Ex post evaluation – Pakistan

Sector: Informal/semi-formal financial intermediaries (CRS 24040)
Project:
A. Microfinancing programme (THB) (BMZ No. 2008 66 541)*
B. Microfinancing programme (THB – subordinated loan) (BMZ No. 2008 66 509)
C. Microfinancing programme (CM) (BMZ No. 2008 70 261)
Implementing agency: Pakistani Microfinance Bank

Ex post evaluation report: 2018

	A + B (Planned)	A + B (Actual)	C (CM) (Planned)	C (CM) (Actual)
Investment costs (total) EUR million EUR	8.00	8.00	1.00	1.00
Counterpart contribution EUR million EUR	0.00	0.00	0.00	0.00
Funding EUR million EUR	8.00	8.00	1.00	1.00
of which BMZ budget funds EUR million EUR	8.00	8.00	1.00	1.00

*) Random sample 2015

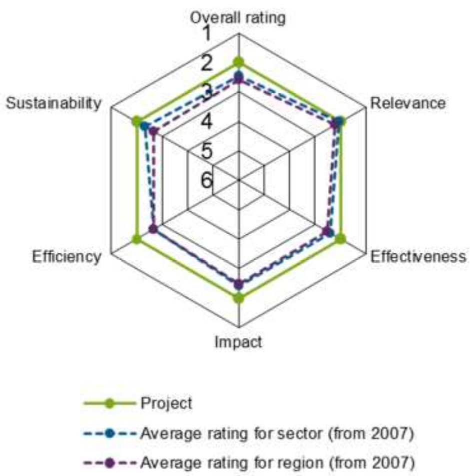
Summary: Alongside creating a national, structured refinancing fund for microfinance institutions, the microfinance programme included (a) an equity investment of EUR 2 million for 16% of the capital in a microfinance bank (MFB) and (b) a subordinated loan of EUR 6 million to fund the further expansion of the bank's business. The equity investment and the subordinated loan helped the bank to formalise its operations and transform part of the operations of an unregulated non-governmental organisation (NGO) – disbursing loans in rural regions – into a microfinance bank. The institutional set-up of the bank was also supported by a sub-component of the complementary measure (CM) for EUR 1 million. The ex post evaluation focuses solely on the afore-mentioned sub-project of the microfinance programme – the microfinance bank – and the associated part of the complementary measure.

Development objectives: The aim of the FC measure was to ensure the sustainable provision and increasing use of microfinance services by micro and small enterprises (MSEs) and (poor) households, especially women. The overarching developmental objective was to broaden and deepen the Pakistani financial sector, thereby creating incomes and jobs, and contributing to gender equality.

Target group: The direct target group of the FC measure was the microfinance bank, which obtained direct access to refinancing and hence to the development of its micro-loan portfolio. The indirect target group of the FC measure consisted of MSEs and (poor) households, especially women, who were to receive improved or even first-time access to appropriate financial services through the microfinance bank.

Overall rating: 2 (all projects)

Rationale: The equity investment, the subordinated loan and the complementary measure all helped the microfinance bank in formalising and transforming part of the operations of a NGO into an independent microfinance bank. Since its establishment in 2011, the bank has become one of the leading microfinance banks in Pakistan, and therefore made an important contribution to formalising the sector and to ensuring improved access to microfinance services in rural areas, especially in the southern districts of Punjab province.



Highlights: In its savings deposit business, the bank averaged a growth rate of 25% per year, thus exceeding the mean market figure, and well exceeding the goals set upon its foundation. Thanks to this business, the bank offers customers who previously had no access to banking services, a safe way to save money. Moreover, the deposits provide a sound refinancing platform in local currency for the loan portfolio, which is similarly enjoying dynamic growth.

