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Microfinance: A Tool for Financial Access, Poverty Alleviation or Gender Empowerment ? - Empirical Findings from Pakistan

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MICROFINANCE: A TOOL FOR FINANCIAL ACCESS, POVERTY ALLEVIATION OR GENDER EMPOWERMENT? – EMPIRICAL FINDINGS FROM PAKISTAN

A Dissertation Presented

by

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ABSTRACT

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December 2013

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In just 30 years microfinance has transformed from a credit-based rural development scheme that has claimed to reduce poverty and empower poor women, to a $70 billion financial industry. In the process, the traditional NGO-led model has given way to commercialized institutions, resulting in an increased emphasis on profitmaking. This has also led to confusion in the sector around its mission: is it to alleviate poverty and empower poor women or simply to provide the "unbanked" with access to formal sources of finance? This research considers the main debates in microfinance with regard to its mission and presents empirical evidence on the effectiveness of microfinance.

The study is based on the Pakistani microfinance sector, which provides an ideal opportunity for a comparative analysis of two distinct models of microfinance – the nonprofit microfinance institutions (MFI) and the microfinance banks (MFB). The research compares the depth of outreach, mission, practice, and borrower experiences of MFIs and MFBs, employing a political economy framework. The data includes 140 interviews with policymakers, donors, senior, mid and low-level microfinance officers, and their clients; as well as observations of practitioner-client interactions, including the process of disbursement and collection, group meetings, and field visits with loan officers in urban Pakistan. It also comprises two district-level surveys: the microfinance outreach survey from the Pakistan Microfinance Network (PMN) and the Government of Pakistan's Social and Living Standards Survey (PSLM). The surveys are analyzed econometrically to test whether district-level socioeconomic differences affect patterns of outreach.

This study broadens our understanding of the extent to which the local political economy shapes the outcomes of a market-based intervention, such as microfinance. It also provides an insight into the evolution of microfinance, specifically as framed by the global development discourse and subsequent public policy choices. Finally, the study provides an authoritative account of how institutional structure affects microfinance's effectiveness as a tool for poverty alleviation, empowerment and financial access.

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hopping over open sewers, as the temperature soared to a 115 degrees fahrenheit. I interviewed the women in their homes, while he kept the men occupied outside and we both fell in love with our country all over again.

ABBREVIATIONS

AKRSP	Aga Khan Rural Support Programme
ASA	Association for Social Advancement
BRAC	Bangladesh Rural Advancement Committee
DFID	Department for International Development
FINCA	Foundation for International Community Assistance
FMFB	First Microfinance Bank
IFC	International Finance Corporation
IFIs	International Financial Institutions
NRSP	National Rural Support Programme
OPP	Orangi Pilot Project
OCT	Orangi Charitable Trust
PPAF	Pakistan Poverty Alleviation Fund
PMN	Pakistan Microfinance Network
PRISM	Program for Increasing Sustainable Microfinance
RSP	Rural Support Programme
SBP	State Bank of Pakistan
UNDP	United Nations Development Programme
UPAP	Urban Poverty Alleviation Programme
USAID	United States Agency for International Development

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CHAPTER 1

INTRODUCTION

The focus on extreme poverty and the world's poorest has sharpened at an unprecedented level since the 1990s (Morduch and Haley, 2002). Global development institutions, such as the United Nations Development Programme (UNDP), and international financial institutions (IFIs), particularly the World Bank, have elevated poverty alleviation to the policy forefront (World Bank, 2013). The Millennium Development Goals (MDGs), ratified at the Millennium Summit by all 189 United Nations member countries, have been influential in translating the lofty goal of poverty eradication into measurable targets that can be monitored at the country and regional level.

But progress on the MDGs has been uneven. For instance, the first MDG, which calls for halving extreme poverty by 2015, has already been met, but 1.2 billion people continue to live in extreme poverty. Similarly, while there have been dramatic improvements in access to healthcare, primary education, basic housing facilities such as sanitation and drinking water, wide disparities remain between and within countries. It is, therefore, unlikely that most MDGs will be met by the 2015 deadline (United Nations, 2013).

The debate on the best interventions to alleviate poverty has consequently heated up. At the same time, the development narrative seems to have converged on the idea that development should be about poverty reduction but also be mindful of "the voices of the poor" (Narayan-Parker, 2000). This last is a reference to the bottoms-up, participatory processes that allow for beneficiary involvement in the design, implementation and monitoring of the interventions that affect them (Rankin, 2002). In other words, successful interventions must reduce poverty *and* reduce inequality by empowering the marginalized, especially poor women.

During the 1990s, as this concept of development began to gain currency, Muhammad Yunus, an economist in Bangladesh, was able to popularize a rural development scheme that involved lending small amounts of money to some of the poorest women and men in a village near Dhaka, Bangladesh. Even though Yunus's scheme was not the first of its kind (Roodman, 2012) he soon became the iconic face of what became known as microcredit.

Microcredit was originally meant to assist the tiny subsistence businesses of the poor. But the loans had to be repaid with interest, which was usually higher than the market rate. Despite this, Yunus reported repayment rates as high as 96 percent (Yunus and Jolie, 1998), later symbolized by the catchphrase "the poor always pay back" (Dowla and Barua, 2006).

The intervention was initially called microcredit and subsequently renamed microfinance, as other small-denomination financial services were added to the mix, such as microsavings, microinsurance and most recently mobile banking.

Microfinance was soon dubbed the *ideal* development intervention. Studies indicated that it could effectively alleviate poverty, empower poor women (Pitt, Khandker and Cartwright, 2006; Khandker, 1998), and facilitate community engagement through group lending (Osmani, 2007). In such arrangements credit would be extended to groups of between five and twenty, with each member jointly responsible for the loans of others. Members would usually be neighbors, friends or extended family (Gine and Karlan, 2007). Group lending began to be known as solidarity lending and was considered a powerful platform for empowerment (Rankin, 2002).

But microfinance's popularity soon became its greatest challenge, at least from a developmental perspective. Its supporters have ranged from global development institutions, the IFIs, nonprofit foundations, governments, private and institutional investors. Defined as a market-based intervention, for more than a decade, microfinance has been under pressure to deliver on its promise of financial sustainability by phasing out reliance on subsidies and demonstrating commercial viability. This has often led to confusion within the sector with regard to its real mission. The zeal to achieve financial sustainability has led to a dilution of emphasis on both poverty and empowerment (Cull et al, 2008).

This confusion has been heightened by recent research, which indicates that microfinance does not have a significant impact on either poverty or empowerment. The result has been a sharp shift in the narrative. *The Microfinance Handbook*, first published by the World Bank in 1998, but rewritten and re-published in 2013, serves as an authoritative guide on microfinance for donors, policymakers and practitioners. In its 1998 version, the *Handbook* describes microfinance as an intervention that spurs entrepreneurial activity and economic development, alleviates poverty and empowers women.

The 2013 revised version, on the other hand, rejects these earlier claims and does not go beyond describing microfinance as a tool for building financially inclusive systems. The

Handbook argues that financial access is a right of the poor in the global South as much as it is taken for granted by those in the North. This mirrors the human rights-based approach to development, first put forward by the UN and subsequently adopted by other global development institutions, as well as much of the scholarship on the subject (Murphy 2006: 206; Gauri and Gloppen, 2012).

But the *Handbook* explicitly states that only commercially viable microfinance operations can expand outreach sufficiently to meet the demand for credit and other financial services by the poor. These ideas are echoed by recent scholarship on the subject (e.g. Schmidt, 2010). On the other hand, there are ample warnings that commercialization in the sector can dilute the emphasis on poverty and empowerment (e.g. Morduch, 2000; Morduch and Haley, 2002; Cull et al, 2008).

Thus, when it comes to microfinance there are two main issues at hand. The first has to do with how the sector perceives its own mission and the second relates to the mechanics of realizing this mission. The answer to the first often implies a response to the second. For instance, those that contend that the sector's real mission is access to finance usually argue that only commercialized microfinance can expand outreach fast enough and efficiently enough to meet the vast unmet demand for formal financial services (Schmidt 2010).

But even if we go by the narrative of financial access, given the importance microfinance continues to receive by donors, policymakers and global institutions, it is critical to question the impact of access to finance on the lives of the poor. More specifically, has access to microfinance significantly improved the wellbeing of the poor, especially poor women? If the answer to the question is yes then this $70 billion global intervention (Sinclair, 2012) should continue to receive the support of the development community. But if this is not the case then financial access alone may not be a sufficient reason to support this rapidly expanding industry.

The present study employs multiple research methods and a multidisciplinary conceptual framework to study these questions through an analysis of the Pakistani microfinance sector.

There are several reasons why Pakistan makes a good case for this study. First of all, Pakistan has two dominant institutional models of microfinance – microfinance institutions (MFIs), which are incorporated as nongovernmental organizations (NGO), and the much more commercially oriented microfinance banks (MFBs). This makes for an ideal comparative study, especially since the market at present is roughly divided equally between MFIs and MFBs. Such a study would serve as the basis of an authoritative inquiry into the tradeoffs between the financial and developmental objectives of microfinance.

Secondly, though Pakistan is a newcomer in microfinance, relative to Bangladesh and India, it is often referred to as a regional leader for having established the new-age version of microfinance institutions. The *2012 Global Microscope Report*, a sector review published annually by the Economist Intelligence Unit (EIU) calls Pakistan "one of the few countries in the world that has a separate legal and regulatory framework for microfinance banks and is generally considered to have one of the most enabling environments for microfinance regionally and globally" (EIU, 2012: 31).

In the same vein, the Consultative Group to Assist the Poor (CGAP), a policy and research center housed at the World Bank, calls Pakistan's microfinance sector a "laboratory for innovation" (2011). The question is does this also mean better outcomes for the poor in Pakistan, in terms of financial access, poverty reduction and empowerment? The present study will address this question by comparing the mission, practice, outreach and client experiences of the traditional NGO model with the newer, more commercialized MFB model.

Finally, as Pakistan faces serious political, economic and security challenges, its growth has faltered and poverty has risen to unprecedented levels. As a market-based intervention, microfinance is considered by some to be less susceptible to such political economy barriers to development (Swain and Floro, 2008). In fact, the literature on conflict and microfinance argues that microfinance, especially microcredit, can jumpstart economies during and post-conflict, by helping to establish and reconstruct local businesses (Nagarajan and McNulty, 2004; Manalo, 2003; Doyle, 1998). The present study will study the extent to which the local political economy influences the microfinance sector's practice, outreach and client experiences in Pakistan. This includes a mini case study on microfinance's experience in Karachi, Pakistan's commercial and financial hub, but also its most violent city.

The study employs multiple research methods. It begins with an econometric analysis of microfinance outreach at the district level, on a quarterly basis from 2007 to 2012. The purpose is to test whether socioeconomic disparities between districts affect patterns of outreach, and the extent to which these disparities affect MFIs and MFBs differently.

Outreach is defined as the number of people a microfinance institution serves. It can also mean the amount outstanding in an institution's loan portfolio. The proponents of commercialized microfinance claim that its real mission is to provide access to formal sources of finance to the poorest. The econometric analysis is designed to test the relationship between commercialization and financial access.

The findings are detailed in chapter 2. The subsequent chapters, that is, chapters 3, 4 and 5 focus on the poverty alleviation mission of microfinance, while Chapter 6 considers the empirical evidence on microfinance and women's empowerment in Pakistan. These chapters rely on findings from field research conducted between 2010 and 2012. The data includes 140 interviews with policymakers, donors, top, middle and lower-level microfinance practitioners, and currently active microfinance clients in Pakistan. It also includes observations of practitioner-client interaction during group meetings, disbursement and collection of loans, and visits to clients' homes and places of business. Specifically, chapter 3 compares MFIs and MFBs with regard to their mission, practice and client experiences, in the light of social enterprise theory. Chapter 4 reviews the changing global development narrative and how that has influenced microfinance's rise to fame, especially as concepts such as participatory development, the informal economy and social capital have gained traction in defining the process and desired outcomes of development. The chapter also reviews the political economy factors most salient to Pakistan's microfinance sector.

Chapter 5 considers how microfinance practice has evolved over time in Pakistan and analyzes the specific impact of the local political economy on microfinance institutions and their clients. Chapter 6 reviews the literature on gender, development and microfinance and considers the evidence on women's empowerment through microfinance in Pakistan in terms of *change*, *choice* and *power* (Kulkarni, 2011), that is, it asks whether microfinance has been able to change the status quo by increasing women's choices and granting them more power? To answer this the study analyzes empowerment as both a process *and* an outcome (Kabeer, 2001).

A. Conceptualizing Poverty

The main theoretical frame that ties each essay together is the capability approach, which is most often associated with the economist Amartya Sen and philosopher Martha Nussbaum, who have deeply influenced development theory and practice since the 1990s. The approach defines poverty as deprivation of the freedoms people value. People are poor when their opportunities are limited and the means to ensure their wellbeing do not exist for them (Alkire, 2007). This conceptualization of poverty and marginalization is used to analyze the experience of microfinance's clients.

B. What is Commercialized Microfinance?

Microfinance is a set of financial services that targets the poor and the least well off. It includes but is not limited to microcredit, microsavings, microinsurance, and mobile banking. Microcredit continues to be the most popular microfinance product in many countries, including Pakistan. Throughout this text, the term microfinance will refer to formal microfinance activities, products and institutions. Informal microfinance activities, reviewed in Section I below, will collectively be referred to as informal borrowing or informal microfinance.

Commercialization in microfinance is characterized by an emphasis on profitmaking. There is a fine line between achieving financial sustainability and profitmaking. Financial sustainability is the complete phase out of subsidies and requires the institution to generate enough revenue to cover all of its operational and nonoperational costs. Profits can only be earned once an institution is financially sustainable, so in that sense achieving financial sustainability is the first stage and earning profits the second.

Both MFIs and MFBs can be commercialized institutions, but commercialization is more strongly associated with MFBs, for as banking institutions they have to be self-reliant and produce profits after achieving breakeven. Commercialization does *not* imply the charging of interest on microcredit, but very high rates of interest can be used by commercialized entities to earn profits, as discussed in Section I below.

I now turn to the main debates and controversies in microfinance.

I. The Microfinance Debates

Despite its popularity, microfinance has recently become a controversial intervention. The literature on microfinance includes heated debates, conflicting evidence, and controversial claims. This section reviews the main debates in the literature and examines the evidence for and against each one. The first deals with the claim that microfinance is a novel development scheme, the second considers microcredit interest rates, the third presents the dominant views on microfinance's main purpose, and the fourth provides an overview of how this study will analyze the question of commercialization and its impact on microfinance's effectiveness as a development intervention.

I.A. Is Microfinance Breaking New Ground?

To say that microfinance provides the poor with access to finance would be misleading. The poor already have a variety of ways to borrow. Contrary to popular images of informal finance, the moneylender is only one source of informal credit. Others include friends and family, the middlemen that provide them with access to the market and the community general store where they make their routine purchases.

In fact, borrowing between family members, neighbors and friends is so common that a study of rural Nigeria found that on average a typical household was a borrower and lender 2.5 times (Udry, 1994). Similarly, obtaining merchandise or supplier credit is standard business practice in the informal economy, though access can depend on non-economic criteria, such as ethnicity (Biggs et al, 2002). Chapter 3 presents findings from this research that suggests that even currently active microcredit clients routinely tap into multiple sources of informal credit.

Of course, credit is not the only informal financial service. Some form of informal savings clubs or rotating savings and credit associations (roscas), are available in most regions of the global South, and average participation rates are reported to be exceptionally high, ranging between 50 to 95 percent in countries such as Nigeria, Kenya and the Ivory Coast (Bouman, 1995). Roscas have traditionally been viewed as a savings mechanism for individuals with no access to formal savings or credit products (Levenson and Besley, 1996). But new evidence suggests that even when formal mechanisms are available, individuals, especially women, continue to use roscas for different reasons, such as protecting their money from their husbands (Anderson and Baland, 2002).

Similarly, the *hawala* or *hundi* system remains a popular mechanism for transferring money, particularly in the Middle East, South and East Asia. This usually consists of an informal agreement that allows for money to be transferred quickly, efficiently, cheaply and without the level of documentation formal money transfer schemes require (Suleri and Savage, 2006).

Thus, the poor regularly tap into a rich and varied network of financial services. The literature on financial access and microfinance does not include these informal financial services within the microfinance umbrella. In fact, it considers informal finance to be a less than ideal mode of financial service delivery that is assumed to automatically disappear as soon as formal microfinance arrives on the scene.

Microfinance seeks to distinguish itself from informal finance by arguing that it provides non-exploitative, predictable and transparent access to finance (Roodman, 2012). Critics of informal credit say that it is an unpredictable source of finance, it can be exploitative, and if the poor are borrowing from members of their own community then their lenders are likely to be poor also, which implies that the amount borrowed is limited to how much the lender can afford to give (Collins et al 2009).

But the favorite microcredit narrative against informal finance centers round the image of a menacing and evil moneylender who charges such high rates of interest that the debt can never be paid back in full. While this is true of a good number of moneylenders across the global South as well as the North, where pay-day loan shops and credit card companies can be considered new age Shylocks, it is certainly not true of the entire spectrum of informal finance. In fact, a study of rural finance in China finds that borrowing from friends and family does not bear any interest at all, which has made it hard for rural credit cooperatives to penetrate in the region. The authors of the study predict that these same social networks will also crowd out registered MFIs (Turvey and Kong, 2009).

Scholars argue that informal credit is easy to access, is available in small denominations, for very short periods, and involves highly flexible loan agreements that are subject to change even during the duration of the loan depending on the borrower's circumstances (Srinivas, 1993). In one study, Banerjee and Duflo (2011) looked at various slums in Hyderabad, India and discovered that even in areas with an active microfinance presence, only one-fourth of families were borrowing from microfinance institutions, though more than 50 percent remained clients of the local moneylender, despite having to pay higher rates of interest to the latter. They concluded that the moneylender's flexibility on repayment made him a more popular choice.

Similarly, it is also misleading to imply that before microfinance there were no other formal mechanisms to provide the poor with credit. Credit cooperatives, postal unions, savings banks, and government sponsored subsidized credit schemes predate microcredit and continue to exist in the South (Roodman, 2012). For instance, the World Council of Credit Unions reports that there are currently 55,952 credit unions across 101 countries (2012). This data does not include China, where the government runs an estimated 40,000 rural credit cooperatives (Ong, 2013).

But critics contend that government sponsored interventions are generally corrupt, inefficient and most of the credit does not reach the poor because of political connections and bribery (Roodman, 2012; Braverman and Guasch, 1986). In comparison, as a private sector intervention microfinance is expected to be less susceptible to these problems. Chapter 5 presents a political economy analysis of microfinance and discusses the extent to which such representations are true.

I turn now to another controversy, which relates to the rates of interest charged on microcredit arrangements.

I.B. A Question of Interest

Microcredit practitioners have always been defensive about the higher-than-market rates that they charge their borrowers. It is true that microcredit is more expensive than regular credit for the lender, because it costs more to lend in small denominations. The poor also usually live in hard to reach remote areas and microcredit quite literally is offered to the borrower at her doorstep, making it a labor-intensive operation. Finally, as the poor cannot offer collateral in a conventional sense and do not have readily available credit histories, the risk involved in lending to them as compared to lending to the non-poor is greater. If microcredit is to become a financially viable business these costs need to be factored into the interest rate.

When it comes to risk, however, the joint liability nature of the lending arrangement reduces the risk of default considerably. Risk is further reduced by the fact that due to the nature of the loan process, microcredit loan officers are familiar with the places where their borrowers work and live, making it hard for a would-be defaulter to evade repayment, as described in detail in Chapter 3.

But it is also important to question the concept of financial viability, for microcredit rates have often been higher than what would normally appear to be just enough to adjust for risk and to cover the cost of operations. For instance, the Mexican MFB Compartamos has charged its clients rates in excess of 100 percent (Rosenberg, 2007). Other examples include Badan Kredit Desa of Indonesia and BancoSol of Bolivia, the former is known to charge 55 percent nominal interest on its loans while the latter's rates have ranged between 47.5 to 50.5 percent (Morduch, 1999).

A recent survey of interest yields, which is the ratio of the total interest accrued over the life of the loan, finds that the current global microcredit interest yields average at 27 percent. The lowest yields are in South Asia, where the cost of labor is the lowest and political considerations have put effective caps on rates, at least in Bangladesh and India. In regions such as Africa and Latin America yields are often higher, varying between 20 and 50 percent (Rosenberg et al, 2013).

But what about the contention that higher rates are necessary to support the high cost of microcredit operations? The same survey finds that of the 879 institutions surveyed across all Southern regions, a quarter earned more than 20 percent on shareholder investments, while 5 percent earned more than 40 percent in profits. The study shows that profits as a percentage of interest income have declined from 20 percent in 2004 to 10 percent in 2011. Nevertheless, 10 percent is fairly significant for an intervention designed to reduce poverty.

But the question of profits refers back to the broader issue of commercialization, which is one of the main themes of this thesis. The next section reviews the debates on microfinance's developmental objectives.

I.C. The Mission: Poverty Alleviation or Financial Access?

The idea that financial inclusion can overcome chronic poverty may have gained currency recently (Morse, 2000; Weiss, et al, 2003), but it is nested within an older narrative, known as the *finance-growth nexus*. More than forty years ago Goldsmith (1969), McKinnon (1971) and Shaw (1973) argued that financial development was necessary for economic growth. The main argument was that a healthy financial system would promote economic development by raising the level of domestic savings and investments, especially among financially constrained borrowers (King and Levine, 1993; Claessens, 2006; Beck, Levine and Loayza, 1999).

More recently, this theoretical framework has been employed to assess the impact of financial development on poverty and inequality across the global South (Li, Squire, and Zou, 1998; Rajan and Zingales, 2003). For instance, Bucchianeri, Burgess and Pande (2005) study the impact of the Indian government's credit initiative that required commercial banks to open bank branches in rural areas and conclude that poverty decreases faster in areas where more bank branches have been opened.

This literature introduces access to finance as an important, perhaps even necessary, ingredient of anti-poverty policies (Hulme and Mosley, 1996). Often referred to as the "democratization of finance" argument, its proponents argue that formal finance has the capacity to overcome the economic exclusion of the poor. Shiller, in describing access to finance as a moral imperative in his book *The New Financial Order* (2003: 2), argues that "we need to democratize finance and bring the advantages enjoyed by the clients of Wall Street to the customers of Wal-Mart", because, "finance must be for all of us in deep and fundamental ways". In a similar vein, Ferguson notes in *The Ascent of Money* (2007: iv) "poverty is not the result of rapacious financiers exploiting the poor. It has much more to do with the lack of financial institutions, with the absence of banks, not their presence." Such arguments parallel the "credit as a basic human right" proposition, first popularized by Yunus (2004) and now an integral part of the mainstream microfinance literature.

At the same time, Ferguson's (2009) claim that access to finance can overcome poverty and marginalization includes only the "industrious poor" (2007: iv). The question is, how many poor individuals are we to consider "industrious"? Traditional microcredit theory claims that most poor people *are* industrious, in other words, ready and willing to become entrepreneurs, particularly if they happen to be women (Yunus, 2004).

The idea behind microfinance, at least as it was originally formulated, was to introduce formal financial services to those working in the informal economy, where by some estimates, the smallest businesses on average produce a marginal return on capital of 100 percent per annum (Huegerich, 2012). A study of Pakistani microenterprises estimates that the average return on assets varies between 29 and 133 percent (Shorebank International, 2011). Of course, what is not mentioned in these studies is that the businesses of the poor are chronically short on capital and the difference is made up by intensive use of family and non-family, wage or unpaid labor. This means that measures such as return on capital and return on assets tend to conflate the true picture.

Nevertheless, such studies have greatly influenced our view of the businesses at the "bottom of the pyramid" (Pralahad, 2005) and microfinance continues to be considered a necessary ingredient in the "inclusive growth" model (Khavul, 2010). In this model, microenterprises serve to fuel economic growth and social transformation.

But even scholars sympathetic to microfinance have begun to admit that not every poor individual is capable or even interested in becoming an entrepreneur. Instead, poor families need credit for day-to-day events such as sending their children to school, making home improvements and paying for funerals (Bauchet et al, 2011). Ogden and Morduch (2013), who run the Financial Access Initiative in New York, employ a rights-based narrative to argue that there needs to be a shift away from a single-minded focus on entrepreneurship and formal financial services should instead be considered a basic right for all.

But if the discussion so far seems more about the poor and less about their poverty, it is because this is exactly how academic inquiry into microfinance has turned the corner. The publication of the first randomized control trials of a microcredit intervention in Andhra Pradesh, India can be considered as the marker for this shift in narrative. In 2009, researchers at the Massachusetts Institute of Technology's (MIT) Poverty Action Lab published the results of this study, which showed that 15-18 months after microlenders frst began to operate in the area, access to microcredit did not increase consumption per capita and there were no measurable impacts on health, education or women's decision making (Banerjee et al, 2009).

The furor caused by the publication was understandable since prior to this the most influential scholarship on the subject was considered to be Shahidur Khandker's. Using panel data fromm Bangladesh, Khandker (1998 and 2003), a World Bank economist, established that microfinance was associated with a significant reduction in poverty, especially when it came to poor women.

Banerjee et al's (2009) study was not the first to find that the link between microfinance, poverty and empowerment was ambiguous. Morduch (1998) had earlier replicated Khandker and Pitt's (1998) research and his study found that while microcredit was associated with a reduction in the consumption volatility of the poor, it did not increase overall consumption levels. Other studies have also confirmed that microfinance does not have a significant impact on the wellbeing or empowerment of the poor (Duvendack et al, 2011; Karim, 2011; Isserles, 2003).

It is little surprise then that microfinance's supporters have now opted to promote it as a tool for financial access, rather than poverty alleviation and women's empowerment. The argument is that access to financial services allows the poor to smoothen their income and consumption, manage their risks and build their productive and non-productive assets (Ledgerwood, 2013).

At the same time, if there is no solid evidence against improvements in the poverty and empowerment status of its clients, can deep investments in microfinance by global institutions, governments of the South and charitable organizations continue to be justified? I return to this question in the concluding chapter after reviewing the evidence on microfinance's experience in Pakistan in the chapters that follow.

These chapters will examine the evolving nature of microfinance in Pakistan and how this has affected the various goals of microfinance proposed by its proponents. I turn now to the last debate to be considered in this section.

I.D. The Mechanism: Traditional NGOs or Commercialized Institutions?

Commercialization in microfinance is no doubt a direct consequence of the pressure by global institutions and governments on microfinance institutions to achieve financial sustainability. But it is also the result of rising private debt and equity investments in the microfinance industry. Current investments in microfinance investment funds, which are global investment vehicles that direct the flow of funds to microfinance institutions in Southern countries, are estimated at $7.5 billion (MicroRate, 2013). This is only one source of investment, others include direct investments by private individuals and institutions. Online investments, through websites such as Kiva.org, are also popular.

As a result of these developments, many of the older, more established institutions have already transformed into profitmaking institutions, while newer institutions are often set up as commercial ventures. In chapter 3, I analyze the impact of legal structure on microfinance's mission, practice and borrower experiences. In chapter 2, I discuss the specific impact of institutional form on microfinance outreach at the district level in Pakistan, by comparing socioeconomic disparities between districts. In chapter 5, I discuss findings related to the impact of the local political economy on each institutional group. Finally in chapter 6, I discuss the impact of institutional form on women's empowerment or lack thereof.

The following section briefly reviews the evolution of microfinance in Pakistan, which is followed by an overview of the policy landscape in which microfinance must operate in Pakistan.

II. Microfinance in Pakistan – Historical Brief

During the early 1990s two major Pakistani NGOs – the Aga Khan Rural Support Programme (AKRSP) and the Orangi Pilot Project (OPP), introduced microcredit in the communities where they worked. The basic aim of both institutions is poverty alleviation through community development (Hasan and Raza 2011; Rauf and Mahmood 2009). Following the AKRSP's success, other rural support programs (RSPs) were established in different parts of the country. There are now a total of 11 RSPs and all of them offer microfinance, that is, microcredit as well as microsavings and microinsurance (RSPN 2011). By the late 1990s, 80 percent of all active microcredit clients were accounted for by the RSPs (Rasmussen et al 2004).

Also in the late 1990s, institutions such as Kashf Foundation began to be established. These were different in that they were set-up exclusively as microfinance institutions, and many of them offered credit primarily to women. These MFIs followed the traditional group-lending model (Jaffer, 1999).

But the 2000 Microfinance Bank Ordinance changed the dynamics of the sector and the first MFBs were established. Today there are a total of 11 MFBs and 24 MFIs registered with the Pakistan Microfinance Network (PMN), the national association of microfinance institutions and banks, accounting for 2.53 million microborrowers (MicroWatch, 2013). Currently, 41 percent of total active microborrowers are accounted for by MFBs and the rest by the MFIs. In terms of the gross loan microcredit portfolio, MFBs account for 57 percent of the total and MFIs 44 percent of the total (MicroWatch, 2013).

While both offer nearly the same service, there are important differences between MFIs and MFBs, the most salient of which are outlined in Table 1 below:

Table 1 Institutional Differences Between MFBs and MFIs

	MFBs	MFIs
Legal Form	Banking institutions	NGOs, with one exception – Orix Leasing, a non-bank financial institution.
Regulation	Regulated by the State Bank of Pakistan (SBP) as per the Microfinance Bank Ordinance	Can be registered under any of the following acts: Companies Act, Trust Act, Societies Registration Act or Voluntary Social Welfare Agencies Act.
Funding	Deposits, commercial bank loans, and specialized grants through the SBP and the Pakistan Poverty Alleviation Fund (PPAF).	Soft lending from the PPAF, grants and subsidies from other donors. The largest MFIs have been able to raise funds from local commercial banks.
Deposit Mobilization	Yes	Deposits collected must be deposited with licensed commercial banks, cannot be used to fund operations.
Products and services	Usually restricted to microcredit, savings, and mandatory life insurance for life of the loan, can also include health insurance.	Microcredit, savings and insurance products - usually life insurance for life of loan, can also include health insurance. Many MFIs also engage in social mobilization and community building activities.

The State Bank of Pakistan (SBP) regulates all MFBs under the 2000 Microfinance Bank Ordinance, but MFIs are registered under various acts, which means that they have no regulatory consistency. In terms of funding, it is hard to determine which type of institution experiences more constraints. At first glance it would appear that MFIs have it easier since they can get grants through individual arrangements with donors and charitable organizations, as well as soft loans from the Pakistan Poverty Alleviation Fund (PPAF). The PPAF is a “social fund” established by the World Bank that acts as a wholesaler of World Bank sourced funds to microfinance institutions at below credit market rates.

In contrast, MFBs have to raise their own money either through deposit mobilization or from commercial banks. But MFBs in Pakistan also have access to concessional facilities and grants through the SBP. These facilities are funded by the UK's Department for International Development (DFID) and the Asian Development Bank. In addition, the PPAF has recently introduced a Program for Increasing Sustainable Microfinance (PRISM) Facility, which allows MFBs to seek concessional funding from it (Pakistan Microfinance Review, 2012). This is the first time since its inception in 1999 that the PPAF is no longer lending exclusively to MFIs.

In terms of deposit mobilization, both MFBs and MFIs can accept deposits but only MFBs are allowed to use deposits to fund operations (Haq and Ahmed, 2010). MFIs have to deposit all savings collected from their clients with a licensed commercial bank. Deposits are an important source of funding for MFBs. In fact, MFBs are allowed to accept deposits from anyone, not just the poor. Therefore, while savings collected by MFIs represent savings by the poor, savings collected by MFBs cannot be considered just the savings of the poor.

At the same time, the savings collected by institutions such as the National Rural Support Program (NRSP), which alone is responsible for 73 percent of rural savings (Microwatch, 2013), cannot be considered voluntary savings. This is because the lending arrangement stipulates that at the time of disbursement 10 percent of the loan must be deposited in a savings account for the borrower. These are precautionary savings in case of default. Thus, despite the fact that there are currently more than 4.8 million so-called "micro-savers" that together account for more than Rs[1]. 25 billion ($250 million) in savings, these can neither be considered as the exclusive savings of the poor nor can they be considered strictly voluntary.

Similarly, microinsurance in Pakistan is not a financial service that the poor voluntarily purchase. Most microfinance institutions require that 2 percent of the loan proceeds be put towards credit life insurance. This is meant to cover loan repayment in the event of the borrower's death, and the policy's main purpose is to cover the institutions' portfolio risk (PPAF, 2012).

Some institutions, such as the NRSP, also offer health insurance to their borrowers. Other health insurance programs include the government-run Benazir Income Support Program's (BISP) microinsurance program, with eligibility determined through a means-tested poverty scorecard. This program, however, is still in a pilot-stage, and most micro-health insurance programs are limited to hospital visits and do not cover outpatient healthcare.

Crop insurance is a new area of focus since the 2010 floods and both the PPAF and the government have recently piloted various microinsurance schemes for farmers, including an index-based crop and a livestock insurance program (PPAF, 2012). The results of the pilot though are not yet available.

Overall, however, while there are currently 3 million microinsurance policy holders in the country (Microwatch, 2013), the data on microinsurance needs to be treated with caution, since the greatest proportion of currently outstanding policies are credit life insurance

[1] Rs. is short for Pakistani Rupees. The exchange rate used here is US$1 = Rs. 100 reflective of the official rate as of June 2013.

policies, which as mentioned above, are compulsory rather than voluntary and are mainly aimed at reducing the lender's risk.

Finally, social mobilization and community engagement, an important component of participatory development, has traditionally been a central focus of the microfinance movement (Rankin, 2002). The original group lending model is particularly well suited to community participation, as the stipulation of joint liability and mandatory attendance at group meetings is said to harness the community's social capital, broadly defined as a community's network of trust and engagement (Putnam, 1995: 67). While most MFIs in Pakistan continue to rely on group lending arrangements, MFBs are increasingly in the process of replacing group lending with individual lending, as detailed in chapters 3 and 6. Of course, group lending has its own problems due to which several MFIs have recently modified their group lending models. This is discussed in detail in chapter 6. Further, while social mobilization has traditionally been considered an important component of MFI operations, the largest MFIs in Pakistan, including the NRSP and AKRSP have now separated their social mobilization activities from their microfinance operations by spinning off their microfinance portfolios into standalone MFBs. Thus, microfinance has become a less participatory intervention overtime, at least as practiced in Pakistan. Details are provided in chapter 5. I now turn to the policy landscape, with particular reference to how microfinance fits within the country's development paradigm.

