Pakistan Microfinance Network

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MicroNOTE

SPOTLIGHT ON MICROFINANCE

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INTRODUCTION

The last three years (2005-08) have seen significant developments in the microfinance industry in Pakistan. In addition to achieving rapid growth in terms of outreach and gross loan portfolio, industry players have significantly enhanced their geographic footprint, made noticeable headway in improving operations, introduced a larger selection of better-designed financial products, and successfully engaged with some of the largest and best known commercial financial players in the national as well as international arena.

Although the number of microfinance players (MFPs) in the country remained comparatively steady during this time, with only a few new entrants[1], there was a resolute shift in industry practice towards specialized programs. A number of multi-dimensional organizations opted to separate out their credit programs operationally and financially. As a result, the total number of specialized players (microfinance institutions and microfinance banks) increased from five to 13 with two others on their way, NRSP is setting up a MFB and SRSP is carrying out a separate audit for its mf operations.

An immediate result of this specialization has been marginal improvements in a number of industry-wide performance metrics (mainly outreach and operational efficiency), and an increase in the variety of financial products offered by industry players (credit and otherwise). Analysis of the data shows that in terms of outreach and efficiency key drivers for the sector continue to be the organizations with the largest client and asset base. The increased variety of financial products however, is not similarly correlated with organizational size and years of existence. Specialization serves as the legitimate explanation not only for the increasing number of financial products being developed but also the reduced time-to-market being exhibited by players in introducing new products.

A widely noticed phenomenon during the ensuing period has been the rapid growth in microcredit outreach that has been achieved by existing players (240% cumulative growth rate). This growth has been achieved using a two-pronged strategy focused on entering new territories with existing products, and improving penetration in existing areas of operation with new credit as well as non-credit products. The preferred strategy however, has been one of accessing new geographies with existing products. Large as well as small players were seen to adopt this strategy.

PMN thanks its members for contributing to this study. Our gratitude also extends to our donors for their continued support.

[1] New entrants since 2005: Tameer Microfinance Bank Ltd. (2005), Pak-Oman Microfinance Bank Ltd. (2006), and BRAC (2008).

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Rapid growth by the sector has resulted in a number of MFPs facing human and financial resource constraints. In an attempt to overcome the former, a number of MFPs raised compensation levels (primarily for middle and senior managers) and increased training budgets. To overcome the latter, some MFPs rationalized their price structures, while the larger players have begun to engage with commercial banks. In 2007 the sector received approximately 11 percent of its total capital requirements from commercial sources.[2]

During this time the industry also garnered more public sector attention: the State Bank of Pakistan (SBP) along with the Pakistan Microfinance Network (PMN) representing key MFPs developed a 5-year growth strategy for the industry. The growth plan set a target outreach of 3 million active borrowers by 2010 and 10 million by 2015. Approval for the strategy was acquired at the highest level within the Government of Pakistan (GoP): the Prime Minister, in the presence of the Ministry of Finance (MoF) as well as the national apex, the Pakistan Poverty Alleviation Fund (PPAF), approved the strategy document in February 2007.

Based on the performance of the last three years and the outreach target set for the industry, growth rates achieved during 2005-08 are likely to continue into the next few years, provided funding is made available through the commercial sector. Given the current macro economic situation and the global financial credit crunch, support from the SBP will be required to achieve this.

Given that a number of MFPs have demonstrated a tendency to overlap services in terms of products as well as geographical presence, the prospect of rapid growth has raised some concerns among industry players and sector analysts. Although industry players do not currently cite competitive pressure as a major challenge given that over 90 percent of the estimated market remains untapped, the presence of multiple credit providers within geographic pockets does have the potential to place additional pressure on organizations that are already coping with the demands of institutional change and rapid growth.

This issue of the Microfinance SPOTLIGHT attempts to capture the developments of the last three years.[3] The findings reported focus primarily on the progress achieved by industry players and the challenges identified to the further expansion of microfinance services. The findings have been organized into three sections: Industry Performance and Trends; Financial Products; and Industry Analysis. The first section looks at performance by peer group and identifies current trends. The second section focuses on changes in the product landscape, detailing current practices as well as potential areas for growth. The last section presents an assessment of the overall competitive landscape of the industry.

The findings presented here have emerged from the responses of 22 MFPs to a survey conducted by the PMN between August – October 2008. To maintain consistency with PMN publications, the respondents to the survey have been grouped into four peer groups (see Box 1).

BOX 1 : Industry Peer Group
MFB – microfinance bank
MFI – microfinance institution (specialized NGO)
NGO – non-government organization (multi-dimensional NGO)
RSP – rural support program

NOTE: Numbers for 2005 may not match those in the Microfinance SPOTLIGHT published in 2005 due to reclassification of organizations within peer groups. See list of participating organizations and peer group classification on back cover.

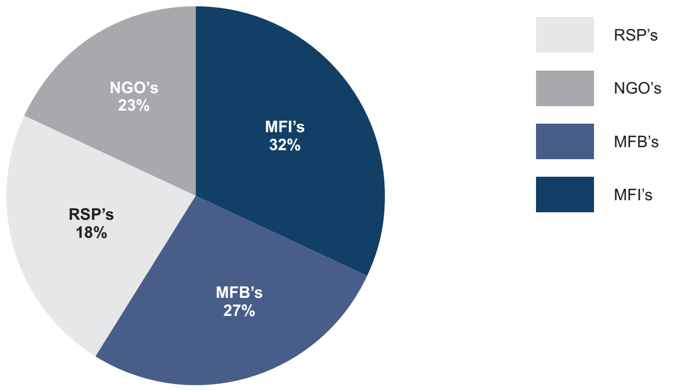
[2] PMN, 2008. Pakistan Microfinance Review (2007).

[3] This issue of The Microfinance SPOTLIGHT has been altered significantly from the first in order to minimize overlap with other PMN publications.

SECTION I: INDUSTRY PERFORMANCE AND TRENDS

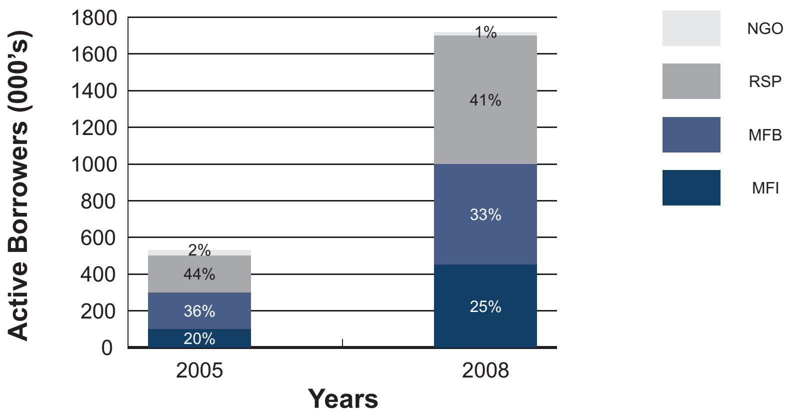
As stated above, 22 MFPs participated in the survey. Microfinance institutions (MFIs) constituted 32 percent of the total sample, microfinance banks (MFBs) 27 percent, non-government organizations (NGOs) 23 percent, and rural support programmes (RSPs) 18 percent.

Exhibit 1: Survey Sample (2008)



During 2005-08 the microfinance industry in Pakistan grew from 0.5 million active borrowers to 1.7 million, demonstrating a cumulative growth rate of approximately 240 percent. Despite constituting only 18 percent of the survey sample, the RSP peer group currently accounts for the largest proportion (41%) in outreach; followed by the MFB peer group (33%). MFIs account for 25 percent; NGOs for 1 percent.

Exhibit 2: Microcredit Outreach by Peer Group

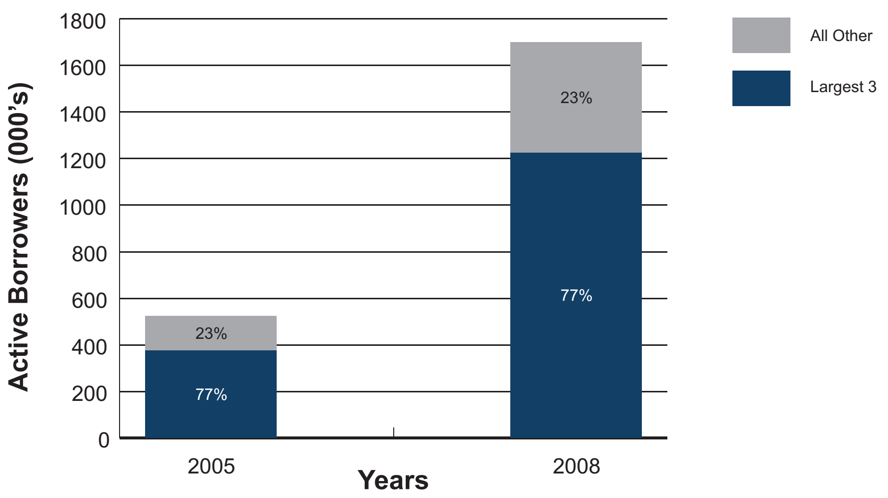


1

Compared to 2005, the RSPs and the MFIs increased their share of total outreach by approximately 5 percentage points each. The MFBs as a group slid approximately 11 percentage points. The primary reason for this was the slowdown in growth by Khushhali Bank Ltd. (KBL) and Tameer Microfinance Bank Ltd. (TMFB). Among the RSP and MFI peer groups, the bulk of the growth in outreach can be attributed to the National Rural Support Programme (NRSP) and Kashf Foundation (KF), respectively.