Rating according to DAC criteria

Overall rating: 2 (all projects)

Ratings:

Relevance	2
Effectiveness	2
Efficiency	2
Impact	2
Sustainability	2

Breakdown of total costs

	Project A (Planned)	Project A (Actual)	Project B (Planned)	Project B (Actual)	CM (Planned)*	CM (Actual)*/**
Investment costs EUR million	2.00	2.00	6.00	6.00	1.00	1.00
Counterpart contribution EUR million	0.00	0.00	0.00	0.00	0.00	0.00
Funding EUR million	2.00	2.00	6.00	6.00	1.00	1.00
of which BMZ budget funds EUR million	2.00	2.00	6.00	6.00	1.00	1.00

* Only taking into account the part of the complementary measure (CM) intended for the microfinance bank (MFB)

** The funds have not yet been fully disbursed. At present, an amount of EUR 342,878.64 has been disbursed. It is expected that the funds will be fully disbursed by the end of 2018.

Relevance

In 2008, only around 11% of the Pakistan population had access to current or savings accounts, and 12% to formal financial services. Pakistan banks limited their lending to larger companies in urban areas, whereas particularly micro and small enterprises (MSEs) and households in rural regions had virtually no formal financing or savings opportunities. Pakistan's microfinance sector was ranked as one of the largest in the world in terms of demand for credit and other financial services, while actual market penetration was below 10%.[1] Improved access to financial services was included as an important development goal in the national poverty reduction programmes of 2003 and 2009.

The programme approach, consisting of an equity investment, a subordinated loan and a complementary measure, was aimed at supporting the (partial) transformation of parts of the operations of an unregulated non-governmental organisation (NGO) that disbursed loans in rural regions into a sustainable and customer-focused microfinance bank. With the loans, the bank's customers would thus be enabled to lay the foundations for their own businesses, expand existing businesses, or compensate for income fluctuations. It was anticipated that this would increase the social security of customers and create jobs as well as income. Since women are especially affected by the poverty and difficult living conditions in Pakistan, they were to be particularly encouraged as borrowers. Overall, the project approach was an appropriate way of contributing to resolving the core problems. However, the potential of women as borrowers of the bank was overestimated. Furthermore, due to their small size, the loans granted by the bank allowed for only limited development of sustainable business activities through investment in production or capital goods.

The approach was in line with the objectives of the Pakistani government, the financial system development sector concept of the Federal Ministry for Economic Cooperation and Development (BMZ) and the "Global Partnership for Financial Inclusion". The cooperation with other donors and development partners

[1] Source: programme proposal as well as Pakistan Microfinance Network reports

(particularly co-partners) set out in the programme approach was also a suitable means of contributing towards solving the core problems.

Overall, we continue to rate the relevance of the FC measures as good.

Relevance rating: 2 (all projects)

Effectiveness

The aim of the FC measures was to ensure the sustainable provision and increasing use of microfinance services by micro and small enterprises (MSEs) and (poor) households, especially women. The achievement of the programme objectives can be summarised as follows:

Indicator	Status PA, target value PA	Ex post evaluation
(1) The number of loans issued increases by at least 10% per year during the project	0, >= 10% p.a.	22% p.a. (average) August 2016 - August 2017: 25% -> **Indicator fulfilled**
(2) Portfolio at Risk > 30 does not exceed 5% of the gross loan portfolio at any time	0, <= 5%	under 5% each year August 2017: 1.4% -> **Indicator fulfilled**
(3) The proportion of women as borrowers is at least 50%*	0, >= 50%	August 2017: 19.5% -> **Indicator not fulfilled in the current programme, however, significantly higher when including the refinancing fund for MFIs**
(4) Financial Self Sufficiency (FSS)** increases and is over 100% in the fourth year of funding at the latest	0, continuous increase and > 100% after four years	4th financial year (December 2015): >100% August 2017: 118% -> **Indicator fulfilled**
(5) In the fourth financial year, the bank refinances itself up to at least 30% from savings deposits	0, >= 30%	4th financial year (December 2015): 51%*** August 2017: 68%** -> **Indicator fulfilled**

* Indicator related to overall programme

** FSS = Adjusted Financial Revenue / Adjusted (Financial Expense + Net Loan Loss Provision Expense + Operating Expense)

*** Sum of savings deposits / balance sheet total

Since its foundation in 2011, the bank has successfully launched new products and financial services, including savings deposits, microinsurance policies, Islamic financial products and automated teller machine (ATM) services. The bank was able to establish itself as the third largest Pakistani microfinance institution (MFI) with a market share of 10.6% of the outstanding loan portfolio and 12.6% of deposits.