III. The Policy Landscape

In July 2013 the Pakistani microfinance sector held its Annual Microfinance Summit. One of the main conference panels was titled "The grand debate in microfinance: whether growth in microfinance should focus towards poverty reduction or access to finance". The title, which speaks for itself, symbolizes the confusion facing microfinance practitioners, policymakers and donors.

The lack of clarity stems at the policy level, as is evidenced by a study of Pakistan's Poverty Reduction Strategy Paper (PRSP). The PRSP approach, initiated by the World Bank and the International Monetary Fund (IMF) in 1999, forms the basis of a countrywide comprehensive poverty reduction strategy, for each country the IFIs lend assistance to (IMF, 2013). Pakistan's first PRSP, PRSP-I, was developed in 2003 and the second, PRSP-II, in 2009 (Government of Pakistan, 2012).

PRSP-I constitutes a four-part poverty reduction strategy, which includes policies to accelerate economic growth, develop mechanisms to improve governance and devolution, invest in human capital, and target the poor and vulnerable with direct transfers. Microfinance features prominently in the last category, that is, direct targets for the poor and vulnerable. The PRSP describes microfinance as a "viable tool" that has the potential to reduce poverty and empower women, but cautions that it must be scaled up in a sustainable fashion. Free markets and private capital investments in microfinance are described as the mechanisms that would enable the sector to achieve financial sustainability.

The PRSP also predicts that as microfinance expands its outreach in the country, social mobilization and participatory development will become a dynamic process. Thus, it is clear that the PRSP presumes that private investment and private actors will work through the market to reduce poverty. This market-driven ideology is not new to Pakistan, as detailed in chapter 4.

In PRSP-II, published in 2009, there is a distinct change in tone and content, at least with regard to microfinance. Microfinance features in the second and eighth pillars of the nine-pillar poverty reduction strategy of PRSP-II. The second pillar, titled "protecting the poor and the vulnerable", corresponds to the fourth pillar of PRSP-I. Microcredit is included here as part of a broader social protection strategy for the "poorest and most vulnerable segments of society". The most recent PRSP monitoring report, which provides data for the first quarter of fiscal year 2011-12, includes microloans worth Rs. 8,360 million in the "direct transfers to the poor and vulnerable" category. This is in reference to microcredit disbursements made through Khushhali Bank, the only quasi-public sector MFB in the country at the time. At the same time, the categorization of microcredit as a "direct transfer" is problematic since these loans have to be repaid with interest. Nevertheless, most of the discussion on microfinance in PRSP-II has moved to the eighth pillar, titled "capital and financial development", where it is incorporated within a wider financial inclusion strategy. The document lauds the SBP's efforts in promoting commercialization in the microfinance industry. PRSP-II also stipulates that the SBP should continue encouraging MFIs to develop commercially sustainable operations and eventually to enter the financial mainstream by transforming into MFBs. The shift in the narrative regarding microfinance between the two PRSPs mirrors the shift in the global narrative on microfinance, as described in Section I above.

It is also obvious that there is a clear policy preference towards MFBs, which may have already resulted in the neglect of MFIs. A major manifestation of this is that since 2000 the largest MFIs have been compelled to spin off their portfolios, either in part or in entirety, into independent MFBs. Three of the 11 MFBs in the sector are MFI spin-offs and others may soon join the group.

MFIs have several incentives for transforming into MFBs. First of all, transformed MFBs receive a 5-year tax holiday. Secondly, while commercial banks are reluctant to lend to most MFIs, the SBP's partial risk guarantee to commercial banks on MFB loans makes commercial bank loans more easily available for MFBs.

Another incentive is the SBP's regulation on deposits, which prevents MFIs to use deposits to fund operations. Deposit mobilization, on the other hand, is an important, low-cost source of funding for MFBs. This serves to attract large MFIs, such as the NRSP, to the MFB sector. In the first quarter of 2011, the NRSP mobilized more than 51 percent of total active savers for the microfinance sector (Pakistan Microfinance Network database, 2011). When NRSP spun-off part of its portfolio to the newly created NRSP Bank, which became operational in 2011, the savings were taken up in part by NRSP Bank and were used for the first time to fund microfinance operations.

The SBP regulates MFBs through the Prudential Regulations[2] for Microfinance Banks, which have been fashioned out of the Prudential Regulations for Banks, but especially

[2] A legal framework instituted by a country's central bank in order to regulate all banking activity within the country.

relaxed in order to promote the MFB sector. As of December 31, 2012, the minimum capital requirement for a regular commercial bank was Rs.19 billion (US$190 million[3]), but for an MFB operating at the national level it was only Rs.800 million (US$8 million). In addition, MFBs, as mentioned in Table 1, have access to special development funds. These funds include the Financial Inclusion Program, the Institutional Strengthening Fund and the Improving Access to Financial Services Fund. Grants for setting up all, except the last of these facilities come from the UK's Department for International Development (DFID). The last was set up with a US$20 million endowment from the Asian Development Bank (Akhtar, 2008).

The SBP has also relaxed the prudential regulations to allow the MFBs to lend against gold jewelry as collateral, which the SBP defines as "zero risk lending". Gold backed loans are now included in the portfolios of all major MFBs and this product has managed to overtake uncollateralized lending for the fastest growing MFBs.

Finally, a key incentive that has led to the setting up of two new MFBs in the last year alone is the SBP's branchless banking initiative. Capitalizing on the global mobile banking movement, the SBP issued a branchless banking initiative in 2008 and revised it in 2011. It called for the setting up of mobile bank accounts, referred to as "mobile wallets". The 2011 revised guidelines for branchless banking include waiving all paperwork requirements for setting up electronic bank accounts, the removal of biometric information requirements for account opening and an upward revision on transaction limits (Pakistan Microfinance Review, 2011). The World Bank based Consultative Group to Assist the Poor (CGAP) has called Pakistan a regional leader in mobile banking, while

[3] US$1=Rs. 100 as of June 2013

the EIU includes Pakistan among the top five countries in the world for mobile banking (EIU, 2012: 12). In the quarter ending December 2012, 34.3 million transactions, worth US 879 million, were completed through the mobile banking network in the country (Chen, 2013). At the same time, the proliferation of mobile banking has so far only served a transactional purpose and neither credit nor savings products are as yet available through mobile banking facilities.

Overall, however, there is no doubt that these incentives and initiatives have helped the industry grow and in a country where investment rates have been falling for the past five years, it has brought badly needed local and foreign private investment into the sector. In June 2012, the country' largest MFB, Khushhali Bank was bought out by a consortium of local and international investors. Similarly, in 2012 the SBP issued three MFB licenses and these went either to private mobile phone company operators or private investment companies.

Nevertheless, the pace of commercialization that has overtaken the industry has to be viewed from the point of view of the industry's clients and those that get left behind due to the increased emphasis on low-risk, high return investments. This is the subject of the present inquiry, and in order to provide a frame for the discussion that is to follow in the next few chapters the following section provides an overview of the nature of poverty and underdevelopment in Pakistan.

IV. The State of Underdevelopment

Pakistan, a lower-middle income South Asian country (World Bank, 2012) of 179.2 million, has four main provinces: Punjab, Sindh, Balochistan and Khyber Pakhtunkhwa

(KPK). Also included within its territory is the tribal belt along the north-western border with Afghanistan - referred to as the Federally Administered Tribal Areas (FATA), the northern region of Gilgit-Baltistan, and Jammu and Kashmir, the territory in dispute with India. The data on these regions is sparse and it is, therefore, difficult to include these in a meaningful socioeconomic analysis.

As of June 2012, the country's gross domestic product (GDP) stood at US$ 231.2 billion (World Bank, 2012), though the past five years have seen a general slowdown in its economy. Prior to this, during the first half of the 2000s economic growth hovered around 7 percent (Husain, 2009), but during the 2008-09 fiscal year it dropped to 0.4 percent. Since then growth has only averaged at 2.94 percent (Economic Survey of Pakistan, 2013), despite the fact that the minimum rate needed to keep pace with the annual increase in the labor force in Pakistan is 7 percent (Rehm and Noshab, 2013). There are several reasons behind the current state of economic affairs, which are detailed in chapter 5, where it is also discussed why growth in Pakistan is not always consistent with poverty reduction. But in this section I review the actual state of underdevelopment in Pakistan, using the MDGs as a framework for understanding the nature and extent of poverty.

The headcount ratio, an income-based measure, is a useful starting point for analyzing trends in poverty over a period of time. Pakistan's headcount ratio indicates that the percentage of people unable to afford a basket of basic goods has risen from 24 percent in 1997 to 36.79 percent in 2011 (Jamal, 2013). The first MDG calls for reducing poverty by half, using 1990 as a baseline. For Pakistan, this would require the headcount ratio to fall to 21 percent by 2015, an unlikely scenario given the present trend.

National averages gloss over wider regional disparities. For instance, while the poverty incidence in the nine largest cities of Punjab averages at 26.41 percent, the same ratio for the small towns of Balochistan is as high as 62.26 percent (Jamal, 2013).

Progress on the rest of the MDGs has also suffered in the past five years, mainly due to the socioeconomic and political conditions reviewed in chapter 5.

II.A. Hunger

The first MDG's second target calls for halving the proportion of people suffering from hunger between 1990 and 2015. For Pakistan this would mean achieving a ratio of 20 percent or lower (UNDP Pakistan, 2013), but that seems an unlikely target to meet, given that 48.63 percent of the population currently faces food insecurity (World Food Program (WFP), 2013).

The most vulnerable provinces in terms of food security are KPK and Balochistan. In KPK, 68 percent of the population in the tribal belt and 56.2 percent in the rest of the province is food insecure. In Balochistan, the food insecure population is estimated at 61.2 percent (Arif, 2013).

District-wise, 80 out of 113 districts have food insecure populations. The most vulnerable is Dera Bugti in Balochistan, where 82.4 percent of the population is food insecure.

Latest estimates indicate that the average household in Pakistan spends 46 percent of its total budget on food, compared to 35 percent in India and only 7 percent in the US (Arif, 2013).

Persistent hunger and the malnutrition that accompanies it is a crisis in itself, for instance

51 percent of women and 62.5 percent of children under-five suffer from anemia in Pakistan (WFP, 2013), but hunger also affects other aspects of development such as education, health and economic growth.

II.B. Education

The second MDG calls for achieving universal primary education by the year 2015. The three indicators that measure progress on this goal include (a) the net primary enrollment ratio (b) the school completion rate from grade 1 to 5 and (c) the literacy rate. According to the 2010-11 Pakistan Social and Living Standards Measurement Survey (PSLM), a national survey that tracks progress on MDG targets, net primary enrollment was only 56 percent, as opposed to the 100 percent required to meet the related MDG. Of course, enrolment refers to the first day of the school year, not the last, which means the high rate of dropouts is not inclusive of it. It is estimated that only about half of those who enroll are able to complete primary schooling (UNDP Pakistan, 2013).

Further, only about 58 percent of the Pakistani population is literate, as opposed to the 88 percent required to meet the MDG target by 2015 (PSLM 2010-11; Pakistan Millenium Development Goals Report 2010). There are also wide gender and regional disparities in literacy, which is defined as the ability to write a simple letter and to be able to read a newspaper. By all accounts Pakistan is unlikely to meet its educational goals by the 2015 deadline.

II.C. Gender Equality and Empowerment

The third MDG relates to gender disparity in education, employment and political participation (UNDP, 2013). Progress on gender parity in education is measured using the gender parity index (GPI), which is a measure of women's access to education relative to men's. Pakistan's GPI for primary school enrolment is 0.82 and 0.84 for secondary school enrolment, while the GPI for youth literacy is 0.78. Even though the GPI has improved overtime, it is highly unlikely that full gender parity in education will be achieved by 2015.

The goal also includes gender disparity in terms of employment. According to the 2010-11 Labor Force Survey, the overall female labor force participation rate is only 15.6 percent.

The political arena is where the greatest progress in reducing gender disparities has occurred. In the year 2000, a resolution was passed which raised the quota for women in provincial assemblies to 33 percent and 17 percent for the national assembly. The number of women contesting in the May 2013 national elections was also 130 percent higher than the number participating in the 2008 elections.

But here again regional disparities are stark. In several districts of KPK and the federally administered tribal areas (FATA), women were barred from voting during the 2013 elections, though in the districts of Bajaur and Mohmand Agencies of FATA women were able to cast their vote for the first time ever (The Nation, May-2013). Similarly, in the by-elections held on August 22, 2013 women were barred from voting in some areas of Punjab and KPK (Dawn, Aug-2013).

II.D. Health

MDGs 4, 5 and 6 relate to health disparities, specifically related to child mortality, maternal health, and the prevalence of HIV/AIDS, malaria and other diseases. Table 2 provides comparisons between actual status and the MDG targets for each indicator monitored under the three goals:

Table 2 Targets for MDG Goals 4, 5 and 6		
Health Measure	**Latest Available Figure**	**MDG Targets 2015**
Infant Mortality Rate (per 1000 live births)	75 (2006-07)	40
Full immunization[4]	81 (2010-11)	>90
Incidence of diarrhea in children[5]	11 (2010-11)	<10
Lady Health Worker coverage[6]	83 (2008-09)	100
Maternal Mortality[7]	276 (2006-07)	140
Percentage births attended by skilled attendants	43 (2009-11)	>90
Percentage getting prenatal care	64 (2010-11)	100
Percentage getting prevention treatment of malaria	30 (2008-09)	75
Incidence of tuberculosis per 100,000	181 (2008-09)	45

*Sources: PSLM 2010-11, MDG Report 2010

Despite the fact that most indicators have improved over time, the available figures make it clear that it is unlikely any of the targets under goals 4, 5 or 6 will be met by the 2015 deadline.

II.E. Environmental Sustainability

The seventh goal pertains to environmental sustainability. Access to clean sources of drinking water is a particularly relevant measure in this regard for Pakistan. The 2010-11 PSLM indicates that only 32 percent of the population had access to tap water while another 28 percent had access to water through a hand pump. Other sources include

[4] Percentage of fully immunized children 12-23 months based on record and recall
[5] Percentage of children under five who suffered from diarrhea in the last 30 days
[6] Coverage of target population (percent)
[7] Per 100,000 live births

motor pumps and wells but their usage is much lower. Access to a safe water source remains a challenge, especially for the poorest, due to both water scarcity and surface water pollution, which is a major cause of water-borne diseases in Pakistan (Pakistan Millenium Development Goals Report 2010).

Availability of toilet facilities is another important measure of environmental sustainability. The 2010-11 PSLM indicates that 18 percent of the population does not have access to toilet facilities, and for districts such as Rajanpur in Punjab and Kohistan in KPK this percentage rises to nearly 70 percent. The World Health Organization (WHO) and the United Nations Children's Fund (UNICEF) estimate that 91 million people in Pakistan live without proper sanitation facilities.

Overall, as economic growth continues to struggle and the political will on addressing these issues remains weak, poverty rates are likely to keep rising. Nevertheless, the MDGs feature prominently in all major development blueprints in the country, including the Medium Term Development Framework (MDTF), the poverty reduction strategy papers (PRSPs) and the New Growth Framework.

Taken together, these documents define Pakistan's official development paradigm. It is important to note that the overarching development framework is based on the idea that free markets, privatization, and increased service delivery by NGOs and the private sector are the solutions to Pakistan's development problems. This is discussed in more detail in chapter 4. This chapter concludes with a brief note on the main contributions this research aims to make.

V. Contributions and Research Significance

There are three main ways in which the present study makes important contributions to the existing literature. First of all, it provides an insight into the evolution of microfinance, in light of the global development discourse and the public policy choices that have been made in this regard. It then uncovers how this evolution has played out in actual practice on the ground and its subsequent impact on the intervention's clients and those that get left behind.

Secondly, the study provides an authoritative account of how institutional structure impacts microfinance's effectiveness as a development intervention, especially as traditional NGO microfinance institutions (MFIs) transform into microfinance banks (MFBs). Countries, including India, Sri Lanka and several African nations, are currently in the process of drafting regulations to convert their microfinance institutions into banking institutions that can be regulated directly by the central bank, in the hope of expanding outreach and achieving financial sustainability. This study can serve as a source of lessons learnt to these countries and others that may join in later, for it provides insights into how development processes and outcomes such as social mobilization, women's empowerment and other aspects of individual wellbeing are affected when institutional structures are transformed.

Finally, the study deepens our understanding of how the local political economy shapes and constrains development, even when the intervention is market-based and self-sustainable. The role of microfinance in conflict-affected areas is examined in detail. In addition, the impact of an economic crisis, weak governance, corruption and culturally persistent gender disparities is discussed with respect to microfinance.

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CHAPTER 2

COMMERCIALIZATION AND FINANCIAL ACCESS

For those that believe commercialization in microfinance is the only way to make meaningful social and developmental change, the evolution of microfinance from a welfare driven activity to a commercially viable banking business has been a “stunning success” (Schmidt, 2010). And indeed in just 30 years microfinance has grown to become a $70 billion dollar global industry that has reached 200 million individuals through microcredit alone (Sinclair, 2012). Proponents of commercialization insist that only by following sound banking principles can institutions reach the maximum number of poor people (Morduch, 2000). The development policy frameworks of countries such as Pakistan are built on such assumptions. Pakistan’s poverty reduction strategy paper (PRSP) states that only through the promotion of commercially sustainable microfinance operations can the dream of financial access become a reality.

This has led to a push to commercialize, changing the nature of microfinance institutions. Traditionally the domain of NGOs, the sector has increasingly been taken over by commercial entities, such as specialized microfinance banks (MFBs). MFBs are banking institutions that differ from commercial banks only in that their target market includes low-income, financially constrained individuals.

Empirical evidence on whether commercialization hurts or helps microfinance achieve its developmental objectives is mixed, with some studies associating commercialization with a loss in mission (Cull et al, 2008) and others quite the opposite (Schmidt, 2010; Khandker, 2005).

Most of the recent work on the subject though has been qualitatively rather than quantitatively driven (e.g. Augsburg and Fouillet, 2010). The few quantitative studies that have been conducted are mainly cross-country analyses (e.g. Zhao and Wry, 2011; Armendariz and Szafarz, 2009; Cull et al, 2008), though one major work has analyzed the specific case of rural Bangladesh (e.g. Khandker, 2005).

The degree to which a microfinance institution serves poor clients is referred to as depth of outreach (Hoepner, Liu and Wilson, 2011). For the most part, quantitative research has not accounted for regional differences in depth of outreach within the same country, though this is critical in order to test the claim that increased commercialization provides access to finance to a greater proportion of the poor. The reason is that disparities within different parts of the same country, especially when it comes to the global South, are often quite stark. Thus, when institutions serve clients in the least well-off regions in a country, they are at least staying true to the professed mission of financial access, and vice versa.

The present study seeks to fill this gap in the literature by analyzing district-level differences in microfinance outreach within Pakistan. The question that is addressed here is whether regional socioeconomic differences play a significant role in determining the supply of microcredit.

Pakistan presents a unique opportunity for studying the impact of commercialization on the depth of outreach, as it currently has two distinct models of microfinance operating side-by-side in the country: the microfinance institution (MFI) and the microfinance bank (MFB). MFIs are mostly NGOs, while MFBs are banking institutions and in Pakistan, as elsewhere, are regulated by the central bank. By March 2013, 12 years after the first MFB was established, 11 MFBs together accounted for 41 percent of total outreach, defined as the number of active borrowers, while the rest were MFI clients (MicroWatch, 1th Quarter 2013).

The data for this analysis comes from two district-level surveys, including an institution-level microfinance outreach survey and a socioeconomic survey that covers multiple indicators of wellbeing. This is the first time the microfinance outreach survey is used to analyze differences in depth of outreach between MFIs and MFBs. In addition, the district level surveys cover all 113 districts of the four main provinces in the country, which provides a very granular level of detail that has not been captured by any other study on microfinance outreach before this.

The surveys are used to construct a loan supply model that studies the impact of socioeconomic differences between districts on the probability that an MFI or an MFB will locate in a particular district. The model then analyses differences in average loan size between districts for each institutional group. Average loan size is often used as a proxy for the borrower's poverty status, as detailed in Section I below, where the existing empirical evidence on the subject is reviewed. Section II presents the main trends in microfinance outreach in Pakistan for the last six years. Section III describes the data, its limitations and how it is used to construct the econometric model. Section IV presents key findings. And Section V concludes with a discussion based on the main findings.

I. Depth of Outreach: The Lay of the Land

The discussion on commercialization in microfinance is quite recent and so far there are only a handful of studies that have analyzed its impact in detail. Perhaps the most well known cross-country study is by Cull et al (2008), which distinguishes institutions by their legal structure. The study concludes that for-profit MFBs are likely to offer larger loans using individual rather than group lending arrangements[8], have fewer women clients, but are more efficient and make higher profits as compared to non-profit MFIs. Schreiner (2001) adds to the list by observing that commercialization has led to an increased preference to lend to urban rather than rural clients.

Given the paucity of data on individual borrowers, especially for cross-country and cross-institution studies, a commonly used proxy for the poverty of microcredit borrowers is average loan size. Smaller loans imply poorer customers, for institutions determine the size of the loan based on the borrower's capacity to repay (e.g. Cull et al, 2008; Armendariz and Szafarz, 2009).

My field research in Pakistan largely confirms this. The typical microcredit loan verification process includes a thorough analysis of the borrower's existing income, total net worth and number of wage earners in the household. This information helps an institution determine the size of the loan for each borrower. During non-participant observations of the disbursement process, I observed several clients across institutions beg branch managers for higher loans and being refused on the ground that they did not make enough money to be able to repay a loan higher than was offered to them.

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[8] Group lending in microcredit involves lending to groups of between 3 to 20 individuals simultaneously, with joint liability. The structure has evolved away from this in some cases recently as described in later chapters.

But Schreiner (2001) argues that loan size is only one aspect of the lending arrangement and should only be used within a proper context. Other aspects of a loan that Schreiner contends should be analyzed are interest rates, fees, guarantees, and whether the loan is disbursed individually or in groups. This is a valid argument but can only be properly addressed when using a much smaller dataset.

Armendariz and Szafarz (2009), who advocate the use of average loan size to determine depth of outreach, point out that there is more than one reason for loan sizes to go up. The first is what microfinance institutions refer to as "progressive lending", which means that as clients complete repayment of their existing loans and are able to demonstrate a clean repayment record, the institution moves them up to higher denomination loans. Thus, older clients are likely to have larger loans than more recent clients. By the same token, older institutions are more likely to have larger average loans than newer institutions, assuming their older clients have stayed with them.

Another reason is cross-subsidization, that is, an institution may lend to wealthier clients in order to finance lending to poorer clients (Armendariz and Szafarz, 2009). This makes intuitive sense because it is operationally more efficient to lend to the less poor, in terms of unit cost per loan and the risk profile of the borrower.

These explanations are consistent with the poverty alleviation mission of microfinance institutions. By this logic a dilution of an institution's social and developmental mission must be defined as the tendency of a microfinance institution to lend to wealthier clients in such a way that it crowds out poorer clients (Armendariz and Szafarz, 2009). When this is observed it can only mean that the profit-making concerns of the institution have won over its developmental objectives.

This implies that average loan size may not be a sufficient measure of depth of outreach. Using an international dataset, Hoepner, Liu and Wilson (2011) show that the relationship between actual client poverty levels and average loan sizes is weak. Of course, these critiques come from studying cross-country data and the relationship is likely to be more controlled for an intra-country analysis.

Nevertheless, it is important to recognize that average loan size is only a proxy and no match for actual borrower statistics. For instance, gender ratios are important because microcredit is widely considered to be a tool for women's empowerment. Section II will describe gender related trends across institutional groups in Pakistan, though the data used to construct these trends is not available at the district level and cannot be incorporated into the econometric model.

Similarly, data on the poverty level of borrowers is unavailable at the district level. At the same time socioeconomic disparities between districts can be stark and are likely to be an important determinant of depth of outreach. Therefore, in addition to using average loan size per district, I also estimate the probability of a positive microfinance presence, given the socioeconomic profile of each district. This essentially provides us with a loan supply function.

The Loan Supply Function of MFIs and MFBs

A loan supply function is simply a theoretical model designed to help predict the extent to which different factors impact a lender's decision to lend. The dependent variable in a loan supply function is usually either the probability an institution will extend a loan

(Ravina, 2008), the expected loan size (Ghosh and Tassel, 2008) or some other lending term, such as the interest rate, or a combination thereof (Ang and Willhour, 1976). Mansuri and Jain (2005), and McIntosh and Wydick (2005) argue that determining a microfinance institutions' objective function is usually much more complex than for a regular profit-maximizing financial institution, as the former has competing objectives to balance off. An objective function defines an individual, group or institution's optimization problem, reflecting a tradeoff between expected benefits and costs (Geoffrion, 1977). While an objective function is not necessarily a loan supply function, the latter can be considered a subset of the former.

Jain and Mansuri (2005), and McIntosh and Wydick's (2005) analysis demonstrates the tension in the microfinance sector between maximizing profits and client welfare. However, their analyses are limited to NGO MFIs and they do not specifically consider microfinance banks. In the present study, I construct two separate loan supply functions, one for MFBs and another for MFIs using two separate indicators of depth of outreach. The first is the probability that an MFI or an MFB will locate in a particular district, given the district's socioeconomic profile, and the second is the expected value of the average MFI or MFB loan, again given the district's socioeconomic profile.

Dimensions of Wellbeing

The socioeconomic profile of each district is created using multiple indicators of wellbeing. The economist Amartya Sen's capability approach, which defines poverty as the lack of individual freedom or the opportunity to exercise a set of valued choices (Sen, 1999), is used to select these indicators.

The capability approach has had a strong influence on the evolving concept of poverty since the 1990s. It has effectively shifted a single-minded focus on income-based measures of poverty towards a multi-dimensional conceptualization of deprivation. For instance, the United Nation Development Programme's (UNDP) employs different dimensions of development, namely health, education and living standards, to construct the Human Development Index (HDI). Every year since 1990, HDI rankings for each country have been published in the UNDP's Human Development Report (HDR).

An alternative and relatively newer measure of poverty, also influenced by the capability approach, is the Multidimensional Poverty Index (MPI). Here again the three dimensions of poverty are education, health and living standards, but living standards for the MPI are measured in terms of household assets and conditions, rather than GDP per capita as in the case of the HDI (Bourguignon and Chakravarty, 2003).

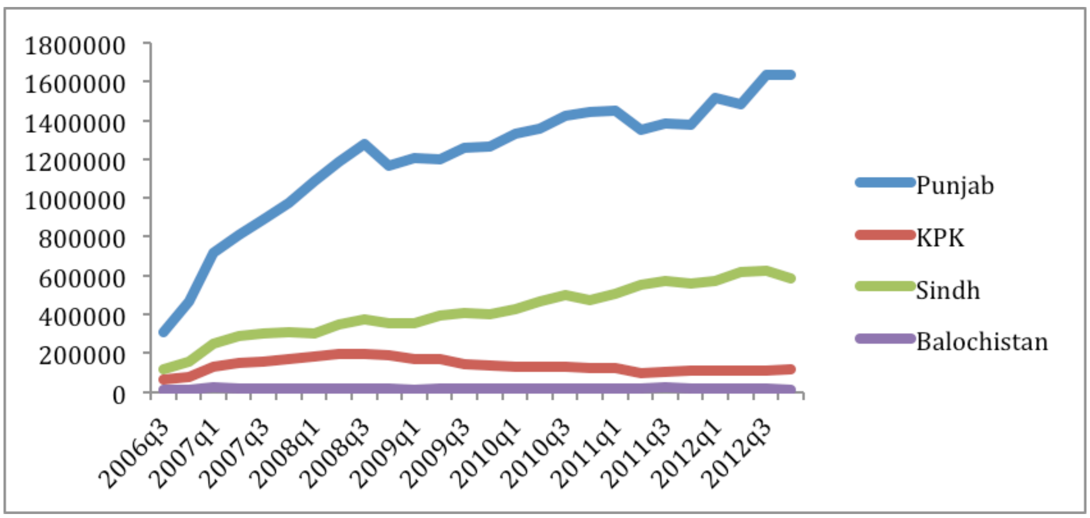
To construct each district's socioeconomic profile I will use the same three dimensions of wellbeing used by the HDI and the MPI. Differences in data availability will, however, influence the choice of particular indicators of health, education and living standards.

The section below describes the main trends in microfinance outreach in Pakistan over the past six years.

II. Trends in Outreach

The Pakistan Microfinance Network's (PMN) database, described in detail in Section III, provides information on different aspects of outreach. This data includes the ratio of rural-versus-urban outreach, male-versus-female borrowers, and individual-versus-group lending. These ratios are not available at the district-level and cannot be incorporated into the econometric model. Therefore, in this section I review the main trends in this data. The first figure, shown below, separates outreach by province. Pakistan has four main provinces, with wide socioeconomic disparities described in more detail in the chapter on Pakistan's political economy. Punjab is by far the most developed, but also the most highly populated province. Sindh is second in line, Khyber Pakhtunkhwa (KPK) third, while Balochistan remains the least developed and most sparsely populated province. Figure 1 indicates that microfinance outreach in Punjab outpaces that of all other provinces combined. Outreach in Balochistan is close to zero and has not been able to pick up through the past six years. A detailed explanation of this trend is provided in the Chapter: Political Economy Influences – Evidence from Pakistan. Outreach in KPK has fallen in recent periods and much of this is due to the escalation in the conflict along the Afghan border.

Figure 1 Microfinance Outreach by Province - Number of Active Borrowers

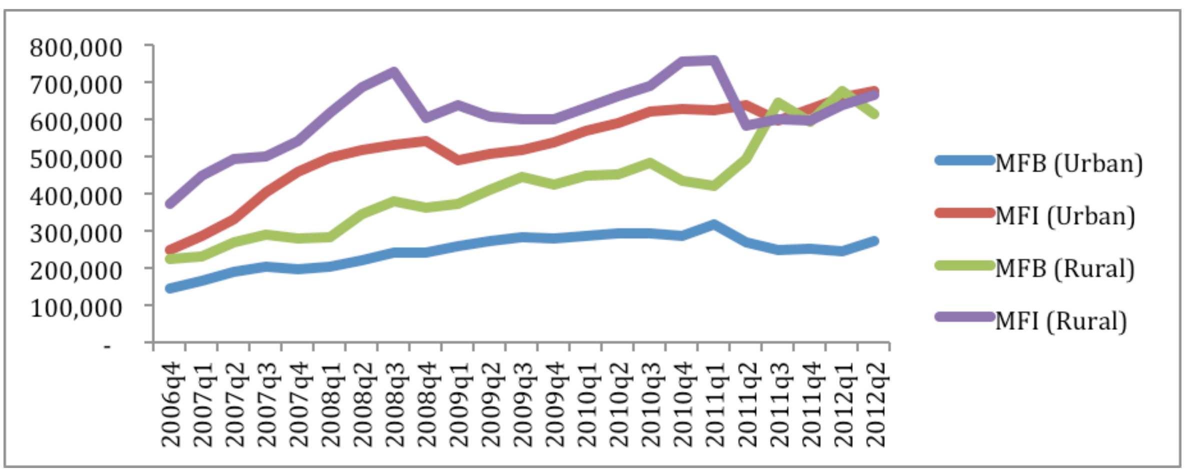


This figure provides a first glimpse of how development and outreach are interconnected in the case of a country such as Pakistan.

The next three figures compare outreach by MFBs and MFIs. Figure 2 relates to rural-urban differences. In the beginning of the data series, it is clear that MFIs have a much heavier presence in rural areas than MFBs. But by the end of 2012, MFBs have caught up to MFIs in rural areas, and MFI presence in urban areas has outstripped MFI presence in rural areas.

Perhaps, the biggest contributing factor to this trend reversal has been the 2010 partial spin-off of the MFI, the National Rural Support Programme (NRSP) into a standalone MFB, the NRSP Bank. As of the first quarter of 2013, the NRSP accounts for 15.8 percent of the sector's total number of borrowers and the NRSP Bank accounts for an additional 7.5 percent. Taken together, this represents the largest number of borrowers associated with any one institution or group (MicroWatch, 1st Quarter 2013). The sharp shift in the rural portfolio from MFIs to MFBs shown in Figure 2 coincides with the timing of the NRSP spin-off.

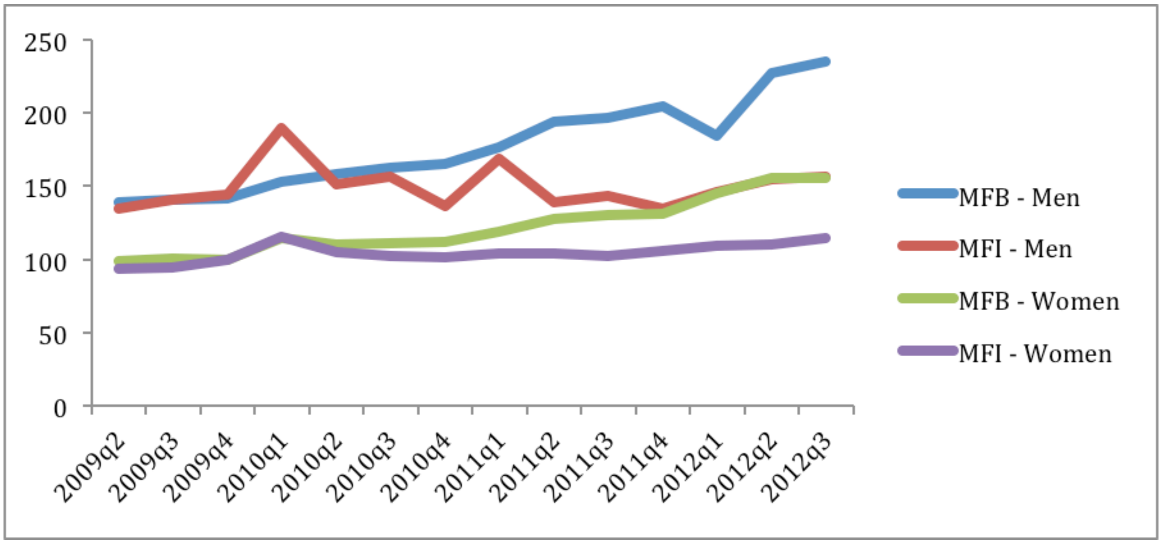
Figure 2 Rural versus Urban Outreach - Number of Borrowers



Recall that the econometric model will use average loan size as a measure of depth of outreach. Gender is not a district-level indicator, therefore, it cannot be used in the model, but we do know that 80 percent of MFI borrowers and only 25 percent of MFB borrowers in Pakistan are women (MicroWatch, 2013). Figure 3 provides average loan size by gender for both MFBs and MFIs. It is clear that loan sizes for men are higher than loan sizes for women. Recall that the average loan size is simply the gross loan portfolio divided by the total number of borrowers. In 2009 when the data on portfolio size by gender first became available, MFI and MFB average loan sizes were roughly the same for men, as well as for women. At the time, the average loan for men was approximately US$40 higher than for women, for the sector as a whole. As described in chapter 6: Women, Development and Microfinance, gender gaps in loan size are not uncommon in microfinance sectors across developing countries.

