Innovations

The **State Bank of Pakistan** mentions the need for innovation at different levels of the microfinance industry. At the financial services level, where new technologies and new types of products could be offered, or at the institutional level, where organizations could innovate in terms of strategy and institutional development. In the Pakistan microfinance context, the creation of two new types of organizations, the PPAF, a wholesale window for MFIs, and the microfinance banks (Khushhali Bank and First Microfinance Bank) could be seen as innovative ventures breaking away from traditional financing windows and vehicles. In addition, the State Bank of Pakistan has established a conducive legislative framework, which features the inclusion of microfinance funds as wholesale facilities and protection mechanisms for borrowers.

Giving due importance to the demand of specific microfinance products, **The First MicroFinanceBank Limited** has designed its loan products after an in-depth market research. Emphasis is placed on identifying specific financial needs and corresponding repayment capacity of the micro entrepreneurs. The Housing Improvement Loan and the Low Salary Employee Loan are two examples where specific customer needs have been serviced. FMFB has also introduced life insurance products for its customers with an additional benefit for the bereaved family in case of the death of the borrower. Customized financial products for women entrepreneurs are also being developed.

FMFB is the only MFI in the country to mobilize voluntary public savings by introducing deposit schemes. With an aim to promote the habit of saving amongst the under privileged, FMFB offers a higher rate of return for small savers (i.e. deposits of less than Rs.25,000). Presently, around 85% of the deposit accounts are of small savers. Moreover, fund transfer facility from one branch to another is also available.

The bank has effective internal control and audit systems in line with the MFI Ordinance, 2001. A comprehensive electronic system is in place to manage and control operational system of the bank. FMFB is also in the process of designing a comprehensive Information Technology System for the MFIs, which will not only be applicable to other MFIs in Pakistan, but can also be implemented in MFIs in other countries.

The **First Women Bank Ltd** has successfully developed a methodology including financial services and skills training for women with the objective of eliminating child labour in the carpet weaving industry.

The **Bank of Khyber** (BOK) has actively sought highly experienced staff from the development sector as resources for its microfinance unit. In this way it has combined local development knowledge with the strength of a commercial bank.

Kashf Foundation has developed products based on research that reflect the financial needs of the poor, for example, its emergency loan is extremely flexible, functioning like a credit card. Clients may access up to Rs.2,000 in times of financial distress. Repayments are made in small instalments over six months with interest applied. Kashf also offers life insurance to its borrowers, through a partnership with a private insurance company, covering the client and the primary breadwinner. Such policies are made available by paying a premium of Rs.100 that cover burial costs and repayment of outstanding loans to Kashf in the event of accidental death. Finally, the foundation has established a standardized model that allows the extension of products and operating procedures to a larger population and to a larger geographical area.

UPAP, the urban arm of the NRSP, innovated by replicating and modifying the Grameen Bank methodology. Loan purposes are flexible to support consumption and productive uses. Moreover, UPAP applies daily interest rates with repayment schedules tailored to the repayment capacity of the clients, for example, a group client could repay its loan earlier than the rest of the group.

The Performance Indicators report compiled by the **Pakistan Microfinancing Network** (PMN) is an innovative and proactive initiative not seen in many other Asian countries. It provides a vehicle to share best practices and standards while ensuring great transparency in the microfinance sector. It includes an individual analysis of each member's performance over time reinforces the practicality and relevance of the exercise.

The Financial Sector Strengthening Programme (FSSP) initiated by the **Swiss Agency for Development Cooperation (SDC)** aims at assisting the microfinance sector to provide services to MSEs and the disadvantaged poor on a sustainable basis. The FSSP is a unique source of technical and financial assistance provided by a donor to the whole microfinance sector, with the objectives:

a. Develop human and institutional capacity of all types of microfinance institutions for efficient delivery of microfinance services;
b. Build the capacity of local expertise providers for increasing the resource base, supporting market oriented approaches; and
c. Support the creation of enabling environment for the growth of the microfinance sector by promoting and supporting coordination among the stakeholders.