In 2011, a total of 127,018 customers and loans were transferred from the NGO to the bank. The bank was able to increase the number of loans issued by an average of 22% per annum to 419,554 by August 2017 (Indicator 1). At the same time, the outstanding loan portfolio grew by an average of 45% per annum, from PKR 2.1 billion (EUR 18.0 million) to PKR 19.2 billion (EUR 156.9 million). The average loan size also increased from PKR 20,505 (EUR 176) to PKR 45,863 (EUR 374). This rapid growth provides evidence of the high demand among the population for financial services on the one hand, and illustrates the contribution of the project to improved access to financial services on the other hand. However, annual growth in excess of 10% in the long term should also be viewed in a critical light, as overly strong growth can impact on the sustainability of the financial institution (e.g. due to the potential for recruiting insufficiently qualified staff). The indicator therefore holds less weighting in the evaluation.

The share of non-performing loans in the loan portfolio (Portfolio at Risk (PaR) > 30 days) in August 2017 was low at 1.4%, or 2.2% including depreciation (Indicator 2). The bank's risk monitoring processes are assessed as good. Thanks to the availability of reliable borrower information from various credit agencies, including a state-owned credit agency under the State Bank of Pakistan, the bank is able to assess the debt and repayment capacities of its customers.

The bank has successfully undergone the transformation process, developed efficient and professional structures, and built up a solid customer base. The targeted Financial Self-Sufficiency (FSS), which is used to assess the financial sustainability of an MFI, has reached 100% every year since the second year of operation (Indicator 4). In August 2017, the FSS was 118%, reflecting the good profitability of the bank.

Savings deposits increased from PKR 0.6 billion (EUR 5.5 million) in 2011 to PKR 20.7 billion (EUR 169.5 million) in August 2017. Savings deposits have thus increased by 25% per year on average. The goal of financing itself up to at least 30% from savings deposits from the fourth financial year was already achieved by the second financial year (Indicator 5). Meanwhile, the bank has been able to refinance itself up to 68% (77% without taking equity capital into account) from savings deposits. In August 2017 the bank had 795,155 savings account customers. In addition to creating a solid and sustainable funding base for the expansion of the lending business, the target group are offered attractive savings opportunities.

In August 2017, the proportion of women as borrowers was 19.5%, and thus below the target of 50% (Indicator 3). In addition, this figure was below the market average of 53% calculated by the Pakistan Microfinance Network (PMN). However, the above-mentioned indicator was defined for the overall programme (i.e. including the refinancing fund for microfinance institutions). In the latter case, the share of female borrowers is well above 50%. The main reason for the low proportion of women at the MFB is that the bank's main customer base is made up of small farmers, who are almost exclusively men. In urban areas, the bank also issues loans to women, including for the sale of tailor-made dresses, cosmetics or handicrafts. In order to increase lending to women, the bank introduced “Women Empowerment Group Loans”. The share of women in the loan portfolio has already risen slightly, from 16.6% in August 2016 to 19.5% in August 2017, showing a positive trend. From today's perspective, the bank could have taken earlier and more extensive measures to increase the proportion of women, for example by offering additional, tailored financial products or by hiring more female employees, who are severely underrepresented on the bank's staff even today.

The objective of the complementary measure was to assist the bank in transforming and establishing institutional structures and human resources, including management capacities, during the bank's first two financial years. The following measures have been funded thus far: 1) Needs analysis, 2) Development of a business strategy, and 3) Development of the bank's Digital Financial Services (DFS)/Branchless Banking (BB) strategy. Although these measures were subject to delays in implementation, they played an important role in the bank's development following the completion of the transformation. In particular, the development of a strategy for digital financial products was necessary for the bank to position itself in the Pakistani microfinance sector, which is increasingly dominated by mobile banking. The currently remaining funds will be used for training and education measures, process improvements (including a new concept for the branch structure) and to employ long-term experts on a range of strategic and operational issues (including Islamic financing, MSME financing) by the end of 2018.