However, in the case of the Pakistani microfinance sector the trend in loan sizes by gender takes an interesting turn by the end of the data series in 2012. Figure 3 shows that while the intra-institution gender gap continues, the inter-institution gender gap closes almost completely in the case of female borrowers of MFBs and male borrowers of MFIs. On the other hand, the gap between the male borrowers of MFBs and female borrowers of MFIs has broadened rapidly overtime, as MFB loan sizes have gone up and MFIs have lagged behind in this regard.

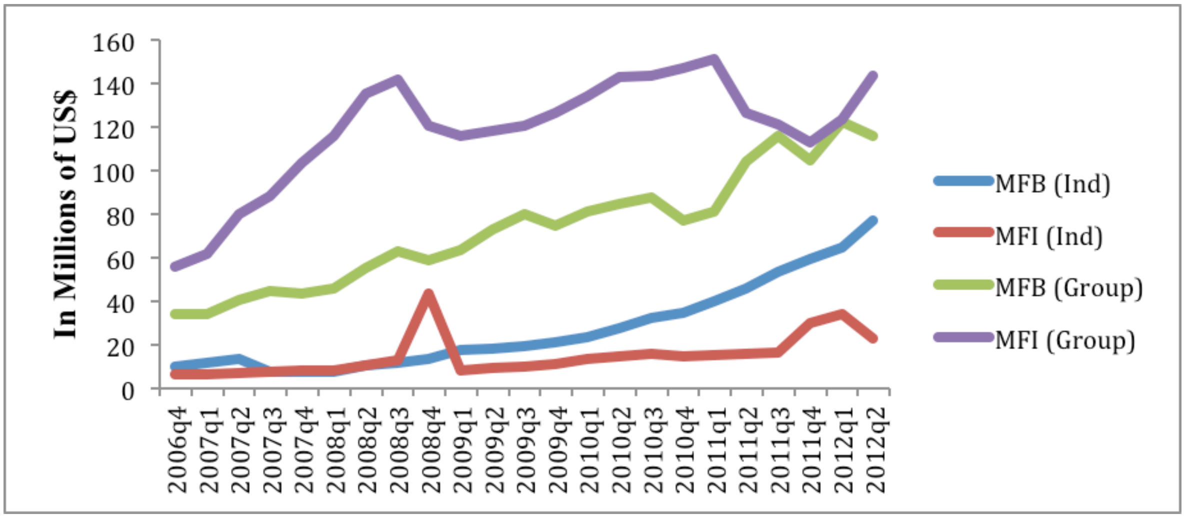
Figure 3 Average Loan Size by Gender and Institution - In US$[9]



Finally, Figure 4 below presents trends in outreach by lending methodology. Group lending constitutes the original microcredit arrangement. Group lending is associated with female targeted lending and a poorer target market, reviewed in more detail in the chapter titled Gender, Development and Microfinance. Figure 4 shows that while group lending far outpaces individual lending arrangements, for both MFIs and MFBs, there is a rapid rise in individual lending for MFBs, indicating a move towards less female-oriented lending and better-off clients. This result is consistent with Cull et al's (2008) cross-country findings described above.

[9] US$1=Rs98.19 as of March 1, 2013

Figure 4 Gross Loan Portfolio by Lending Methodology



We move now to a detailed analysis of district-level differences in outreach between MFIs and MFBs. The section below describes the two times series, their limitations and model construction.

III. Data and Methodology

Data for this study is taken from two time series in order to test for a possible relationship between socioeconomic development at the district-level and depth of microfinance outreach. The literature is conflicted on the locational preference of the more commercially oriented microfinance entities but a review of the qualitative findings detailed in the next four chapters lead me to expect that MFBs are more likely than MFIs to avoid the poorest districts. The two time-series used here are (a) the Pakistan Microfinance Network's (PMN) outreach survey, and (b) the Pakistan Social and Living Standards Measurement (PSLM) survey. The following sub-sections describe each in detail.

A. Microfinance Outreach

The PMN is a hub agency established by a network of local microfinance institutions and incorporated under the Companies Ordinance. Since 2006 it has collected data on microfinance outreach, which is extracted from quarterly forms submitted by each institution registered with the PMN. Taken together these institutions constitute 98 percent of total microfinance outreach in the country[10].

The PMN consolidates and publishes this data in its quarterly bulletin MicroWatch. The more extensive dataset, which includes every outreach indicator for each institution since 2006, was made available for this study through a negotiated agreement with the PMN. This will be the first time the dataset would be used to analyze district-level outreach differences between MFIs and MFBs.

I construct the model using data from 24 quarters, that is, from the first quarter of 2007 to the last quarter of 2012. Pakistan's four main provinces are sub-divided into 113 districts. And as of the first quarter of 2013, the microfinance sector has been able to reach a total of 92 districts (MicroWatch, 1st Quarter 2013).

The PMN data is listed on the Microfinance Information Exchange (MiX), an online database of registered microfinance institutions across the globe. MiX is operated by the Consultative Group to Assist the Poor (CGAP), an independent policy and research center housed at the World Bank in Washington DC. MiX data has been used extensively in studies on microfinance outreach, including the influential study on depth of outreach by Cull et al (2008).

[10] Interview with Aban Haq, Chief Operating Officer, PMN (June 2012).

In addition, several academic publications originating from Pakistan have used PMN's outreach data. Examples include Muhammad (2010), and Rauf and Mahmood (2009). International donor reports also use PMN data, for instance the International Finance Corporation's (IFC) 2008 publication and the UK Department for International Development's (DFID) 2006 publication relied extensively on the PMN database. As the primary databank of the microfinance sector in Pakistan, the PMN receives assistance from these institutions for capability building and institutional strengthening (DFID, 2006). Thus, we can safely say that the PMN provides the most reliable and extensive data on microfinance outreach in Pakistan.

But this data does not include information on borrower income or poverty status. However, as discussed above, there are other ways to measure depth of outreach, such as average loan size and district-level socioeconomic disparities.

Since PMN collects district-wise data on the number of active borrowers as well as gross loan portfolio by institution, average loan size is easily computed by dividing the former with the latter. I compute this for every institution and then add up the district-wise quarterly outreach for MFBs as a whole and MFIs as a whole, to create two sets of panel data. The data is strongly balanced since outreach is either positive or zero.

The second time series used in this analysis is the socioeconomic survey data collected by the Ministry of Finance, Government of Pakistan.

B. Pakistan Social and Living Standards Measurement Survey

The Pakistan Social and Living Standards Measurement Survey (PSLM), published by the Federal Bureau of Statistics – a division of the Ministry of Finance – is a population-based survey of socioeconomic and living conditions. The survey is used to monitor the implementation of the Poverty Reduction Strategy Papers (PRSP). The PRSP is a poverty reduction policy blueprint most developing countries are committed to developing, implementing and monitoring in order to remain eligible for foreign aid from international financial institutions (IFIs), such as the World Bank and the International Monetary Fund (IMF).

According to Pakistan's PRSP, the country is committed to implementing 16 poverty-reduction targets and monitoring 37 socioeconomic indicators, out of which the PSLM tracks 14 (Ministry of Finance, 2010). These targets are based on the Millennium Development Goals (MDGs), ratified at the United Nations' (UN) Millennium Summit by all 189 UN member countries, as a means to eradicating poverty across the global South.

PSLM data is collected and published at the district and the provincial level. The provincial-level is conducted every year while the district-level is conducted every other year. So far, four district-level PSLM's have been completed and published, including the PSLM 2004-05, PSLM 2006-07, PSLM 2008-09 and PSLM 2010-11.

Since the PMN data is available quarterly, there is a period mismatch between the two surveys. This is dealt with using statistical imputation described later in this section.

B. (i) Sampling and survey methodology

The PSLM survey universe includes all urban and rural areas of the four provinces and the country capital, Islamabad, excluding military restricted areas. There are separate sampling frames for urban and rural areas. The urban area frame divides each city and town into “enumeration blocks”, each consisting of 200-250 households. Each enumeration block is further divided into three categories: low, high and middle income (Ministry of Finance, 2010).

The rural frame is based on the last population census conducted in 1998. In the provinces of Sindh, Punjab and Khyber Pakhtunkhwa (KPK), each district is defined as a strategic unit or stratum to develop the rural sampling frame. For the province of Balochistan, a larger geographical space, referred to as a “division”, is used to define each stratum, since it is the most sparsely populated province.

The primary sampling unit (PSU) is the village in the case of rural areas and the enumeration block in the case of urban areas. The secondary sampling unit (SSU) is the household within each primary sampling unit. A total of 16 SSUs from each rural PSU and 12 SSUs from each urban PSU are included in the district-level survey. The following table provides the total number of rural and urban PSUs and SSUs:

Table 3 Breakdown of PSLM Sampling Units

Level	Primary Sampling Units			Secondary Sampling Units		
	Urban	Rural	Total	Urban	Rural	Total
District	2333	3230	5563	27996	51680	79676

*Source: Federal Bureau of Statistics, Pakistan (2013)

Indicator selection for the loan supply functions is informed by the capability approach, which was reviewed in Section I. The three dimensions of wellbeing used in the model are education, health and living standards.

Since data on life expectancy, child and maternal mortality, the most commonly used indicators of health, is not available through the PSLM, I use the following indicators: the percentage of fully immunized children - based on parent recall and immunization records, the percentage of pregnant women that received tetanus shots, and the percentage of births that took place in a government or private clinic. These indicators are meant to proxy infant and maternal health status.

For measuring educational attainment, the UNDP's HDI uses mean years of schooling and expected years of schooling, while the other measure of multi-dimensional deprivation, the MPI, uses average years of schooling and school attendance. Again this data is not available through the PSLM and the following indicators are used instead: the literacy rate for ages ten and older, primary enrollment rates for children between the ages of five and nine, and the percentage of the female population that has ever attended school. While literacy and enrollment rates are no longer considered ideal indicators for measuring actual educational attainment, the issue is data availability. The last indicator serves as an additional measure of gender-based disparities in education – an important dimension of the MDGs.

Finally, for living standards the HDI uses income per capita, while the MPI includes measures of housing conditions and assets. The district-level PSLM does not collect data on income, but uses a subjective measure of economic wellbeing. It also includes data on housing facilities.

The subjective measure is an economic perceptions indicator that asks respondents to measure their economic wellbeing relative to the year before. Responses are based on a five-point scale, with choices including much better, slightly better, the same, slightly worse and much worse. For this paper I add the "slightly worse" and "much worse" categories to create an indicator of subjective deprivation. In addition, I also include four housing facilities indicators, including availability of tap water, availability of toilet facilities, availability of oil and gas for cooking purposes and the percentage of electrified households.

Ratio of Urban Population

Using Schreiner's (2001) suggestion to include rural-urban differences, I also incorporate an urban population ratio into the model. Data for this comes from the 1998 census. Rural poverty in Pakistan is much more severe than urban poverty, which makes this ratio an important one to include in this analysis. Specifically, one-third of all rural households are extremely poor, but only eight percent of all urban households can be categorized as extremely poor (Naveed and Ali, 2012).

The following table provides descriptive statistics for the main variables:

Table 4 Descriptive Statistics				
Variable	**Mean**	**Std. Dev.**	**Min.**	**Max.**
Average Loan Size - MFBs (in Rupees)	13,119.73	6,494.36	0	53,502
Average Loan Size – MFIs (in Rupees)	10,836.25	4,634.93	0	37,168
Economic perceptions – worse + much worse	0.3554	0.2045	0	1
Percentage of urban population by district (1998 census)	0.2213	0.1664	0	0.9475
Indicators for Education:				
Literacy rate (10 and up)	0.5013	0.1495	0.0625	1
Net primary enrollment (ages: 5-9)	0.5297	0.1522	0	1
Percentage of females ever attended school	0.3382	0.1826	0	0.81
Indicators for Health:				
Percentage children fully immunized – based on record and recall	0.7097	0.2183	0	1
Percentage pregnant women received tetanus shot	0.5345	0.2656	0	1

Percentage women delivering baby at private or government clinic	0.3087	0.2017	0	1
Indicators for Housing Utilities:				
Percentage homes electrified	0.84245	0.1905	0	1
Percentage homes with tap water	0.3136	0.2377	0	1
Percentage homes with oil and gas avail. for cooking	0.22	0.2444	0	1
Percentage homes with toilet	0.7773	0.1819	0.13	1

These indicators are used to develop loan supply functions for MFBs and MFIs, after performing a series of data manipulations, which are described below, but first I review the main limitations of the study related to issues of data availability and quality.

C. Data Limitations

Objections can be raised regarding the PMN dataset's quality. The dataset constitutes self-reported data from each institution and despite the fact that the PMN runs regular quality checks, errors occur often, especially with smaller institutions that do not maintain the same level of quality control as the larger institutions. Therefore, in order to reduce the level of error, I have spent a considerable amount of time running trends on each institution's data-series. The staff at the PMN has been extremely helpful and has gone over every outlier that I have pointed out to them and even gone back to check with the institutions in question to make sure the data was as error-free as possible.

Data availability is a secondary, but nevertheless noteworthy issue with the microfinance outreach survey. As pointed out before the best measures of depth of outreach incorporate the borrower's poverty status but this data is unavailable in the survey.

Another important measure of outreach is interest, but again data on effective interest rates charged by each institution for the districts and time periods covered in this study are unavailable for this study. All we know is that the average effective interest rates charged on microcredit are 35.9 percent (Shorebank International, 2011).

As far as the PSLM is concerned, the only issue is data availability. For instance, income per capita is unavailable in the district-level PSLM and a subjective measure of economic wellbeing has to be used in its place.

In addition, data on what are currently considered the ideal measures of health and educational status, such as actual time spent in school and infant and maternal mortality, is unavailable through the district-level PSLM. Instead less than ideal measures have to be used to proxy district-level socioeconomic development.

Finally, I would have liked to incorporate conflict data into the model, since conflict has been a strong determinant of the extent to which microfinance has been able to reach the poor in Pakistan, as detailed in the Political Economy Chapter, but reliable district-level conflict data is hard to find. Currently, the most reliable source is the Armed Conflict and Event Dataset (ACLED), but they only have conflict data on Pakistan for the year 2008-09, while data for the other years is currently in the process of being verified.

Finally, there are other factors that should have been included in the model had the data on them been available. For instance, distance from the institutional headquarter is an important consideration for selecting the location of a branch, as are cultural considerations such as the segregation of the sexes and the stigma attached to women's earnings in the remote districts of Pakistan, particularly Balochistan and KPK. It is a limitation of the model that it does not incorporate these factors.

Nevertheless, the PSLM indicators used in the model do capture an important dimension of the supply-side dynamics of microfinance outreach. The section below reviews the steps involved in preparing this data for analysis.

D. Data Manipulations

The first problem we have to deal with has to do with the period mismatch, since the PMN data is quarterly and the PSLM data is biennial. One simple approach for filling in the "missing" PSLM quarters is linear interpolation, which uses the first and last observed values between each missing period to make estimations. But linear interpolation presumes that the data moves in a smooth line, which is not a realistic assumption for the PSLM, which has a large degree of variation. Thus, a more sophisticated imputation technique has to be used here. The method I choose is referred to as single imputation employing stochastic regression.

Generally speaking, imputation creates a balanced dataset in a way that minimizes bias. It does so by running a multivariate regression to produce conditional group means, medians or modes. Single imputation's main limitation is that it assumes that imputed values *are* the same as observed values, which lowers standard errors and produces generous levels of significance, also referred to as over-fitting the data. In order to overcome this problem I artificially add random noise to the imputed series after running the regressions. The specific steps in the imputation process are detailed below.

D. (ii) Single Imputation for Missing Values

In the first stage, a regression model is developed with each socioeconomic indicator as the dependent variable and time and district serving as independent variables:

$SEI = \alpha + \beta_1 time + \beta_2 district + \varepsilon$ Equation 2

Where, SEI is the socioeconomic indicator, α the intercept term and ε the error term. β_1 and β_2 are the coefficients of the independent variables. Missing data is imputed using mean values for each socioeconomic indicator from the regression. As mentioned above, using just the mean values to estimate the missing data will result in very high significance levels for all parameter estimates.

To overcome this, artificial noise or randomness is added to the mean by randomly generating two continuous standard uniform distributions that vary between zero and one. The values generated from this distribution are also referred to as pseudo-random numbers. The distribution itself is stationary since its mean and variance do not vary overtime. This means that the series does not have a trend, that is, the past and present values of the series are not correlated, a phenomenon that would be called autocorrelation (Chatfield, 2004). This is an important attribute for a time series that is to be used for statistical modeling. Most statistical models require stationary series, and when this assumption is violated there is danger that the regression will show spurious correlations. By using the uniform distribution to create imputed values, we allow for the introduction of artificial noise, which reduces the problem of non-stationarity and over-fitting of the data.

This involves taking the standard errors of time and district and multiplying them by the uniform distribution series and finally, adding them to the mean values estimated from the regression model. These steps are repeated for each of the 11 PSLM indicators included in this analysis.

D. (iii) Time Series Differencing

While it can be assumed that we have adequately de-trended the rest of the socioeconomic variables by using the techniques described above, this may not be enough for the economic perceptions indicator. Recall that the economic perceptions indicator is correlated with the previous period, since it asks respondents to compare their present economic situation to the previous year. This results in the problem of autocorrelation. Therefore, it is reasonable to assume that for this indicator we need to go one step further in order to make it a stationary series.

One way to do this is to transform the indicator into a period-to-period difference series. If the series is first-differenced the change is calculated from one period to the next. Thus, if t_1 denotes period one and t_2 denotes period two, the first difference will be the difference in economic perceptions from t_1 to t_2. To test whether or not the series still has the problem of autocorrelation, I use the Levin-Lin-Chu test for unit root testing with panel data. The test confirms that the first-difference economic perceptions series is now stationary (output reproduced in Appendix A).

The next step in the process is principal component analysis.

D. (i) Principal Component Analysis (PCA)

PCA is a data-reducing technique used specifically when correlations between variables are suspected, making it redundant to use each variable separately. There is a high likelihood that the present set of indicators are correlated, for instance it is unlikely that the literacy rate is mutually exclusive of the percentage of women that ever attended school.

The PCA is also effective in reducing the observed number of variables to a smaller set of artificial indicators, called "principal components". The PCA estimation equation is represented below:

$$X_i = a_{i1} F_1 + a_{i12}F_2 + \ldots\ldots\ldots\ldots\ldots\ldots\ldots + a_{ij} + F_j \qquad \text{Equation 1}$$

Where,

X_i is the *i*th development indicator,

a_{ij} is the factor loading and represents the proportion of variation in X_i accounted for by factor *j*.

And, F_j represents the *j*th factor.

A statistical program, such as Stata, can be used to calculate a factor loaded composite index for the indicators. The first few factors account for the maximum variation. Eigenvalues measure the amount of variation observed in the actual data that is explained by each principal component. For this paper, I use factors that have eigenvalues of at least 0.5, that is, factors that explain at least 50 percent of the variation in the underlying indicators. I create three sets of principal components or factors: one for education, another for health and a third for availability of housing utilities.

For education, the first factor alone accounts for 82 percent of the variation across all three educational indicators and is the only factor with an eigenvalue greater than 0.5. The factor loadings for this factor, referred to in the subsequent analysis simply as "education", are provided below:

Table 5 Factor Loadings for Education	
Education Indicators	**Factor Loading**
Literacy rate (age: 10 and up)	0.9543
Primary enrollment rate (ages: 5-9)	0.8772
Percentage of females ever attended school	0.8834

The table indicates that 95.43 percent of the variation in the education factor is accounted for by the literacy rate, 87.72 percent by the primary enrollment rate and 88.34 percent by the female school attendance rate.

For health, I use two factors that together account for 92 percent of the variation in health status, these two factors each have eigenvalues greater than 0.5.

Table 6 Factor Loadings for Health		
Health Indicators	**Factor Loadings**	
	Women	Children
Percentage children fully immunized	0.1983	0.9599
Percentage pregnant women receiving tetanus shot	0.6941	0.6116
Percentage women delivering baby at private or government clinic	0.9556	0.1783

We can see from Table 6 that the first factor titled “women” is defined by women’s pregnancy and delivery related variables, while the second is most strongly associated with immunization rates for children.

For housing utilities, I use the first three factors that together account for 88 percent of the variation in the data and with eigenvalues greater than 0.5 in each case. The factor loadings are represented below:

Table 7 Factor Loadings for Housing Utilities			
Housing Utility Indicators	**Factor Loadings**		
	Toilet & electricity	Cooking fuel	Tap water
Toilet	0.6432	0.5386	0.0164
Electricity	0.9240	0.1849	0.0834
Cooking – Oil and Gas	0.2103	0.9361	0.1227
Tap water	0.0587	0.0931	0.9927

Table 7 indicates that the first factor, “toilet and electricity” is defined by the availability of toilets and electrification rates; the second, “cooking fuel” by availability of oil and gas for cooking fuel; and the third, by availability of tap water for household use. Finally, we move to estimating the regression model.

E. Estimating The Regression Model

There are two dependent variables, one for each loan supply function. The first is the probability of a positive microfinance presence and the second is average loan size. For each function the principal components of the district-wise socioeconomic indicators and the urban population ratio serve as the model's independent variables.

The model is referred to as a “corner solution”. In corner solution models, the dependent variable is continuous, and takes the value of either zero or some other positive number. As the name suggests, corner solution models refer to cases where the data for the dependent variable is truncated and “piles up” at a given value, but is continuous otherwise. Equation 4 and 5 show the statistical specification of corner solution models (Burke, 2009):

$y_i = y_i^* \text{ if } y_i^* > 0$ Equation 4

$y_i = 0$ if $y_i* \leq 0$

and, $y_i* = \alpha + X_i\beta + \varepsilon_i$ Equation 5

Where y_i is the dependent variable and X_i the independent variable.

For the loan supply function this means that the average loan size per district per quarter is either zero or higher, that is, there is no possibility of a negative loan size. This is essentially an institution-level maximization problem, as discussed in Section II. The maximization problem here consists of where to locate, based on the costs and benefits of operating in each district.

The literature talks about transaction cost differences between lending to the poor versus the non-poor. In a similar fashion, there are significant cost differences between operating in more developed versus less developed regions and this is often an important contributing factor in the decision to locate. It is plausible that there will be times when not maintaining a presence in a particular district will be the optimal choice and in this case the average loan will be zero, which then *is* the corner solution. For other districts, the optimal choice will involve maintaining an active presence and the probability of positive outreach here will be greater than zero. The clustering at zero has to be for a non-trivial part of the population in order for the model to give meaningful results (Woolridge, 2008). In this case, the MFB model has 30.46 percent clustering at zero while the MFI version has 38.75 percent clustering at zero.

The simplest way to estimate the outreach model would have involved applying ordinary least squares (OLS), often the first model to be considered for establishing a linear relationship between a dependent variable and a set of independent variables. However, the linearity assumption needed for OLS is violated in corner solution models, because a high proportion of the observed independent variables are associated with the dependent variable being equal to zero (Woolridge, 2009). Thus, a more sophisticated regression such as Tobit can be considered for estimating the loan supply function.

Tobit models are used specifically to estimate the relationship between non-negative dependent variables and a set of independent variables. In other words, Tobit models are employed when the dependent variable is constrained and there is a clustering of observations at the constraint.

Tobit essentially provides answers to two questions. The first is referred to as the participation decision. In the case of microfinance outreach, the participation decision has to do with the location of a microfinance branch in each district. The second question is the amount decision, which in this case refers to the average loan size for each district, given a positive presence. Tobit uses one mechanism to provide a single answer to both questions. This is a limitation of Tobit since ideally each question should be treated separately.

Another limitation of Tobit is that it has the same assumptions as the OLS model. Specifically, the Tobit model will result in inconsistent results if the model's error term ε_i is not normally distributed or if the error term is heteroskedastic. This is a major drawback. Thus, the choice of Tobit is problematic both from the theoretical and the statistical viewpoints.

For the initial estimation, I tested the model using Tobit and plotted the fitted values of the regression against the residuals. The plot indicated that the error term was heteroskedastic. A Lagrange Multiplier test also confirmed heteroskedasticity. But a plot of the error term indicted that it was normally distributed.

The problem of heteroskedascity is effectively taken care of, as long as the error term is normally distributed, by employing a double-hurdle model, also called a two-tier model. The double-hurdle model is essentially a generalized version of the standard Tobit model, but is an improvement upon Tobit in that it has a separate mechanism for estimating the participation decision and the amount decision (Burke, 2009).

The double-hurdle model has been found to produce significantly better estimates than the Tobit (Stewart, 2009). Double-hurdle models are designed to account for the presence of heteroskedascity but not for non-normality, which we saw from applying Tobit is not a problem with the current model. The double-hurdle model I use is called Cragg's Tobit Alternative, operationalized by Burke (2009) and used in recent studies on various global development issues, particularly agricultural economics (e.g. Ghebru and Holden, 2013; Fernandez et al, 2009).

The model is estimated in two steps. The first uses Probit to estimate the probability of a positive outreach and the second uses a truncated normal regression to estimate expected average loan values.

Probit is a binary response model in which the dependent variable can take either one of two values. It is usually used to predict the probability of an event occurring or not occurring, in this case, whether or not there is an actual microfinance presence in a particular time and place.

A truncated regression is one where part of the data is missing. A truncated normal model is simply a truncated regression where the dependent variable is normally distributed. Combining these two processes gives us the Cragg double-hurdle model. As Buraimo (2010) notes, there are three components to Cragg's Tobit Alternative: observed engagement, a participation equation and an engagement equation.

The double-hurdle model is advantageous because it allows us to see how various factors impact each decision separately. The Cragg double-hurdle is especially useful because it has an option that allows for standard errors to be heteroskedascitic, as long as the observations are observable, which is the case with corner solution models in general. The specification for determining the marginal impact of each independent variable on the dependent variable is specified as follows for each tier (Burke, 2009):

Tier 1: *Probability (AV) = f* (PCAe, PCAh, PCAhsg, U, EP) Equation 6

Tier2: AV= *f* (PCAe, PCAh, PCAhsg, U, EP) Equation 7

The model assumes that Tier 1 and Tier 2, that is, the probit and the truncated normal regression, are unassociated with each other and are estimated separately. Which makes sense since empirically we know that the decision to locate in a particular district is distinct from considerations affecting the average loan size, such as the socioeconomic status of the target market, the lending arrangement – group or individual – and institutional gender targets (Cull et al, 2008). In Pakistan, gender targeting is done mainly by MFIs, many of whom lend exclusively to women. MFBs, on the other hand, maintain modest gender targets if at all.

While the model does not have a variable that captures the impact of gender, the graphs in Section II describe trends in gender-based outreach for both institutional groups.

The predict option in Stata is used after running the hurdle model to estimate the coefficients for each tier. The first tier estimates the marginal probability, that is, the partial effect of each independent variable on the probability that microfinance presence will be positive for each district and period. The second tier estimates represent the expected value of the average loan size associated with each independent variable. The Stata output with details on coefficient estimation using Stata's predict function is provided in Appendix A.

After estimating these coefficients, I test for the robustness of the model by separately running a Probit regression to confirm Tier 1 findings and a truncated regression model to confirm Tier 2 findings. The separate estimation results are identical to the Cragg model estimates.

For the significance testing of Tier 1 estimates, Burke (2009) recommends running a Probit regression and using it to test for the significance of each Tier 1 parameter. For Tier 2 significance testing, Burke (2009) has developed a bootstrap routine. I run this routine with 100 iterations (results reproduced in Appendix A) and verify the results by also running a truncated regression. Finally, to test for the validity of the overall model specification I use a Wald test, which works by testing the null hypothesis that the coefficients associated with each independent variable are jointly equal to zero. The null in this case is rejected because the p-value is equal to zero, which confirms that each coefficient adds value to the model. Section IV presents findings from this model.

IV. Main Findings

The table below summarizes the main results of the estimation. The column titled "Tier 1" includes the partial effect of each independent variable on the probability of a positive microfinance presence. The column titled "Tier 2" represents the conditional average partial effect (CAPE) of each independent variable on the average loan value.

Table 8 Tier 1 and Tier 2 Parameter Estimates

	MFBs		MFIs	
Variable	Tier 1 (partial effect on probability)	Tier 2 (CAPE)	Tier 1 (partial effect on probability)	Tier 2 (CAPE)
Education	0.049*** (0.003)	-1142.15 (0.783)	0.084*** (0.000)	-108.66** (0.012)
Women	-0.0035 (0.797)	2361.15*** (0.000)	0.0338* (0.048)	397.13*** (0.009)
Children	0.0145 (0.215)	697.81** (0.018)	0.0358*** (0.003)	-138.60* (0.077)
Toilet and electricity	-0.0118 (0.288)	831.48* (0.058)	-0.0406*** (0.001)	-373.88*** (0.005)
Tap water	-0.0089 (0.399)	-1294.09*** (0.000)	-0.0349*** (0.003)	-509.21*** (0.000)
Cooking fuel	-0.0587*** (0.000)	283.40** (0.020)	-0.0743*** (0.000)	-156.90*** (0.000)
Economic perceptions (first diff.)	0.051 (0.670)	1940.16 (0.799)	-0.143 (0.936)	-635.65 (0.901)
Urban population	1.677*** (0.000)	5451.50*** (0.000)	1.628*** (0.000)	-3963.50*** (0.000)

*** represents significance at the one percent level, ** represents significance at the five percent level and * represents significance at the ten percent level. P-values are provided within parentheses next to coefficient estimates.

The results confirm that the socioeconomic and demographic status of each district is a significant determinant of depth of outreach, for both MFBs and MFIs.

The two indicators of outreach this model employs are the probability of a positive microfinance presence and average loan size. The findings suggest that MFIs are more likely to locate in less developed districts than MFBs. The same is true for average loan size. In fact, MFI loans are on average higher in less developed districts than in more developed ones.

The indicator that seems to have the strongest influence on both the decision to locate and the average loan size for MFIs and MFBs is the urban population ratio. The indicator that appears to have the least impact on outreach for both groups is the economic perceptions indicator.

The sections that follow review the impact of socioeconomic and demographic differences between districts on each measure of depth of outreach.

IV.A. Partial Effects on the Decision to Locate

The education factor is strongly significant and appears to be positively associated with the decision to locate, for both MFIs and MFBs. As educational levels improve, the probability that an MFI or an MFB branch will open in a district is likely to increase.

Health-related indicators, however, do not seem to be a good predictor of the probability that an MFB will open a branch in a particular district. On the other hand, the probability that an MFI branch will be located in a particular district is strongly associated with better immunization rates for children.

Housing facility indicators do not seem to affect the decision to locate for the typical MFB, with the exception of the cooking fuel indicator, which has a small but negative association with the probability of a positive MFB presence.

For MFIs, as housing facilities improve the probability of a positive institutional presence goes down. This is consistent with the heavy rural presence of MFIs, where such facilities are largely absent.

The urban population ratio indicates that both MFIs and MFBs are more likely to operate in districts where the urban population is a higher proportion of the total population. Since each district has a varying proportion of rural and urban populations, this does not undermine the earlier statement that MFIs as a group have a heavy rural presence.

IV.B. Conditional Average Partial Effect on Average Loan Size

The second depth of outreach indicator in this model is average loan size. Education seems only to affect MFI loan sizes, which go down by a small amount when education indicators improve.

Indicators for the health status of a population, seem to have a much more significant impact on MFBs. A one unit improvement in women's health-status increases average MFB loan sizes by Rs.2,361 and MFI loan sizes by only Rs.397, indicating that MFBs are much more sensitive than MFIs to this important socioeconomic indicator.

Housing facilities affect average loan sizes of MFIs more than MFBs. The results indicate that MFI loans are on average smaller for districts with better housing facilities, which makes sense when considered with the results of the urban population ratio.

In the case of MFBs, higher urban populations increase average loan sizes by Rs. 5,451, which is a sizeable value given that the mean average MFB loan size is only Rs. 13,120. But the relationship for MFIs is reversed. MFI average loans are lower by nearly Rs.4,000 for more urban districts as compared to less urban districts.

While the MFB result makes intuitive sense, since urban populations are less poor and can handle higher denomination loans as compared to rural populations, the MFI result requires closer examination. Recall from Chapter 1 that microcredit was first offered in Pakistan through the rural support programs (RSPs), which currently constitute 50 percent of total MFI active borrowers (Microwatch, 2013). Thus, the fact that rural MFI loans are higher than urban MFI loans is simply evidence of “progressive lending”. Since loan sizes go up with each successive cycle, the newer and more urban MFIs are likely to have smaller average loans than the RSPs.

Therefore, while the MFB results imply crowding out of the rural population, the MFI results indicate progressive lending, which is not inconsistent with the developmental mission of microfinance. Nevertheless, it is important to see how MFIs that are not RSPs perform on indicators of outreach.

IV.C. The Case of Non-RSPs

Table 9 below shows how the MFI group estimates change significantly when the RSPs are removed from the equation. The results indicate that the non-RSP MFI sector is much less likely to be affected by the socioeconomic differences between districts. The only indicators that can predict the probability of a positive MFI presence in this modified model are an increase in the urban population ratio, improvement in women’s health and a decrease in the availability of oil and gas for cooking. Similarly, only the urban population ratio and the cooking fuel indicator have a significant impact on average loan sizes for non-RSP MFIs.

The results makes intuitive sense since we would expect NGOs to be a lot less sensitive than the commercially run MFBs to district level socioeconomic differences when making the decision of where to locate. Their location is more likely to be based on considerations such as the founders' social mission and existing social network, at least initially. The considerations for average loan size are also likely to be more varied, especially since many MFIs primarily target women and this variable has not been included in the model thanks to data unavailability at the district level.

The only surprising result is that the urban population indicator remains a strong predictor of the probability of the non-RSP group's presence in a particular district. Similarly, the urban population indicator suggests that urban average loans are much lower than rural average loans for the non-RSP MFIs.

