

INTERNATIONAL THE NEWS

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Empowering the un-banked

More than three billion people in the world seek access to basic financial services essential to managing their lives. Micro-finance is not the only tool in the reduction of poverty. In many countries, like Bangladesh, Indonesia and Bolivia, access to basic financial services, low-cost housing, savings and micro-insurance has empowered millions of people to work their way out of poverty.

The Consultative Group to Assist the Poor (CGAP) has developed 11 principles to assist governments and practitioners to establish frameworks. Let us examine some of these principles, determine how Pakistan is performing against these principles, and then look at the use of micro-finance as a powerful poverty reducing tool.

- Micro-finance, the building financial systems serving the poor, will reach its full potential only if it is integrated into the country's financial system
- Micro-finance can pay for itself, and must do so if it is to reach a large number of poor people. Unless micro-finance providers cover their costs, they will be limited by a scarce and uncertain supply of subsidies from governments and donors
- Poor people need a variety of financial services, not just loans. In addition to credit, they want saving, insurance and money
- The government's job is to enable financial services, not provide them directly. Governments can almost never do a good job if they can set up a supporting policy environment

Pakistan has a population of about 160 million. However, the country's commercial banking system comprising 34 commercial and Islamic banks lend to only 3.2 million people. This situation is made more acute by the fact that the bulk of the existing customer base is concentrated in five major cities and that we do not have any cooperative banks, credit unions, rural banks or postal banks. Institutions that specifically cater to micro-finance include specialised micro-finance banks, NGOs and national and rural programmes. The number of such institutions is around 800,000. If we assume that one-third of our population lives below the poverty line and if we include those below the poverty line whom the commercial banks do not cater for, we have a minimum un-banked population of 50 million.

If we wish to use micro-finance as one of the tools to reduce poverty, we must aim to have at least 10 million active micro-finance clients in the next ten years. This is not an easy undertaking if we bear in mind that Bangladesh, the pioneer of micro-finance, took over a decade to reach its outreach level of 24.6 million. In order to achieve the target, micro-finance needs to become a mainstream activity and all — i.e., commercial banks, specialised micro-finance banks and NGOs — need to be supported and a more enabling environment created. In the commercial banks we find that not a single one has any meaningful micro-finance activity. Given that the commercial banks made an after-tax profit of \$1.5 billion in 2006, the rationale for not participating starts to become clearer. With this industry's high profits, there is no motivation for it to move out of its established target market.

It is unlikely that Pakistani commercial banks will enter the micro-finance field on a voluntary basis. Despite the State Bank's best efforts, there is no solution other than a directed credit requirement by it to induce this sector to enter this market and accept responsibility, albeit on a commercial basis. The central bank in Lebanon has mandated that the commercial banks invest 5% of their reserves in micro-finance. If they do not meet this requirement then, they do not earn interest on 5% of their reserves. As a result, commercial banks have started lending to creditworthy NGOs in dire needs of commercial funding to expand their portfolio, while looking at establishing their own operations.

The CGAP's second principle states that in order to be sustainable micro-finance must achieve scale and cover operational and financial costs. Five specialised micro-finance banks are privately owned while one is a public/private entity. Of these, three are national while two are district-based. It is unlikely that with their small capital base the district-based micro-finance banks will make a major impact on the targeted outreach number. The three remaining private banks with the national presence could not have an impact if the enabling environment is further strengthened.

There are three principal needs. Firstly, the State Bank or the government should provide avenues for raising funds on a commercial basis. The largest constraint for fast growing banks is always funding as their deposit base usually lags their loan growth. Secondly, like all other banks that the government wishes to support, it should provide a five-year tax holiday, so that more investors are attracted to the new micro-finance banks. Thirdly, the State Bank needs to take another look at its capitalisation requirements. A 15% capital requirement, in the absence of the ability to raise tier two capital will clearly hamper the banks' achieving scale. Lastly, while all the private banks are allowed to charge a commercial rate that covers their costs, the partially owned government micro-bank is not allowed to charge a commercial rate. If it contributes towards the target it must be allowed to charge a commercial rate.

The CGAP's third principal states that the low income group's needs are not limited to credit. Research indicates that small-value is the second biggest need after working capital requirements. Unfortunately, the outreach in this segment is even smaller than with commercial banks only targeting the higher end customers. The State Bank needs to make a special arrangement for the allow them to lend up to Rs1 million for housing construction and home improvement purposes, as opposed to their current limit. Like commercial banks, life insurance companies need to take another look at this market. Other than credit life which they already must develop term life and livestock insurance. Existing micro-banks and NGOs can be a useful distribution channel. Lastly, the pension programme should be approved by the SECP so that appropriate products may be developed for this market

The last principal states that the government should provide an enabling environment as opposed to be in the business itself. a great job in establishing the first public/private micro-bank. However, since it does not have a commercial view, the bank has sustainability because its operations are not managed on a commercial basis. Given the government's successful track record in the sector banks, it is time that Khushhali Bank was privatised as well so that it can leverage its network.

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