In addition, SDC has provided support to the development of microleasing products and providers through support to Network Leasing, Orix Leasing and other leasing companies operating in Pakistan. The Leasing to Small and Micro Scale Enterprises Program (LMSE) project aims to increase earning and employment in the MSE sector in NWFP and Northern Areas through an improvement in access to leasing services on a sustainable basis. More details are provided in this section.

Innovation: Microleasing

Lease Financing in Pakistan (Described by SDC):

The Swiss Agency for Development and Cooperation (SDC) considers lease finance as "perhaps the most suitable financing instrument for developing MSE's" in Pakistan. The following overview is largely taken from "*Forms of Regional Cooperation in Micro Finance - the SDC involvement in Pakistan*" presented by Ayesha Khan, Programme Officer, SDC during the BWTP workshop in Islamabad on 29 January 2004.

SDC collaborates with five leasing organizations: the Leasing Association of Pakistan, Network Leasing Corporation, Orix Leasing Pakistan, Crescent Leasing Corporation Limited and Al-Zamin Modaraba. Since the inception of the project in 1996, lease finance has been provided to more than 4,000 microentrepreneurs, for a total cumulative disbursement of Rs.40 million.

Lease financing by its nature promotes flexibility through an essentially non-collateralized makeup, cash flow base, and marginal financing practices making it an ideal financing tool for MSE. Generally, due to the financial circumstances of their clients, MSE entrepreneurs cannot meet commercial bank requirements regarding collateral, account information, and management structures making access to reliable capital prohibitively difficult. The practice of leasing enables borrowers to access funds quickly, without the provision of detailed, comprehensive documentation and under simple terms and conditions. In this manner leasing is particularly suited to servicing the needs of impoverished clients.

No requirement for collateral
The leasing company does not require additional security because the lessor retains ownership of the leased asset. The lessor is looking at the ability of the lessee to repay the rental from his future earnings. In case of default, the lessor will seek to repossess the asset so that it can be sold to recover the investment in the lease.

Leasing is term finance
A lease's term is structured to have some correlation with the useful life of the leased asset. The lease term may stretch up to 70% of the estimated useful life of the asset. In this way, should a leased asset need to be recovered due to delinquency, the value of the lease is not depreciated beyond the resale value of the asset.

Risk evaluation relies on alternate criteria
As a result of the diminished need for collateral, risk evaluation is conducted differently from commercial banks. Small entrepreneurs are invariably unable to provide satisfactory financial data for the adequate evaluation of their viability as loan recipients. However, leasing companies, unlike

commercial banks, have the ability to adopt alternate evaluation criteria based on the MSE future cash generation potential as the loan itself acts as its own collateral.

Documentation is simple
Once again due to the self-collateralising nature of a lease arrangement, the requisite documentation usually consists of a standard lease agreement, promissory note and an acceptance receipt evidencing that the asset has been received.

Tax advantages can be considerable
In the lessee's books, the total rent payable (which is combination of principal plus profit) is expensed and is allowable for tax purposes. In case of a bank loan, only the interest portion is allowed, as tax expense although there is the additional charge of depreciation, which in leasing is available to the lessor and not the lessee. Quite often the after tax cost of leasing is lower because the principal amount being repaid in instalment is also allowed as tax expense.

Leasing can operate in harmony with Islamic (Sharia) Law
Considering the absence of usury, leasing is a form of financing particularly attractive to use in Pakistan as it remains permissible under Islamic (Sharia) Law,

The leasing industry and MSE sector offer each other a source of term financing for one and new market opportunities for the other. The business of lease finance essentially requires the lessor to assess and take on the enterprise risk of the lessee and the cash flow the enterprise is expected to generate. Making micro leases, if done properly, has been found to be a profitable activity, besides benefiting the poorer sections of society and thus alleviating poverty.

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Sources

- *"Forms of Regional Cooperation in Micro Finance - the SDC involvement in Pakistan*" presented by Ayesha Khan, Programme Officer, SDC during the BWTP workshop in Islamabad on 29 January 2004