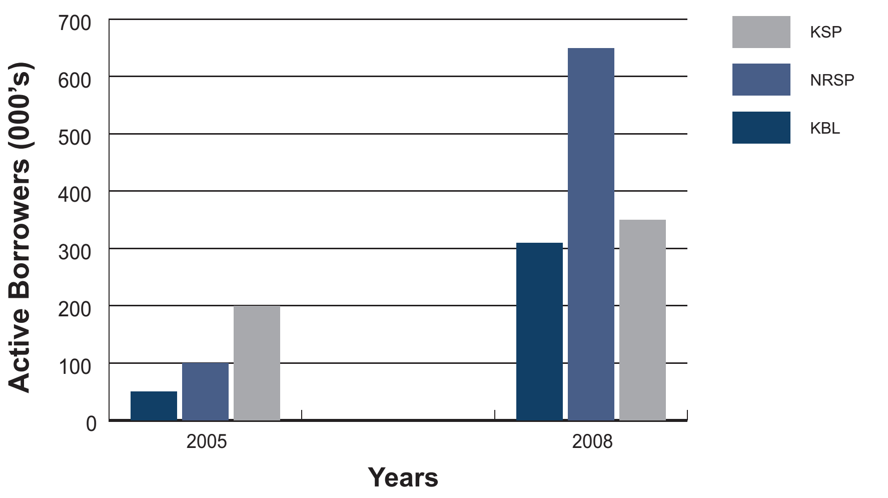
As was the case in 2005, KBL, KF and NRSP continue to be the three players with the largest number of borrowers. Together these three players account for 73 percent of the total microcredit outreach, compared to 74 percent in 2005, indicating a marginal dilution of market share. It is worth noting that the three largest players in the industry do not belong to any one institutional category—NRSP is an RSP, KBL is a MFB, and KF is classified as a MFI.

Exhibit 3: Industry Concentration (Largest Three v. All Others)



Since 2005 NRSP and KBL have traded positions with NRSP (33%) now being the largest player in terms of outreach, followed by KBL (21%). At 18 percent, KF has maintained its position in third place.

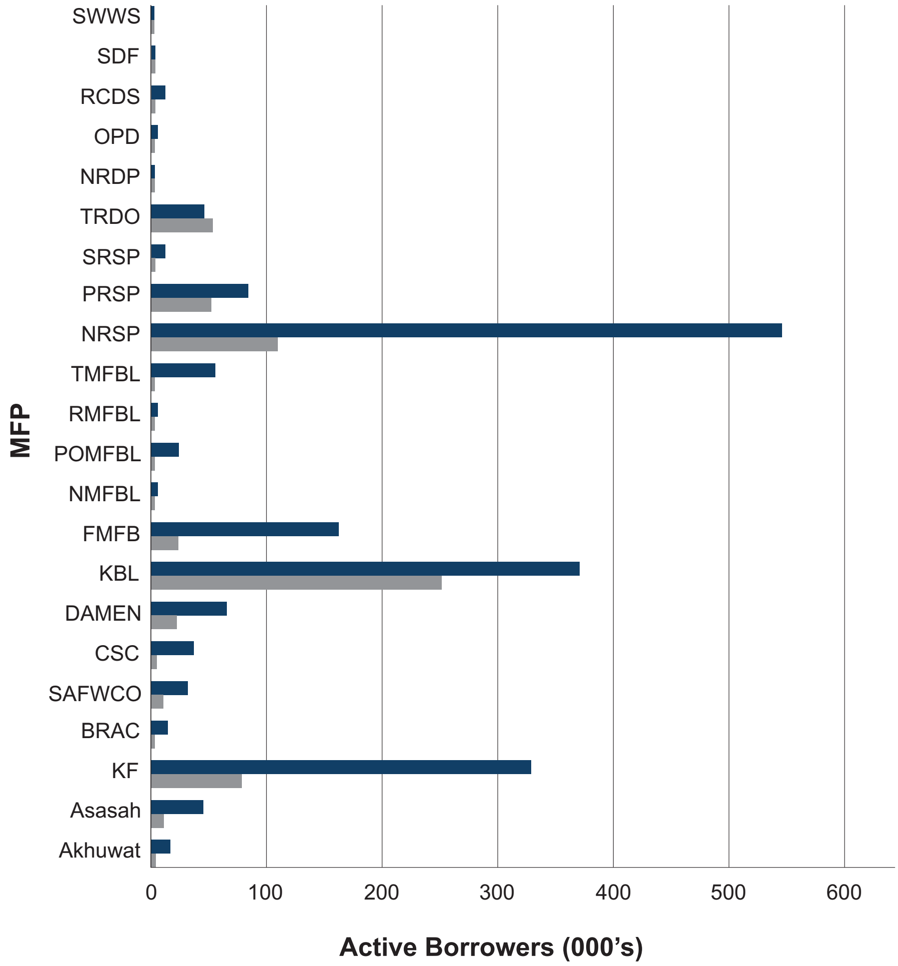
Exhibit 4: Outreach of Three Largest Microcredit Providers



In addition to the industry leaders, the First MicroFinanceBank Ltd. (FMFBL) also achieved substantial growth, increasing its share of total outreach from approximately 3 percent in 2005 to 9 percent in 2008.

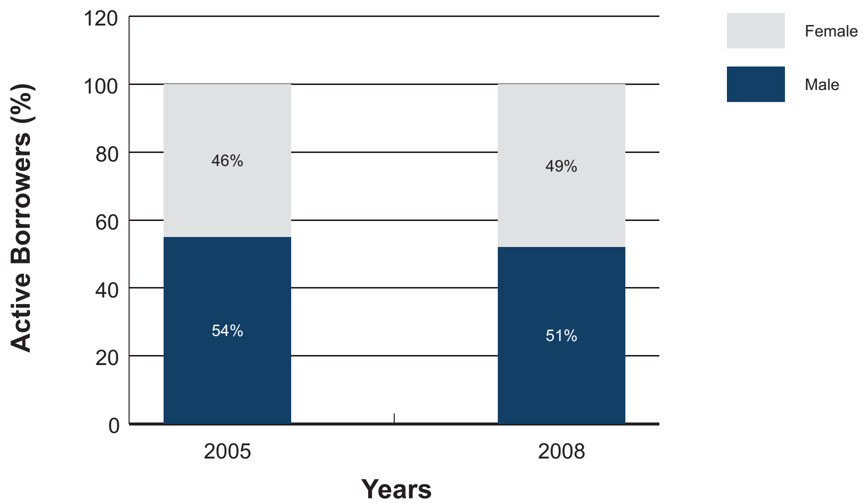
While most MFPs registered varying degrees of growth in their microcredit outreach during this period, a small number of players recorded a decline. MFPs with a reduction in outreach largely cited institutional reasons for the decline (institutional consolidation, separation of credit program); reduced or weak demand was not considered to be a reason for their declining clientele.

Exhibit 5: Microcredit Outreach by MFP



In June 2008 women borrowers accounted for 49 percent of total outreach, compared to 45 percent in 2005. Although the numbers indicate a small improvement on the part of the industry, penetration among female clients remains low compare to the numbers achieved by neighboring South Asian countries: Bangladesh-99.3% and India-100%.[4]

Exhibit 6: Proportion of Male-Female Borrowers

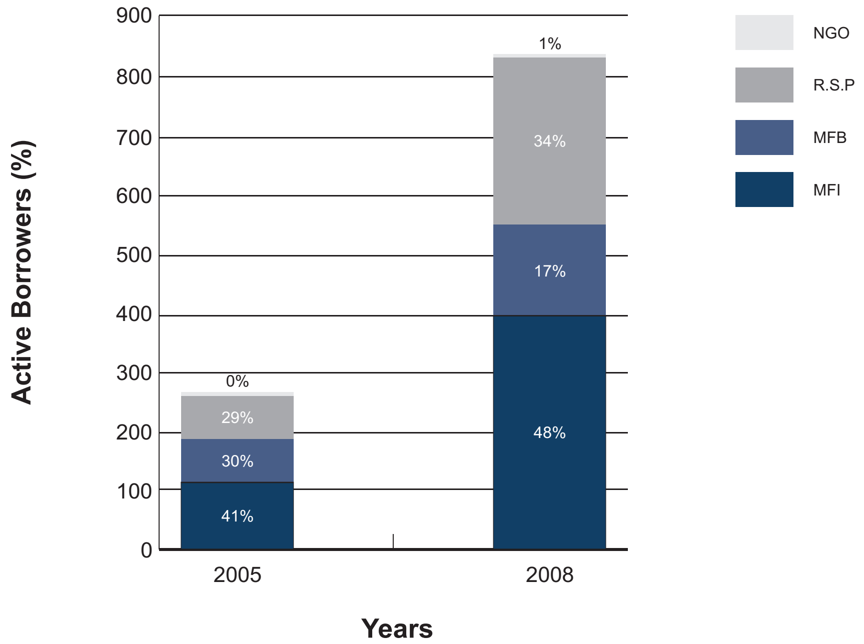


[4] 2006 Asia Benchmarking Report by The MiX.