Table 9 Tier 1 and Tier 2 Parameter Estimates for Non-RSPs

	Non-RSP MFIs		MFIs	
Variable	Tier 1 (partial effect on probability)	Tier 2 (CAPE)	Tier 1 (partial effect on probability)	Tier 2 (CAPE)
Education	0.025 (0.142)	324 (0.532)	0.084*** (0.000)	-108.66** (0.012)
Women	0.0579*** (0.001)	-67.04 (0.841)	0.0338* (0.048)	397.13*** (0.009)
Children	-0.004 (0.734)	-354.81 (0.104)	0.0358*** (0.003)	-138.60* (0.077)
Toilet and electricity	-0.191 (0.208)	-298.28 (0.487)	-0.0406*** (0.001)	-373.88*** (0.005)
Tap water	0.025* (0.080)	-64.93 (0.774)	-0.0349*** (0.003)	-509.21*** (0.000)
Cooking fuel	-0.056*** (0.000)	-615.17*** (0.002)	-0.0743*** (0.000)	-156.90*** (0.000)
Economic perceptions (first diff.)	-0.030 (0.824)	210.66 (0.932)	-0.143 (0.936)	-635.65 (0.901)
Urban population	1.14*** (0.000)	- 4893.38*** (0.004)	1.628*** (0.000)	-3963.50*** (0.000)

*** represents significance at the one percent level, ** represents significance at the five percent level and * represents significance at the ten percent level. P-values are provided within parentheses next to coefficient estimates.

V. Conclusion

This study confirms that commercialization has compromised the financial inclusion objectives of microfinance. By examining the patterns of outreach and considering the impact of socioeconomic and demographic differences between districts on indicators of depth of outreach it is clear that the more commercialized institutions, that is, the MFBs have targeted the more urban, less vulnerable and better-off clients. While MFB clients on average receive larger loans than MFI clients; to a great extent, women, rural households and the poorest are crowded out of the MFB market. MFIs, on the other hand, are geared towards smaller loans, poorer borrowers, women, and rural areas. Nevertheless, the estimation results indicate that the non-RSP MFIs are much less sensitive to district level socioeconomic differences than the MFI group as a whole. These conclusions have important implications for public policy, especially since Pakistan's PRSP clearly states that only by commercializing microfinance institutions can the sector's financial inclusion objectives be achieved. This policy has been operationalized by offering several incentives, such as a five-year tax holiday, to the larger MFIs should they transform into MFBs. In addition, MFBs are offered grants, subsidized lending arrangements and loan guarantee facilities. These incentives have resulted in the MFB sector growing faster than the MFI sector in the past few years. But the results of this study suggest that the Government of Pakistan's faith in commercialization as a vehicle of financial inclusion is misplaced.

The study is also a useful starting point for analyzing the full impact of commercialization on the development goals of the microfinance sector. Qualitative research findings, presented in the next four chapters, confirm and expand upon each of the findings provided here and allow us to create a much more nuanced picture of how the microfinance sector's mission to alleviate poverty and reduce gender based disparities has been affected by the pressure to become financially sustainable.

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CHAPTER 3

INSTITUTIONAL STRUCTURE, MISSION AND OUTCOMES

The traditional microcredit model consists of group-based lending in which all members of the group are jointly liable for each other's loans. Joint liability reduces the lender's risk and the borrower is freed from the need to provide collateral. This model is often referred to as the "Grameen model" after the institution set up by Muhammad Yunus in Jobra Village, Bangladesh (Grameen Bank, 2011).

As discussed in the previous chapter, commercialization has led to not just an evolution in the lending arrangements but also in the institutional structure itself. Initially, all institutions that offered microcredit were referred to as microfinance institutions or MFIs. Even now, the term persists in many circles as a blanket reference to any and all institutions conducting microfinance business, even though the organizational structure now varies widely and includes registered as well as unregistered nonprofits, private as well as public, bank and non-bank financial institutions (Basu, Blavy and Yulek, 2004; Jansson and Taborga, 2000).

Institutional models often vary by country and region. For instance, in Bangladesh the Grameen-style nonprofit is still the most popular version (Karim, 2011). In India, credit and savings cooperatives called self-help groups (SHGs) work alongside commercial and nonprofit non-bank financial institutions (Reddy and Manak, 2005). In Indonesia, microfinance is offered by nonprofits as well as by the specialized microfinance "units" of local commercial banks (Meagher, et. al., 2006). In some Latin American countries, such as Bolivia and Mexico, microfinance has reached rapid scale mainly through the rise of microfinance banks (MFBs), which are essentially commercial banks conducting microfinance business (Schipani, 2012). The most prominent examples include Bolivia's BancoSol and Mexico's Compartamos. MFBs can also be found in Africa. In fact, Nigeria has 820 registered MFBs (Udoh, 2012). Kenya (Ryan and Seel, 2009) and Tanzania (Kanayi, 2010) also have active MFB sectors. Others, such as Ghana and South Africa, have preferred to stay with the traditional model, allowing their larger MFIs to grow into for-profit non-bank financial institutions. Microfinance in sub-Saharan Africa, on the other hand, has not graduated to independent commercially viable institutions (Ryan and Seel, 2009). Thus, the dominant institutional form in each country seems to be determined in part by the sector's stage of development and in part by specific regulatory regimes (Meagher, et. al., 2006).

In the case of Pakistan, the subject of this case study, the MFI and MFB models are at present equally dominant. This essay compares the mission, practice and borrower experiences of MFIs versus MFBs in Pakistan to broaden our understanding about how moving into the mainstream financial sector has affected microfinance's effectiveness as an anti-poverty intervention.

Previous studies have approached the subject either from the institution's point of view (e.g. Battilana and Dorado, 2010; Rhyne, 2005; Christen, 2001) or the client's (e.g. Karim, 2011; Sanyal, 2009; Banerjee et. al., 2009). What is missing from these assessments is a full account of the relevance of institutional form on microfinance's effectiveness as an anti-poverty scheme. This essay seeks to bridge the existing gap in three ways. First, by presenting a through comparative analysis of MFIs versus MFBs. Second, by analyzing how organizational structure impacts institutional practices, including client outreach and the institutional parameters of transparency, reliability and flexibility - especially relevant for microfinance (Roodman, 2012). Third, by considering how institutional practice impacts clients' poverty related experiences.

For this study, I determined qualitative research, specifically a case-study approach, to be the most suitable methodology. First of all, no quantitative dataset currently in existence can adequately answer questions of effectiveness from both the institution's and the client's point of view. Secondly, while research on microfinance has always been heavily quantitative, most recently, there has been recognition that more qualitative research is needed to understand the complexities of when, why and how microfinance works to achieve its developmental objectives (Roodman, 2011; Huda, 2012).

This research employs semi-structured interviews and observations. A total of 88 key informant and practitioner interviews were conducted at the senior, middle and lower management levels, as well 52 interviews of currently active microcredit clients. The qualitative data also includes 12 day-long observations of client-practitioner interaction. The data is analyzed using a multi-disciplinary conceptual framework, informed by the fields of organizational theory and development economics. Organizational theory, specifically social entrepreneurship theory, frames the discussion on institutional form, mission and practice (Dorado, 2006; Battilana and Dorado, 2010), while borrower experiences are analyzed using the capability approach (Sen, 1999; Alkire, 2007).

The rest of the paper is organized as follows: first, a description of the study's conceptual framework; second, a section on research questions, methodology, data and study limitations; third, a description of the main findings; and finally, a concluding section on discussion of findings.

I. Conceptual Framework

The conceptual framework draws upon social entrepreneurship theory and the capability approach. This study is concerned with the experience of institutions as well as borrowers. Social enterprise theory frames the discussion on institutions, while the capability approach is used to develop multiple indicators for analyzing the experience of borrowers.

I.A. Microfinance Institutions as Social Enterprises

The recent rise in critical research on microfinance has concerned itself with the apparent contradiction between the sector's zeal to become financially sustainable and its original mission of poverty reduction (Nugroho and O'Hara, 2008; Morduch and Haley, 2002). Some call it "mission drift" (Augsburg and Fouillet, 2010) while others argue that in its sustainability-seeking commercialized form, microfinance actually ends up hurting the poor (Karim, 2011; Bateman, 2010). The push towards financial sustainability, though relatively recent, is quite strong. Not only are commercial MFIs and MFBs expected to become profit-making institutions (Cull, Demirguc-Kunt and Morduch, 2008), donor driven nonprofits are also increasingly required to demonstrate financial viability while delivering on their social mission (Nugroho and O'Hara, 2008; Morduch and Haley, 2002). One way to evaluate institutions on their poverty alleviation promise is by applying social enterprise theory.

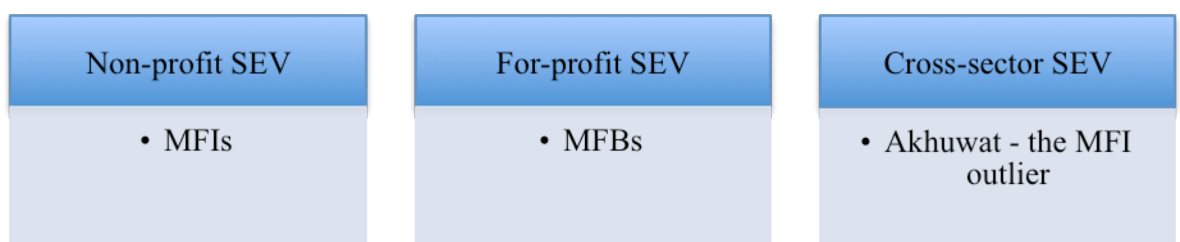
Social enterprise ventures (SEVs) are institutions that are designed to solve specific social problems (Bornstein, 2010; Johnson, 2000) in a financially sustainable manner (Dorado, 2006). Social enterprise theory analyzes, even promotes, the proliferation of SEVs in the social sector, a space once only occupied by nonprofits and the state (Phills, Deiglmeier and Miller, 2008). What distinguishes SEVs from other institutional forms is their dual emphasis on financial sustainability and solving social problems (Mair and Marti, 2006; Pomerantz, 2003). Theoretically, SEVs are distinct because whether they are nonprofit or for-profit in legal form, their social mission takes precedence over profitmaking (Dacin, Dacin and Matear, 2011). This social mission is nearly always related to poverty or empowerment in one way or another (Seelos, Mair, Battilana and Dacin, 2010).

Social enterprise theorists have applied different categorizations to the growing number of SEVs. For instance, Peredo and McLean (2006) classify SEVs based on the strength of their mission, while Dorado (2006) categorizes based on forms of governance. Peredo and McLeon (2006) find that SEVs place different degrees of emphasis on their mission. At one extreme are institutions, which insist their social mission, and not wealth creation, is the central focus of their enterprise. If wealth is created it is only a means to an end and certainly not the requirement of social entrepreneurial activity (Dees, Emerson and Economy, 2002). Further along this spectrum are institutions, sometimes referred to as double bottom-line institutions (Davis, 1997). The double bottom-line refers to the simultaneous pursuit of financial and social returns (The Northland Institute, 2001). At the far end are profit-seeking enterprises, which also seek a social end (Peredo and McLean, 2006).

Dorado's (2006) classification is based on forms of governance. She develops three distinct categories. The first is the non-profit SEV that employs a business model, the second the for-profit SEV for whom social goals are central, and finally the cross-sector SEV, an institution or even a movement which aims at solving a particular social problem. The profit motive is largely irrelevant for the third type and so is institutional permanence, if the problem for which it was created is solved or the goals met, the SEV is disbanded.

These categorizations provide a useful classification system for the different types of microfinance institutions operating in Pakistan. The figure below maps Dorado's categories onto the sector:

Figure 5: SEVs and the Microfinance Sector in Pakistan



Broadly speaking, Pakistani MFIs fit the non-profit SEV category. Most of them are nonprofits committed to providing low-income clients with financial services. Typical MFBs fit the second category. For-profit SEVs, also referred to as double bottom-line institutions or hybrids, are run like regular enterprises (Dorado, 2006). In the same vein, MFBs operate like ordinary commercial banks, the only difference being that they have a mandate to provide financial services to the poor.

Dorado (2006) describes the third type, that is, cross-sector SEVs as institutions for whom the profit motive is the least relevant. Even the development of a new organization is not the primary motivation for its entrepreneur, rather it is the creation of a path designed to alleviate a complex social problem. In the Pakistani case, the MFI Akhuwat, a zero-interest based microcredit NGO, fits this third category. Unlike other MFIs and MFBs, Akhuwat is unconcerned about earning economic returns, and depends almost entirely on individual charitable donations rather than lines of credit, soft loans, institutional grants or even interest on the loans it extends to its clients. Akhuwat's path is aligned instead to the Islamic principles of brotherhood and generosity (Saqib, 2011) and yet it has been able to scale-up its operations successfully as described in Section III below.

I.A.i. SEV Type and Institutional Mission

Classifying microfinance institutions as social enterprises is not a new idea (e.g. Alter, 2007; Dunford, 2000) but the question is can this categorization help us understand how these institutions perceive their own poverty alleviation agenda and how this gets translated into strategy and practice?

Social enterprise theory tells us that SEVs realize that success cannot be measured in strictly financial terms, since one of their main aims is to solve a social problem (Mair and Marti, 2004). But it is also clear that not all SEVs are the same and it makes sense to see social enterprises along a spectrum determined by the degree to which they value their social mission (Alter, 2007; Dees, 1998). This also implies that by rigidly classifying institutions into two groups, that is, MFIs and MFBs will not enable a meaningful comparison. Differences within groups are at least as important as the differences between them. Nevertheless, we can begin with making a simplifying categorization based on Dorado's suggested classifications. On average, we can expect MFIs to emphasize the social objective of poverty alleviation more than MFBs, since MFBs as banking institutions are under much more pressure to generate profits. This is why many have expressed concern about the long-run sustainability of the social mission of commercial microfinance organizations (e.g. Rhyne, 2005; Christen, 2001).

The case of MFBs created as spinoffs of larger MFIs needs to be addressed specifically. Battilana and Dorado (2010) describe the double challenge such institutions face - not only do they need to work hard to survive as new ventures, they also have to learn to balance the banking and development logics to avoid "mission drift". The section on findings will shed light on this special case. But one key aspect of this study is how an institution's mission and actual practice impacts its borrowers. Practice is measured in terms of client outreach, the institutional parameters of transparency, reliability and flexibility (Roodman, 2012), while findings related to borrower experiences are framed by the capability approach, which is briefly reviewed below.

I.B. The Capability Approach and Client Experiences

Assessing client level impact in microfinance has been both difficult and controversial. In the 1990s, research on the subject focused on quantitatively driven survey data and used ratios such as the proportion of repeat clients or repayment rates to establish success (Fenton, 2010; Cohen, 2002). Not surprisingly, the numbers were positive and microfinance received glowing reviews, since growth was rapid and repayment rates extremely high (e.g. Pitt and Khandker, 1998).

In 2009, the results of the first randomized control trials on microfinance demonstrated that while it did have a small but significant positive impact on entrepreneurship, it did not improve multi-dimensional indicators of poverty and wellbeing such as health, education or empowerment (Banerjee et. al., 2009; Karlan and Zinman, 2010).

The concept of multi-dimensional poverty is informed by the capability approach. The traditional measure of poverty in economics has always been income, which has defined a uni-dimensional poverty line (Alkire and Sarwar, 2009). The capability approach moves the discussion on poverty away from a single-minded focus on income to one that incorporates inadequacy of food, clothing, shelter, self-esteem, employment opportunities, and market access (Sen, 2000).

The theory has two essential elements: capabilities and functions. Capabilities are the *freedoms* people have to lead the kind of lives they value, while functions are the state of being or doing valued by the individual. Thus, the capability approach views poverty as deprivation of the freedoms people value (Alkire, 2007). People are poor when their opportunities are limited and the means to ensure their wellbeing do not exist for them. As a development construct, this theory has been instrumental in shaping the human development approach, a development paradigm that informs policy choice in several areas, including poverty (Fukuda-Parr, 2003).

Thanks to the capability approach, the multidimensional view to poverty and wellbeing has entered the mainstream since the 1990s (Alkire and Sarwar, 2009). Academics routinely turn to this approach to analyze development interventions (e.g. Tao, 2010; Ferrero and Zepeda, 2006). The question is how does this theory evaluate the effectiveness of microfinance?

From the capability perspective, if financial exclusion means the poor do not have access to formal sources of credit then anything that helps them overcome this improves their capabilities. Thus, the theory can actually provide a rewarding framework for proponents of microfinance (see for example Cabraal, 2011; Mohindra and Haddad, 2005).

On the other hand, the capability approach stresses that true development must enhance total individual wellbeing. In other words, the concern here is with *combined capabilities* (Nussbaum, 2002) rather than individual ones. This implies that if microcredit only improves access to formal credit, without a commensurate increase in other aspects of poverty such as health, and education, it may measure poorly against other poverty reducing interventions such as job creation in the formal sector, where employee health benefits and other opportunities for enhancement in wellbeing are also offered.

One challenge in using the capability approach is figuring out how to operationalize it (Comim, 2001). Because of the rich array of desired capabilities Amartya Sen, its primary author, provides there are practical issues to consider such as which one to place above others, and how exactly to value a particular set of capabilities (Sugden, 1993). Alkire (2005) refers to this as Sen's "fundamental or assertive incompleteness". She defends him by saying that no one list of capabilities can be made relevant to every assessment or evaluation. She argues instead for a participatory approach in developing a list of capabilities, keeping the local context in view.

Using Alkire's suggestion, I develop the following set of indicators to assess the experiences of microcredit clients in Pakistan. These include both economic and non-economic measures. The economic measures include: setting up of a new business or the expansion of an existing business as a direct result of the loan; self-perception of improvement in economic wellbeing; and reduced reliance on informal borrowing.

The choice of economic measures is based on the existing literature. As reviewed in chapter 1, the primary purpose of microcredit has been to allow the poor to set up a new enterprise or expand an existing one. The businesses of the poor across the global South are generally considered to be high return ventures (Field et. al., 2012), with an estimated average marginal return to capital of 100 percent per annum (Huegerich, 2012). If this is correct we should expect the perception of wellbeing among borrower households to rise significantly.

The second indicator measures self-perception. Self-perception has become an increasingly popular measure of wellbeing in economics (see for example Cracolici, Giambona and Cuffaro, 2011; Hoyo and Seifert, 2002). Scholars argue that self-perception of economic wellbeing should be included in economic analysis for the simple reason that perception is after all a key target of economic policy, even if it does not exactly measure actual welfare. Critics argue that non-economic factors, such as marital status, can affect self-perception as it relates to economic wellbeing, making it hard to determine the extent to which respondents' perception of economic wellbeing is free from non-economic effects (Cuffaro, 2011). However, this problem is avoided here since multiple measures of wellbeing are employed.

Apart from spurring entrepreneurship, another major goal of microfinance is to reduce the reliance of the poor on informal sources of credit, such as borrowing from friends and family or the village moneylender (Collins et. al, 2009). The third indicator will measure the extent to which microcredit has reduced reliance on informal sources of credit among the borrowers in my sample.

These three economic wellbeing measures should be able to inform us of the extent to which the institutions in my sample have been able to impact the lives of their clients. I also use three other measures of wellbeing, which include: the educational status of clients' children, proxied by school enrollment and attendance; homeownership status; and other benefits of receiving the loan.

These noneconomic benefits are intended to measure the extent to which microfinance is able to improve multidimensional poverty indicators for borrower households. Research shows that education is a priority for the poor, but poverty leads to high rates of dropout (Narayan, et. al.; 2000). Homeownership is also important, especially in large cities such as Karachi, where overpopulation and land grabbing has resulted in high rents, causing a great deal of economic hardship for the poor (Human Rights Commission of Pakistan, 2011).

Improvement in household spending and consumption smoothening (Banerjee et al, 2009) is a more recent criterion of borrower wellbeing, but one that has become increasingly important as the "credit as a basic human right" proposition has gained ground (Ogden and Morduch, 2013). The last indicator titled "other benefits of receiving the loan" considers big-ticket consumption items such as financing a family wedding or funeral through a microloan.

Before presenting the main findings related to each of these measures, the section below reviews the main research questions, reviews the qualitative methodology, describes the sample, and the limitations of the research.

II. Research Questions and Methodology

This study considers the impact of institutional form on both institutions and clients. The first set of findings relates institutional form to mission and practice, while the second set extends it to the client sample.

Data for the study was collected between December 2010 and June 2012, using semi-structured interviews and observations (details provided in Appendix B). The data includes 140 interviews, 88 of which are with key informants in the sector and microfinance practitioners at the senior, middle and lower management levels, and 52 with currently active microcredit clients.

Apart from the interviews, the data also includes 12 day-long observations of client-institution interaction. Observations were made of the loan process, including verification, disbursement, and collection; monthly and weekly group meetings; home visits and visits to clients' places of business.

Interviews with clients, loan officers and branch managers were conducted in Urdu (I am a native speaker), while interviews with senior officers at the MFIs, MFBs, SBP, PPAF and PMN were conducted in English, since that is the language of the elite (Lieven, 2012: 131). The observation data was collected during, before and after the interviews.

II.A The Sample

The institutional sample consists of 12 institutions, including eight MFIs and four MFBs, which as of the last quarter of 2012 represent 82 percent of the total number of active microcredit clients in Pakistan, accounting for 80 percent of the industry's total gross loan portfolio (Pakistan Microfinance Network dataset, 2012). The institutions were identified using the Pakistan Microfinance Network's (PMN) database. The PMN is the research and development warehouse of the microfinance sector. It has 28 member organizations, which together account for 98 percent of the sector's total outreach (interview Aban Haq, 2012).

The client sampling was *purposive*, that is, clients were identified using the institutional network. The justification for that is provided in the section on limitations below. The sample includes 50 urban clients from Karachi, Lahore and Rawalpindi, and 2 rural clients from Tando Allahyar, a rural town 40 kilometers from the southern city of Hyderabad. Karachi, Lahore and Rawalpindi were chosen because urban microfinance activity is most concentrated in these areas (MicroWatch, 2012). As of the fourth quarter of 2012, the total number of active borrowers in these cities was: Lahore - 195,111, Karachi - 135,426, Rawalpindi - 76,400 and Tando Allahyar – 10, 859. Lahore and Karachi have the highest outreach for any city or district in the country. Rawalpindi is also considered a high concentration city in terms of outreach, though there are other cities with higher numbers of borrowers. Rawalpindi was primarily a convenience choice, since it is Islamabad's sister city – the capital of Pakistan, and the headquarters for PMN, PPAF and several MFIs and MFBs, and travel to Islamabad was essential for conducting key informant and senior practitioner interviews (see Appendix B).

Tando Allahyar, on the other hand, though not a high outreach area is a rural town and included in this sample to get an idea of how rural microcredit may differ from its urban version. In case significant differences were found, a future study could focus on rural microcredit clients and their particular experiences.

The section below discusses the limitations of the study, and describes how the threats to the validity of the sample have been addressed.

II.B. Limitations

In terms of the cities covered in the sample, Karachi and Tando Allahyar are located in the province of Sindh, while Lahore and Rawalpindi are in the province of Punjab. The other two provinces were not included in the present sample due to the separatist conflict in the province of Balochistan and the terrorist conflict in the province of Khyber Pakhtunkhwa. Due in large part to the threat of violence, microfinance outreach in these areas is at present very low, as shown in the outreach map in Appendix C. These regions shows up on the map in Appendix C as mostly grey, signifying little or no microfinance outreach.

Another limitation is that 79 percent of the sample consists of female borrowers, while in Pakistan women represent only 58 percent of active microborrowers. The sample, therefore, can be criticized for not adequately representing the perspective of male borrowers.

But perhaps the single most important limitation of the present study is limited funding. In response to this, I have chosen to concentrate most of my fieldwork to Karachi, where the cost of interviewing each respondent was the lowest due to the fact that this is my hometown. Since microfinance outreach in Karachi is second only to Lahore, by focusing on Karachi I was able to reach a wide range of borrowers, from multiple institutions. The table in Appendix B shows that 36 clients were interviewed in Karachi, 14 in Lahore and Rawalpindi combined and only 2 in Tando Allahyar.

But fieldwork in Karachi was also problematic. The port city of Karachi is not just the country's largest urban metropolis with a population of 21 million (Khan, 2012), its commercial and financial center, it is also home to the largest migrant population. This makes it is the most ethnically diverse city in the country. Karachi's situation is characterized by tension between the different ethnicities in the city, which has resulted in a prolonged spate of violence and general lawlessness. This is discussed in detail in chapter 4.

During the summer of 2012 when interviews were being conducted, Karachi was particularly tense with "target killings" having become a daily event in several parts of the city (Gayer, 2012; Gazdar, 2011). In Karachi, target killings refer to politically motivated murders. Between January and August 2012 these killings had claimed the lives of 1,725 people (Human Rights Commission of Pakistan, 2012).

The violence is the result of ethnic clashes between the Pathans, the Pushto-speaking migrants from the Northern province of KPK, and the Muhajirs, the Urdu-speaking descendants of the migrants from India, who arrived in Karachi at the time of the country's independence from British controlled India in 1947.

The ethnic tension was particularly problematic for this study since this type of violence in Karachi is almost always concentrated in low-income Muhajir or Pathan majority areas (Ghazi, 2011), the very places where microfinance institutions and clients most often live and operate their businesses in.

The institutions themselves have to take several precautions for the safety of their personnel. For instance, the branches of all institutions I visited in Karachi had armed guards at the entrance and the gate was padlocked even during daytime hours. In areas such as the town of Liaquatabad in the heart of Karachi and a Mohajir stronghold, the situation was particularly tense and the institution had to arrange for clients to come into the closest branch so the interviews could take place in relative safety.

In other instances, I could only visit a client in her home, which also served as her workplace, when accompanied by a loan officer. This was mainly because of cultural considerations rather than issues of security.

The following factors, however, reduce the threats to validity of this purposive sample:

1. Most of the interviewees were clients who happened to visit the MFI/MFB branch the day of my visit, either for disbursement or collection, or those whose homes/workplaces were most easily accessible to the loan officer who took me around by foot, or those who were at the monthly or weekly group meetings attended that day by the loan officer – these meetings are typically pre-scheduled, determined by the start date of the loan cycle. This reduces the likelihood that the institution would only introduce me to their best clients.
2. The sample includes borrowers from a varied economic background. It is widely accepted that the poor are not a homogeneous category, and their socioeconomic

backgrounds tend to vary widely (Kabeer, Huda, and Kaur, 2012). Thus, the poor neighborhoods covered in the sample include both the poorest neighborhoods where microfinance institutions operate as well as relatively better-off neighborhoods. For instance, in Karachi the poorest neighborhood covered was Ibrahim Haidery, while the least poor was Liaquatabad. Nevertheless, both were impoverished neighborhoods.

3. The sample covers different branches of the same MFI or MFB within and across cities. For instance, the sample includes both Karachi and Lahore-based clients of Kashf Foundation. Similarly, the sample includes Tameer Bank's clients from different branches within Karachi, such as Manzoor Colony and Liaquatabad. This ensures that differences in client experiences were not based on inter-institution, inter-neighborhood, inter-city differences, or some combination thereof.

There remains one limitation to this study, however, which the above factors do not mitigate. This relates to the fact that I have only interviewed currently active clients and there is no consideration of non-borrowers. This must be kept in mind when reading the section on findings below, which begins with a discussion of the sample institutions' mission and practice parameters before detailing the findings related to the client sample.

III. Findings

The findings detailed below show that due to increased commercialization in the sector, MFBs have experienced a dilution in their mission. MFIs, on the other hand, on average emphasize poverty alleviation more than MFBs but institutional practice does not always translate this mission uniformly down to the lowest management levels. Secondly, each MFI spin-off has handled its transition differently and it is hard to make a conclusive statement regarding mission dilution during transition and after. In terms of practice, while MFIs are generally more pro-poor, MFBs appear to offer more transparency and flexibility to their clients. Lastly, client experiences have been affected by institutional outreach and practice, but the experiences of MFI and MFB clients cannot be compared since they do not share the same socioeconomic characteristics, as detailed in the last sub-section of Section III.

III.A. Institutional Form and Mission

In this sub-section, I compare MFIs to MFBs in Pakistan and consider whether institutional form impacts their mission, as predicted by Dorado (2006). The broad distinctions between MFIs and MFBs were identified in Table 1 in chapter 1 but are discussed in more detail below, followed by the special case of MFI spinoffs, an analysis of organizational missions, the clients they target and the institutional parameters of transparency, reliability and flexibility.

III.A.i. MFIs versus MFBs – Governance, Operational Costs and Staffing

As described in an earlier section, Pakistan's MFBs are licensed and regulated by the State Bank of Pakistan under the Microfinance Institutions Ordinance 2001. MFIs, with the exception of Orix Leasing's microfinance department, are NGOs registered under one of the following Acts: (a) The Societies Registration Act, 1860 (b) Voluntary Social Welfare Agencies Ordinance, 1961 (c) Trust Act, 1882 or (d) Companies Ordinance, 1984 (Shah, 2011). None of these four acts explicitly provides MFI specific regulation in a manner comparable to the prudential regulations the SBP uses to monitor MFB activity. This distinction begets all other major differences between MFIs and MFBs in the country.

For instance, many in the sector feel that MFI governance is weak and lacks accountability, since as NGOs most of them are practically unregulated (interviews: Head Microfinance SBP, 2011; Tameer Bank Head Operations, 2011; Chief Operating Officer PMN, 2012). The Pakistan Poverty Alleviation Fund (PPAF), as the principal lender to most MFIs, has tried to beef up its regulatory stance with the MFI by developing specific Appraisal and Monitoring Guidelines (Shah, 2011). However, these are only guidelines and cannot be enforced through any type of policy action. While the PPAF can threaten to withhold future funding, in most cases this does not occur as long as repayments on PPAF loans are made on a timely basis. Industry wide initiatives such as MicroWatch – PMN's quarterly outreach bulletin, the newly setup electronic credit information bureau and Microeye – an online mapping tool used by MFIs and MFBs to keep track of the sector's expanding branch network on a real-time basis – have served to make information on MFI outreach publicly available.

But concerns over the sector's management practices remain, especially after Kashf Foundation, one of the largest and most prominent MFI, was affected by a massive repayment crisis in 2008-09. The crisis was so severe that in April 2009, when the situation was at its worst, approximately 80 percent of Kashf's clients had refused to repay their loans (Burki, 2009). The details of the crisis are discussed in chapter 5, but it will be noted here that the crisis exposed major institutional weakness. It also showed that it is not just MFBs that are under pressure to scale-up their operations rapidly, instead several MFIs such as Kashf have used dubious means, detailed in chapter 5, to compete for clients in areas where multiple institutions are operating at the same time. In the process the institution's clients have had to suffer. During interviews with Kashf's clients in Lahore it was mentioned that during the crisis it would be normal for group members to go to non-paying clients' homes and take away household items, such as television sets, and only return them once the loan was paid off.

However, such practices were not just restricted to the MFIs. Tameer Bank, an MFB, experienced a similar setback during the mid-2000s when it tried to expand outreach quickly by relying on local community "agents". Defaults and operational losses soared and it was only when Telenor, a multinational telecom operator with stakes in other microfinance institutions such as the Grameen Bank (Singhal, Svenkerud and Flydal, 2002), stepped in and bought a 51 percent majority stake in the MFB, that the institution was able to regain lost ground. Tameer has since strengthened its controls, overhauled its verification process and most recently shifted 80 percent of its portfolio to lending against gold to reduce its reliance on clean or uncollateralized lending (interview Director Operations, Tameer Bank, 2012).

One major difference between the MFIs and MFBs is in their cost structure. The NRSP which has just spun off part of its portfolio into a standalone MFB described how it would require just Rs.6,000 (US$64) to set up an MFI branch but an MFB branch would mean a heavier investment since banking regulations come with their own costs. For instance, the SBP requires that each branch should have its own properly trained and certified risk management officer. In addition, extensive operational records and client information must be electronically available anytime for the SBP to review. Such costs reduce the institution's flexibility and limit its ability to expand as rapidly as it could when it was an MFI (interview Program Coordinator NRSP, 2012).

MFIs are also able to control their costs by keeping the salaries of their personnel quite low. While MFBs have to hire individuals with accounting and business degrees, especially for higher-level positions, MFIs make do with lower educational backgrounds and less experience. Salary structures, therefore, differ significantly between the two institutional groups. District Manager Karachi at NRSP's Urban Poverty Alleviation Programme (UPAP) spoke about this when he said: "We can't afford to hire a very educated staff – just a matriculate (10^{th} grade) or intermediate (high school graduate). And since most of them are teenagers we end up with very high levels of staff turnover". A similar observation was made by an Area Manager of the MFI, ASA Pakistan. Such hiring practices and turnover rates have direct implications for the weak management generally attributed to MFIs in Pakistan. At the same time, the pressure to increase outreach results in high turnover at MFBs (interview Head of Business Banking, Kashf Bank, 2012).

Overall, while MFBs and MFIs are by no means homogenous categories there are significant differences between the two groups in terms of governance, operational costs and staffing patterns as predicted by Dorado (2006). Much of this has to do with the lack of regulatory authority over MFIs, but it is also due to the fact that MFIs don't have access to important sources of funding such as mobilized deposits, institutional strengthening funds from the United Kingdom's Department for International Development (DFID) and the SBP's guarantee facility through which commercial banks are able to lend to MFBs.

The important question is how do such differences affect institutional missions across the sector?

III.A.ii. Microfinance Institutions and their Mission

In Section I, I hypothesized that the first type of SEVs, that is, NGOs with a business model, are likely to emphasize their social mission more than the second, that is, for profits with a social mission. In this section I relate findings on institutional missions to test this hypothesis.

Khushhali Bank, the first MFB to be established in Pakistan in 2000, has a model of outreach that involves partnering with local nonprofits in the communities where it has a branch network. This is why Khushhali has been referred to as a quasi-NGO. But in June 2012 a consortium of local and international investors acquired a majority stake in the Bank (Bloomberg, 2012). It is expected that in the coming months it will transform to a much more competitive and commercially driven entity (interviews: Executive Vice President Khushhali Bank, 2012; Senior Joint Director SBP, 2012; Associate Financial Services Group, PPAF, 2012). This is likely to have a big impact on the sector as a whole, as Khushhali with a presence in 72 out of 113 districts, has the largest branch network of all MFBs in Pakistan. Moreover, Khushhali is the largest microfinance institution in the country, accounting for 19.1 percent of total active borrowers in the sector (Microwatch, 2012).

The other MFBs in the sample include Tameer Bank – the largest institution in terms of gross loan portfolio (17.6 percent of the sector total), FMFB and Kashf Bank. While FMFB states that its primary mission is poverty alleviation, the main focus of the other two is achieving financial sustainability (interviews: directors and senior management at all three institutions, 2010-12).

FMFB is a spinoff of AKRSP and continues its operations as an Aga Khan Foundation subsidiary, a transnational Foundation with a strong commitment to social service based on the religious philosophy of the Aga Khan, the Imam[11] of the Ismaeli community, a minority Muslim sect. The strength of the institution's mission is demonstrated by the fact that all seven officers of this institution who were interviewed, ranging from the CEO to the loan officers, clearly stated that poverty alleviation was the institution's primary mission. Observations of institution-client interactions also show that institutional practices are closely aligned to this agenda.