Contrary to its original plans, the bank has not established itself as a country-wide MFI and has instead set its geographic focus mainly on the South of the Punjab province, notably on the districts around the bank's headquarters in Bahawalpur. The business parts that are still in operation under the umbrella of the NGO serve the Northern districts of Punjab, as well as certain districts in the provinces of Sindh and Balochistan. There has been no further transfer of other branches or districts to the bank since 2011. Thus, the areas originally served by the NGO have been practically split between the NGO and the newly established bank. At an average loan amount of PKR 21,868 (EUR 178), the loans issued by the NGO are much smaller than those granted by the MFB at PKR 45,863 (EUR 374 EUR). Furthermore, the NGO is unable to accept deposits as it has no banking licence. Although Punjab is the most populous province in

Pakistan, and is currently home to 76% of microfinance borrowers, 52% of savings account customers and 82% of insurance customers, the bank's regional focus may limit its long-term growth prospects. This limited focus also leads to concentration risks in the loan portfolio, which are further exacerbated by the bank's sectoral focus on small farmers who grow only a limited number of agricultural products (mainly cotton, wheat and sugar). The bank's geographic and sectoral focus entails significant risk in terms of exogenous environmental factors (including drought, flood and climate change) as well as price risks.

It was deemed necessary to lower the effectiveness rating, as women were not promoted as a special target group of the programme approach to the extent originally planned. Furthermore, due to the delayed implementation of the support measures, the complementary measure made only a limited contribution to the transformation process. However, the measures planned for the future are considered to be appropriate for institutional development. Finally, contrary to its original plans, the bank has operated so far as a regionally oriented MFI, and has thus had an impact only in its core area. Nevertheless, we rate the overall effectiveness as good as the bank has developed extremely well both financially and institutionally and has therefore created the conditions necessary to position itself as the leading MFI in the country.

Effectiveness rating: 2 (all projects)

Efficiency

The investment, in excess of an equivalent of EUR 2 million in PKR (or 16% of the equity capital), strengthened the bank's capital base. Thanks to the bank's full retention of profits to date and the stable exchange rate development of the Pakistani Rupee (PKR) against the Euro, which registered a devaluation of only 6.4% between 2011 and 2017, the value of the investment has now increased to EUR 4.7 million. The maintaining of the real capital value of the investment has therefore been ensured. The capital adequacy ratio is currently at 17.1%, and thus above the minimum of 15% set by the central bank. The subordinated loan of EUR 6 million was disbursed in Pakistani Rupees and has a maturity of eight years; it thus represents a long-term funding option in local currency. It can therefore also count towards the capital adequacy and thus additionally strengthens the bank's capital base. In addition, the subordinated loan played an important role as a risk buffer for the bank when it issued a bond of over PKR 3 billion (EUR 25 million) on the local capital market. At any rate, the subordinate loan was the first of its kind at a Pakistani MFI, and thus introduced a new refinancing product to the market. Taken together, the equity investment and the subordinated loan made a significant contribution to the establishment of a profitable, sustainable and customer-focused microfinance bank.

The subordinated loan was only disbursed in January 2016, following a delay of four to five years compared to the original timetable. This delay was mainly due to the conversion of the originally planned FC loan to a subordinated loan, with the funds being transferred through the Pakistani government. This subordinated loan was then disbursed directly to the bank by KfW, as the trustee. In addition, registering the loan with Pakistan's central bank, purchasing a currency swap and fulfilling the disbursement conditions led to further delays. Ultimately, however, the bank would have had no need for the funds at an earlier date. From today's perspective, the disbursement in January 2016 is still considered by the bank to be good timing.