The MFI peer group reaches the largest proportion (47%) of women borrowers, followed by the RSP (34%) and MFB (17%) peer groups. Compared to 2005, the MFB peer group saw a significant decline in the total proportion of female borrowers serviced, from 30 percent to 17 percent of the total. The decline can partially be explained by the emphasis on individual lending by a number of the new entrants into the MFB peer group. Individual loans are typically larger and target a near-exclusive male clientele.

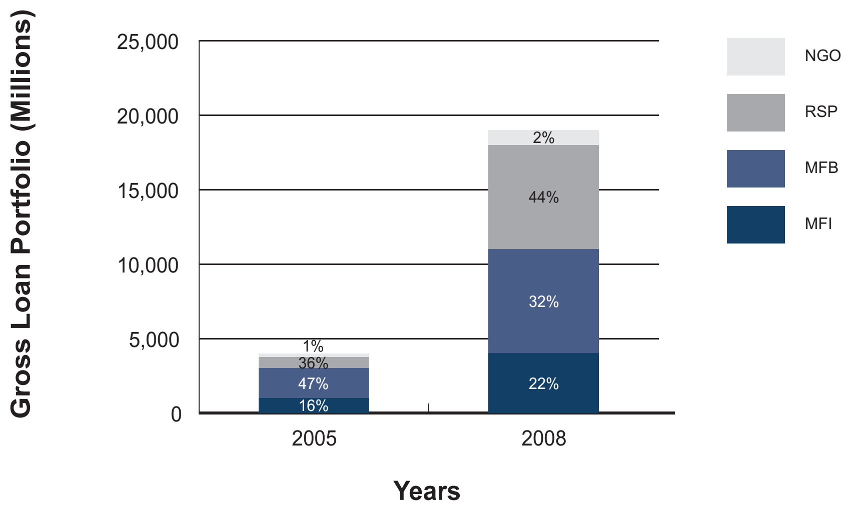
This period also saw KF, previously focused exclusively on women borrowers, move into the male borrower segment with its individual lending product in a bid to retain market share and deepen penetration in existing areas of operation.

Exhibit 7: Female Outreach by Peer Group



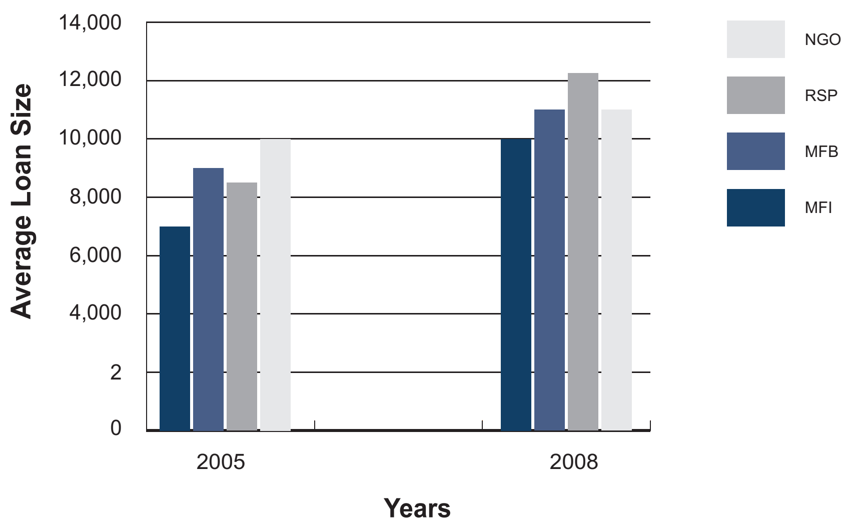
Gross loan Portfolio (GLP) increased at a faster rate than the increase in outreach. This is also accounted for largely due to the introduction of individual lending (characterized by larger loan sizes) by a number of institutions in the MFI and MFB peer groups, increasing the average loan size for the industry as a whole from approximately PKR 8,600 in 2005 to PKR 11,400 in 2008.

Exhibit 8: Gross Loan Portfolio by Peer Group (PKR)



The average loan size for the MFB and MFI peer groups falls under the industry average; whereas the RSP and NGO peer groups exceed it marginally.

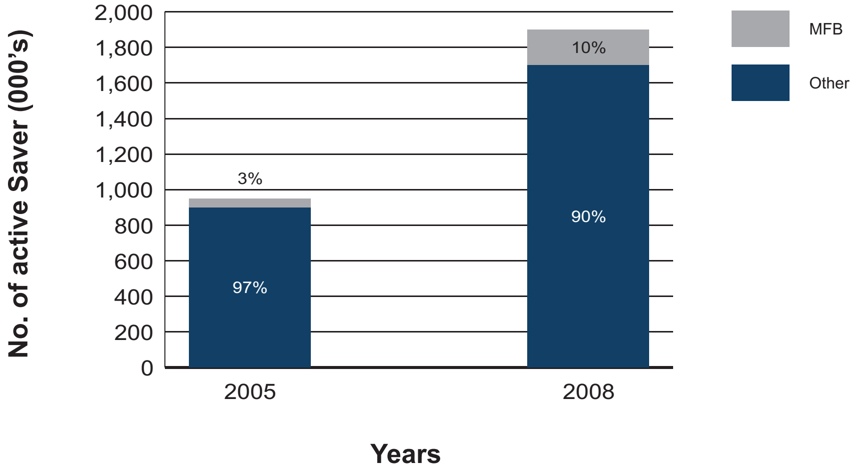
Exhibit 9: Average Loan Size by Peer Group (PKR)



During 2005-08 the number of savers increased from 0.95 million to 1.9 million. This increase is largely attributable to the rapid expansion by NRSP, and partially to the fact that a number of MFBs introduced savings products that are suited to the needs of the micro-saver.

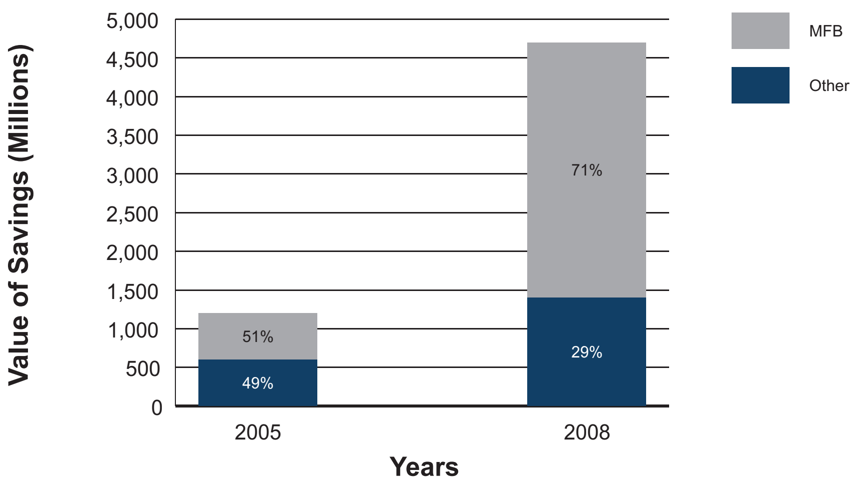
A significant proportion of depositors (91%) are accounted for by the non-MFB peer groups i.e., the RSPs, MFIs, and NGOs.

Exhibit 10: Number of Depositors by MFB and non-MFB Peer Groups



Total savings increased from PKR 1.2 billion to PKR 4.8 billion. The MFBs account for 9 percent of savers; but 70 percent of total savings, up from 2 percent and 50 percent, respectively in 2005. The RSP's account for 28 percent of total savings, down from 48 percent in 2005.

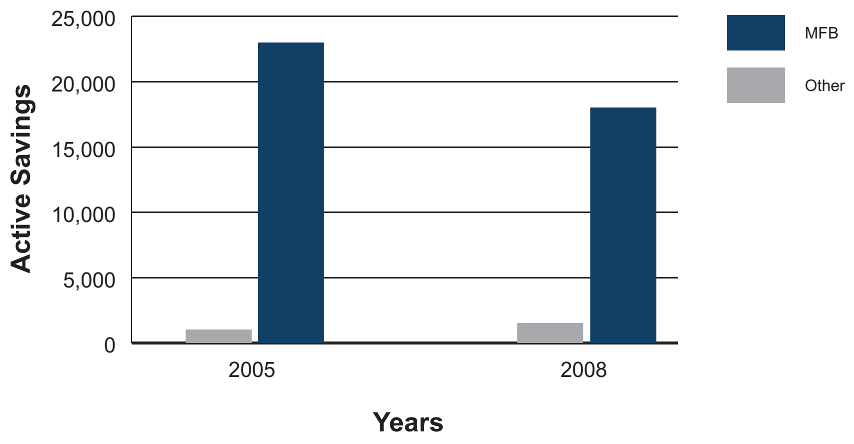
Exhibit 11: Total Savings by MFB and Non-MFB Peer Groups (PKR)



The dramatic increase in savings achieved by the MFB peer group is largely attributable to FMFBL, which accounts for 76 percent of the total savings deposited with MFBs. TMFB accounts for 19 percent of the total. According to both banks, the volume of their savings comes from large accounts, which follows global microfinance industry trends.