Of course, affinity to the institutional mission across management levels is hard to measure. But among the MFIs in the sample the institution that stands out is Akhuwat, which is a zero-interest based MFI. At Akhuwat a spirit of volunteerism and commitment to the institution's philosophy of brotherhood and generosity was clearly demonstrated in the staff at all organizational levels at Akhuwat's Lahore operations, much more than at any other institution in the sample. Akhuwat has remained relatively insulated from the sector-wide winds of change brought on by the recent emphasis on commercialization for it depends on *individual* charitable donations, rather than assistance from international

[11] Spiritual leader

donors and the PPAF. It has managed to keep its operational costs extremely low by relying on volunteers and places of worship as venues for disbursement (Akhuwat, 2012). In Lahore I visited an Akhuwat client for an interview, during which I was offered a cold drink to beat the searing Lahore heat, but the Akhuwat officer next to me was not. The client sensed my unasked question and said “I have been Akhuwat’s client for 12 years but never has any officer from this organization accepted anything from us as a gift of appreciation, not even a glass of cold water”.

In Figure 1 in Section I, Akhuwat is classified as a cross-sector SEV, as it does not fit the other two categories, that is, the nonprofit SEV with a business model or the for-profit SEV with a social mission.

Apart from Akhuwat, the MFIs, NRSP and its sister organization - the Urban Poverty Alleviation Programme (UPAP), Bangladesh Rural Advancement Committee’s (BRAC) Pakistan operations, Orangi Pilot Project (OPP), and Thardeep Rural Support Programme stated that poverty alleviation and a commitment to social change was their primary mission.

Kashf Foundation’s stated mission is development through women’s empowerment. The Bangladeshi MFI, Association for Social Advancement’s (ASA) Pakistan operations considers poverty alleviation as its primary goal, but stresses that success only comes through commercially viable operations. The MFI, Orix is an exception as it is not an NGO but is a division of the non-bank financial multinational institution, Orix Leasing. Orix Pakistan is perhaps the classic double bottom-line institution from Dorado’s perspective, as it places an equal emphasis on financial sustainability and the social mission of microfinance. Orix admits that as it is not an NGO and employs a business approach to microfinance, its ties with its clients are not as close as those of other MFIs (interview Orix Pakistan CEO, 2011).

However, observation data indicates that the social mission is not always translated into actual practice due to competing demands on MFI officers. For instance, during visits to various NRSP branches, I was informed by loan officers and branch managers alike that clients are asked to make their monthly repayments a few days ahead of the actual due date so that if payment is delayed by a day or two, the loan does not have to be termed "pass due". Not surprisingly, when I visited the regional office of NRSP in Karachi, the Director proudly showed me his loan-book, which clearly showed that less than one percent of his portfolio was "pass due".

For the cross-sector SEV, Dorado's third category, the profit motive is least relevant. As mentioned earlier, the MFI Akhuwat is classified as a cross-sector SEV. Akhuwat's institutional philosophy is based on four principles: (a) zero-interest microcredit (b) arranging group meetings at "indigenous" venues, which is a reference to places of worship, usually mosques (c) volunteerism, senior management works strictly on a voluntary basis but paid staff is also asked to adopt a social service attitude and (d) reciprocity, it is strongly encouraged that current and past borrowers become part of Akhuwat's donor pool. In 2010, former borrowers provided a total of Rs.15 million (US$159,575) in donations (Candland, 2011). As Akhuwat does not accept grants or soft loans from institutional donors it is able to keep its mission from getting diluted by a donor-driven agenda.

Dorado (2006) predicts that cross-sector SEVs are likely to be short-lived initiatives. The zero-interest based microcredit model is also considered impractical (Roodman, 2012, pg. 183) and there are concerns regarding its sustainability (Tedschi, 2006). Akhuwat, however, continues to grow despite such expectations. For instance, at the end of 2006 it had just over 7,000 borrowers, but by the fourth of 2012 its total active clientele had risen to 104,600, with a gross loan portfolio of over Rs.1,156 million (US$116million). Akhuwat direct presence is spread over 27 districts, across three provinces, and it has helped at least one other institution replicate its model in Sindh, the only province where it does not have its own branches (PMN, 2012; interview CEO Akhuwat Karachi, 2010). An important reason for Akhuwat's growing popularity is its zero interest model. This has put serious pressure on MFIs operating in the same areas. In Lahore I met at least two borrowers that were active clients of other microfinance institutions who said they would like to switch over to Akhuwat, as it does not charge interest. Branch managers from other MFIs operating in Lahore and Rawalpindi also expressed concern that Akhuwat was gaining advantage over them because of its zero interest policy.

Overall, however, it is evident that MFBs are generally less likely than MFIs to place poverty alleviation over their financial sustainability objectives, with the exception of FMFB. And amongst the MFIs in the sample, Akuwat seems to have the most undiluted focus on poverty alleviation.

III.A.iii. Spinoffs and Mission Drift?

Section I mentions the risk of mission drift in MFI spinoffs that have shed their NGO status. There are currently three such entities in Pakistan's microfinance sector – FMFB, Kashf Bank and NRSP Bank. The description above for FMFB demonstrates that such a mission drift has not occurred, but for Kashf Bank, a spinoff of Kashf Foundation, the outcome is quite different. While Kashf Foundation lends only to women and states that it is committed to gender empowerment, 95 percent of Kashf Bank's lending is to men, and the Bank targets borrowers from a higher socioeconomic class than the Foundation (interviews: senior management at Kashf Foundation and Kashf Bank, 2012). This is a clear departure from the Foundation's original mission and confirms Battilana and Dorado's hypothesis.

NRSP Bank's transformation, which began in 2010, is still in process. Senior management admitted that they have slowed down the divestiture of the microfinance portfolio from the MFI to the MFB after realizing that an MFB has much less flexibility for expansion than an MFI (interview Program Coordinator NRSP, 2012). Still, even though both the MFI and the MFB cater to rural borrowers, the gender profile of the two is drastically different. While men make up only 24 percent of the total borrowers at NRSP, they constitute 88 percent of total borrowers at NRSP Bank (PMN data, 2012). Male borrowers are usually associated with higher loan amounts and better socioeconomic status (Agier and Szafarz, 2010), which implies that at least some mission drift has occurred with the transformation, partially confirming Battilana and Dorado's hypothesis.

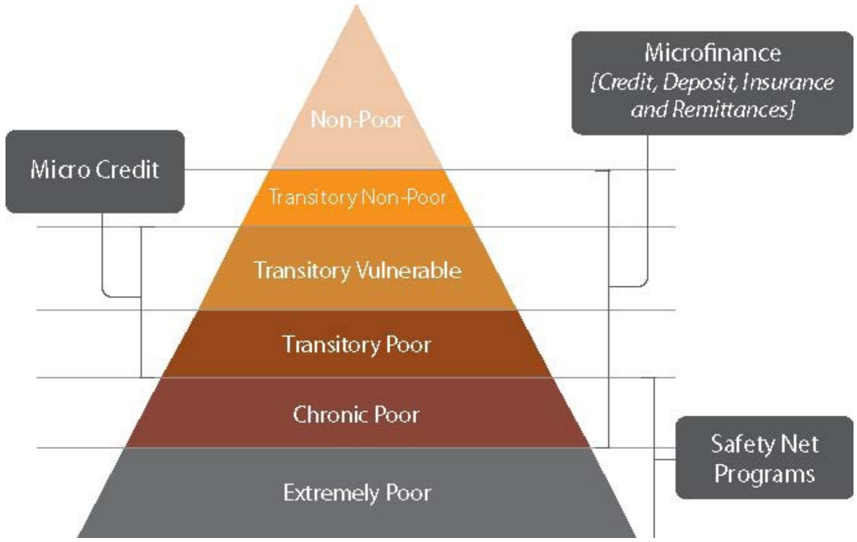
Given these differences in mission, is there a way to distinguish MFIs and MFBs based on their pattern of client outreach? The section below describes this in some detail, though district-level outreach differences between MFIs and MFBs were analyzed econometrically in chapter 2.

III.A.iv. Outreach - Targeting the Less Vulnerable

The *Economic Survey of Pakistan 2007-08* places the national poverty line at an individual annual income level of Rs.11,400 (US$121) (Ministry of Finance, Pakistan). This is the same definition used in Pakistan's Poverty Reduction Strategy Paper (PRSP) (United Nations Development Programme, 2012). In contrast, in the 2007 Prudential Regulations for Microfinance Banks, the SBP defines a poor individual as one whose annual income is less than Rs.150,000 (US$1,596). Even more striking are the 2011 revisions in the Prudential Regulations where all mention of the word "poor" has been removed, and income eligibility has been increased to Rs300,000 (US$3,192) (SBP, 2011; SBP, 2007).

This changing emphasis is reflected in a sector wide discussion on borrower characteristics, symbolized by the "poverty pyramid" referenced during interviews by several practitioners and the SBP's Microfinance Director, and as prominently displayed at PMN's office in Islamabad. The pyramid first appeared in a publication by the Consultative Group to Assist the Poor (CGAP), a microfinance research institute housed at the World Bank (Hashemi and Rosenberg, 2006).

Figure 6: The Poverty Pyramid



*Source: Pakistan Microfinance Network (PMN)

Practitioners use the pyramid as a reference point in arguing that microcredit is best aimed at those just above or below the poverty line, while other financial products such as microsavings and microinsurance can be used to target everyone except the extremely poor. To date, however, there has been little success with these products in Pakistan, as discussed in chapter 1.

A related phenomenon is the evolving segmentation within the sector, with MFBs being increasingly encouraged to target clients above the poverty line, leaving MFIs to serve those below the line (interview Aban Haq, 2012; Shah, 2011).

Additionally, in mid-2012, the SBP passed legislation allowing MFBs to target clients in the small medium enterprise (SME) sector[12] by increasing the microcredit loan ceiling to Rs.500,000 (US$[13]5,439). The original regulation had placed the ceiling at Rs.150,000 (US$1,631) and stipulated that 80 percent of an MFB's loan portfolio must consist of

[12] An SME is larger than a microenterprise in terms of number of employees, sales volume and balance-sheet size (Inter-American Development Bank, 2003)
[13] US$1=Rs.100 as of June 2013

loans less than Rs.100,000 (US$1,064) (Berrada, 2012; SBP, 2007). The new regulations expand MFB options for scaling up to higher-income borrowers. It is expected that MFIs will fill in the gaps thus created by serving the lower-income clients (Shah, 2011; interview Aban Haq, 2012; interview DFID and World Bank Consultant for Pakistan, 2012).

How have these policy "nudges" affected actual practice in the sector? The table below shows the targeted socioeconomic status of borrowers by institution:

Table 10 Microcredit Targeted Borrower Profile

Institution	Targeted Socioeconomic Status
Tameer Bank (MFB)	Just *above* the poverty line. Existing business required (at least 2 years business tenure).
FMFB (MFB)	The poorest but with demonstrated repayment capacity. Bank assists in getting market access for clients in certain areas (pilot phase). Group majority must be homeowners.
Khushhali Bank (MFB)	Existing business required (at least 2 years business tenure). Group majority must be homeowners.
Kashf Bank (MFB)	Higher income clients than Kashf Foundation's (see below). Existing business required (at least 2 years business tenure).
Kashf Foundation (MFI)	The working poor, earning up to Rs.25,000 a month (a typical lower-middle-class salary). Existing business required (at least 6 month business tenure).
Orix (MFI)	Working poor: existing outside employment for the borrower or male household members required.
OPP (MFI)	Around the poverty line, existing business required in its direct lending operations. For the indirect lending portfolio, criteria determined by the local MFIs OPP partners with.
NRSP and UPAP (MFI)	Categorized as the poorest in the community, but with demonstrated repayment capacity. At least one woman in a group of three needs to be a homeowner.
Thardeep (MFI)	The poorest of the poor.
Akhuwat Foundation (MFI)	Categorized simply as poor but with demonstrated repayment ability.
BRAC Pakistan (MFI)	"Middle" poor. Existing business not a requirement. Never married women not eligible.
ASA Pakistan (MFI)	"The economically vibrant poor" or those living around the poverty line.

*Source: Based on practitioner interviews

The table describes how each institution defines its own borrower criteria. Some of it is based on lending methodology and practical considerations. For instance, the homeownership criterion is important when targeting low-income clients. Practitioners stress that renters move houses often in low-income neighborhoods, and if they happen to leave in the middle of a loan cycle it is hard to track them down to ensure loan repayment. In a group lending arrangement where there is joint liability, if one or more of the group members are homeowners they can be called upon to pay for the absent client. However, the criteria for selecting clients are also based on the value the institution places on its social mission relative to its concern for financial sustainability. Among the MFBs in the sample, Tameer and Kashf Bank clearly target higher-income clients, while FMFB targets the lowest income clients in the sample.

The MFIs in the sample also vary in their targeting approach. While Thardeep states that it targets "the poorest of the poor", BRAC, ASA, OPP and Orix target the higher income poor, which are referred to by these institutions alternatively as "the working poor", the "middle poor" or the "economically vibrant poor".

Interview data also shows that FMFB and Thardeep are the outliers in their respective groups when it comes to ensuring on time repayments. FMFB staff, especially at the branch level, talked about giving clients a "grace period" in the event of a genuine emergency. Clients of FMFB's Korangi Branch in Karachi stated that the staff allowed them to make late payments because of the law and order situation paralyzing Karachi. Thardeep's Director of Microfinance for rural Sindh indicated a similarly soft stance on loan utilization and repayment. Branch staff and clients at other institutions, on the other hand, described the strict loan repayment policies the staff was required to enforce to maintain credit discipline among clients.

All MFBs, except for FMFB, required that first-time clients have an existing business. The reverse was true for MFIs, where no institution except Kashf Foundation had an existing business requirement.

On average, however, the socioeconomic status, homeownership stipulation and business tenure requirements demonstrate that very few institutions target the poorest. The emphasis is on targeting clients that already have a basic skill set, existing business or employment and who are leading less precarious lives than the poorest. A recent study of microfinance outreach in rural Punjab also confirms that microfinance institutions refrain from targeting the poorest households and focus instead on the less poor (Ghalib, 2012). Finally, the section below analyzes the institutional parameters of transparency, reliability and flexibility.

III.A.v. Institutional Practice Parameters

It is helpful to remember that when microfinance first entered the scene it took its place somewhere along the middle of a spectrum, one end of which consisted of informal networks of savings and finance the poor have always used, including friends and family, informal store credit from the community's general store, buying and selling on credit from the middlemen for their small businesses, and of course the infamous moneylender. At the other end were commercial banks, who since the sixties have been asked to dedicate part of their portfolio for concessional lending to the poor, but who have always managed to find ways to evade such regulations (Ahmed, 2010). Informal sources of finance are usually non-transparent, unreliable, but very flexible (Roodman, 2012). The question is how does microfinance measure up against these parameters?

In the Microfinance Banks Prudential Regulations, the SBP stipulates that MFBs make full disclosure of the important terms and conditions of the products they offer, including lending and deposit rates, in a manner easily accessible and understandable to their clients (SBP, 2007). MFIs that are member organizations of PMN have also signed on to the PMN Code of Conduct for Consumer Protection with stipulations similar to the Prudential Regulations (Haq, 2009). However, critics argue that such codes require self-regulation, which is less reliable than regulation in ensuring transparency, especially when it comes to pricing (Mazer, 2012).

One aspect of transparency peculiar to microfinance is the mental absorption capacity of its clients (Roodman, 2012). More than one practitioner mentioned this during interviews. They insisted that because of low levels of literacy, clients did not always fully understand the terms of the loan and even when they did most of them were liable to forget soon afterwards (interviews: Business Development Manager, FMFB Islamabad, 2012; Branch Manager Kashf Karachi, 2012).

This was also confirmed during interviews when clients were asked details regarding the credit life insurance policies they were required to purchase upfront. Responses were limited to “we were told if something happens to us the debt would be taken care of”. When asked about the pricing of this mandatory insurance product the response would often be a vague silence or simply “I don’t know”.

In terms of reliability, however, most MFIs and MFBs seem to be doing rather well. Most clients appeared to know their loan amounts, the monthly repayment sum, repayment dates and group meeting times. Borrowing informally from friends and family is often one of the most unreliable sources of finance but one of the first the poor try to access (Banerjee and Duflo, 2011). In addition, much of the economic lives of the poor are based in the informal economy, characterized by informal, unwritten contracts (Roodman, 2012). During interviews, several clients appreciated having access to a "bank" that provides them with a reliable source of credit. The reference to "bank" was for both MFIs and MFBs.

Flexibility is the last parameter in this analysis. The moneylender, though exploitative and lacking transparency, is usually highly flexible, for he truly understands the high incidence of unexpected emergencies, such as sudden death and illness, in the lives of the poor. As there is no enforceable written contract, if he tries to exact payment when the client is facing an extreme hardship he risks losing his entire future stream of income (Banerjee and Duflo, 2011). MFIs and MFBs, on the other hand, are much less flexible. They insist on timely repayment, a fact that most borrowers mentioned in their interviews. This finding is discussed in more detail in the section on client experiences. Another aspect of institutional flexibility is the number of different products on offer. Until recently, most MFIs and MFBs in Pakistan had just two main products: the equal monthly installment (EMI) loan for urban consumers, and the bullet loan for rural consumers, based on harvest dates. Recently, however, MFBs have begun to offer additional credit products. For instance, FMFB and Tameer Bank now offer higher denomination housing loans, that can go up to Rs.500,000 (US$5,319). Apart from the microenterprise loan, Tameer also offers a motorcycle loan, in addition to a new line of agricultural products. However, Tameer's reliance on collateralized lending, against the household's stock of gold jewelry, has already increased to 70 percent of its total portfolio.

FMFB also offers a "low- salaried non-tax paying loan" and a "pensioner's loan", in addition to its regular EMI enterprise loan and bullet agriculture loan. Kashf Bank and Khushhali Bank have a more restricted product portfolio, though they too have recently introduced the gold backed loan and the housing loan, following the SBP's revision of the Microfinance Bank Prudential Regulations.

MFIs, on the other hand, offer fewer choices. Most of them offer group-based loans only for enterprise development. Exceptions include ASA and Akhuwat. ASA has recently begun to offer larger denomination SME loans. Akhuwat, on the other hand, has nine different loan categories targeting specific vulnerable groups, based on its social change agenda. These include the enterprise loan, the "liberation" loan intended to pay off an existing moneylender related debt, an education loan, a health loan, a housing loan, and a marriage loan (interview Assistant Manager Akhuwat, 2012; Akhuwat's website, 2012).

These findings suggest that MFBs are more transparent than the average MFI, both appear equally reliable, but are low on the flexibility scale as compared to informal sources of finance, though one aspect of flexibility, that is, the product line is slowly becoming more diverse, at least for MFBs.

The following section presents findings related to the client sample.

III.B Client Wellbeing Indicators

The sample includes 32 MFI clients and 20 MFB clients, of these 41 were women and 11 men. The average loan size for MFI clients in the sample was US$308.51 and for MFB clients it was US$306.63. At first glance, MFI loan sizes appear higher than MFB loans. However, if we take out the outliers from the MFI and MFB pool, the picture appears a bit different. An Akhuwat client in his 12th loan cycle had a loan of US$800, which is nearly US$400 higher than the second highest loan amount in the MFI category. Removing this loan from the pool, the MFI average goes down to US$254. Similarly, in the MFB sample, a US$532 loan is an outlier because it is the only gold collateralized loan in the sample. Removing this loan, the MFB average goes down to US$292.55. Now, the average MFB loan is nearly US$40 higher than the average MFI loan in the sample, which is, as we would expect, given the discussion in the previous section. The following table provides the break-up by lending methodology:

Table 11 Sample by Lending Methodology

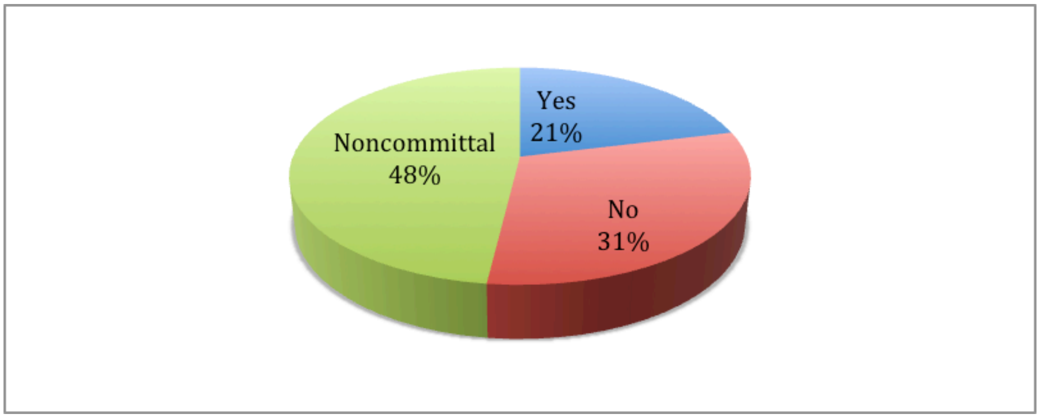
	Group	**Individual**	**Total**
MFI Loans in Sample	30	2	**32**
MFB Loans in Sample	10	10	**20**
Total	**40**	**12**	**52**

As expected, MFIs are more likely to offer group loans than MFBs. The 10 group loans in the MFB sample are from Khushhali Bank, Tameer Bank and FMFB, but not Kashf Bank since it only does individual lending. The analysis below presents detailed results from client interviews and observations of client-practitioner interactions.

III.B.i Economic Indicators of Wellbeing

The three economic indicators defined in Section 2 were self-perception of an improvement in economic wellbeing, expansion of business and reliance on informal borrowing.

Figure 7: Self Perception - Improvement in Economic Wellbeing



The chart shows that 21 percent, that is, a total of 11 clients felt an improvement in their economic wellbeing while 31 percent, that is, 16 clients said their wellbeing did not improve and 48 percent, that is, 25 clients were noncommittal in their responses. Those that felt their economic wellbeing had improved were involved in different types of microenterprises including welding, running a kiryana[14] store, making machine parts, running a sewing training center for women, making sea-shell jewelry and ladies tailoring. Of these, seven were MFI clients, while four were MFB clients. The first seven were clients of the following MFIs: two from NRSP's Urban Poverty Alleviation Programme (UPAP) – one from Karachi and the other from Lahore, one from the Bangladeshi MFI ASA's Karachi-based branch, one from Kashf Foundation's Lahore-based branch and two from Akhuwat's Lahore-based clients. The other four clients were

[14] *Kiryana* literally means the corner store

all from the MFB Tameer Bank, and all of them were Karachi-based, having taken loans from two different branches of the Bank.

It is important to note that not all of those who felt their economic wellbeing had improved attributed it to microfinance. For instance, one of ASA's clients felt things had improved since she had taken on a job as a housemaid. Her husband could only find work sporadically, and working as a housemaid finally provided the family with a steady source of income. It was this income that gave her the "courage" to take on the responsibility of a microloan. Job insecurity is almost always the top concern for the poor (Narayan, et. al., 2000).

Similarly, a Kashf Lahore client was satisfied with her economic situation because she was able to manage the ups and downs of market demand thanks to the three different types of home-based work she had taken on, including ladies tailoring, flag sewing, and making shutters for commercial shops, while her husband also had a steady job as a commercial driver.

Clients who felt their wellbeing declined, expressed various reasons for feeling this way. The two rural clients from Tando Allahyar described how the recent floods devastated their crops and pushed the price of their livestock down. They bought the livestock with the loan and expected to be able to sell at a profit. When this did not happen they suffered losses but still had to pay the loan off.

Karachi-based clients blamed the ethnic violence in the city as a primary reason for the fall in the demand of their products. Similarly, Lahore and Rawalpindi-based clients expressed that the frequent power outages in the city caused a large drop in their output.

This is discussed in more detail in chapter 5 where the impact of the local political economy on client wellbeing is analyzed.

The next indicator tells us how many clients were able to expand their business directly as a result of the loan they received. Out of the 52 clients in the sample, only 11 said they expanded the business with the loan, while two others said the loan enabled them to buy raw material in bulk, which reduced the unit cost of their input. Of the 11, six were from MFIs while five belonged to MFBs. All five MFB clients were Tameer Bank's Karachi-based clients. Two MFI clients mentioned that the business expansion allowed them to afford school for their children, and two other clients said they were able to make major home improvements because their business improved as a direct result of the loan – one was an MFI client while the other was an MFB client.

Half of the six MFI clients were in their 4th cycle, the others were 3rd, 5th and 12th cycle clients. The biggest loan was Rs.75,000 (US$798), which belonged to the 12th cycle client of Akhuwat. Three of Tameer's clients were in their 2nd cycle, while the other two were 3rd and 4th cycle clients. Their loan sizes varied between Rs.20,000 (US$213) to Rs.40,000 (US$638).

The last economic indicator measures reliance on informal sources of credit. Of the 52 clients in the sample, 10 mentioned that they often had to borrow informally, from friends and family, to make their loan repayments on time. Six of these were MFI clients while four were MFB clients. A Karachi-based MFI borrower, who taught young girls in the community to read the Quran, said that she would borrow often to make on-time payments. Sometimes she would borrow from her students to repay the loan, and if her students didn't have the money they would borrow from their family and friends to lend the needed sum to their teacher.

When asked what would happen if payment was not made on time a few mentioned having to pay late fees, but several also mentioned the humiliation of having loan officers turn up at their doors and make a fuss until the neighbors found out. They described paying the loan on time as a matter of "*izzat*", meaning honor. This is one way microloans are different from regular loans. Not having financial collateral to fall back upon, loan officers use social pressure to elicit payment.

But if social capital doesn't work there are other alternatives. One of Tameer Bank's branch managers in Karachi explained this: "if a client cannot repay we approach his guarantors. The client feels embarrassed and is usually able to pay by borrowing from someone. If that is not possible we offer an emergency loan, that is, a loan backed by the household's gold jewelry."

Client interviews show that borrowing from one another to repay loans is routine and not out of the ordinary. Several mentioned borrowing from parents or siblings to make payments on time. Another mentioned that it was usual for the family to miss meals in the days leading up to the repayment date.

And then there is the informal credit offered by the middlemen the clients deal with in their businesses. An MFB client remarked "the market can give credit anytime but the Bank only gives you a loan once (a year)". She was referring to the suppliers' credit that the wholesaler would give her when she was short on cash and needed to buy material. The "market" is the middleman. The middleman is both the buyer and the seller for the small home-based producer. A woman making seashell jewelry or embroidered fabric would buy her material from the middleman, he would provide her with a sample which would show her how to make the product, and once it was ready she would sell the finished product back to him. The middleman would make a profit not just from the higher retail price charged on the product but also on this informal credit arrangement. The client, who is often short on cash, is dependent on the middleman, and this dependency becomes even more acute because the middleman is inconsistent with the timing of his payment to the small producer. Several clients reported that the "market people" often held back payment, but would give credit whenever needed.

While this is a description of the urban middleman arrangement, a similar practice occurs in rural areas where the middleman sells seeds and fertilizer, but is also the buyer of the crop and livestock. FMFB Karachi's Regional Manager described how group lending was being used to break the hegemony of the middlemen over their clients, but only to an extent as described in chapter 5. The success of this could not be ascertained at the rural level since the client sample was mostly urban. The middleman arrangement in urban areas so far does not appear to have changed at all with the advent of microfinance.

Practitioners also recognize that the loan amount they approve is often not enough to meet the credit needs of the poor. For instance, NRSP's Programme Coordinator referring to their rural operations admitted that while a single cow costs around Rs.60,000 (US$640) his MFI can only lend between Rs.10,000 (US$106) to Rs.20,000 (US$213) to the farmer, and he has to borrow the rest from someone else.

MFB loans on average are higher, but the repayment capacity of the borrower does place a limit on loan size as discussed in chapter 2. MFB activity in rural areas remains limited, with the exception of FMFB and NRSP Bank.

III.B.ii Non-economic Indicators of Wellbeing

The three non-economic indicators reviewed in this section are education, homeownership status and all the noneconomic benefits accruing from the loan.

The responses on education are from clients that either had school-aged children currently or whose children had passed their schooling years. Out of the 52 clients in the sample, there were 23 responses from MFI clients and 12 from MFB clients. The responses, shown in the table below, indicate that the majority of the children had or were attending school:

Table 12 School Enrollment - Client's Children		
	MFI	**MFB**
Never attended school	2	1
Some attended school, others dropped out early	2	2
Attend school when times are good, not when times are hard	1	0
Older children with college degrees, or currently in college	2	2
All children attend school	16	7
Total	**23**	**12**

On average, the 12 MFB clients mentioned in the table above were in their 2nd cycle. All of Tameer Bank's clients that responded to this question said "yes" to their children attending school and two of this MFB's clients mentioned that some of their children were also attending college.

Client and practitioner interviews, however, indicate that the educational status for MFB clients in general and Tameer Bank's in particular, are the result of targeting less poor clients, rather than due to a significant improvement in economic status through microcredit. Similarly, those with children that had either received a college degree or were currently attending college, were the least poor clients. This is also obvious when one considers the fact that in Pakistan the higher education system enrolls only about four percent of the population in the corresponding age bracket of 17 to 23 years and, as with other developing countries, higher education is directly correlated with socioeconomic status (World Bank, 2009).

For the MFIs, Kashf Foundation and Akhuwat's clients seemed to be doing better on the schooling indicator as compared to NRSP's UPAP and the Bangladeshi MFI BRAC's Karachi Branch. But note that NRSP and its sister organization, UPAP, target the poorest people in the communities they operate in. With reference to his clients' educational outcomes, UPAP's District Manager Lahore said: "their interest in educating their children is low and the expense is high so they don't emphasize education and therefore remain dependent on daily wages. Most families you meet earn daily wages and only find work 3-4 days a week."

Even though this study is restricted to urban clients, practitioner interviews indicate that the situation in rural areas is more dismal. FMFB's Area Manager Sindh, recalls the responses of his rural client's when they are advised to put their children in schools: "we can't afford to put our children in schools. If we do who will provide the labor on our land?"

The second non-economic indicator of wellbeing defined in Section 2 was homeownership status. Information on this indicator was provided by 24 clients, and is shown in Table 13 below:

Table 13 Homeownership Status of Clients in Sample		
	Homeowner	**Renter**
MFIs	10	4
MFBs	7	3
Total	**17**	**7**

The table indicates that homeowners far outnumber renters for both MFIs and MFBs. This, however, is no coincidence since MFI and MFB practitioners confirm that homeowners are given priority over renters in urban areas, since renters move houses often and it is hard to keep track of them. Recall that in Table 10 in Section III.A homeownership is an important criterion for client selection. For instance, Khushhali Bank requires at least one homeowner in a group of three and at least three in a group of five (interview: Branch Manager, Rawalpindi, 2012).

Clients who were renters mentioned that one of the stipulations of their loan agreement was that their landlord must act as the loan guarantor. At least one interviewee mentioned that landlords demand payment from clients who ask them to provide guarantees on their loans. If this can be confirmed as a common practice, it should be included as a hidden cost of the loan.

These homeownership statistics also show that higher income clients greatly outnumber lower income clients, since renters are almost always less well-off than homeowners, especially in a country like Pakistan where homes are usually purchased on a cash basis (Baharoglu and Kessides, 2002: 128). This is why the SBP has allowed MFBs to offer housing loans, but these loan amounts are higher denomination and usually unaffordable for those living below or at the poverty line.

No client in the sample mentioned being able to realize a homeownership goal as a direct or indirect result of microfinance. However, two clients mentioned that the loan helped them towards home improvements, which brings us to the last noneconomic wellbeing indicator, that is, other benefits accruing from the loan.

Table 14 Other Self Reported Loan Uses

Loan Use	**Institution**	**Number of Clients**
Financed sister's wedding	Khushhali Bank – MFB	1
Sent son to Dubai to seek better-paying job	Kashf – MFI	1
Co-purchased a motorbike with a friend	Kashf – MFI	1
Paid off an old debt	ASA – MFI	1
Paid off outstanding utility bill	ASA – MFI	1
Purchased *Eid* clothes for family members	ASA – MFI	1

Table 14 presents the big-ticket consumption items clients in the sample mentioned were paid for by their loans. The majority of these were MFI clients. Of course this does not mean that clients who did not detail their loan usage only applied the credit received towards their businesses.

III.B.iii Borrower Findings and Study Limitations

Framing these client related findings against the limitations of this study, specified in Section II, I find no systematic differences between the urban clients from Karachi, Lahore or Rawalpindi.

On the other hand, the experiences of the rural clients in the sample appear to differ from that of their urban counterparts. For instance, the homeownership pattern in rural areas is such that except for the landless sharecropper everyone else is a homeowner, even if being a homeowner means living and working on the same narrow piece of land. The landless sharecropper is generally among the poorest and is, therefore, not eligible for microfinance.

Similarly, interview data shows that sending their children to school is much more important for urban parents than to rural parents, especially when it comes to female children. This is corroborated by the fact that while the national literacy rate is 58 percent, rural literacy rate is only 49 percent and rural female literacy is only 35 percent (Ministry of Finance, Pakistan, 2011).

Thus, the client related findings from this study largely represent urban microfinance and a separate study would is required to sufficiently incorporate the experience of rural microcredit clients.

IV. Discussion and Conclusion

This paper confirms the hypothesis that the pressure to earn commercial profits has weakened the poverty alleviation agenda for most MFBs. MFIs, in comparison, appear more committed to their social mission. Part of the reason is that MFIs are operationally more flexible and are able to keep their operational costs low, thanks to fewer regulatory requirements, which allows them to expand outreach to poorer clients, who are in general more expensive from the institutional point of view.

However, the findings also suggest that the distinctions between the two institution types are to a large extent policy driven. For instance, recent policy changes have nudged MFBs to target individuals over the poverty line and the lower end of the SME sector, while MFIs have been expected to fill in the gaps thus created, by targeting those below the line.

The case of spinoffs is interesting, as each institution has dealt with the transition in its own way. For instance, FMFB, the first spinoff, has remained strong on its poverty alleviation agenda, while Kashf Bank seems to have moved to the other extreme, shedding its social agenda almost completely to achieve commercial success.

The sector as a whole has become more committed to achieving financial sustainability. This has meant that most MFIs and MFBs now target the less poor or even the non-poor; most MFBs and some MFIs do not lend to start-ups; at least one MFI asks its borrowers to pay a few days ahead of the actual due date so that repayment rates can look good; and most MFBs have stepped up lending against gold – a clear departure from the original non-collateralized microfinance model.

