s was that microcredit insisted on repayment, on charging interest rates that covered the cost of credit delivery and by focusing on clients who were dependent on the informal sector for credit"[11]

According to Robinson 1980 was the important year in the history of microfinance service because in that year most of MFI (microfinance institute) and Grameen Bank came into existence and started their work in the field of microfinance and issuing small loans and savings services at the large scale. 1990 was also very important year for microfinance in this year a good number of microfinance institute came into existence. 1990's is the microfinance decade in this decade microfinance converted or turned into industry. Ditcher (1999), "The development in micro credit institution, attention changed from, just the provision of credit to the poor (micro credit) to the provision of other financial services such as savings and pensions".

Conclusion

10 Journal of International Development. Special Issue. 1996. Vol. 8, No. 2. p. 154.
11 Journal of International Development. Special Issue. 1996. Vol. 8, No. 2. p. 154

The historical development of microfinance in Pakistan reflects a transformative journey from informal, community-based systems to a structured sector. The establishment of dedicated institutions has significantly broadened access to financial services among low-income and marginalized communities. This evolution highlights the effectiveness of models such as group lending and hybrid approaches, which integrate traditional practices with modern financial mechanisms, in addressing diverse financial needs.The variety of financial instruments, including micro-loans, savings accounts, and micro-insurance, has empowered individuals to manage risks, invest in entrepreneurship, and build more resilient livelihoods. However, the study also acknowledges ongoing challenges, such as regulatory limitations, political instability, and cultural factors that impede the sector's growth. Additionally, the potential of digital finance and fintech to enhance outreach and streamline operations presents new opportunities for microfinance in Pakistan. Overall, the findings emphasize the need for sustained innovation, supportive regulatory frameworks, and targeted policies to ensure that microfinance remains a viable and impactful tool for economic empowerment and poverty reduction in Pakistan. Continued advancements in this sector are crucial for creating lasting socioeconomic progress, fostering resilience, and promoting financial independence among underserved populations across the country.