The complementary measure was intended to support the bank during its first two years. The significant delay in the disbursement of funds is due to the bank having been successful in implementing many of the originally planned development measures in-house with its own resources, as well as to the bank hesitantly identifying the needs for implementing the funds. From today's perspective, the funds earmarked for the complementary measure exceeded both the demand for human resources and the bank's implementation capacities.

The strong growth in loans and savings indicates that the bank's products meet the needs of the target group and the bank facilitates access to financial services in rural areas. An analysis of the average interest rates for ultimate customers at Pakistani MFIs in 2016 showed that the bank's average effective interest rate of 31% per annum came in at the lower end of the MFI spectrum, with average effective rates between 31% and 42% per year. Despite its competitive interest rate structure, the bank has been able to generate profits every year since its establishment.

Altogether, we rate the efficiency of the programme's approach as good.

Efficiency rating: 2 (all projects)

Impact

The overarching developmental objective is to broaden and deepen the Pakistani financial sector, thereby creating incomes and jobs, and contributing to gender equality.

The following indicators were selected at the programme appraisal to measure the target achievement:

Indicator	Status PA, target value PA	Ex post evaluation
(1) At the latest four years after the commencement of the bank's business activities, at least 75% of surveyed SMEs or households experience much more positive income and employment effects.	--, >=75%	2016: 95% -> **Indicator fulfilled**
(2) At the latest four years after the commencement of the bank's business activities, at least 75% of surveyed women experience clear improvements in their financial and/or social situation.	--, >=75%	2016: 86% -> **Indicator fulfilled**

By founding a market-leading microfinance bank, the project has helped to broaden and deepen the Pakistani financial sector. Since the loan portfolio of microfinance banks grew at an average of 45% – in comparison to 9% in the banking sector as a whole – they were able to increase their share of the Pakistani loan portfolio from 0.5% in 2012 to 1.5% in 2016. The bank has made a significant contribution in this regard. The Bahawalpur district, which is considered the bank's core area, has one of the highest market penetration levels of all Pakistani districts in terms of number of borrowers (rank 5), savings account customers (rank 5) and insurance customers (rank 4). Punjab province has a 31% market penetration in relation to borrowers, which is above the national average of 25%.

With regard to the evaluation of indicators 1 and 2 relating to income and employment effects, a survey conducted by the co-shareholder at the beginning of 2016 can be used. This involved conducting a phone survey of 213 randomly selected borrowers at the bank, with questions relating to income effects and the impact of disbursed sub-loans. The methodology underlying this survey was very simple. The results can therefore only be used to a limited extent for the evaluation's purposes. For example, no conclusions can be drawn as to whether the financial services and/or other factors are responsible for the effects described below. The survey found that 95% of borrowers and 86% of the women interviewed confirmed positive effects on their income. The survey also found that 83% of respondents earned less than USD 3.75, and 57% less than USD 2.50 per day. 90% of the bank's loans are issued in rural areas, mainly to smallholders, and 93% are issued without any collateral. 78% of borrowers own fewer than five fields (around two hectares) and 15% of borrowers lease land. This indicated that the bank's main customer group is the poor rural population, as was planned at the project appraisal. The impact on gender equality for women falls short of expectations, however, as there are hardly any women among small farmers. Thanks to the comparatively good regulatory environment, the successful establishment of credit agencies and the strict debt limits placed on microfinance customers by the central bank, the target group has not experienced any over-indebtedness to date.

We rate the overarching developmental impact as good.

Impact rating: 2 (all projects)