The research finds Akhuwat, a zero interest based MFI, to be the sector's clearest outlier. It mainly seeks social change and poverty alleviation and has little interest in becoming commercially viable. However, there are other institutions such as FMFB, an MFB, and Thardeep, an MFI, for whom the poverty alleviation agenda takes precedence over seeking financial returns.

On the whole, the sector appears more reliable and transparent than informal sources of finance, but the order is reversed when it comes to flexibility. Institutions do not make allowances when life events or environmental conditions make it hard for borrowers to repay on time and clients either end up having to borrow informally, skipping meals to repay on time or having to face loan officers demanding payment in a manner clients report as humiliating.

In terms of wellbeing, only 21 percent in the client sample report feeling that their economic situation has improved. Similarly, only 21 percent report that they were able to expand their businesses because of the loans they received. Many clients report that their reliance on informal borrowing has not reduced, since loan sizes are often inadequate for business investments such as buying livestock. But a major reason for continued reliance on informal borrowing is because clients often have difficulty making loan repayments on time.

In terms of non-economic indicators of wellbeing, the educational status of clients' children was found to be better than the national average. The majority have school-aged children attending school. The homeownership rate is also high for the sample. However, the discussion on socioeconomic targeting suggests that the real reason for the strength of these results is that microfinance institutions do not target the poorest, in fact many target those over the poverty line.

What conclusions can we then draw about the impact on poverty of microfinance? Clearly, the microfinance sector has experienced mission drift and is no longer serving just the poor. Those that are being targeted are either just below or over the poverty line, and even they have not experienced a vast improvement in their lives. It would, however, be wrong to say microfinance offers no benefits to its clients. It is a reliable source of formal credit and has helped some expand their businesses, and others have used it for consumption smoothening. While this may not result in poverty reduction through the expansion of entrepreneurship amongst the poor as hoped for by the original promoters of microfinance (Yunus and Jolie, 1998), it nevertheless provides the poor with an additional source of credit to bridge the ever-widening gap between their incomes and expenditures. This is especially true in Pakistan where the harsh economic climate has made it harder for the poor to make ends meet, as detailed in chapters 4 and 5.

In terms of which institutional structure serves the poverty mission better, MFIs on average seem to be doing more for the poor than MFBs. However, it is difficult to provide a definitive answer to this question, as MFIs often have weak controls, inexperienced staff and have used dubious practices to expand outreach. Finally, Akhuwat, the only zero interest based institution in the sample, appears most focused on its mission of poverty alleviation and social change. These conclusions largely confirm Dorado's (2006) expectations that for-profit SEVs will have the most diluted emphasis on their social mission, that cross-sector SEVs will be most focused on their social objectives and that non-profit SEVs will fall somewhere in the middle. Of course exceptions, such as the MFB FMFB also exist.

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CHAPTER 4

MICROFINANCE: POLITICAL ECONOMY INFLUENCES AND CONSTRAINTS - A LITERATURE REVIEW

Political economy narratives regarding the global South often characterize the state as a corrupt, inefficient and apathetic entity represented by a bureaucratic structure that does more harm than good (Candland, 2001; Morduch, 1999). To make matters worse, such states often wield power against their own citizenry, and dole out favor and patronage where and when they please (Cheema, Khwaja and Qadir, 2006; Desai, 2010). In these societies, inequalities become inter-generationally entrenched, the consequences of which are borne by both the disadvantaged individuals and society as a whole. Individuals suffer social, economic and political exclusion, and society from lost human capital (Guinier, 2001).

True development, on the other hand, as the current discourse on global development suggests, is a vibrant process in which people actively mobilize for institutional, political, economic and social change (McMichael, 2012). In advanced countries, this is possible through participation in social movements and by exercising the right to vote (Mitlin and Bebbington, 2006; Desai, 2010). But when such agency-granting tools are not readily available, as is the case in many Southern countries, individuals must instead rely on their networks of trust and engagement, collectively referred to as their social capital (Putnam, 1995: 67). Social capital is the readiness of the members of a community to cooperate with each other and their willingness to participate in civic endeavors together (Desai, 2010). Modern development theory considers social capital, especially as defined by Putnam above, to be an essential building block of the South's development process (Rankin, 2002).

Given the context of a hostile state and the urgency of participatory development, it follows that a successful intervention should have the following ingredients: the ability to bypass the state machinery; enabling, empowering and engaging its constituents, ideally by employing the community's social capital; and ensuring self-sustainability.

It is no wonder then that when microfinance hit the global stage in the eighties and nineties, it quickly garnered broad-based support for it fulfilled all the above three conditions. As an intervention that provides access to credit to those that live on the fringes of society, it was said to reduce both poverty and disempowerment among vulnerable groups, specifically women (Pitt, Khandker and Cartwright, 2006; Khandker, 1998). It was also asserted that it allowed communities to come together through group lending arrangements, which enabled participation in collective action (Osmani, 2007). And the best part was that the process was self-contained and sustainable without a long-term need for government or donor support (Armendariz and Morduch, 2010).

However, 30 years and more than 200 million clients later, members of the development community have begun to reassess their unqualified support for microfinance. Much of this stems from microfinance's evolution from a modest rural-development intervention to a commercialized financial activity, trying to achieve rapid scale. This trajectory of change has important implications for the ultimate beneficiaries of the intervention and this essay reviews the process through which microfinance came to be regarded as an essential tool for poverty reduction and empowerment, as well as its subsequent commercialization, globally and in Pakistan. It will also analyze the political economy constraints within which microfinance must operate. To frame the analysis Pakistan's current social, political and economic situation will be reviewed in order to provide a spatial and temporal context to the discussion. This analysis will then be employed to contextualize Pakistan's microfinance experience in the chapter that follows.

The first section of this essay traces microfinance's movement into the development mainstream, while the second provides a brief overview of Pakistan's development history. A third and final section details the salient features of Pakistan's political economy from the perspective of the microfinance sector and its clients. This section also includes a review of the complex political economy of Karachi, the city from which nearly 70 percent of this study's client sample was drawn. Karachi is Pakistan's economic and financial capital, and unfortunately its most violent city as well.

I. The Political Economy of Global Development

While development is generally understood to be the priority of the state, it is not the business of the state alone. Global development institutions, including the World Bank, the United Nations Development Fund (UNDP) and international development agencies, such as the United States Agency for International Development (USAID), are important stakeholders in the development process both at the global and the local level. They wield considerable power in shaping the development experience across the global South. Among these, it is the international financial institutions (IFIs), that is, the World Bank and the International Monetary Fund (IMF), that have most often been criticized for relying on archaic models of growth (Easterly, 1999). Models, such as the "big push" theory of development, emphasize large-scale investment projects for achieving rapid economic growth (Saad-Filho, 2010), and use measures such as GDP per capita to calibrate development (Pender, 2001). Poverty reduction is not the principal concern here, and some increase in inequality is considered unavoidable in the early phase of development (Saad-Filho, 2010), though in the later stages it is expected that the benefits of growth will trickle down to the masses (Menon, 2007). Unfortunately, there has been little evidence of an actual trickle down, and the experience across the South has not been one of inclusive growth (Melville, 2002; M'Cormack, 2011). Inclusive growth is defined as one where benefits are shared across sectors and by a large proportion of the workforce (M'Cormack, 2011).

Not surprisingly, IFI policies have been deeply unpopular in the South. A recent example is the structural adjustment program that has accompanied international debt restructuring, beginning in the eighties (Saad-Filho, 2010). Structural adjustment calls for privatization, restricted government spending, removal of price and other subsidies, and trade and financial liberalization. The difference between these and the earlier "big push" models is that structural adjustment programs are much more pro-market and anti-state than the latter (Pender, 2001).

By the 1990s it was clear even to the IFIs that their policies had failed on several accounts. Structural adjustment programs, for instance, were found to have either a negative or a net zero impact on growth (Easterly, 2006); were associated with rising unemployment thanks to privatization conducted in nascent markets (Stiglitz, 2002); were said to lead to a growing sense of insecurity among people in recipient countries who felt they had no control over their own lives (Stiglitz, 2002) which led to rising levels of political instability (Hsieh, 2009).

As the evidence against these policies mounted, the 1990s ended up as a decade of intense debate and reorientation within the World Bank. This was also a time when the human development approach began to influence development thought. Mahbub ul Haq and Amartya Sen, the formulators of the approach argued that the aim of development should be to enlarge people's choices and to create an enabling environment for them to lead fulfilling lives (UNDP, 1990). These ideas were crystalized in the first Human Development Report (HDR), published in 1990 by the UNDP.

Sen went on to extend his conceptualization of development as the enhancement of human capabilities with Nussbaum and others. *Capabilities* were defined as the freedoms people value and their capacity to exercise these freedoms were referred to as *functions* (Alkire, 2007). These ideas expanded the concept of development to include all possible aspects of human well-being, including health, education, gender equality, self-esteem, political and economic participation (Sen, 1999; Nussbaum, 2002; Alkire, 2007). Development, thereafter, came to be defined as a set of practices that increased the capacity of individuals to control their own lives (Murphy, 2006:30). This shift was instrumental in relativizing GDP growth as just one aspect of development, giving prominence instead to the more holistic idea of individual wellbeing (Pender, 2001). Finally persuaded by these shifts in the narrative, the World Bank began to reconsider its own development discourse (Saad-Filho, 2010). The experience with structural adjustment had made the need for a broad based buy-in abundantly clear and the Bank signaled that involvement in the development process by all stakeholders would become an important policy focus. Social mobilization and community participation became the cornerstones of its new development policy. These were defined as active engagement of the partners and the beneficiaries of development in determining the priorities, processes and ends of development (Shah and Baporikar, 2012; Cornwall and Brock, 2005).

In the 2000s, the Bank and its partners unveiled an inclusive growth paradigm (Saad-Filho, 2010), which called for “equality of opportunity, in terms of access to markets, resources and an unbiased regulatory environment for businesses and individuals” (World Bank, 2009: 2). As part of the inclusive growth agenda, the Bank established various “social funds” across a number of developing countries, through which it began to invest in micro-projects, in partnership with local nongovernmental organizations (NGOs), public or private sector entities.

A key characteristic of these funds is that they are demand-driven, that is, projects are funded based on proposals prepared by local organizations (Abbet and Covey, 1996). Over time, IFI funding for local projects through these funds has grown significantly, indicating a move towards a more participatory development process, and one that relies on local institutions for support and service delivery (World Bank, 2002). This symbolizes a move away from the previous one-size-fits-all prescription of liberalization, privatization and unfettered markets, towards a stronger commitment to indigenous poverty reduction and empowerment programs (Stiglitz, 2004). It is estimated that the World Bank has invested more than $85 billion over the past decade on development assistance for participatory projects (Mansuri and Rao, 2013).

At the same time, critics argue that these funds have distanced the state further from the social sector, and may not represent as much of a change from the Bank's free market philosophy as often assumed (Chakrabarti and Dhar, 2013). Many NGOs also complain that funding often goes to private contractors, rather than local institutions, who have a deep knowledge of the communities being served, and that contractor-based projects run the risk of being a lot less participatory (Abbot and Covey, 1996).

Finally, new research on participatory development indicates that civil society failure is as likely to occur as market or government failure, since NGOs are also susceptible to problems of coordination, asymmetric information and pervasive inequality. More importantly, donor driven large-scale participation projects are not as effective as organic participation, which occurs spontaneously to solve social issues. This research also finds that the poor often benefit less from participatory processes than the non-poor, as do the less-literate and those living in more remote and isolated localities (Mansuri and Rao, 2013).

Nevertheless, the shift in the development discourse and the increasing importance of micro project financing had had important implications for the microfinance sector.

A. Microfinance and Participatory Development

In the eighties, microfinance was mainly a grassroots movement that sought to alleviate poverty by providing access to credit (Kabeer and Mahmud, 2010). By the mid-nineties, development had a put on 'a human face' (UNDP, 1999), that is, it had come to be understood in terms of individual freedom and wellbeing. Sen referred to this as individual agency, that is, giving people control over what they valued and had reason to value (Alkire, 2008). As social mobilization or community development, became the new mantra of participatory development, microfinance began to achieve new prominence. It appeared to be an ideal alternative to the basic needs approach to poverty alleviation (Rankin, 2002), where the poor were seen as passive receivers of social services that were reduced to a commodity-like status (Fukuda-Parr, 2003).

It was in this capacity that microfinance became the intervention of choice across Latin America and South Asia, and later in Africa, Eastern Europe and the Caribbean. In several countries, the World Bank helped develop nascent microfinance sectors through its Social Funds. In Pakistan, the World Bank established the Pakistan Poverty Alleviation Fund (PPAF) in 1999. Chapter 1 describes how the PPAF wholesales funds to microfinance institutions at below credit market rates. As part of its original lending criteria, the PPAF would fund institutions that participated in social mobilization and institution building at the village and city union council[15] level (World Bank, 2013).

But exactly how does social mobilization work through and with microfinance? The answer to this lies in two important concepts that rose to prominence in the past two decades, that is, the informal economy and social capital (Rankin, 2002; Elyachar, 2002; Morduch, 1999). The following sections review the importance of each for the microfinance movement.

[15] Union councils are the smallest administrative units at the city level in Pakistan.

B. The Informal Economy, Public-Private Partnerships and Microfinance

The informal economy has been subject to multiple interpretations in the past few decades. During the fifties and the sixties, it was referred to as the traditional sector that included craftsmen, petty traders and casual workers who were expected to disappear as traditional economies transformed into modern capitalist economies, employing the models of rapid growth described in the previous section (Women in Informal Employment: Globalizing and Organizing (WEIGO), 2013). This idea was dispelled in the early seventies as the first international labor organization's (ILO) World Employment Mission to Kenya reported that the informal sector had not only persisted, but had expanded to include larger, more profitable enterprises (ILO, 1972).

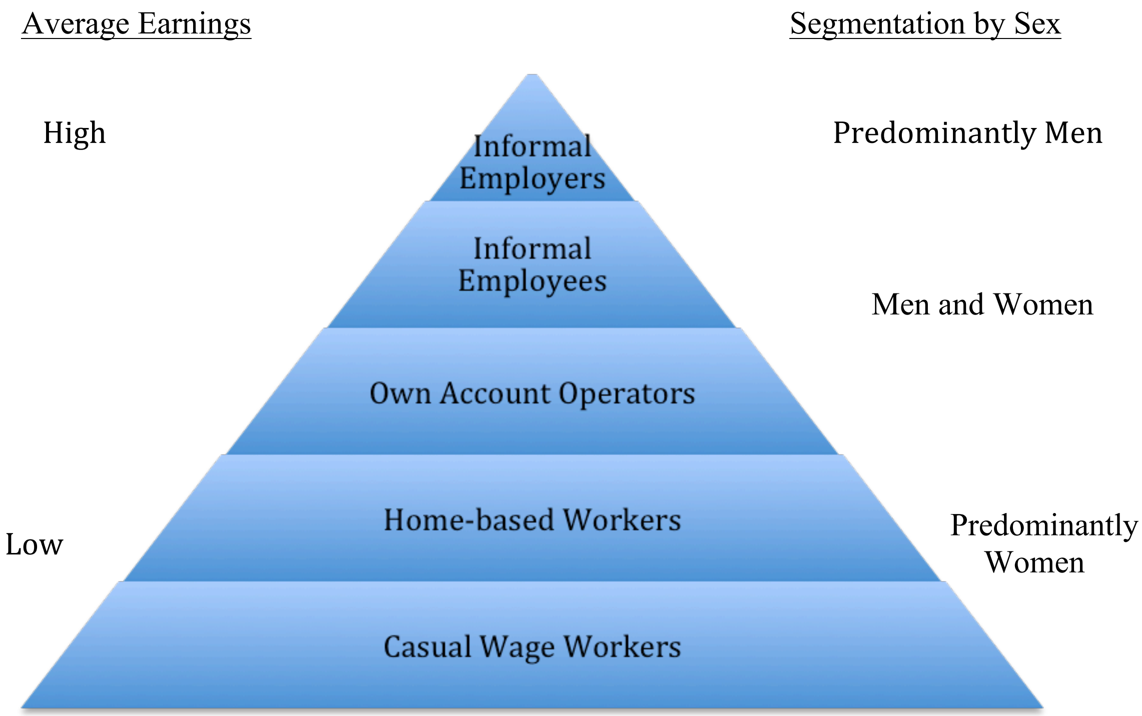
During the eighties it came to light that during a recession the informal sector would expand to absorb unemployed labor from the shrinking formal economy across the global South (Tokman, 1992; Lee, 1998). As the world economy globalized during the nineties and became increasingly competitive, the informal sector grew as result of a host of new developments. These included decentralization and flexible specialization, moving production offshore to places where labor laws were lax and employment was piecemeal and based on short-term contracts, without benefits (WEIGO, 2013).

As the nature of informality evolved, its definition went through several rounds of changes. Arthur Lewis (1954) is credited for having proposed the original notion of the informal economy as the traditional sector and predicting that it was a temporary phenomenon, which would disappear as economies modernized. Even though such a transformation never took place (Hossein, 2012), the idea that the informal sector was marginal and separate from the formal sector continued to hold sway (ILO, 1972) until globalization eventually changed production and employment conditions in the world economy.

Today our understanding of the informal sector is much more nuanced. Much of it stems from the work of women's movements such as the Self Employed Women's Association (SEWA) and WEIGO. They have defined the informal economy as consisting of a range of informal enterprises and informal jobs that fall outside the purview of government regulation and protection. These include self-employment in informal enterprises, employment in informal jobs and home-based workers (Chen, 2007). Particular attention is paid to the vulnerability and poverty of informal workers, as well as the gender segmentation within the informal economy.

Research shows that the informal economy constitutes the poorest section of society, made even more vulnerable by the contractual and variable nature of this type of employment. These jobs do not provide health and safety legislation, nor is there any type of risk protection, such as insurance or pension benefits (Bertulfo, 2011; ILO, 2013). Women represent the largest component of the informal economy, and for women the informal sector is the primary source of employment (Chen, 2000). For instance, it is estimated that women constitute 80 percent of home-based workers in South Asia (Doanne, 2007). Figure 1 describes the relationship between poverty, vulnerability and gender within the informal economy.

Figure 8 Segmentation in the Informal Economy



*Source: Chen. (2007) United Nations.

The figure indicates that women dominate the bottom of the pyramid, where earnings are lower and employment conditions most precarious. In addition, much of home-based and casual wage work remains unremunerated. Finally, in comparison with the formal sector, average earnings in the informal sector are lower and the gender-based wage gap higher (Chen, 2000).

Most importantly, from the point of view of the development community, the informal sector employs the majority of the workforce in developing countries. For instance, household surveys in sub-Saharan Africa indicate that two-thirds of non-farm employment can be attributed to the informal sector (Sparks and Barnett, 2010). In general, it is understood that the relative size of the informal economy correlates inversely with countries' income levels (Pina, et al, 2012), but even for those higher up the development ladder, the informal economy continues to play a prominent role. For instance, in Bolivia the informal economy accounts for 67 percent of total employment and in India, approximately 86 percent (Tannuri-Pianto et al, 2004; Chen, 2001).

The dissemination of such research has been instrumental in persuading the IFIs that the informal economy is not something external to the "real" economy (Elyachar, 2002). It is also argued that by focusing on the informal economy the gender problem can be addressed, as feminist scholars have long objected that the benefits of development have bypassed women, especially in the present age of globalization (Parpart et al, 2002: 3).

In this context microfinance has been identified as an ideal tool to assimilate the informal economy into the mainstream (Elyachar, 2002), for the clients of microfinance are the operators of informal enterprises and home-based work.

In order to collaborate directly with the microfinance sector, the IFIs and the international development agencies such as the UNDP and USAID have had to change their *modus operandi*. From dealing exclusively with the state, as has been their norm, the IFIs have now moved into the NGO realm, giving birth to the concept of public-private partnerships.

These partnerships are defined as collaborations between impoverished communities and the private sector, which includes NGOs, mediated by the state for localized social service delivery (Elyahchar, 2002). The implicit assumption is that the public sector is lacking both in will and ability, and that the private sector, by employing a business model for social service delivery will be naturally much more efficient. Scholars have argued though that when the private sector is driven by the profit motive there will be an inherent conflict with the welfare-driven needs of the community (Miraftab, 2004).

But when it comes to NGOs, the international development community often takes it for granted that they are much better at service delivery, compared to the inefficient, bloated and corrupt state (Kabeer, 2010). At the same time, there is no agreement in the current scholarship on whether NGOs are the ideal vehicle for promoting development (e.g. Moore and Putzel, 1999; Davis and McGregor, 2000; Lewis and Opoku-Mensah, 2006). In fact, research by Mansuri and Rao (2013) finds widespread evidence of civil society failure, especially with respect to participatory development projects.

Kabeer (2010) is more optimistic and contends that there is an ongoing tussle between the competing ideas of market and state within the NGO sector, and argues that affinity with the local community will depend on which idea wins in a certain time or space. In other words, the nature of the local institution will determine outcomes at the community level. This certainly applies to the microfinance sector, which includes institutions that vary along a wide spectrum, with one extreme driven only by social motives and the other mainly by profits. The findings presented in the previous chapter largely confirm this.

This is why the state is required to play an active role in such partnerships (Miraftab, 2004). In fact, the effectiveness of participation is enhanced by a pre-existing cooperative infrastructure, which can only occur where there are functional state institutions (Mansuri and Rao, 2013). In actual practice though, these partnerships are designed to limit state involvement. This is true for microfinance, where the necessity of dealing with state actors is easily bypassed (Fine, 1999), because microfinance is said to depend not on government support, but the community's social capital (Rankin, 2002).

C. Microfinance, Social Capital and Empowerment

Social capital refers to the informal networks of trust and reciprocity that exist within a community (Putnam, 1993). In line with the idea that development must be participatory, the World Bank (2001) has declared that it is the task of development to identify, use, and invest in a community's social capital. Yunus (1998) and others have similarly claimed that the very success of microcredit rests on the efficiency with which the community's social capital is harnessed. The original group-lending methodology of microcredit was specifically designed to harness the power of social capital. Groups are based on trust and members strive to maintain "group solidarity" as continued eligibility for future loans depends on the group's repayment performance (Khandker, 2012). In this way, the community's social capital becomes the linchpin of microcredit operations, allowing it to lower operational costs, reduce repayment risks and, at the same time, empowering those it serves, at least theoretically.

The group-lending model involves extending credit to groups of between five and twenty, with each member responsible for the loans of others in the group. Members are usually neighbors, friends or extended family (Gine and Karlan, 2007). Early research on the subject provides a rich narrative on how group lending empowers women by creating peer mentoring and a support network. Since the intervention is targeted mostly at women and transactions are usually conducted without the intermediation of men (Hashemi, Schuler and Riley, 1996; Bernasek and Stanfield, 1997, Bernasek, 2003), it becomes especially important for regions such as South Asia, where economic participation rates for women are low and they are seen as the life long dependents of men (Kabeer, Huda, and Kaur, 2012).

Further, as group lending requires regular attendance at weekly or monthly meetings, women who might otherwise be socially isolated, are able to defend their attendance as a social and household level obligation. Attending these meetings is, thus, argued to have its own intrinsic value (Johnson and Rogaly, 1997) and has been referred to as empowerment through *mingling* (Osmani, 2007). In this way, mere participation in the group borrowing process was, and often continues to be, seen as a proxy for empowerment. But critics point out that this has led to an unjustified focus on the poor as agents of change and survival, ignoring the structural causes of poverty and inequality (Rankin, 2002).

Secondly, in actual practice the financial sustainability imperatives of microfinance institutions often end up reducing the collective power of the group to the point of merely serving to reduce the institution's own risks and costs (Rankin, 2002). When the bottom-line is at stake, social mobilization is often too time and resource intensive. In such cases, social capital can be used exploitatively, as shown by accounts of borrowers in rural Bangladesh who would confiscate each others' belongings or participate in "house breaking" when faced with a delinquency (Karim, 2011). This is referred to as financial discipline through peer pressure (Yaron, 1991).

Joint liability programs are also notoriously inflexible, disregarding the precarious nature of poverty (Gine and Karlan, 2007; Roodman, 2012). It is this inflexibility that is thought to contribute to repayment problems in an intervention where zero default is taken for granted (Dowla and Barua, 2006). Recent research has pointed out incidents of group "unzipping" in Bangladesh, India (Gine, et al, 2011) and Uganda (Wright and Rippey, 2003). "Unzipping" refers to an *en masse* default of all members of a borrowing group, either as a result of an excessive debt burden or because of an exogenous shock that affects all or most members (Rutherford, 1999).

Most recently, group lending has been on a gradual phase-out. Grameen Bank, the institution that popularized the group-lending model, now allows renegotiation of loans on an individual basis (Gine and Karlan, 2010). Similarly, the Bangladeshi microfinance giant, the Association for Social Advancement (ASA) has done away with joint liability contracts and maintains the group lending structure only for coordination purposes (Gine and Karlan, 2010). Thus, the solidarity aspect of microfinance lending arrangements has become less important with time, especially as microfinance enters the age of commercialization. Group lending is generally considered more conducive for small loan sizes, female creditors and the very poor (Khandker, 2012), aspects of microfinance not necessarily consistent with commercialization.

But even before microfinance became an attractive business proposition, international development institutions were attracted to it because of the promise of sustainability that it offered.

D. The Financially Sustainable Intervention

Financial sustainability is often referred to as one of three elements in the "critical triangle of microfinance", the other two being outreach and impact (Zeller and Meyer, 2002). This simply means that unlike other development interventions, such as public works, microfinance does not need long-term donor or state support, in order to deliver social benefits on a permanent basis (Littlefield, Morduch and Hashemi, 2003; Morduch, 1999). As eschewing subsidies and achieving financial sustainability becomes the dominant philosophy in microfinance, successful institutions increasingly need to demonstrate that they are following good banking principles (Morduch, 2000). It is often argued that only sustainable institutions can efficiently deliver on the poverty alleviation account (Schmidt, 2010). The idea being that such institutions are able to reduce costs and expand outreach simultaneously allowing for maximum impact.

As microfinance comes of age, its popularity with socially responsible investment funds and individuals interested in both a social and a financial return on their investments has risen. Private investments are often funnelled through investment vehicles known as microfinance investment funds or MIVs. There are presently over a 100 MIVs in business, with assets worth approximately US$7.5 billion (MicroRate, 2013). From the point of view of such public and private investors, microfinance presents a “rare” opportunity to “have your cake and eat it too” (Economist, 2010).

From the development perspective, critics have pointed out that the emphasis on sustainability has often pared microfinance down to a strictly financial dimension of poverty alleviation. When institutions reward their officers based on the number of loans disbursed, rates of repayment, and design procedures and products specifically to reduce administrative costs, staff has little incentive to go the extra mile to build collective consciousness through social mobilization (Rankin, 2002).

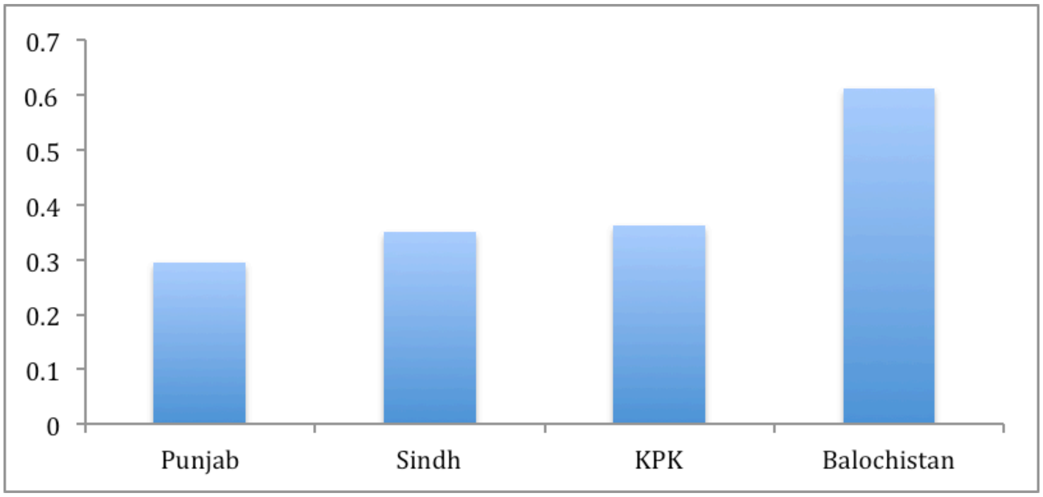
The discussion now will shift from the global to the local. The following section briefly reviews Pakistan's development history and how microfinance came to evolve as a commercially driven development intervention in the country.

II. Pakistan's Development History

Pakistan, a South Asian country of nearly 177 million, is classified by the World Bank as a lower middle-income country (2012). Its four main provinces are Punjab, Sindh, Balochistan and Khyber Pakhtunkhwa (KPK). In addition to these, there is Kashmir, which remains a disputed territory with India; Gilgit-Baltistan, an amalgam of seven districts to the North - a de-facto province that does not enjoy full constitutional rights; and the border region between KPK and Afghanistan, referred to as the federally administered tribal areas (FATA).

In Pakistan, an estimated 58.7 million currently live below the poverty line (Naveed and Ali, 2012). Figure 2 below is a representation of relative poverty in the four main provinces, using the multidimensional poverty index (MPI), which is based on Sen's capability approach. The index is constructed using 2005-06 survey data on housing, education, access to water, access to sanitation facilities, access to electricity, asset and land ownership, and empowerment. The index defines poverty as deprivation in at least three of these areas (Masood, et al, 2012). The figure indicates that Punjab is the least deprived province in aggregate terms, while Balochistan is the most deprived.

Figure 9 Province-wise Analysis of Multidimensional Poverty



*Source: Masood, et al (2012)

The UNDP's 2013 Human Development Report (HDR) ranks Pakistan 146 out of 186 countries based on the multidimensional human development index (HDI). The index employs indicators of income, education and health status to measure development. Pakistan's HDI ranking places it in the low human development category. While this presents an overall dismal picture, regional disparities are starker. For instance, approximately 21 percent of Pakistani households can be categorized as extremely poor, but most of these live in rural areas. Specifically, among the extremely poor are one-third of rural households and only eight percent of urban households. A provincial analysis shows an even more skewed rural-urban picture. In Balochistan, 74 percent of rural households are poor, while in Punjab only 28 percent of rural households are poor (Naveed and Ali, 2012).

Development theorists have found various reasons for Pakistan's continued state of underdevelopment, including the persistence of colonial legacies (Ahmed and Khan, 2009); passive engagement with the IFIs (Shah, 2013); half-hearted attempts at applying structural adjustment programs (Ahmed, 2011); corruption (Siddiqui, 2012); ethnic divisions (Easterly, 2001); and a politically repressed labor movement (Candland, 2007). Developmentally, Pakistan's early years were characterized by a state controlled import substitution industrialization (ISI) regime, on the premise that a strong industrial base was essential for development and in order to modernize, dependence on agriculture must be reduced (Hussain, 1999). The implementation of this policy was financed through substantial foreign aid and economic planners were soon rewarded with high rates of growth, averaging around six percent. During this period, usually associated with the sixties, Pakistan was globally showcased by the IFIs as a country that was "doing everything right" (Zaidi, 2010).

At that time it was generally believed that these rates could only be achieved by faithfully following a growth-led-development paradigm of "functional inequality" that involved the concentration of capital, allowing only a minimum to be set aside for social welfare (Candland, 2001). The expectation was that the benefits of such growth would eventually trickle down and equalize the initial unequal distribution of resources. However, Pakistan performed poorly on this aspect of development, earning it the dubious title of a country with "growth without development" (Easterly, 2001). The adoption of the functional inequality model also meant that human development outcomes suffered as growth rates rose, particularly during the sixties. Of course, there were other factors that contributed to rising inequalities, such as the dominance of an elite that did not wish to support human capital investments in the masses (Easterly, 2001), and rent seeking by local industrialists and feudals (Husain, 1999).

One example of this was the Green Revolution in agriculture during the sixties, which increased crop yields two-fold, through the use of new fertilizer and seed technology (Husain, 1999). But the benefits remained limited to a few regions only, for access to credit became a substantial hurdle for smaller farmers, further deepening rural inequalities (Islam, 1996).

Despite the fact that a democratic government with a socialist agenda ruled the country during most of the seventies, this was an era of rising poverty thanks to neglect of the agricultural sector and widespread nationalization of the social, economic and financial infrastructure in the country, which depressed incomes and investment (Husain, 2009).

By contrast, the eighties were a period of rapid economic growth, averaging around 6.6 percent annually, spurred by the Afghan war and an influx of foreign aid (Husain, 2009). Poverty declined but inequality increased during this decade (Arif and Farooq, 2011).

Towards the end of the eighties, Pakistan was again faced with an economic recession and turned to the IMF for financial assistance. The IMF asked the country to adopt structural adjustment, which called for deregulation, liberalization and the privatization of state owned enterprises (SOEs) (Shah, 2013).

Comparing the structural adjustment experience in Pakistan to that of India, Candland (2007: 108-122) argues that while in India workers unions were effectively able to block the privatization of SOEs, in Pakistan the government was able to divest from most SOEs despite widespread protests by workers unions. The critical difference that led to such divergent outcomes in the two neighboring countries is that India is characterized by political party-based unionism, while labor movements in Pakistan have been unable to find a voice in formal politics (Candland, 2007: 3).

Thus, it is hypothesized that the present state of the development sector in Pakistan is a direct result of a repressed labor movement that was never allowed to gain a political foothold in the country. In other words, when the IFIs pressurized the state to adopt market-based development policies in the 1990s, there was no politically significant social movement that could provide enough of a counter-pressure.

In the late 1990s, the World Bank approached the State Bank of Pakistan and asked it to develop a regulatory framework that would promote a bank-led model of microfinance, that in the process would end up deemphasizing the existing NGO-led model. There was no opposition to this idea, as the free market, financial liberalization and privatization development paradigm was already well entrenched in the country. This experience is in marked contrast to that of other South Asian countries, particularly India and Bangladesh, where microfinance is mainly the business of NGOs and self-help groups, barring some non-bank financial institutions in a few Indian states. This is not to say, however, that these institutions have not run into periodic trouble for pushing the market-led agenda too far (Karim, 2011; Kinetz, 2012).

Interestingly, at the same time that the State Bank of Pakistan was preparing the rules on bank-led microfinance, the World Bank established the Pakistan Poverty Alleviation Fund (PPAF) in 1999. Through the PPAF, the World Bank contends to have helped develop more than 80,000 community organizations, implement 16,000 community infrastructure projects, provide more than 232,000 people with enterprise and skill development training and provisioned more than 1.9 million microcredit loans (PPAF, 2012). But since 2012, the PPAF has also begun to extend its financial assistance to the microfinance banks (MFBs), which symbolizes the coming full-circle of the process of market-led development.