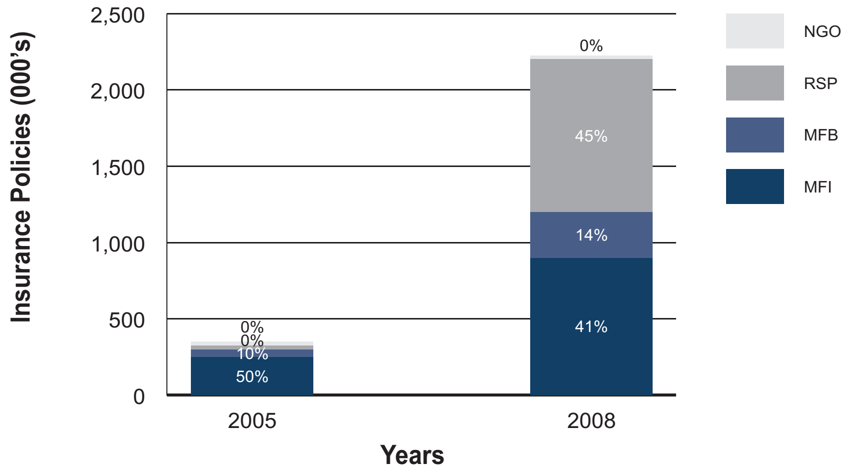
For the microfinance industry as a whole average savings increased marginally from PKR 1,256 to PKR 2,538 during the same period. For MFBs however, average savings declined to approximately PKR 18,500 from PKR 23,000 in 2005. The decline can be explained by the increase in the proportion of micro-savers to high net worth depositors (primarily institutional).

Exhibit 12: Average Savings by MFB and non-MFB Peer Groups (PKR)



The number of insurance policies sold annually increased from approximately 0.3 million in 2005 to 1.2 million in 2008. The largest proportion of policies sold annually is accounted for by the MFI peer group (72%), followed by the MFBs (25%). The number of insurance policies claimed increased from 0.12 percent to 0.19 percent of total policies sold.

Exhibit 13: Insurance Policies by Peer Group



This overall increase in outreach by the microfinance industry has been achieved on the back of greater geographic spread. MFPs sported a presence in 78 districts in 2006, compared to 105 by 2008.[5] Large as well as small players were seen to adopt this strategy (see Exhibit 13). The widespread use of this growth strategy indicates that most MFPs prefer to set up additional facilities and roll out existing products rather than develop new products. Although this strategy reduces the need for intensive market research, it does necessitate investment in well-developed and tightly implemented management systems and processes that are responsive to challenges that go hand-in-hand with geographical spread.

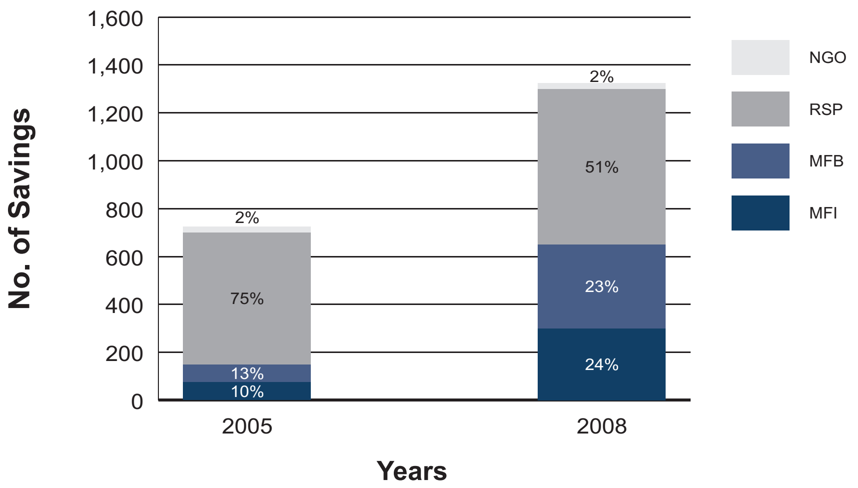
[5] PMN 2006, 2008. MicroWATCH: A Quarterly Publication of Microfinance Outreach in Pakistan.

Exhibit 14: New Districts Entered 2006 - 08

	1st Entrant	Year of Entry (2005-08)	2nd Entrant
New Districts Entered			
FATA	KBL	Jan 2007	None
Pishin	KBL	Jan 2007	None
Zhob	KBL	Jan 2007	None
Mustung	KBL	Jan 2007	None
Loralai	KBL	Jan 2007	None
Narowal	NRDP / PRSP	Oct 2006	KBL (Mar 07)
Gujrat	PRSP	Oct 2006	KBL (Mar 07)
Sialkot	PRSP	Oct 2006	KBL (Mar 07)
Mandi Bahauddin	PRSP	Oct 2006	FMFB (Mar 07)
Toba Tek Singh	PRSP	Oct 2006	KBL (Mar 07)
Leyyah	PRSP	Oct 2006	KBL / FMFB (Mar 07)
Khanewal	PRSP	Oct 2006	KBL / FMFB / Asasah (Mar 07)
Hafizabad	PRSP	Oct 2006	KBL (Mar 07)

The total number of offices increased from 680 to 1,355 during 2005-08. The RSPs account for the largest proportion of infrastructure (50%). The MFI and MFB peer groups have also significantly expanded their geographic footprint.

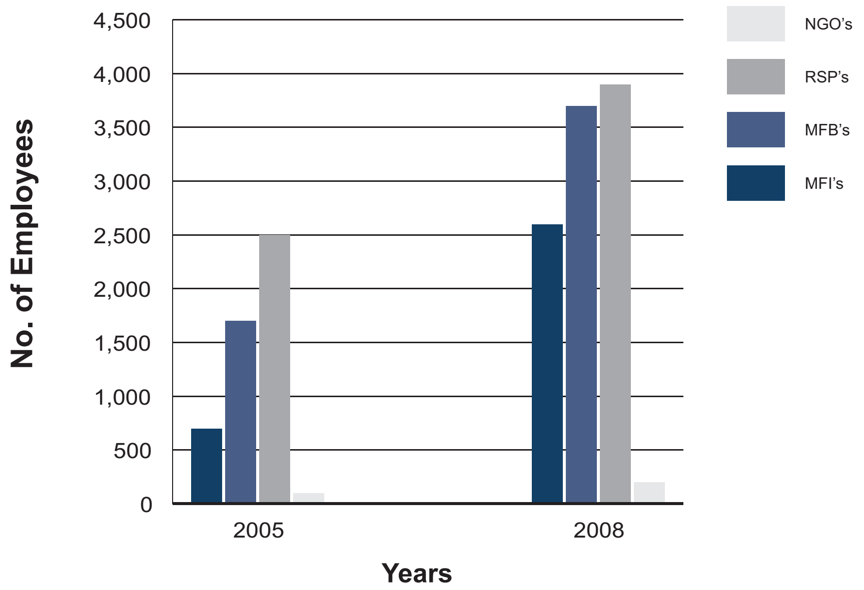
Exhibit 15: Number of Office Buildings by Peer Group



The increase in infrastructure has been accompanied by an increase in the number of clients serviced through each branch: the overall industry average increased from 743 borrowers in 2005 to 1,255 in 2008. The RSP group saw a significant increase (355 to 1,009 borrowers per branch), indicating increased depth of outreach in existing areas of operation. The MFBs on the other hand showed a decline from over 2,602 borrowers per branch to approximately 1,781. This can be explained by rapid increase in geographic spread that has recently been undertaken by KBL, FMFB and TMFB. The same is true for the MFI peer group, which saw a marginal decline from 1,433 to 1,344 borrowers per branch. The NGO peer group saw a substantial improvement from 179 borrowers per branch to 476 borrowers, although well below the levels achieved by the other peer groups.

The total number of people employed by the industry doubled from approximately 5,000 to more than 10,000. RSPs account for the largest proportion of employment provided by the sector (37%), followed by the MFBs (35%), and the MFIs (25%).

