

'Service delivery costs will go down as loans portfolios in microfinance sector expand,' President, Khushhali Bank

Khushhali Bank Limited was founded in the year 2000 by the Government of Pakistan. A retailer of microfinance services, the bank operates under the supervision of the State Bank of Pakistan.

Sitting in the corporate office in Islamabad, the President of Khushhali Bank, Ghalib Nishtar, started off with a brief overview of the bank's activities. "Khushhali Bank has sufficient experience of about 13 years in the microfinance sector. We have scale with 700,000 clients; about 18 percent of the market which makes us the market leader. We have the largest and most diverse network across provinces and AJK, which has given us a lot of insight about the market. We operate like any other bank does, but for a different segment of the market. Our main focus is on micro loans, but we also target savings. We also provide money transfer and remittance services, and we have an inbound remittance arrangement with the Western Union".

Access to financial services is a major requirement for the improvement of livelihoods in Pakistan, stated Nishtar. He explicated: "The requirement for microfinance is there at every household and micro-enterprise. That demand has traditionally been served by the informal sector, through money lenders and aarhtis, whose terms of business have generally been unfair. So, there was a tremendous need for the state to move into the sector, which was precisely the premise based on which Khushhali bank was formed back in 2000." The microfinance veteran asserted that the bank provides a better business proposition for borrowers who can get away from aarhtis by gaining access to financial services from specialised microfinance institutions that are regulated by SBP.

Addressable market The potential market for microfinance clients is in the range of 25 to 30 million, he informed. He added: "The current market participants are catering to only 10 percent of the sector's potential. It's a huge market and commercial proposition exists for the private sector to participate in the sector, which has happened over the last decade. For instance, Khushhali Bank was the first microfinance bank (MFB)-now, there are ten specialized MFBs, all in the private sector."

So, how to reach out to the 90 percent addressable, but un-served potential microfinance clients? Ghalib Nishtar feels that Pakistan has sufficient number of players in the market now, who need to extend their collective footprint: "In Bangladesh, where a different model is operative compared to Pakistan, three to four microfinance NGOs are adequately covering the market. The market coverage in Cambodia is dominated by just one institution, more than the number of MFIs on the ground. Pakistan needs strong and well-capitalised microfinance institutions."

He explained that Pakistan adopted a very structured path towards developing microfinance, and SBP has a strategic plan for the sector to ensure that it will continue to grow steadily just as it has over the past decade. "Understanding the market required time and moving on, product development and efficiency gains will also require time to come through", he said, while also noting that the financial access channels have to be responsive to the micro clients' needs, in order to wean them away from aarhtis.

To break the hold of the middleman, Nishtar feels that establishment of small local markets in agricultural belts can help. "Such markets have to be linked with regional and national markets, which in turn are linked to the international markets. MFIs can help develop markets, and commercial banks can cater to those markets whose funding needs are higher. Unfortunately, the co-operative model hasn't really taken off in Pakistan due to excessive government intervention in the past. But, growers in the agriculture sector need support in terms of financial services, need storage silos, advisory services, etc, and the most challenging is the predicament of subsistence farmers," he elucidated.

Nishtar foresees three things happening in the sector in next five years: Business growth, innovation in

products and improvement in service-delivery. Highlighting the progress made in the previous decade he said: "The last ten years saw investments in environment and institutional development. Today Pakistan is ranked number one in the world in terms of regulatory framework for microfinance by the EIU. Pakistan is also amongst the top three countries in the world in terms of conducive business environment for the microfinance sector."

Nishtar stated that big regional players are now moving their investments to Pakistan while telecom companies too have either acquired MFB licenses or started green field institutions. Khushhali Bank is also a case in point. "We went into the international market last year, and various prominent investors and institutions have invested in the bank. Today, a large part of the investment in the bank is from international sources, from investors belonging to the US and Europe," informed Nishtar.

CHALLENGES FACING THE SECTOR "From the policy perspective, SBP's strategic document highlights a number of challenges to the sector, among which is funding. Given the potential size of the market, it requires huge amount of funding from different sources," he highlighted. Nishtar informed that back in 2000 the bank's senior management realized that donors alone can't arrange that much funding, while the government too cannot commit resources for this sector in a sustained manner. "That is why, for Pakistan, a sustainable business model was followed, which relied on raising deposits from savers," he said, explaining the rationale behind allowing MFBs to take deposits from clients.

He added that borrowing from commercial banks is another viable avenue for raising funding for the sector adding that for this to be possible and sustainable "both institutional governance and balance sheet have to be strong. We have no funding issues following this approach, as we can tap into domestic as well as international commercial markets".

Another challenge has been the high operating costs, which increased over the years due to heavy initial investment on infrastructure and market development activities. "But as institutions mature and as their loan portfolios increase, these costs are eventually rationalised. Our loans portfolios remained conservative for many years, but lately it has started to grow, and this growth will multiply in the future. Service-delivery costs will go down as loans portfolios in microfinance sector expand, but the delivery mechanisms need to be more efficient," stated the bank president.

On delivery channels, Nishtar said branchless banking is a welcome channel for the sector as it enables the mobilisation of convenient and low-cost small savings. "We are looking to develop savings products on this channel with our strategic investor, UBL (OMNI) and our systems are being integrated: he informed, adding that "for sustainable growth, the economy needs domestic savings and investments, our view on BB channel is different from that of the telcos".

To mitigate the credit default risk, Nishtar referred to the sector stakeholders who have set up the Credit Information Bureau (CIB) that is exclusive to microfinance clients. "With improvement in the management and human resource quality, the credit assessment and the risk underwriting will improve. Moreover, using new lending methodologies for individuals and community-based lending as well as micro enterprise lending, will also improve credit uptake appetite," he highlighted.

"We can't really control external factors, such as earthquakes and floods that have hit our portfolio consecutively for the past three years. But the sector is looking to set up through SBP assistance a risk mitigation mechanism that can help during the calamities," he informed. Nishtar stated that 70 percent of the bank's portfolio is rural-based, which explains the hit it took due to the 2010 deluge. "But, we rescheduled our clients' loans, and the majority of them paid back. We did the handholding and didn't write off those loans," he explained how the bank and its clients made it through that rough patch together.

DIRECTED CREDIT POLICY FOR MICROFINANCE "Directed lending is a thing from the past, and going forward, it has to be market mechanisms that should guide the sector," Nishtar strongly argued. "There is a

baggage associated with directed credit; there are targets, on a quarterly basis, which results in imprudent lending to avoid penalties," he contended. The bank president reiterated that commercial interests and demand from the market should drive lending.

In conclusion, Ghalib Nishtar stressed that the strong regulatory framework has provided a head start and impetus for strong growth of the microfinance industry. He expressed confidence that the coming decade will see microfinance grow at a much stronger pace as compared to the preceding decade during which the roots of the sector spread and went deep.

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