Thus far, we have reviewed the processes of global and local development and how they have affected microfinance's rise to prominence as a new age development tool. The narrative shifts now to a discussion of the specific political economy factors that affect microfinance's effectiveness as a tool for financial access, poverty alleviation and empowerment in Pakistan. This analysis will provide the frame for the empirical findings detailed in the next chapter.

III. The Salient Features of Pakistan's Political Economy

Like most Southern countries, Pakistan faces a complex political economy, which makes poverty alleviation an especially difficult task. At the same time, rarely has it faced as many crises on as many fronts as it does so now. Some suggest that as a market-based intervention, microfinance is less vulnerable to local political economy constraints than other development programs (Swain and Floro, 2008). But this makes intuitive sense only to an extent, since microfinance actors must navigate the same space as the rest of the citizenry.

What follows is a discussion of the political economy factors most salient to the microfinance sector, from the point of view of the institutions and their clients. These include the security crisis that has enveloped the country since the 9/11 attacks in New York; the existing pattern of governance, power and patronage in the country; the faltering economy and the economic devastation in the wake of the 2010 and 2011 floods. Gender-based disparities are another component of the country's complex political economy, but these are covered in detail in Chapter 6. The last part of this section consists of a brief review of Karachi's unique political economy. This will help contextualize findings from the client sample in the following chapter, as nearly 70 percent of the microcredit clients interviewed for the study are Karachi-based.

A. Security Crisis:

In the post 9/11 era Pakistan has become a frontline state in the War on Terror and has dealt with the worst security crisis in its history. From 2003 onwards, approximately 16,210 civilians have been killed in terrorist violence along with 4,990 security forces and a total of 25,867 "terrorists"[16] (Institute of Conflict Management, 2013). In the first three months of 2013 alone, there was a weekly average of 70 incidents of terrorism, violence and unrest in the country – mainly concentrated in KPK, Balochistan and Karachi (Center for Research and Security Studies, 2013).

In addition, between June 2004 and April 2013, US drone strikes have killed between 2,541 and 3,533 in KPK. Of these, between 411 and 884 have been civilian deaths, and between 1,173 and 1,472 among the injured (Bureau of Investigative Journalism, 2013). Apart from the fatalities and injuries, drone strikes and Taliban insurgencies have had a considerable impact on the daily lives of ordinary citizens in KPK and other areas. Economic losses for civilians include damages to homes and places of business, loss or disability of a key breadwinner, medical costs incurred in caring for victims and the

[16] The "terrorist" figure is disputed, since official figures conflict with the accounts of families and eye-witnesses.

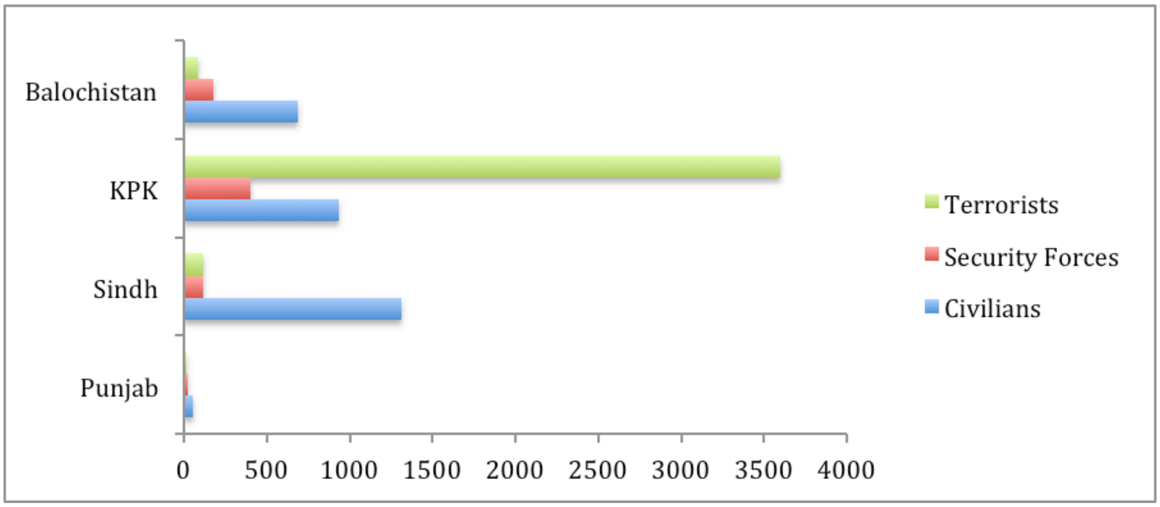
psychological issues that come with the constant threat of death. These are significant costs, more so for people living in the tribal regions, since underdevelopment and poverty is already at its worst here (Cavallaro, Sonnenberg, and Knuckley, 2012).

The overall security situation has cost the economy US$67.93 billion from 2001 to 2011. These costs include compensation for affectees, losses to infrastructure, exports, foreign investment, industrial output, tax collection, and other costs associated with uncertainty (Ministry of Finance, Government of Pakistan, 2011).

In the province of Khyber Pakhtunkhwa (KPK) alone it is estimated that out of 2254 industrial units, a total of 1660 units have closed down due to the war, leading to a loss of 44,000 jobs. This in turn has lowered spending on social sectors, including health and education, both locally and nationally, despite the much greater need for reconstruction in the affected communities. Several hundred educational and healthcare facilities have been either completely or partially destroyed by the Taliban during continuing waves of violence. In KPK, 427 schools have been either fully or partially damaged and 63 percent of the fully damaged schools have been girls' schools. In addition, 63 health facilities, representing 29 percent of the total, and 30 percent of area water supply schemes have been damaged (Social Policy and Development Centre (SPDC), 2010).

Balochistan, Pakistan's other western province is also currently enveloped in a major wave of insurgency. It is the country's poorest province, but has the largest landmass and is rich in mineral, and oil and gas resources. Tensions between the center and the provincial have always existed. Episodes of major outbreaks of violence include the 1948 insurgency, the insurgency of the sixties and the insurgency of the seventies (Alamgir, 2012). These insurgencies are the result of what the people of Balochistan perceive to be the federal government's policy of expropriation, marginalization and dispossession (Grare, 2006). The latest insurgency has also resulted in a major escalation of violence in the province. The figure below provides a breakdown of violence-related fatalities for each province:

Figure 10 Province-wise Breakdown of Fatalities in 2012



* Data Source: South Asia Terrorism Portal (2013)

The figure indicates that while violence related fatalities were high in all provinces other than Punjab in 2012, the highest number of civilian deaths occurred in Sindh. Most of these were accounted for by the violence in Karachi.

The Center for Research and Security Studies (CRSS) tracks fatalities across Pakistan. It refers to the recent surge in violence in KPK as "religio-terrorism", the violence in Balochistan as "nationalist-separatist", and the violence in Karachi as "ethno-political". In June 2013 alone, the Center recorded 222 violence related deaths in Karachi, which represents 36 percent of the total violence related death toll in the country (CRSS, 2013).

Karachi is a special case within Pakistan, and has its own complex political economy. Given that the bulk of the client sample is from this city it deserves special attention and will be dealt with separately in a later section.

Microfinance and Conflict

A small body of literature developed at the turn of the century, dealing specifically with microfinance's experience in conflict and post-conflict zones, such as Haiti, Eretria, the Democratic Republic of Congo, and the West Bank and Gaza. The main argument was that microfinance, especially microcredit, could serve as a useful tool to jumpstart economies during and post-conflict, by aiding in the establishment and reconstruction of local businesses (Nagarajan and McNulty, 2004; Manalo, 2003; Doyle, 1998).

The research did provide a note of caution to donors and practitioners, warning that they should not expect to achieve financial sustainability in the short-term, as the costs and risks of operating in such an environment, were much higher than in non-conflict regions. The research also warned that "successful" implementation of microcredit programs in these areas depended on the underlying socio-economic conditions, including a minimum level of political stability (Bruett et al, 2004). This implies that while sustainability-seeking microfinance may make some difference in conflict-affected areas, it is not necessarily a pathway out of poverty. More than anything else, political stability depends on the state and existing patterns of governance and power in a country, which in turn affect the development and implementation of social policy, as discussed below.

B. Governance, Power and Patronage

Low-income settlements across Pakistan are characterized by choked sewerage lines, neglected water supply schemes, "ghost schools"[17] and abandoned healthcare centers (Baqir, 2006). The state for the most part has failed to provide basic services, especially to the poor.

The system lacks a systematic, clearly articulated framework (Gazdar, 2011; Asian Development Bank, 2002), resulting in a range of overlapping, mismatched social welfare schemes that are either the result of ad hoc responses to particular problems at different points in time (Government of Pakistan, 2009) or based on the recommendations of international donors, rather than on an actual assessment of local needs (Jamal, 2010).

The ad hoc nature of the system is manifested in several ways. First of all, there is no systematic targeting of vulnerable populations. A World Bank study (2007) found that 27 percent of the recipients of a monthly cash transfer scheme and 37 percent of those receiving rehabilitation grants happened to be non-poor. The implementation of social policy occurs with little coordination between agencies and departments, resulting in a lack of focus and duplication of efforts (Bari et. al, 2005).

Pakistan also spends fewer resources on its social sector than even some of the poorest sub-Saharan countries. For instance, in 2012 less than one percent of GDP was spent on health and less than two percent on education (UNDP, 2013). This ends up severely

[17] Ghost schools are registered as public schools but are not active educational institutions, though teachers may be drawing salaries and the school grounds being used as stables or grazing grounds for cattle (Khan, 2013).

restricting the financial and institutional capacity of the various institutions administering development schemes, which means that benefits are spread so thinly across the target population that the impact is negligible (Sayeed, 2004; Bari et. al., 2005; Jamal, 2010). These problems are symptomatic of the larger issue of governance. Governance is defined as the manner in which power is exercised in the management of a country's social and economic resources, which presumes the ability to turn public resources into positive human development outcomes (Asian Development Bank, 2002). Unfortunately, Pakistan's governance capabilities have weakened considerably in the past few years. The World Bank's World Wide Governance Indicators show that the country does not fare well compared to others in the region. Table 15 below provides scores on six governance indicators including: voice and accountability, political stability, government effectiveness, regulatory quality, rule of law and control of corruption:

Table 15 World Wide Governance Indicators - Pakistan 2011

	Governance Score (-2.5 to 2.5)	Regional Average	Standard Error
Voice and Accountability	-0.83	-0.52	0.11
Political Stability	-2.69	-1.36	0.25
Government Effectiveness	-0.82	-0.57	0.19
Regulatory Quality	-0.61	-0.43	0.16
Rule of Law	-0.90	-0.58	0.13
Control of Corruption	-1.00	-0.61	0.16

*Source: The World Bank Group, 2012

Pakistan's performance is below regional averages on *all* indicators of governance. Even more disturbing is the downward trend in these indicators over time. For instance, political stability was given a score of -1.14 in 2000 but by 2011 it had declined to -2.69. Corruption also worsened from -0.82 to -1.00 over the same period (The World Bank Group, 2012).

Weak governance is associated with higher levels of poverty and underdevelopment. For instance, when apathy is combined with corruption in public sector bureaucracies, it leads to problems such as illegal service delivery, which can only be afforded by those with a minimum level of resources (Baqir, 2006; Haq and Zia, 2009). Corruption in Pakistan is systemic in all branches of the government: the executive, judiciary and legislature (Haq and Zia, 2009). According to Transparency International's 2012 Corruption Perceptions Index, Pakistan is the 37th most corrupt state out of a total of 176, with a low score of 27 against a possible 100.

Even though Pakistan was never a corruption free state, it was not until the 1990s that corruption became endemic rather than isolated, petty and sporadic. This was ironically also the first democratic decade in the country's history, even though changes of government occurred several times (Husain, 2009). The dismissals of all but the last government in this decade were based on charges of corruption and mismanagement. It was during this decade that corruption became associated with the highest level of political participation (Khan, 2007; Noor, 2009). This becomes dramtically clear when considering tax evasion. A recent study reported that 61 percent of policymakers did not pay taxes in the years they contested elections (Cheema, 2012).

But perhaps the worst fallout of corruption is that ordinary citizens have to encounter it on a daily basis (Khan, 2007). A 2006 Transparency International Survey asked respondents whether they had to face corruption when dealing with different public institutions. The percentage of respondents that said “yes” when asked about the police was 90 percent, power 70 percent, judiciary 77 percent, land revenue 91 percent, taxation 84 percent and customs 88 percent (Transparency International Pakistan, 2006).

During the 2010 floods, that killed approximately 1800 and displaced nearly 20 million, the impact of corruption on the poor and the vulnerable was made acutely clear. Fear of misuse of aid money by corrupt officials kept badly needed international aid away from the country’s desperate millions (Rashid, 2010; Nelson, 2010). This was not surprising since most evaluations of the country’s social welfare schemes have found evidence of corruption, embezzlement, nepotism and patronage (e.g. Sayeed, 2004; World Bank, 2007; Jamal, 2010).

Participatory development in such an environment becomes difficult if not impossible. In his anthropological study of rural Pakistan, Lyon (2002: 186) describes how poor villagers in Punjab and Khyber Pakhtunkhwa (KPK) exhibit a fundamental belief that the state exists only to serve the interests of the rich and powerful.

An unsympathetic state, low institutional quality, little opportunity for political and civic inclusion, all work in tandem to subvert the agency of the poor (Cheema, Khwaja and Qadir, 2006; Desai, 2010; Baqir, 2006). This results in a permanent state of disenfranchisement and poverty even during periods of growth, inevitably leading to higher levels of inequality (Candland, 2007).

While the discussion so far has concentrated on corruption and the concentration of power by the state, there is another hypothesis worth reviewing with regard to the pattern of power and patronage within Pakistan. This theory states that power in Pakistan is not just concentrated in a relatively small elite minority, such as the top echelons of the bureaucracy and the military as commonly hypothesized (Jalal, 1990; Haqqani, 2004; Ziadi, 2011; Rashid, 2011), but is distributed asymmetrically through ties of kinship, caste and political relationships and even the very poor can gain some favors through such "human resource networks" (Lyon; 2002; Lieven, 2011: 213). These networks are informal and involve personal interactions.

These networks can be considered as a special type of social capital, which Putnam refers to as "bonding social capital" (2003). While Putnam calls this the super glue that holds societies together, there is evidence that the presence of such networks leads to higher levels of corruption (Harris, 2007).

Such patterns of patronage are most commonly found in societies fractured along ethnic, social and political lines (Jehangir, 2012). Pakistan's four main provinces represent its four dominant ethnicities– the Punjabis, Sindhis, Balochis and the Pakhtuns. In addition, there are the Muhajirs, the families that migrated from India to Pakistan in 1947 and who settled mainly in Karachi, Hyderabad and other urban areas in southern Sindh. Within these dominant ethnicities lie a much more complex web of caste, religious groupings and sub-ethnicities. Lieven (2011: 11) describes this as a "wheel within a wheel, an identity within an identity, which in turn overlaps with another identity". Rising levels of economic inequalities have only resulted in intensifying these divisions (Islam, 1996).

All other problems, such as poor governance and corruption, as well as the current security crisis, can be attributed to the fractionalized state of its people (Lieven, 2011: 11). Thus, instead of looking at the state as the unpredictable and unreasonable aggressor, this line of reasoning contends that anyone with the slightest bit of power plunders the state for patronage and favor. Lieven (2011) points out that favor is distributed through kinship ties, weakening the state but maintaining the power of the feudals in the countryside and owners of industry and capital in the cities. This is corroborated by Craig and Porter's (2003) account of how "elite capture" prevented attempts at reform of the bureaucratic machinery during the last military government's devolution of power in the 2000s.

But understanding the role of power and patronage in relation to social service delivery is not an easy task. For instance, the traditional view is that the feudal landlord in Pakistan represses the masses by keeping basic resources, such as access to education, away from them (Herring, 1979; Shah and Shah, 2012). Gazdar (2001), on the other hand, paints a more complex picture. He describes how landlords compete with one another to get the most out of a meager pot of public resources, such as funds for building schools for locals in their areas. Admittedly, the purpose is political patronage rather than public service and these power struggles end up damaging public resources. Thus, while local politics can often secure some services for the poor, they are the result in most cases of misappropriation and misallocation for the sake of securing and maintaining political support and loyalty.

As a private sector intervention, microfinance should theoretically be able to bypass such issues of weak governance, corruption, and misappropriation. Microfinance practitioners insist that this is indeed the case. At the same time, a deeply entrenched culture of corruption and patronage does have an impact on the sector's performance as described in the following chapter, but we turn now to the economic crisis facing the country.

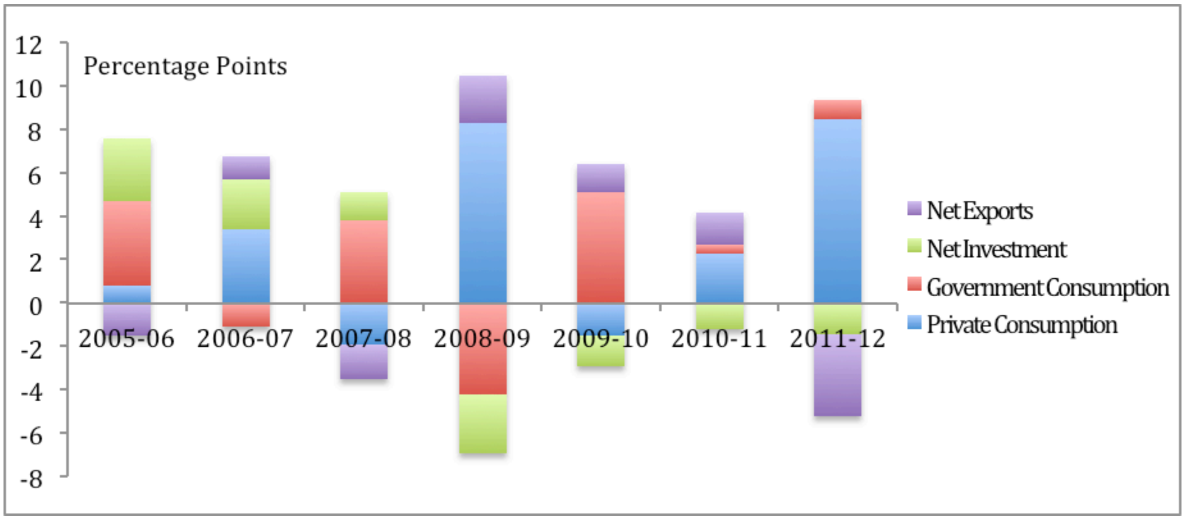
C. The Economic Faultline:

To most observers, Pakistan's fragile security and political problems are its biggest issues. But there has been a gradual awakening to the fact that its economic downslide in the past five years may be the country's biggest challenge yet (Stokes, 2013). During the past five years, inflation-adjusted economic growth was only 2.9 percent (Stokes, 2013), compared to the 7 percent needed to keep pace with the annual rise in the labor force (Rehm and Noshab, 2013).

The recently released World Economic Forum's 2012 Global Competitiveness Index ranks Pakistan 138 out of 142 countries, in terms of the macroeconomic environment. This speaks to what has been termed as a "very, very critical economic crisis in the country" (Rashid, 2012).

Growth has faltered due to the security crisis and the increasing frequency of natural disasters, discussed below, but the main cause is generally understood to be weak governance and corruption.

Figure 11 Composition and Trends in GDP Growth



*Data source: Economic Survey of Pakistan 2011-12, Ministry of Finance, Pakistan

It is clear from Figure 2 that net investment has been negative for the past five years. Net exports, which are gross exports less gross imports, have also had a choppy history since 2005. Private and government consumption have taken turns to keep the economy going during this period, but without a steady increase in investments and exports, the country cannot expect to achieve a growth rate that can match the needs of a growing population. The current population growth rate is 2.03 percent, thanks to which the country is the sixth most populous in the world (Pakistan Economic Survey 2011-12).

But macroeconomic fundamentals have rarely been as precarious as in the past five years, resulting in negative rates of investment and exports as shown in Figure 4. Consumer inflation too has been consistently above 10 percent, though the most recent official estimate puts it just below double digits (Khan, 2013).

In addition, the state's budget deficit is 8.5 percent of GDP and the government's debt to GDP ratio is currently at 62.5 percent (State Bank of Pakistan, 2013), which has crowded out private investment. Lending to the public sector appears less risky than to the private sector, which is an important factor behind the negative rate of growth in private investment in the country.

In fiscal year 2012, exports contracted by 2.8 percent, partly due to falling investment levels and the rest due to the chronic energy shortage. The power shortage is estimated to have cut annual economic growth by up to 4 percent over the past few years, and forced shutdowns of hundreds of factories, paralyzing production, investment, and employment. The current power shortfall is 7,000 megawatts, against a total generation of 10,500 megawatts (Khan, 2013). The crisis is the result of inefficient fuel-mix choices; insufficient revenue to support generation thanks to an already burdensome public debt, non-payment of energy and tax dues that are again symptomatic of weak governance; and a lack of political will to revise power subsidies (Kugelman, 2013; Kessides, 2013).

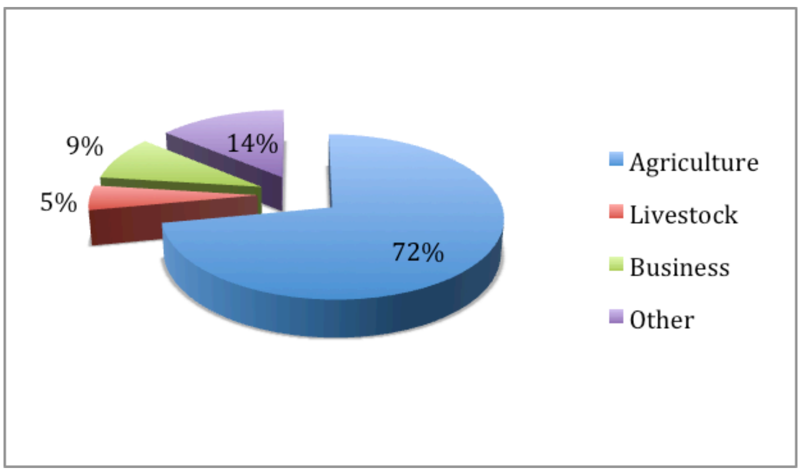
The power crisis has important implications for microfinance clients since as small business owners they cannot afford private power generation and must depend on the national grid for all their energy needs.

The 2010-11 Floods

In addition to these economic woes, Pakistan has also recently faced major natural disasters, which have resulted in a heavy toll on its human and physical infrastructure. These disasters include the 2005 earthquake that killed approximately 73,000 people (The Guardian, 2005); and the annual floods since 2010 that have killed hundreds and displaced millions.

The 2010 floods were especially damaging for the microfinance sector and require special mention. In the latter half of 2010, nearly one-fifth of the country's landmass was submerged, killing more than 1800 people and affecting nearly 21 million, across 84 of the country's 120[18] districts (Arshad and Shafi, 2010; Humanitarian Response Index (HRI); 2011). The damage caused to the social, physical and governance infrastructures, the economy, and the environment was estimated to be in excess of US$10 billion (Arshad and Shafi, 2010). The economic damage was estimated at 6 percent of GDP. The figure below provides a breakdown of flood-related economic losses:

Figure 12 Breakdown of Economic Losses by Sector from the 2010 Floods



* Source: Arshad and Shafi. (2010) Government of Pakistan

Clearly, agriculture was the most flood-affected sector, accounting for 72 percent of total losses. Province-wise, Sindh was the hardest hit with 46 percent of total damages, followed by Punjab with 36 percent of total damages to crops, livestock and fisheries (Arshad and Shafi, 2010). In 2011, while recovery efforts were still underway, heavy rains hit areas in Sindh and Punjab once again. This not only brought relief efforts to a

[18] This includes 113 districts in the 4 main provinces and an additional 7 in the de-facto province of Gilgit-Baltistan.

standstill, but ended up affecting an additional 5.8 million people, with 1.8 million people categorized by the UN as “living in extremely vulnerable conditions of displacement” (Singh, 2012; HRI, 2011).

Post-flood analysis has blamed breaches in Sindh’s Left Bank Out Drain (LBOD) – a drainage system designed to channel excess water into the sea - for the devastation that occurred in Sindh (Strengthening Participatory Organization (SPO), 2011; Junejo, 2011; Ahmed, 2011). This drainage system was designed and funded by the World Bank and the Asian Development Bank in the midst of widespread public protests in the eighties and nineties. The initial design also called for water to drain in Shakoor Lake, which borders India. Fearing a backlash both within and beyond the border, the Government changed the initial design to appease some of the landlords and prevent a border-crisis from occurring, by ensuring that excess water would fall into the Arabian Sea rather than the Lake. Many have blamed the breaches caused by the floods on alterations in the original design of the drainage system (SPO, 2011).

The floods have been especially devastating for the microfinance sector, as described in the following chapter. Relegated to the bottom of the economic pyramid, rural microfinance clients are especially vulnerable to natural disasters, rising food prices, and cuts in development budgets. This has implications for the institutions that offer them financial services, since repayment abilities come into question, as do the possibilities for future growth. Before moving on to the next chapter to discuss these implications in detail, we take a brief look at the political economy of Pakistan’s largest and most complex city, Karachi.

D. Karachi – Mini Pakistan:

"How innocent are the people of your city
They murder and then ask whose funeral is that?"
–Translated from Urdu, painted at the back of a public bus in Karachi (2012)

Karachi is one of the world's 21 "mega cities" (Todaro and Smith, 2012) with a population approaching 15 million, according to official estimates, and 21 million, according to unofficial estimates (Khan, 2012). Its ethnic and religious diversity has earned it the title "mini Pakistan" (Budhani, et. al. 2010).

Karachi is also economically and socially more advanced than the rest of the country. For instance, Pakistan's overall literacy rate was estimated to be 58 percent in 2011 (Ministry of Finance, 2011), but Karachi's literacy rate according to 2007 official estimates was 79 percent (Inskeep, 2011). Karachi is also a major contributor to the national economy. Its contributions constitute 94 percent of Sindh's tax revenues, which in turn is responsible for 70 percent of the country's total income tax collections (Hasan and Mohib, 2003).

As the country's largest metropolis, and its commercial and financial center, Karachi is home to migrants from all over Pakistan, making it the most ethnically diverse city in the country. According to the 1998 census[19], Muhajirs, the children of migrants from India, make up 48.52 percent of Karachi's population; Punjabis from the province of Punjab represent 13.94 percent of the city; Pathans, from the northern province of KPK, 11.42 percent of the city; while Sindhis and Balochis, the original inhabitants of the city, are

[19] The latest census was conducted in 2011 but city-wise demographic details are not scheduled to be released until mid-2014 according to the Census Bureau of Pakistan.

now only 7.22 percent and 4.34 percent of the total population respectively (Hasan and Mohib, 2003; Gazdar, 2011).

This diversity is one reason why Karachi has become one of the world's most violent cities (Gayer, 2013). Over the years, tension has grown between the different ethnicities that jostle for power and control over the city's economic and financial resources, resulting in continued violence and general lawlessness. This "chronic state of emergency", which includes political conflict and criminal violence, began in the mid-1980s but has escalated since 2007 (Gayer, 2013).

Political parties claiming to represent the Muhajirs, Pathans, and Sindhis are mainly to blame for the perpetuation of this state of affairs. What keeps violence central in the lives of Karachites is that no ethnic party enjoys a monopoly in terms of popularity and the city's heterogeneity is not just along ethnic lines, but also in terms of class and socio-economic status, keeping the various groups in a constant state of war. A complex web of patronage and struggle for power is behind most of Karachi's turf wars, which inevitably ends in ethnic violence.

Violence in the city is characterized by "target killings" of members of warring ethnic groups that take hundreds of lives each year and "ethnic riots" that shut down the city on a regular basis (Gayer, 2012). In 2012 alone, 2,500 people died as a result of violent crime in the city. What is even more alarming is that this figure is 50 percent higher than that of the year before. While sectarianism remains the main cause of murder in the city, violence by extremist groups has recently been added to the mix, with the murders of over 200 Shias, a minority Muslim sect, occurring in 2012 alone (Temple-Raston, 2013).

Karachi's other major problem is extortion, which affects small business owners more than anything else. The extortionists, locally called the "*bhatta* mafia", have the support of the major political parties in the city and are quick to kidnap or murder when threatened with non-payment (Ebrahim, 2012). In the Orangi Town neighborhood of Karachi, suspected extortionists recently threw hand grenades in a private school over non-payment of extortion money, injuring several children in the process (Dawn, May 2013).

Some argue that Karachi's disorder has a state of order and violence is now "manageable" for its population, so that after each wave of killing, "normalcy" returns to the city within four days (Gayer, 2013). At the same time, these observers admit that "normalcy" has increasingly included kidnappings, torture, murder and extortion (Gazdar, 2011).

The city's largest political party is the Muttahida Qaumi Movement (MQM), which claims to represent the Muhajirs, the largest ethnic group in the city (Gazdar, 2011; Gayer, 2012). It considers itself a secular and progressive movement, representing the lower middle class (MQM, 2013). The MQM's popularity is driven in part by the fact that more than half of Karachi's population lives in poor, unplanned and unregularized migrant settlements, that are often the hub of political activity by disenfranchised youth (Gazdar, 2011; Hasan and Mohib, 2003).

As a migrant city, Karachi is pockmarked with low-income and largely unplanned slums, known as *katchi abadis*. The unplanned nature of these settlements, lack of access to basic services and a painfully slow process of regularization, heightens political and ethnic conflict. Census data provides an interesting view of the socio-economic heterogeneity in the city, even within what are generally lumped together as lower-middle class neighborhoods.

The last national census was conducted in 2011, but the data from this will not be available until June 2014, therefore, for city-level census data we are dependent on the 1998 census, keeping in mind that significant changes have occurred since then in the city's demographics.

Before examining city-level census data, it is important to note that Karachi is divided into five districts and 18 towns, and further subdivided into 180 Union Councils, with an average of seven charge circles within each Union Council, as reported in the 1998 census (Gazdar, 2011).

At the district level there is a high level of variance in socio-economic indicators such as the literacy rate. For instance, the literacy rate in District Central is 75 percent, but only 50 percent in Malir District (Gazdar, 2011). But if we slice the data further and examine it at the charge circle level, the variation becomes starker.

Table 16 below provides different socio-economic indicators for five census charge circles, each of which represent a neighborhood included in this study's client sample. These circles were selected from the 12 neighborhoods covered in the study, representing seven different towns of Karachi.

Table 16 Socio-economic Indicators Across a Sample of Karachi's Charge Circles							
Charge Circle	**Town**	**District**	**Literacy ratio (10+)**	***Pacca*[20] House**	**Potable water**	**Toilet Facilities**	**Electricity**
Liaquatabad - Dak Khana	Liaqatabad	Central	86.70%	99.75%	97.17%	59.34%	99.51%
Manzoor Colony Block D	Jamshed	South	74.20%	99.62%	25.31%	68.94%	99.52%
Kashmir Colony	Jamshed	South	59.10%	93.51%	26.86%	51.51%	97.91%
Shah Rasool Colony	Saddar	South	40.50%	100.00%	37.79%	43.09%	100.84%
Pahar Ganj and Bhangi Para	North Nazimabad	Central	35%	99.27%	77.61%	21.25%	98.53%

* Source: Karachi Census Report 1998

The circles in the table represent neither the extremely poor nor the particularly well-off neighborhoods of Karachi, instead they represent lower-middle and upper-poor communities, since this is where the majority of microfinance clients reside. The table shows that the ratio of *pacca* houses (permanent, as opposed to impermanent housing), as well as the percentage of electrified households is largely homogenous among all five communities. On the other hand, there is wide variation in literacy rates, availability of potable water and toilet facilities across the five circles. For instance, the literacy rate in Liaquatabad is highest at 87 percent and lowest in Pahar Ganj at only 35 percent. Similarly, potable water availability is highest in Liaquatabad at 92 percent and lowest in Manzoor Colony at only 25 percent. Finally, availability of toilets is highest in Manzoor Colony at 67 percent and lowest in Pahar Ganj at only 21 percent.

[20] Permanent structure, as opposed to *kaccha* house, which is an impermanent structure.

This demonstrates the wide variation in access to basic services among the different middle-class and poor neighborhoods of Karachi, which as noted above is an important reason for creating an unstable political climate.

Although a deeper analysis of Karachi's political economy is beyond the scope of this essay, it is important to make a few points regarding the city's dominant political party, the MQM. Its critics characterize it by the extortion rackets that it is said to run throughout the city and the terrorist tactics it employs to maintain its dominance. But its supporters point to the fact that, more than any other political party in recent history, it is the MQM that has been instrumental in providing previously impoverished areas in Karachi with basic social services such as sewerage lines, water sanitation plants, and schools. The city's landscape also changed dramatically between 2005 and 2008, a time during which the MQM controlled Karachi's municipal functions (Lieven, 2011; Gazdar, 2011) and was influential in constructing major flyovers and express roads that connected the different parts of this mega city.

Other parties engaged in turf wars with MQM, especially the ethnic Pakthun, Awami National Party (ANP), and the Sindhi nationalist Pakistan's People's Party (PPP) have in contrast not been able to keep up the parts of the city that come under their control (Lieven, 2011), leading to the disenfranchisement of their constituencies.

Nevertheless, as violence, lawlessness and extortion rates rise in the city, it takes a heavy toll on the city's economy. The impact this has on microfinance activity in the city will be reviewed in the following chapter.

III. Conclusion

This essay has reviewed how shifts in the global development discourse and policy helped the microfinance movement achieve prominence and in the process changed the nature of the intervention itself. The following chapter will describe how the evolving nature of microfinance has played out in practice in Pakistan.

While it is sometimes assumed that microfinance, as a market-based activity, is less vulnerable to local political economy constraints, the essay that follows details the extent to which local context matters. The aspects of Pakistan's political economy that are most salient to microfinance operations were reviewed in this essay, including the country's current security situation, weak governance, patterns of patronage and power, its faltering economy and increasing susceptibility to natural disasters. The essay also included a brief description of Pakistan's largest city, Karachi's current socio-political climate.

This essay is intended to provide a frame for the following chapter, which reviews research findings on microfinance's outreach and impact in Pakistan.

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CHAPTER 5

THE POLITICAL ECONOMY OF MICROFINANCE - EMPIRICAL FINDINGS

As a participatory, capability enhancing and financially sustainable development tool, microfinance has been the intervention of choice for international development institutions and policymakers since the 1990s. The United Nations marked 2005 the “Year of Microcredit” and the Consultative Group to Assist the Poor (CGAP), housed at the World Bank, has referred to microfinance as a powerful instrument against poverty (2004).