Exhibit 16: Total Employees by Peer Group

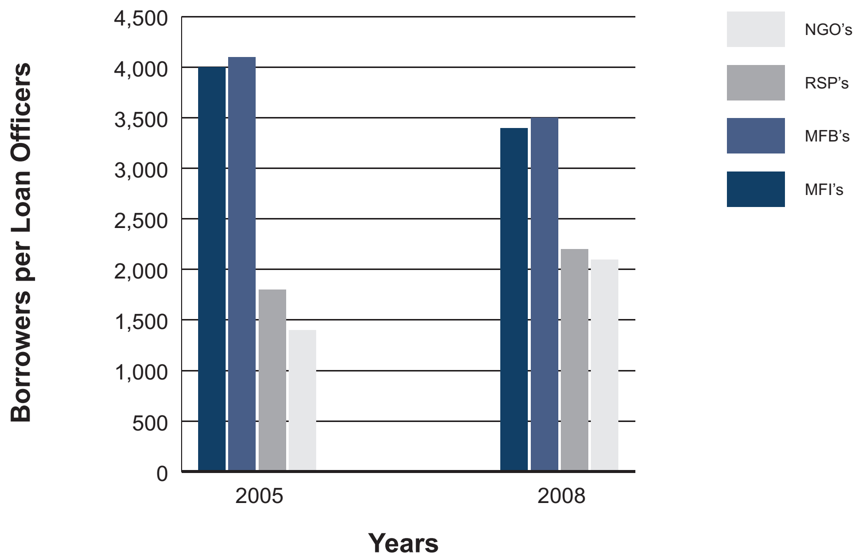


Compared to 35 percent in 2005, in June 2008 56 percent of the total number of persons employed in the industry were loan officers (LOs). The industry average for the number of borrowers per LO remained steady at approximately 285.

Despite a slide in the borrower-to-LO ratio for both the MFI and MFB peer groups, they continue to outperform the other two peer groups by a substantial amount. The RSP and NGO peer groups have shown improvement on this performance metric. NGOs rank the lowest among all four peer groups. De KBL ()

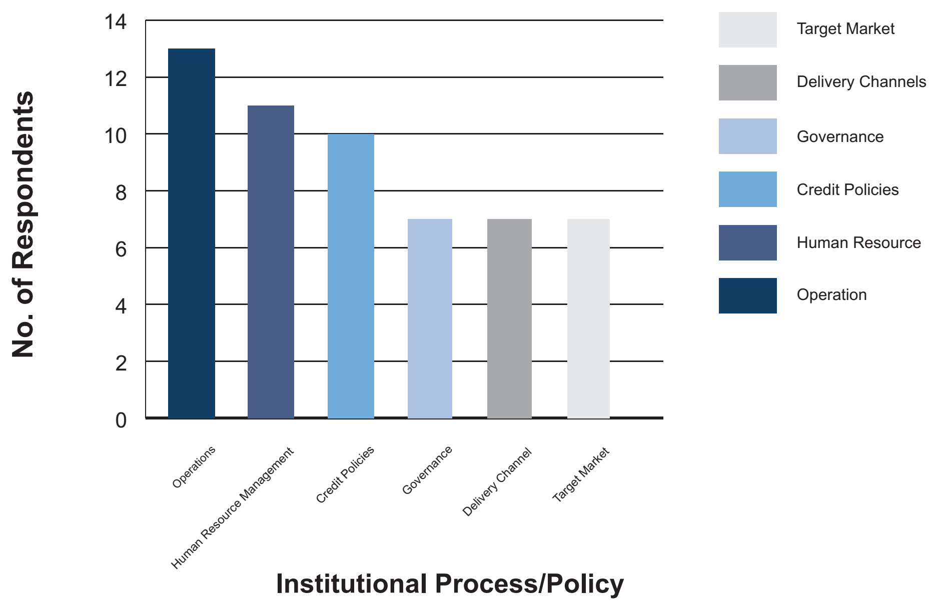
Organizations with the highest borrower to LO ratios include KBL (572), TRDP (528), and KF (427). In 2005 KF stood at 733 borrowers per LO. Rapid expansion in the last two years has resulted in a decline in this ratio. However, it is likely to increase as new employees build up their portfolios and presence in new areas is consolidated.

Exhibit 17: Borrowers to Loan Officers by Peer Group



To cope with the growth, most organizations made improvements to their operations, human resource management practices, and credit policies. In addition to the above, the MFI and MFB peer groups introduced changes in institutional governance; the RSP's focused primarily on improving delivery channels. The NGO peer group undertook limited institutional improvements.

Exhibit 18: Institutional Changes Undertaken (2005 - 2008)



Over the last three years the industry has moved out of an embryonic stage into a growth phase. This can be evidenced in the increased use of largely quantitative reporting regimes as opposed to primarily qualitative ones, an accelerated involvement of sophisticated market managers as opposed to entrepreneurs, and a proliferation of formal organizational policies and organizational structures as opposed to smaller more free-form type of organizations. Institutional emphasis has also shifted from market research to operations research e.g., cost-cutting technology options. All of the above show that the industry is on the upswing on the industry lifecycle trajectory.

SECTION II: FINANCIAL PRODUCTS

A core objective of the microfinance industry is to improve access to financial services among micro clients. In addition to tracking the number of clients reached, this can be measured in terms of the range of services provided to meet a variety of financial needs. As already evidenced above, the microfinance industry has achieved sustained growth in outreach. As the following sections show, it has also achieved progress in introducing new products.

CREDIT

Credit is the mainstay of the microfinance industry in Pakistan. The RSP peer group accounts for approximately 44 percent of the total microcredit extended by the sector. The MFB and MFI peer groups account for 31 and 22 percent, respectively.

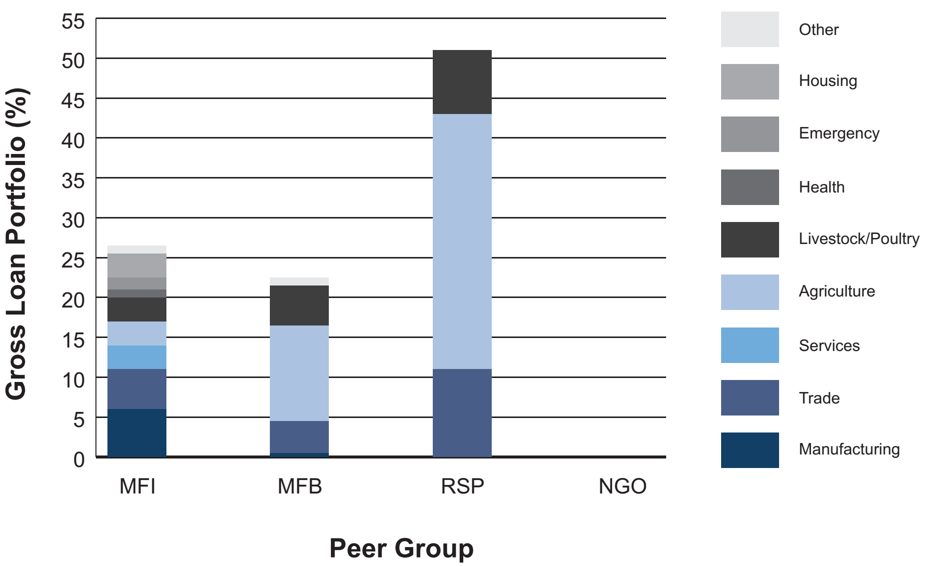
Microcredit is extended for a range of productive (micro enterprise) and non-productive (consumption) purposes. A large share of the credit extended is for the purpose of agriculture, followed by trade and livestock/poultry. Productive loans i.e., loans other than emergency, health and housing loans continue to account for the bulk (94.62%) of the credit extended by sector players. Also, most consumptions loans are bundled with productive loans i.e., only those borrowers who have already taken credit for a productive purpose can access additional credit for consumption purposes. Thus, productive loans continue to be the 'platform' products around which additional financial services (credit and otherwise) are constructed.

Exhibit 19: Credit Categories (2008)

The RSPs are the largest providers of agricultural credit, followed by the MFB and MFI peer group. This is largely due to their geographical location and organizational mission i.e., with the aim to service Pakistan's rural population the RSPs have a significant rural presence compared to the other peer groups.

Emergency loans are provided mainly by the MFI peer group. However, the amount is small compared to other loan categories such as loans for trade, manufacturing and services.

Exhibit 20: Credit Categories by Peer Group (2008)



[1] All the numbers about inflation quoted here are drawn from recent newspaper reports and accounts. These are tentative numbers but the more important point is to examine the trends and the scale of the trends. The actual numbers are merely suggestive and indicative of the scale of the problem.

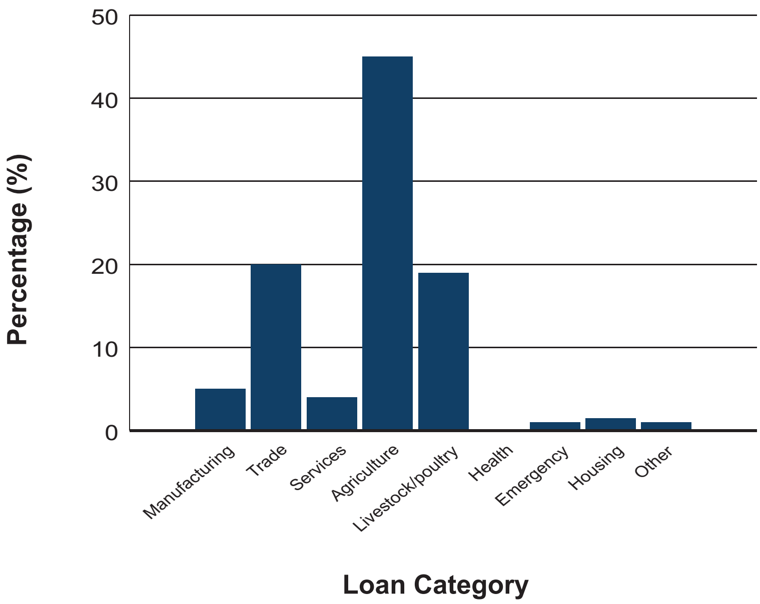
During 2005-08 the largest number of new loan products were introduced by MFBs. As mentioned earlier, this can largely be accounted for by the fact that most of the organizations that fall into this peer group are less than 5 years old and are still in the process of developing their core product offerings.