Sustainability

The bank has established efficient organisational structures, has operated profitably since its second year, and has a high-quality portfolio. It has created a solid funding base, consisting of deposits, loans from local and international banks and a bond issued on the local capital market, which forms the basis for the planned further expansion of the loan portfolio. The bank's sustainability may be affected, however, by the bank's governance structure. The NGO is the majority shareholder of the bank, holding 52% of the shares. It provides three of the eight (non-executive) members of the Supervisory Board and selects two independent directors, while three directors are delegated by KfW, the IFC and Acumen. The ninth (executive) member of the Supervisory Board is the Managing Director of the bank. As a result, the NGO has a strong influence over important strategic decisions at the bank, which may have a negative impact on its development, particularly in the event of conflicts of interest between the bank and the NGO (for example, when expanding into districts served by the NGO). In addition, the bank's regional focus may limit its sustainability over the long term. Although a market penetration of 31% of potential borrowers in Punjab province still leaves room for growth in principle, borrowing capacity and profitability will tend to diminish with the development of the remaining customer segments. The bank has reported a recent increase in competition for eligible customers among MFIs. Expansion into other provinces would contribute to sustainability by creating growth opportunities, achieving geographic diversification and counteracting potential over-indebtedness risks for customers.

Ultimately, factors beyond the bank's influence may affect its sustainability, including market distortions, interventions in the regulatory environment or a deterioration in Pakistan's economic or political development. Although the government last launched an interest-free and thus potentially market-distorting microcredit programme in 2014, we rate the other state support of the microfinance sector – particularly that offered by the Pakistani central bank – as fundamentally positive, which is reflected in a comparatively well-regulated market environment for MFIs. Economic and political development is also considered to be stable for the time being.

From today's perspective, the bank will continue to be in a position to improve the access of poor, rural MSEs and households to financial services. Due to the good earnings situation of the bank and stable currency development, the maintance of the real capital value of the equity investment has been ensured. In the long term, however, the bank will only be able to prevail against its competitors and implement its vision of becoming the market-leading microfinance bank in Pakistan by operating as an MFI on a national level. Ultimately, the bank should tap into new customer segments with a higher borrowing capacity – as it has already begun to do over the past year or two – in order to further increase its profitability and encourage greater borrower investment in production and capital goods. Altogether, we rate the sustainability of the project as good.

Sustainability rating: 2 (all projects)

Notes on the methods used to evaluate project success (project rating)

Projects (and programmes) are evaluated on a six-point scale, the criteria being **relevance, effectiveness, efficiency** and **overarching developmental impact**. The ratings are also used to arrive at a **final assessment** of a project's overall developmental efficacy. The scale is as follows:

Level 1	Very good result that clearly exceeds expectations
Level 2	Good result, fully in line with expectations and without any significant shortcomings
Level 3	Satisfactory result – project falls short of expectations but the positive results dominate
Level 4	Unsatisfactory result – significantly below expectations, with negative results dominating despite discernible positive results
Level 5	Clearly inadequate result – despite some positive partial results, the negative results clearly dominate
Level 6	The project has no impact or the situation has actually deteriorated

Rating levels 1-3 denote a positive assessment or successful project while rating levels 4-6 denote a negative assessment.

Sustainability is evaluated according to the following four-point scale:

Sustainability level 1 (very good sustainability): The developmental efficacy of the project (positive to date) is very likely to continue undiminished or even increase.

Sustainability level 2 (good sustainability): The developmental efficacy of the project (positive to date) is very likely to decline only minimally but remain positive overall. (This is what can normally be expected).

Sustainability level 3 (satisfactory sustainability): The developmental efficacy of the project (positive to date) is very likely to decline significantly but remain positive overall. This rating is also assigned if the sustainability of a project is considered inadequate up to the time of the ex post evaluation but is very likely to evolve positively so that the project will ultimately achieve positive developmental efficacy.

Sustainability level 4 (inadequate sustainability): The developmental efficacy of the project is inadequate up to the time of the ex post evaluation and is very unlikely to improve. This rating is also assigned if the sustainability that has been positively evaluated to date is very likely to deteriorate severely and no longer meet the level 3 criteria.

The **overall rating** on the six-point scale is compiled from a weighting of all five individual criteria as appropriate to the project in question. Rating levels 1-3 of the overall rating denote a "successful" project while rating levels 4-6 denote an "unsuccessful" project. It should be noted that a project can generally be considered developmentally “successful” only if the achievement of the project objective (“effectiveness”), the impact on the overall objective (“overarching developmental impact”) and the sustainability are rated at least “satisfactory” (level 3).