Trade, livestock and agriculture are considered to be potential high-growth options for microcredit. Many respondents quoted the existence of a large untapped market and high demand as primary reasons for this high growth potential. A number of respondents however, noted the challenges inherent in the extension of credit to rural communities.

Health and manufacturing are considered to be low growth options, with the former better suited to insurance products rather than credit products. Manufacturing is not considered to be a particularly promising area for a number of reasons including the fact that poor households usually concentrate on activities that have low barriers to entry and are therefore susceptible to new entrants.

Housing was considered to be a low growth option primarily due to the issue of property rights. Many poor households in urban areas do not hold title to the land they live on, which makes them a risky proposition for the lender.

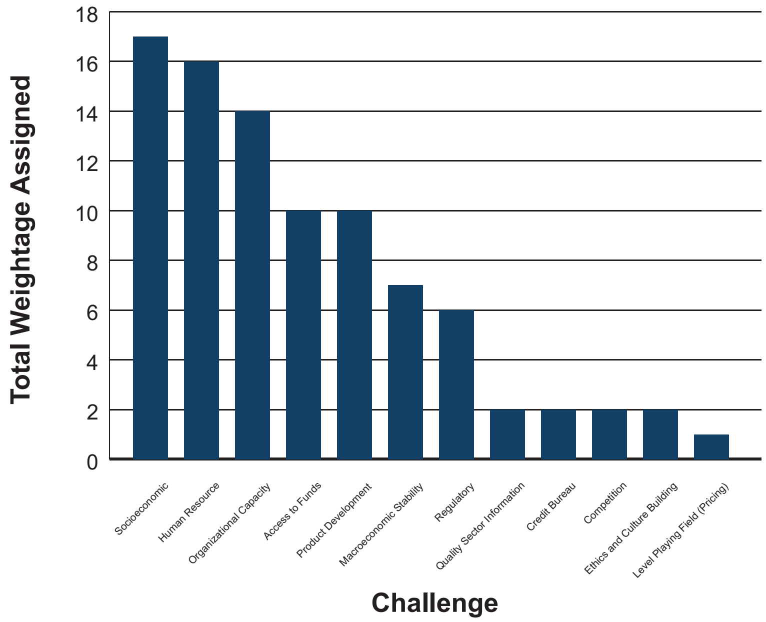
Exhibit 21: High Growth Credit Options



5 High Growth Potential; 1 Low Growth potential

Primary challenges identified for the rapid expansion of microcredit include socioeconomic challenges, closely followed by inadequate institutional capacity, and limited access to trained human resource. These three challenges were followed with undiversified credit products and models offered by sector players and inability to access adequate funds. Socioeconomic factors identified include low level of literacy among target clients and limited access to female borrowers.

Exhibit 22: Challenges to the Rapid Expansion of Microcredit



SAVINGS

As was the case in 2005, in 2008 also the RSPs report the largest number of savers—approximately 84 percent of total savers. It is important to note however, that the RSPs do not intermediate savings. Under the regulatory framework for the microfinance industry in Pakistan MFPs not regulated by the State Bank of Pakistan (SBP) are not allowed to take deposits. Thus, MFIs, NGOs and RSPs are unable to accept deposits; instead savers are facilitated to deposit savings with commercial banks regulated by the SBP.

The NRSP accounts for 54 percent of the total micro savers facilitated by the sector, followed by the Punjab Rural Support Programme (PRSP) at 17 percent, and Thardeep Rural Development Programme (TRDP) at 11 percent.

The RSPs offer voluntary as well as mandatory savings services. All village organization members are encouraged to maintain voluntary savings; all credit clients have to maintain mandatory savings amounting to 10 percent of the amount borrowed. In effect, mandatory savings serve as collateral, reducing the risk borne by the concerned MFP.[1]

MFBs are directly regulated by the SBP, which means that they are allowed to accept and intermediate deposits. As of June 2008 the MFBs in Pakistan accounted for 70 percent of total savings and 9 percent of total savers. The most successful MFB in mobilizing deposits so far is FMFB. The savings products offered by it include current accounts, savings accounts, and time deposits. FMFB's total deposits in June 2008 accounted for 75 percent of the total savings placed with MFBs.

The MFB peer group also offers the largest number of savings products. Except for KBL, which still does not offer savings facilities, all the remaining five MFBs offer time deposits as well as demand deposits. Requirements for maintaining a deposit account differ as per the type of account. For time deposits, minimum amounts and interest rates payable are generally higher than for demand deposits. Current accounts can be

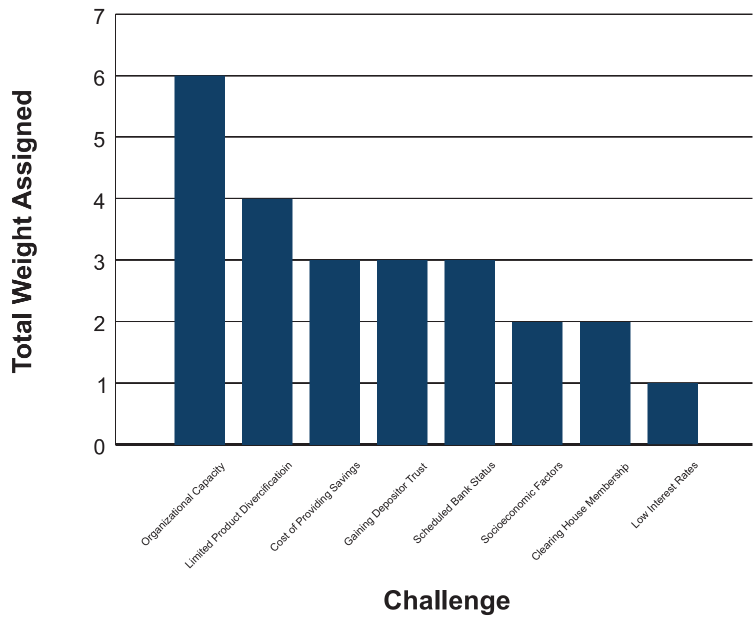
[1] All the numbers about inflation quoted here are drawn from recent newspaper reports and accounts. These are tentative numbers but the more important point is to examine the trends and the scale of the trends. The actual numbers are merely suggestive and indicative of the scale of the problem.

opened with as little as PKR 5 and have no minimum balance requirements. Time deposits however, have minimum balance requirements, mostly set at Rs 5,000. Savings services by MFBs are largely voluntary.

The total amount of savings deposited with MFBs account for only 0.04 percent of the total value of national savings, and 0.31 percent of the number of savings accounts, signifying the need for a more aggressive approach to savings mobilization.

Primary challenges identified by the MFB peer group for the rapid expansion of micro savings in Pakistan include limited institutional capacity and a larger variety of savings products better suited to the needs of micro savers.

Exhibit 23: Challenges for the Rapid Expansion of Micro Savings



OTHER FINANCIAL PRODUCTS

In addition to credit and savings products, a number of industry players offer micro insurance products. MFPs provide insurance products through the agency-partnership model. Partner firms identified include Adamjee Insurance Company, New Jubilee Insurance Company, ALICO (AIG) Life Pakistan, State Life Insurance, and EFU Insurance.

NRSP-Adamjee Insurance Co.
Package Insurance
Death, Disability, Hospitalization
Premium: PKR 100

In 2005 credit-life was the most common type of insurance product offered by a limited number of players. Since then, MFPs have introduced insurance products that cover permanent disability, and health and hospitalization (NRSP and KF) insurance. TMFB has also introduced an endowment product.

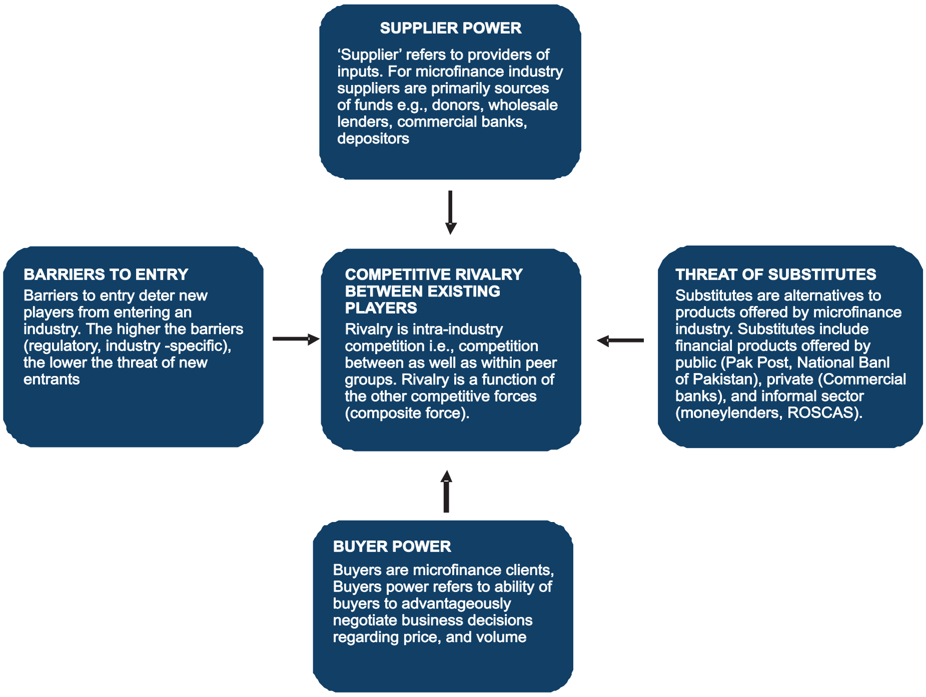
Insurance is offered as a voluntary as well as a mandatory product. Credit-life insurance policies are usually bundled with credit products. Thus, MFPs with a significant numbers of clients locked into credit transactions have the potential to serve as convenient and cost-effective conduits to the low-income insurance market.

Other financial products and services introduced by the microfinance sector include remittance products that allow the transfer of money nationally as well as internationally. FMFB and TMFB both offer funds transfer facilities. Both MFBs also provide online cheque and cash transfer facilities. Network Microfinance Bank Ltd. (NMFB) Introduced mobile banking in 2006. In 2006 TMFB introduced ATM and Debit Card services to facilitate depositors.

SECTION II: FINANCIAL PRODUCTS

Five driving forces shape every industry and market: the negotiating power of suppliers; the negotiating power of buyers; the ease of entry into an industry; the threat from substitutes; and overall rivalry (see Exhibit 23). These forces determine the intensity of competition and hence, the profitability of an industry. The scope of analysis is shown in the exhibit below:

Exhibit 24: Competitive Landscape of the Microfinance Industry
(Source: Adapted from Porter's Five Forces for the Microfinance Industry)



BARGAINING POWER OF SUPPLIERS

The term 'supplier' comprises all sources of inputs that the microfinance sector needs in order to provide financial services. Given the nature of the industry, the analysis will focus primarily on suppliers of funds, the primary input for a financial intermediary. Suppliers of funds for the industry include donors (bilateral, multilateral, local), wholesale lending entities (PPAF), commercial banks, and at present, to a lesser extent, depositors.

Supplier power in the microfinance industry is considerably 'high' i.e., organizations with a funding stake in MFPs maintain a large say in the way organizations conduct their business. This is largely due to the fact that funding sources for the industry are limited. Although commercial funding sources have recently been mobilized to augment funds traditionally provided solely by donors and the national apex, these providers are few in number. Moreover, most of the participating organizations are multinational players, which translates into direct competition for funds with the global microfinance industry. This issue is compounded by the presence of a limited number of attractively large, and financially sustainable MFPs capable of providing profitable returns on investments, making the Pakistan industry as a whole a less attractive option. With real and expected annual growth rates exceeding 30 per cent over the next three years, large financial injections will be required. Demand as well as competition for funds among sector players is therefore expected to remain high. As a result, bargaining power will remain skewed in favor of the in favor of the suppliers of funds in the short- to medium-term (2 – 5 years).

Exhibit: Factors Determining Bargaining Power of Suppliers

Factor	Bargaining Power	Comment
Supplier Concentration	●	Few suppliers of funds: local capital markets and the banking industry are not actively involved; the microfinance industry in Pakistan must compete with other developing countries for funds provided by donors and international private debt/equity sources. Translates into significant bargaining power for suppliers.
Impact of Input on Cost	●	Cost of capital contributes significantly to an MFP's bottom line. Additionally, financial covenants limit an MFPs ability to leverage its balance sheet for accessing additional funds. Contributes significantly to supplier power.
Switching Costs of Firms in Industry between Suppliers	●	The cost of switching between suppliers of funds is high for an MFP due to the relative inexperience of the commercial financial sector with microfinance. Educating a supplier is time-consuming and thereby costly. Translates into high bargaining power for suppliers.
Presence of Substitute Inputs	●	Considering deposits as a substitute for funds provided by commercial sources, supplier power is still high. This is largely due to the relative inelasticity in supply of deposits (for a varied number of reasons). Since growth from this source is likely to be limited in the short-term, it is not a threat to suppliers.
SUPPLIER BARGAINING POWER	●	**HIGH**

● High ⊙ Medium O Low

MFPs are cognizant of the skewed relationship with suppliers. As a consequence of the limited availability of funds, a number of MFPs have accessed a mix of suppliers. Accessing multiple sources simultaneously however, has not reduced the collective bargaining power of suppliers. This will require the microfinance industry as a whole to build a healthy track record as an investment-worthy sector. In the long-run (10 years), as more organizations begin to provide positive returns on investment, meet the requirements of their funding partners (conduct annual ratings, streamline management and governance structures, prove the social impact of their programs), and competition forces commercial banks to move down market, bargaining power will balance out to some extent. In the short- to medium-term however, the balance of power is likely to remain highly skewed.

BARGAINING POWER OF CUSTOMERS

The bargaining power of customers determines how much leverage microfinance clients have in determining pricing and volume decisions of service providers. At present the bargaining power of customers is 'low'. The total national demand for microfinance is currently estimated at approximately 30 million borrowers, of which the sector is servicing less than 10 per cent. Thus, given the limited supply, bargaining power is skewed in favor of the MFP. This however is likely to change to 'medium' within the short-term if MFPs continue with their existing growth strategy i.e., moving into the same geographical areas with similar products.

Exhibit: Factors Determining Bargaining Power of Customers

Factor	Bargaining Power	Comment
Buyer Concentration	○	Given the nature of the industry buyer concentration is low (each borrower accounts for a very small proportion of the outstanding portfolio). Low concentration translates into low bargaining power for customers. If MFPs continue to overlap their areas of operation however, it is likely to increase moderately.
Buyer Information	○	Buyer information is currently low, contributing marginally to buyer power. As competition increases, organizations are beginning to improve their awareness-raising campaigns. This is likely to increase buyer power over the short- to medium-term.
Brand Identity	●	Lack of brand identity contributes to high buyer power as buyers are likely to switch based on factors such as product design, price, etc.
Price Sensitivity of Customer	○	Microfinance clients are relatively price insensitive i.e., decisions to borrow are based on multiple factors in addition to price. This price insensitivity decreases the clients' bargaining power.
Product Differentiation	⊙	As organizations offer products tailored to client needs, clients are less likely to resort to substitute financial service providers (money lenders) or move to competitors. Currently product diversification is limited which contributes to moderate buyer power.
Switching Costs for Customers	○	Traditionally, switching costs for microfinance clients are high given the group solidarity and step-credit methodologies adopted by MFPs. Recent changes in the sector however, such as refinancing facilities, individual lending, are likely to reduce buyer switching costs.
Credit Bureau	⊙	Within the context of increasing competition the absence of a credit bureau is likely to result in increased bargaining power for the client. If this condition is to persist over the long-term, buyer power is likely to rise.
Multiple Financial Products (credit, savings, insurance)	○	As organizations increase the range of products offered, clients are less likely to approach competitors, or substitute financial service providers (money lenders). Since
CUSTOMER BARGAINING POWER	○	**LOW**

Client bargaining power derived from overlapped operations can be curtailed with the use of a credit information system. By exchanging negative client lists with partner organizations, MFPs can hinder the movement of defaulting clients within the industry. An MFP can also reinforce its bargaining position by strengthening brand identity (increase customer loyalty), improving product design, and providing a wider array of financial services (savings, insurance).

THREAT OF NEW ENTRANTS

The easier it is for other firms to enter an industry, the larger the number of competitors, and the higher the competition in that industry. New entrants can change major determinants of the market environment (e.g., market shares, prices, customer loyalty) because entry by new players always brings with it a latent pressure for reaction and adjustment by existing players in an industry. The intensity of this threat depends on the effectiveness of the barriers to entry. Barriers to entry for the microfinance industry are 'medium'. This is largely due to the existence of a regulatory framework for setting up a MFB. Although the regulatory framework has enabled private investors to enter the industry, it also subjects new entrants to specific entry and operational requirements, thereby simultaneously limiting the number of new entrants. Years of experience with microfinance has also resulted in MFPs being subjected to more rigorous performance requirements by donors, limiting access to funds for new entrants without the requisite expertise.

Exhibit: Factors Determining Barriers to Entry

Factor	Threat of New Entrant	Comment
Proprietary Learning Curve	⊙	The techniques and methodologies for providing microfinance services are not proprietary information. Although practice does make perfect (learning curve advantage), specific knowledge of microfinance does not serve as a sufficient deterrent to new entrants familiar with managing financial organizations. This is evidenced in the entry of three Greenfield banks into the sector since 2005. Thus, the threat of new entrants can be categorized as medium.
Capital Requirements (up - front investment)	●	As financial service providers MFBs face low capital requirements relative to commercial banks. Non-SBP regulated MFPs have even lower capital requirements in terms of infrastructure and regulation. Thus, the threat of new entrants is high.
Regulatory Barriers	⊙	In terms of regulatory barriers, the threat of new entrants is low for MFBs but high for NGOs and MFIs. Moreover, specialized microfinance organizations have begun moving beyond national borders (ASA, BRAC). This has also resulted in an increase in the threat of entry from competitors.
Economies of Scale	●	Although 79% of the sector's outreach is accounted for by five organizations, the cost per borrower for these organizations indicates that the current impact of cost is more likely the result of improvements in systems and processes (organizational efficiency) rather than the advantage of size. Thus, this factor does not constitute a sufficient disincentive.
Access to Inputs	⊙	Human resource is a key input for a service industry. Given the unemployment level in the country, the microfinance industry is not likely to face a human resource crunch with respect to credit officers. Senior management and middle management are areas MFPs will need to concentrate on as they compete with commercial banks at this level of recruitment.
Brand Identity	●	Brand identity for firms in the industry is still weak. Thus, the threat to new entrants from existing firms is low, since a large customer base is not committed to existing service providers. This translates into a lower entry barrier for newcomers i.e., a higher threat of entry.
Expected Retaliation	●	Based on the experience so far, retaliation to new entrants has not been severe. Competition (real as well as perceived) has spurred a number of MFPs to move into new geographical locations, and develop new products. Although some organizations have reduced borrowing costs to clients, these have resulted more from operational efficiencies. There is no evidence of 'price wars'.
Proprietary Products	●	The unavailability of deposit-taking to NGOs does give MFBs an advantage over NGO-MFIs. However, this advantage is tempered by the fact that MFBs also have to meet SBP requirements for the safe-keeping of deposits (Depositor Protection Fund, SLR, CRR)
BARRIERS TO ENTRY	⊙	**MEDIUM**

Thus, significant new entrants into the microfinance industry are likely to hail from the commercial private sector. They are more likely to be Greenfield microfinance banks or specialized multinational MFPs (e.g., BRAC, ASA). In the short- to medium-term commercial banks are unlikely to go down market using their own infrastructure; they are expected to remain an important source of funding for the industry.

MFPs can raise entry barriers by achieving economies of scale through rapid growth. Not only will economies of scale result in cost advantages, it will also serve to lock in funding sources available to the industry.

THREAT OF SUBSTITUTES

Substitutes are products offered as alternatives to products offered by the microfinance industry. Considering alternatives offered by the formal as well as informal sector, substitutes for microfinance include credit products from commercial sources and money-lenders, savings products offered by public sector entities (Pakistan Post, National Bank of Pakistan), commercial banks, and ROSCAS (rotating credit and savings associations), and remittance services provided through the hawala-hundi networks. A threat from substitutes exists if the alternative products have better performance parameters for the same purpose.

Currently, substitutes present a 'moderate' threat for the industry. The threat is largely the result of the availability of services provided by the informal sector. It is more severe for savings and remittance services as compared to credit services. The informal sector's hold on the credit market for very small borrowers (< PKR 30,000) has been loosened through the provision of cheaper and more flexible alternatives. As organizations increase loan sizes and develop their individual lending models, the threat from the informal credit market is likely to recede further. The threat from deposit and remittance service providers however, is intense. For deposit services a number of factors impact utilization rates, the most important being accessibility of savings at the time of requirement, and financial literacy. Preference for the hundi-hawala service is largely the result of lower cost (lower commission, more favorable exchange rate), convenience (easier access), and widespread networks.

MFBs have begun offering an array of savings products (time deposits and demand deposits).

Exhibit: Factors Determining the Threat of Substitutes

Factor	Threat of Substitutes	Comment
Switching Costs	⊙	The costs of switching to alternative products provided by both the formal and informal sector are medium. Thus, the threat offered by substitutes is medium.
Buyer Inclination to Substitute	O	Buyer inclination to substitute has declined as MFPs have diversified their credit products, and to a smaller degree the range of financial services offered. With MFBs offering credit, insurance and savings products under one umbrella, the inconvenience of switching between financial service providers has also reduced client inclination to substitute.
Price Performance	O	Literature and client surveys have shown that microcredit clients are relatively price-insensitive. 'Access' and 'convenience' are more likely to top the list of required credit service features. It is therefore more useful for organizations to study features offered by the informal credit market rather than focusing on price as the driver of client decisions. In the case of deposits access, hidden costs, financial literacy and distance are important features.
THREAT OF SUBSITUTES	⊙	**MEDIUM**

Competitive Rivalry between Existing Players

Competition between players within the industry is defined as rivalry. The level of rivalry in an industry is a composite of the four competitive forces described above in addition to factors such as market concentration, and market growth. High competitive pressure results in downward pressure on prices, margins and hence, profitability.

Rivalry in the microfinance sector is 'moderate'. This is largely due to the fact that annual growth rates in the last three years have been in excess of 30 percent coupled with a penetration rate of less than 10 percent. Thus, existing organizations have sufficient room to grow.

Exhibit: Factors Determining Rivalry Between Existing Players

Factor	Rivalry	Comment
Number of Firms	O	The number of organizations in the industry has increased marginally. The increase has not contributed to an increase in intra-industry rivalry.
Market Growth	O	Annual growth rates for the industry exceeded 200% during 2005-08. Market penetration is still less than 10%. Thus, the impact on rivalry is not significant.
Fixed Costs	⊙	Fixed costs for the industry are relatively low. Although MFBs have higher up-front capital investment requirements, they are low compared to the regulatory requirements in place for commercial banks, or the investment in specialized machinery required by some businesses. Since fixed costs are low, potential rivalry can be categorized as medium.
High Exit Barriers	⊙	Particularly in the credit market, withdrawal is difficult with heavy investments in the form of deposits. Withdrawing from the savings market is easy. Overall, exit barriers are moderate resulting in moderate rivalry.
Diversity of Rivals	⊙	Due to differing regulatory requirements for the four peer groups in the industry, some players feel that a level playing field does not exist. This diversity of MFPs results in higher rivalry.
RIVALRY	⊙	**MEDIUM**

However, compared to 2005 rivalry in the sector has increased—within peer groups as well as across peer groups. This can largely be attributed to the fact that switching-costs between products and organizations have been lowered due to low product differentiation, and there is a lack of intra-MFP client-tracking mechanisms.

ACRONYMS

FMFBL	First MicroFinance Bank Ltd.
GoP	Government of Pakistan
GLP	Gross Loan Portfolio
KF	Kashf Foundation
KBL	Khushaali Bank Ltd.
LO	Loan Officer
MFP	Microfinance Player
MFB	Microfinance Bank
MFI	Microfinance Institution
NGO	Non-Government Organization
MoF	Ministry of Finance
NMFB	Network Microfinance Bank Ltd.
NRSP	National Rural Support Programme
PMN	Pakistan Microfinance Network
PPAF	Pakistan Poverty Alleviation Fund
RSP	Rural Support Programme
SBP	State Bank of Pakistan
TMFB	Tameer Microfinance Bank Ltd.
TRDP	Thardeep Rural Development Programme

ANNEX

Annex: Survey Sample

Category	Microfinance Player	Acronym	Reporting Status 2005	Reporting Status 2008
MFB Microfinance Bank	Khushhali Bank Ltd.	KBL	✓	✓
	Pak-Oman Microfinance Bank Ltd.	POMFB	-	✓
	Network Microfinance Bank Ltd.	NMFB	-	✓
	Rozgar Microfinance Bank Ltd.	RMFBL	✓	✓
	Tameer Microfinance Bank Ltd.	TMFB	-	✓
	The First MicroFinanceBank Ltd.	FMFBL	✓	✓
MFI Microfinance Institution	Akhuwat		✓	✓
	Asasah		✓	MW
	Community Support Concern	CSC	-	✓
	Development Action for Mobilization and Emancipation	DAMEN	✓	✓
	Kashf Foundation	KF	✓	✓
	Orangi Pilot Project	OPP	✓	✓
	Sindh Agricultural and Forestry Workers' Cooperative Organization	SAFWCO	✓	✓
RSP Rural Support Programme	National Rural Support Program	NRSP	✓	✓
	Punjab Rural Support Program	PRSP	✓	MW
	Sarhad Rural Support Program	SRSP	✓	✓
	Thardeep Rural Development Program	TRDP	✓	✓
NGO Non-Government Organization	Sungi Development Foundation	SDF	✓	✓
	Swabi Women's Welfare Society	SWWS	✓	✓
	Narowal Rural Development Program	NRDP	✓	✓
	Organization for Participatory Development	OPD	✓	✓
	Rural Community Development Society	RCDS	✓	✓

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MicroNOTE: The Impact of Inflation on Microfinance Clients and its Implications for Microfinance Practitioners

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