In Pakistan too microfinance has figured prominently in both poverty reduction strategy papers (PRSPs) that its policymakers have developed in consultation with the international financial institutions (IFIs).

The previous chapter outlined the trajectory of microfinance’s rise to prominence in global development. This chapter will focus on microfinance’s evolution in Pakistan. From a modest intervention that sought to alleviate poverty and empower women to one that has become an important part of the country’s financial landscape, microfinance has come of age in Pakistan as a financially sustainable social business. At the same time, its impact as a development intervention is challenged first by the very nature of its own evolution and second by the constraints placed on it by Pakistan’s political economy.

In the previous chapter we learnt that the successful development intervention of today should have the following ingredients: the ability to bypass the state machinery; be able to enable, empower and engage its constituents, ideally by employing the community's social capital; and be self-sustaining. This essay will explore the question of whether or not in its modern form microfinance fits these criteria. Secondly, it will analyze the impact of Pakistan's political economy on the practice, outreach and outcomes of the local microfinance sector from the point of view of its institutions as well as its clients. The analysis is based on the qualitative data described in chapter 3 but also includes trend analysis of the quarterly microfinance outreach data described in chapter 2.

The essay begins with a contextual analysis of access to formal financial services in Pakistan. The history of the Pakistani microfinance sector was covered in chapter 1. Section II will detail findings related to the political economy of microfinance in Pakistan, and Section III will conclude with a discussion related to the findings.

I. Financial Access in Pakistan

In Pakistan, access to formal sources of finance is severely restricted due to both supply and demand side factors. Supply side factors include the unwillingness of commercial banks to lend to the less wealthy, a weak legal and institutional infrastructure and a slow pace of technological advancement, though with the rapid proliferation of mobile banking this last factor is now being addressed. Demand side factors include poor socioeconomic conditions, gender inequalities, low educational levels and the general lack of financial literacy (Nenova, Niang, and Ahmad, 2009).

In terms of access to formal credit, the low and middle-income country average is 95 commercial bank borrowers per 1000 adults. Within South Asia there are wide regional disparities, with India at 133.5 commercial bank borrowers per 1000 adults and Afghanistan at only 3.1 borrowers. In Pakistan's case, there are only 26.6 commercial bank borrowers per 1000 adults (World Bank, 2013).

In terms of deposit account penetration, South Asia has 256.63 commercial bank depositors per 1000 adults. Again there is a wide variation in the region, with only 199 depositors in Afghanistan and as many as 726 in India, per 1000 adults. In Pakistan, there are 256.63 commercial bank depositors per 1000 adults (World Bank, 2013)

The average Pakistani household remains excluded from the formal financial system, keeping savings at home and borrowing from family and friends when in need. Only 10 percent of Pakistanis have a formal bank account, and only 1.56 percent received a bank loan in the past one year (World Bank, 2012).

Only 14 percent of Pakistanis have access to a full range of formal financial services, including savings, credit, insurance, and remittance services. In comparison, 32 percent of the population in Bangladesh has access to these services, 48 percent in India and 59 percent in Sri Lanka (Nenova, Niang, and Ahmad, 2009).

Once informal financial services are included, access to finance increases to 50.5 percent in the country. Informal access includes the informal organized sector such as Rotating Saving and Credit Schemes referred to locally as "committees", moneylenders, store credit and *hawala*[21] money transfers, while the unorganized sector includes borrowing from family and friends. Figure 1 presents the state of financial inclusion in the country with the latest available figures.

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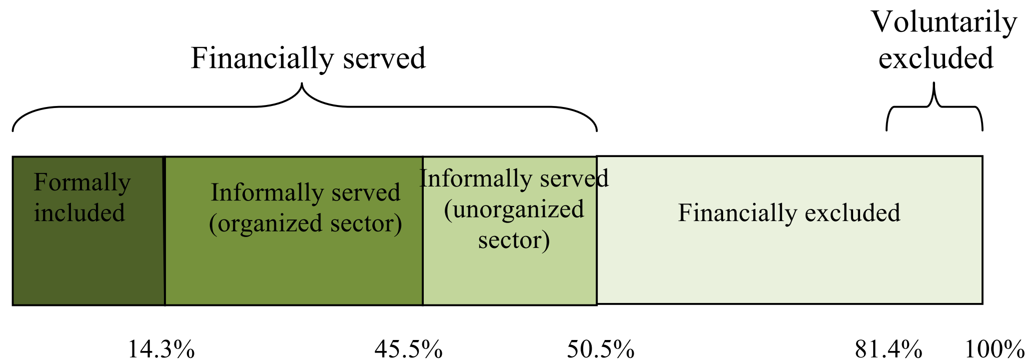
[21] An informal money transfer mechanism in which a financial obligation between two parties is transferred to a third party. These transactions are not formally recorded.

Figure 13 Financial Access in Pakistan



*Source: Nenova, Niang, and Ahmad. (2009). World Bank

The 19 percent "voluntarily excluded" represent those that refuse to use these services due to a lack of need, poverty or religious beliefs (Nenova, Niang, and Ahmad, 2009). Financial access, especially access to formal finance, is lowest among the poorest, women, small entrepreneurs and those living in rural areas. For instance, in 2008 only 30.9 percent of the total 8,343 bank branches were located in rural areas (Nenova, Niang, and Ahmad, 2009), despite the fact that Pakistan's rural population constitutes 67.5 percent of the total population (Population Census Organization, Government of Pakistan, 1998).

Women's access to banking services is only 5.5 percent versus 21.1 percent for men. But while women's access to borrowing is 24.7 percent versus 46.4 percent for men, their access to savings services is 52.6 percent versus 58.5 percent for men. If informal savings are included, the figure for women would dwarf the one for men, since women are significantly more likely to save as compared to men (Nenova, Niang, and Ahmad, 2009).

The microfinance sector, which mainly targets the poor, particularly the women among them, so far represents only 0.2 percent of total financial assets and reaches only 9 percent of its target market in Pakistan (MicroWatch, 2013), as opposed to more than a quarter of the population in other South Asian countries such as Bangladesh and India (Nenova, Niang, and Ahmad, 2009).

Similarly, small and microenterprises, together with medium-sized firms make up 90 percent of the industrial sector, employing nearly 78 percent of the non-agricultural labor force and contributing to 30 percent of the total GDP. But lending to small and medium enterprises (SME), accounts for only 16 percent of total commercial lending volume and only 4 percent of the total customer base. Consequently, small and micro-enterprises generate 90 percent of their own working capital and 81 percent of new investment capital (Nenova, Niang, and Ahmad, 2009).

An important source of financial services in underserved areas is the Pakistan Post Office, which has a network of 13,419 branches throughout the country and offers savings, insurance, and remittance services through its 7,276 bank branches. It is regulated by the Ministry of Finance and not by the State Bank of Pakistan. It is often the only formal banking service available in remote areas (Nenova, Niang, and Ahmad, 2009). However, the post office is not a full service bank and does not extend credit. In 2010, the First Microfinance Bank, a microfinance bank signed an agreement with the Pakistan Post Office that would allow it to use the latter's network to expand its outreach of microfinance services in rural and remote areas of the country. However, with the recent proliferation of mobile banking in the country, as discussed in chapter 1, the post office's financial services are likely to lose their significance over time.

II. Empirical Findings

The main questions this essay will address include the following:

1. How has microfinance's evolution in Pakistan from a small-scale development scheme to a commercialized financial sector activity affected the social mobilization aspect of its operations?
2. What are the political economy constraints on microfinance's outreach, practice and outcomes in Pakistan, from an institutional perspective?
3. What are the political economy constraints on microfinance's clients in Pakistan?

This section systematically answers each of the above questions. The first part of this section discusses the evolution of microfinance as a new-age development tool in Pakistan, the second describes the impact of the local political economy on microfinance institutions, in terms of outreach and operations, while the third details the extent to which the political economy constrains the sector's borrowers.

A. Microfinance: A New-Age Development Tool?

As described in the previous chapter, the narrative on development has converged on the idea that the process of development should have little government involvement, be highly participatory and financially sustainable. In this section I analyze whether microfinance, at least as it is practiced in Pakistan, fits these criteria.

A. (i) Microfinance and State Involvement

In its early days in Pakistan, microfinance activity was exclusively an NGO led effort, as described in chapter 1. The PPAF was established in 1999 as a public-private partnership, to lend to and assist these NGOs. As mentioned before, the PPAF is a World Bank funded social fund that runs without any government involvement.

The Government of Pakistan's poverty reduction strategy papers (PRSPs) also made it clear that the government would only provide a supporting role in the microfinance, as described in chapter 1. Indeed, the only state actor that actively participates in the microfinance sector is the State Bank of Pakistan (SBP). After the passage of the Microfinance Bank Ordinance in 2000, the SBP established a regulatory framework for the sector and began issuing licenses for the setting up of MFBs. As a regulator it has actively supported the expansion and commercialization of the sector. For instance, since 2008 when it issued the Branchless Banking regulations, the SBP has promoted mobile banking by easing account opening restrictions for mobile wallets, which are bank accounts linked to mobile phones, and issuing microfinance bank licenses to at least three investor consortiums in 2012 that have expressed interest in expanding the mobile banking network in the country, including a telecommunications operator. While mobile banking rapidly expands access to financial services in the country, it is also a low risk-high return venture.

Similarly, in 2010 the SBP amended prudential regulations for microfinance banks to allow collateralized lending against gold jewelry, calling it a “zero-risk” lending product. Officers from Tameer Bank say that these amendments were made at the request and initiation of their Bank. Another amendment to the prudential regulations recently increased the ceiling on loan sizes and relaxed borrower income limits, in order to encourage MFBs sector to lend to higher net-worth clients and medium-sized enterprises, as opposed to micro-entrepreneurs, the traditional target market for microcredit.

Apart from this, as described in chapter 1 the SBP offers several facilities to MFBs, including development grants and loan guarantees. Global financial institutions such as the UK's DFID, the World Bank and the Asian Development Bank provide funding for most of these facilities.

The only quasi-public institution in the sector until 2012 was Khushhali Bank, the first MFB set up in Pakistan with funding from the Asian Development Bank. Despite the fact that Khushhali Bank had the largest district-level presence among all MFBs in Pakistan, the SBP has been disappointed by its failure to achieve financial sustainability (interview: Microfinance Director SBP, December 2010). In 2012, Khushhali Bank was sold to a consortium of national and international investors, ending its quasi-public status.

In Bangladesh and India the state has played almost no role in the microfinance sector, even as a regulator, that is, until the borrower suicide scandal broke out in the Indian state of Andhra Pradesh. Since then Indian regulators have been trying to get a microfinance bill to pass through the legislator, which will allow it to beef up its microfinance regulatory regime. The SBP on the other hand, as the sole public actor in the microfinance sector, has played a significant role in helping microfinance banks reduce their risk, increase their scale and improving their prospects for financial sustainability. For this it has earned international recognition as described in chapter 1. But what are the implications of these developments for the sector's social mission?

A. (ii) Microfinance and Social Mobilization

As mentioned in chapter 3, when the PPAF entered the market as a wholesaler of funds to microfinance institutions in Pakistan, it did so by emphasizing that subsidized lending to MFIs would be subject to their meeting the social mobilization criteria (interview: founder and ex-CEO, PPAF, Jan. 2011; World Bank, 2013), that is, instead of following a passive process of loan disbursement and collection, MFIs would have to engage the communities they served for broader social change.

This did not pose a problem for older MFIs, as social mobilization has been a strong component of NGO activity in Pakistan since the late eighties. This entails partnering with community members, to form village organizations (VOs) in rural areas and union councils (UCs) in the cities. Each group elects a community leader to address community level issues and collaboratively works to solve problems such as such as lack of sanitation, health or education facilities. The NGOs at the social mobilization forefront include the Orangi Pilot Project (OPP) and most rural support programs, especially the Aga Khan Rural Support Programme (AKRSP) and the National Rural Support Programme (NRSP)[22] – all of which are also important players in the microfinance sector.

However, in contrast to their early years of operation, during which social mobilization was considered an integral part of microfinance activity, most NGO-MFIs have separated their social mobilization activities from their microfinance programs. For instance, the

[22] NRSP's sister institution the Urban Poverty Alleviation Programme (UPAP) has never had a social mobilization component. UPAP is included in the institutional sample.

AKRSP has spun off its microfinance portfolio into a standalone MFB, the First Microfinance Bank (FMFB). Similarly, the OPP has set up an independent microcredit institution, called the Orangi Charitable Trust (Hasan and Raza, 2012). Finally, the NRSP announced in 2006 that it was separating its social mobilization program from its microfinance activities and in 2010 set up a separate MFB, called the NRSP Microfinance Bank (NRSP, 2010). This indicates that even institutions that see social mobilization as an important part of their mission and work, no longer find it consistent with their microfinance operations.

It is noteworthy that most of these changes occurred in the post-2000 era, after the passage of the Microfinance Bank Ordinance, which spurred commercialization by opening up the field to microfinance banks. As far as the SBP and most MFBs are concerned, the main criteria for success is financial sustainability and increased outreach – the sector has been under pressure by the SBP to achieve the 3 million borrower mark and it is now expected that this will be achieved within the next five years (Ahmed and Basharat, 2013:10).

While the MFIs are not under the direct purview of the SBP, international donors and the PPAF emphasize that MFIs should reduce their reliance on subsidies, become operationally more efficient and revise their pricing structure upwards (Stephens, et. al. 2006; Ministry of Finance, Pakistan, 2006).

One institution that remains unaffected by these developments is the zero-interest MFI, Akhuwat, whose institutional philosophy is based on the Islamic principle of brotherly engagement, as described in chapter 3. All senior, middle and lower managers interviewed at Akhuwat headquarters and Lahore branch described their commitment to social change, though it should be noted that this research does not include interviews with officers working in Akhuwat branches in other cities, where the distance from the headquarter may have affected commitment to the institution's mission and philosophy. Akhuwat seeks social change by engaging borrowers in discussions pre-disbursement and encourages their participation in fundraising. In 2010, former borrowers provided Rs.15 million (US$159,575) in donations (Candland, 2011). Akhuwat does not receive or seek support from either the PPAF or the SBP. This no doubt allows it much more liberty and flexibility than other institutions in the sector. At the same time, social mobilization is envisioned a bit differently at Akhuwat, for it does not involve community participation around local issues. Rather, the engagement is with the most and least prosperous members of the community "in a spirit of brotherly love" to meet the community's financial needs (Munir, 2012).

These findings are consistent with the existing literature (Kabeer, 2010; Miraftab, 2004; Fine, 2009), which tells us that the nature of the NGO determines actual outcomes on the ground. This is especially true where the state's capacity as a monitor of the people's interests has been deemphasized. At the same time, this research is limited by the fact that it has not been able to determine the extent to which the social mobilization and community development schemes employed by major MFIs such as NRSP in the past have improved the capabilities of the poor in Pakistan.

Social mobilization in microfinance has traditionally been linked to the group lending arrangement, first popularized by Muhammad Yunus in Bangladesh in the eighties. This calls for the use of the community's social capital as described in the previous chapter. The section below reviews Pakistan's experience with group lending.

A. (iii) Microfinance and Social Capital

Social capital was the basic building block of the original microcredit model. Group lending relies on the community's existing social network, replacing financial collateral with a social contract in which everyone is at the same time responsible for everyone else's loan. Early microcredit arrangements in Pakistan followed a similar pattern until a repayment crisis brought the entire group-lending model to its knees.

The Repayment Crisis:

In 2008, the microfinance industry was hit with a highly publicized repayment scandal that initially affected the MFI Kashf Foundation, and later spilled over to other institutions. Kashf is Pakistan's first specialized microfinance institution. It lends exclusively to women and was set up in 1996 with technical assistance from the Grameen Bank.

The crisis at Kashf began in a peri-urban area surrounding Lahore, the city where it is headquartered, and quickly spread from there. The problem was so serious that in April 2009 it was estimated that roughly 80 percent of Kashf's clients had refused to repay (Burki, 2009).

A post-crisis analysis conducted by the Pakistan Microfinance Network (PMN) suggests that Kashf and other institutions in the province of Punjab had bribed local community leaders to help them identify prospective clients. Practitioners were aware that these leaders were also charging commission from prospective clients. This was a result of pressure from the management on local officers to expand outreach, which meant that Kashf and other institutions operating in Punjab were competing for the same clients. Multiple borrowings increased as a result of growing concentration in and around Lahore, the capital of the province of Punjab. Research indicates that during this period 40 to 70 percent of borrowers in the crisis-ridden parts of Punjab had taken out multiple loans (Burki, 2009; interviews: Program Coordinator NRSP, 2012; Head Operations Tameer Bank, 2011).

During interviews, every client of Kashf Lahore made reference to these events even though they had occurred nearly three years ago. One client described how in the confusion that ensued during the crisis, group members would go to non-paying clients' homes and confiscate household items such as television sets and only return them once the loan was paid off.

There are conflicting reports regarding the tipping point of the crisis. One factor that many point to is political interference, which is reminiscent of the microfinance crisis in the Indian state of Andhra Pradesh (Ross, 2010). In Kashf's case a member of the National Assembly is said to have told a few borrowers that they did not need to repay their loans and the news spread rapidly through the social network resulting in an en masse default (Chen et al, 2010).

Tameer Bank had a similar experience during the mid-2000s for it too tried to expand outreach by relying on local agents. Defaults and operational losses soared and it was only when Telenor, a multinational telecom operator with stakes in other microfinance institutions, such as the Grameen Bank stepped in, and bought a 51 percent majority stake in the MFB, that the institution was able to regain lost ground (Singhal, Svenkerud and Flydal, 2002).

These crises are reminiscent of “unzipped” group lending arrangements that occurred in India, Bangladesh and Uganda (Gine et al, 2011; Wright and Rippey, 2003), as described in the previous chapter. Post-crisis these institutions contend that the original group-lending model needs reconsideration.

Kashf’s officers say that this crisis wiped out the community’s social capital, and admitted that trust among community members suffered such a deep blow that even the informal savings circles community members had always maintained were dismantled in the areas affected by these events. Post crisis, Kashf and several other MFIs changed their lending agreements. Now even though disbursements continue to be made in groups, most loans have individual rather than joint liability and there are no group meetings or group leaders. Kashf’s new policy requires post-dated checks from borrowers at the time of disbursement.

It is clear from this experience that the race to scale led to broken bonds of trust. The branch manager of one of the affected areas recalled how group meetings would often end up in arguments between neighbors, or even between spouses.

This comment was corroborated by an incident that occurred during field research in Karachi when an MFB’s loan officer and I knocked on a borrower’s door in the neighborhood of Korangi. The borrower’s husband answered the door, reluctantly let us in and answered each question with silence, finally he said that taking the loan was his wife's decision and he did not support it. If microfinance is said to enhance a community's social capital as suggested by the World Bank and others (see the previous chapter), these findings do not give credence to this claim.

According to the MFBs Tameer Bank and Kashf Microfinance Bank, another reason for the rapid move towards individual lending is that it is more consistent with higher denomination loans and better off clients, which means that it is individual rather than group lending that is more consistent with the concern for financial sustainability. This is corroborated by research from other countries (Roodman, 2012).

A. (iv) Commercialization and Financial Sustainability

A senior official at the MFB, the First Microfinance Bank (FMFB), described her frustration with rural clients: "their level of literacy is low, which makes them apathetic, and it hampers their capacity to absorb and understand…but donors want quick results without appreciating the reality on the ground."

She felt this pressure ended up pushing institutions to mold their agenda in accordance with the donor's wishes. While some would say this is evidence that donor dependence reduces an institution's flexibility, the official went on to comment that the pressure to achieve financial sustainability had made the situation even more problematic since it often results in conflict at the top, making it difficult for mid and lower level officers to figure out how to balance concern for the bottom-line with the institution's social service mission.

But the situation at FMFB is quite different from that of other MFBs, such as Tameer Bank where there is no such conflict, because Tameer's senior management is very clear that the financial bottom-line takes precedence over other considerations. As their Director Operations put it: “microfinance is hard commercial business”.

Newer MFBs such as Kashf Bank closely follow Tameer’s example, for Tameer Bank is considered an industry leader. It was the first MFB to achieve financial sustainability and maintains the highest growth in the industry in terms of gross loan portfolio.

While sustainability is an important criteria in development and is often lumped with institution building (World Bank, 2013), more socially oriented MFIs say that in a sustainability-driven environment they find it difficult to meet their social goals.

The director of the NGO Resource Center in Karachi described how her institution had struggled to provide microcredit in rural Sindh. She admitted that they failed to maintain the zero-default criteria commonly expected from microcredit operations. Her explanation was that the institution was too close to its clients, after having worked with them for decades on other issues such as education and health: “we understood their problems well and could not insist on repayment at all costs.” Consequently, a few years ago her NGO decided to give up on microcredit and continue with its core operations.

In the same vein, the head of Thardeep Rural Support Programme’s microfinance unit stated that her client’s lives were too precarious and default was often driven by real crises rather than willful nonpayment. The distinguishing aspect of both institutions is that they serve the poorest population in Tharparker, one of the most deprived regions of rural Sindh. Microcredit experts argue that it is not an intervention meant for the extremely poor (DFID, 2010). But the PPAF has recently taken steps to support the expansion of microfinance to the most remote areas in Pakistan. For instance, last year it reversed its policy of extending credit subsidies based on institution size. Lending rates are now subsidized according to a pre-set four point scale that ranks each institution's area of operations using the human development index (HDI) and the food security index. The PPAF has also recently developed a Disaster Management Strategy and Investment Program aimed at developing a comprehensive plan "to mitigate, prevent, protect against, respond to and recover from the effects of disaster" (PPAF, 2012). The plan includes an investment of over US$200 million in various interventions, over a period spanning 2012 to 2015 (PPAF, 2012). While this is not the first disaster management program developed in the country, it is the first of its kind that directly affects microfinance practitioners and the communities they serve. As part of this strategy, the PPAF announced in January 2013 that it was introducing an indexed weather-based micro-insurance product to facilitate and compensate small farmers in Pakistan (Millan, 2013). It remains to be seen how much of an impact these initiatives will have in the face of a strong sector-wise thrust towards commercialization.

The most important learning in this section, though, is that institutions find it hard to balance financial sustainability pressures with their development objectives. The end result is that one objective nearly always wins over the other, as confirmed by the literature reviewed in the previous chapter (e.g. Morduch, 2000).

But these findings have to be contextualized against specific political economy conditions that can constrain actual practice on the ground, especially outreach, practice and client experiences. The previous chapter included a detailed review of Pakistan's political economy, including the current security crisis, weak governance, the existing pattern of power and patronage, the faltering economy and the increasing incidence of natural disasters. The section below reviews the impact of these factors on microfinance institutions.

B. Political Economy and the Institutional Perspective

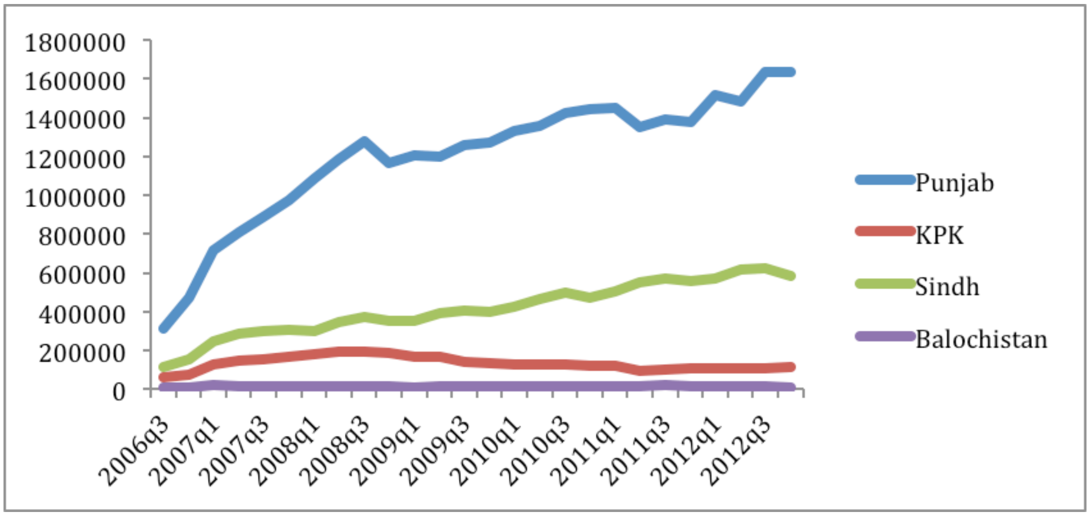
Until the late 1990s Pakistan's microfinance sector was run by local NGOs, restricted to microcredit and offered as part of a host of other services such as access to education, healthcare, sanitation, and housing. By the turn of the century, microfinance was ready to enter its second phase of development with the setting up of specialized MFIs such as Kashf Foundation, the establishment of the PPAF and the licensing of MFBs through the passage of the Microfinance Bank Ordinance in 2000. This new phase was characterized by rapid growth. Between 2004 and 2008, the sector's annual compound growth rate was no less than 67 percent (Chen et al, 2010).

However, beyond 2008 this growth could not sustain itself. There are several reasons for this, the most important of which is the deepening security crisis in the country.

B. (i) Expansion in the Face of War and Threats to Security

Nearly 13 years have passed since the year 2000 when the country is said to have begun its growth as an organized microfinance sector in earnest (interview: SBP Director Microfinance, 2010), but the penetration rate remains quite modest at only 8.6 percent of the potential market (Microwatch, Quarter 4-2012). Moreover, existing outreach is unevenly distributed as shown in Figure 2 below:

Figure 14 Microfinance Outreach by Province - Number of Active Borrowers



*Data Source: Pakistan Microfinance Network, 2013

The figure indicates that outreach in Punjab, measured here in terms of number of active borrowers has far outpaced that of other provinces. Overall, province-wise outreach rankings match province-wise development rankings in the country. Figure 2 in the previous chapter showed that according to a measure of multidimensional poverty, Punjab is by the far the least deprived province in the country, followed by Sindh, KPK and Balochistan. This is the same order as the representation in Figure 1 above. Given that microfinance is a poverty reduction and financial access tool, we would expect the pattern to be reversed.

In terms of pattern of growth it is clear, especially from Punjab's trend-line, that until the latter half of 2008 outreach was rising sharply, but growth fell thereafter and has not been able to recover. The figure indicates that growth in KPK (which includes the northern province of Gilgit-Baltistan in this figure) has been affected more than in any other province.

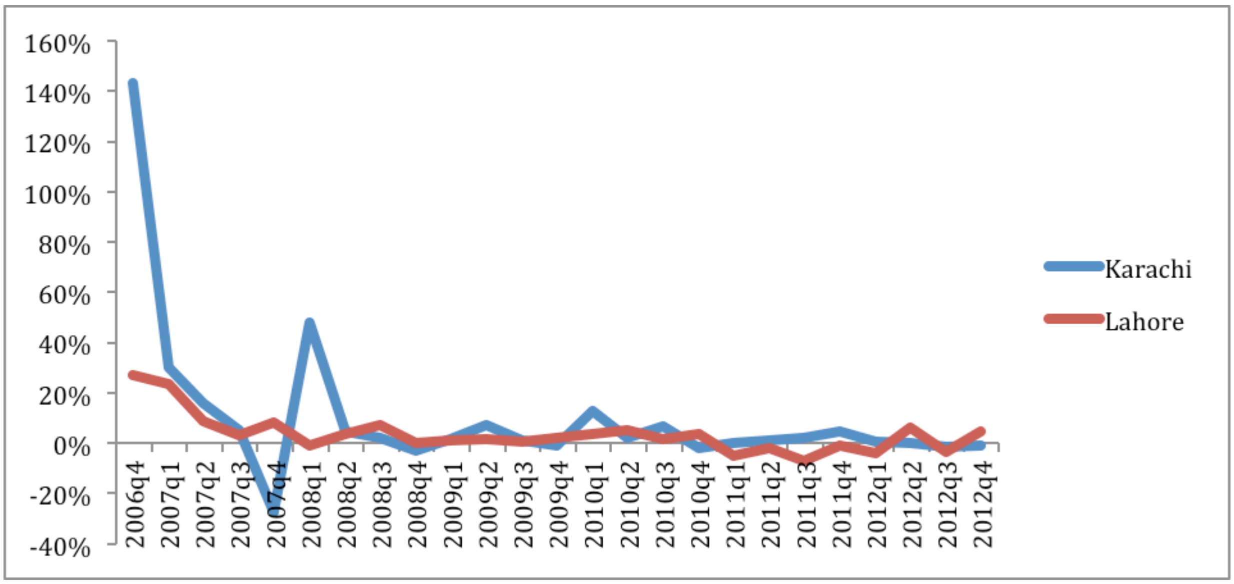
The decline in microfinance activity in KPK and Gilgit-Baltistan can be directly attributed to the war on terror. Since these areas border Afghanistan, they have suffered the most from both Taliban and drone attacks. The area has seen the highest percentage of human as well as infrastructure losses, as described in the previous chapter.

The MFI, the National Rural Support Programme (NRSP) reported during interviews that KPK was one of its fastest growing regions, in terms of microfinance outreach, before the war escalated in KPK. Post escalation it lost some of its branch network to bomb attacks, suffered attrition as several loan officers were kidnapped and had to write-off a significant portion of its portfolio (interview with Development Director NRSP, July 2012). As a result, not only did NRSP rapidly scale back its presence in the province, other MFIs also decided to stay away. Consequently, at this time only Punjab and Sindh continue to see any growth in outreach.

Expansion in Balochistan, as evidenced by the figure above, has always been slow. Outreach is mainly limited to Quetta, Balochistan’s capital city for several reasons. First of all, even though according to landmass Balochistan is Pakistan’s largest province, population-wise it ranks last. The terrain is dry, mountainous and difficult, as a result the province is sparsely populated which results in especially high operational costs for expanding outreach. Secondly, Balochistan is Pakistan’s least-developed province, with very high poverty levels, which provides little opportunity for commercially based microfinance to thrive. Thirdly, as mentioned in the previous chapter, due to security threats it remains a dangerous place to operate in. Finally, since the primary target market for microfinance institutions, especially MFIs are women, the closed, patriarchal Balochi tribal culture makes outreach particularly problematic.

Overall growth in the sector has been inconsistent. Even in Sindh and Punjab, where outreach is much higher relative to the other two provinces, growth has been uneven. Figure 3 describes the pattern of growth in Karachi and Lahore, the two cities with the highest outreach in the country. Karachi is Pakistan's largest city, its economic and financial center and the capital of the province of Sindh, while Lahore is the capital of Punjab, by far the most economically developed province.

Figure 15 Growth Trends in Microfinance Outreach in Lahore and Karachi



*Source: Pakistan Microfinance Network Database, 2013

Since the latter half of 2008, growth rates, measured in terms of the number of active borrowers per quarter, appear to have averaged close to zero for both cities. With nearly 200,000 active clients, Lahore remains in the lead, in terms of the number of active borrowers, but the figure shows that for most of 2011 and part of 2012, the city experienced negative growth. There are two main reasons for this. The first is that the penetration rate in Lahore has risen to 22 percent (MicroWatch, 2012) and in many areas of the city the sector has crossed its saturation point. For instance, clients in the areas of Lahore covered in this research reported six to seven different institutions competing with each for their business. At the same time, there has been a sector-wide move to reduce the incidence of multiple borrowing. Secondly, economic activity in Lahore has sagged recently due to the chronic power shortage, which also makes increased exposure to this city risky from an institutional perspective.

The figure shows that for Karachi growth rates have also hovered close to zero. First of all, despite the fact that the power crisis in Karachi has not been as catastrophic as in Lahore, economic activity everywhere has been affected by it. One estimates puts the drop in overall investment as a result of the power shortage at 37 percent (Siddiqui et al, 2011).

But the most important reason for the falling growth rate in Karachi is the city's continuing ethnic violence for the past five years as detailed in the pervious chapter. During the summer of 2012 when this research was conducted, at least eight people were killed on a daily basis as a result of these clashes. In addition, protests related to these murders often erupted into ethnic riots and calls for city-wide strikes paralyzing major parts of the city occurred at least once a week.

During interviews, practitioners in Karachi complained that their work was disrupted due to tensions in the city, which meant that they could not come to work and even if they did they could not go into the field to reach their clients. Clients would also have difficulty coming to the branch office to make their repayments.

The regional manager of Kashf Foundation described how plans for expanding the MFI's presence in the city have been put on the backburner since the escalation of violence in the city in the past five years. FMFB's regional manager for Sindh described what appeared to be a policy of retrenchment in the city. The institution had just closed down a branch in Liaquatabad, a particularly tense part of the city controlled by the MQM. Since FMFB is associated with the Aga Khan Foundation, which historically has had a strong presence in the northern areas of Pakistan, its presence in an MQM controlled area was understandably problematic. When I went door knocking with an FMFB loan officer in Korangi, another neighborhood of Karachi, I observed the care the officer who was from Gilgit, the area bordering KPK, had to put in appearing particularly unobtrusive because of MQM presence in the area. At one point he said defensively, "even though we are not Pathans we get mistaken for them all the time" in reference to MQM hostility towards Pathan migrants in Karachi.

The literature on microfinance in conflict-affected areas cautions that successful implementation of microfinance programs requires a minimum level of political stability (Bruett et al, 2004). This is confirmed by my findings, which indicate that growth in the microfinance sector has been seriously affected by the security crises.

Problems of corruption and patronage, on the other hand, affect day-to-day operations more than strategic decisions related to outreach that affect growth.

B. (Ii) Corruption, Power and Patronage

During interviews nearly all microfinance practitioners stated that problems of non-repayment were not significant, since loan sizes were small and the target market included people with little political clout. By contrast, commercial banks in Pakistan are weighed down by non-performing loans. The World Bank estimates that as of 2011, the Pakistani banking sector's nonperforming loans were 16.2 percent of total gross loans. This is often attributed to corruption within the banking sector, especially public sector banks, the political clout of feudal landowners and industrialists, and the chronically slow and corrupt judicial process (Husain, 2003; Haneef et al, 2012).

At the same time, as described above, the microfinance sector has had to deal with a major repayment crisis that was the result of corruption within the sector, misplaced judgement on the part of local loan officers as well as some political interference. As a direct result of this crisis, Kashf Foundation replaced the joint liability clause in its loan agreement with taking post-dated checks as guarantees at the time of disbursement. What is significant is that even though the borrowers on the books are women the post-dated checks are drawn on their male relatives' bank accounts. When asked about this practice, a senior Kashf official explained that in case a check bounces it is difficult to imprison a woman:

"We don't have women's prisons where they can stay overnight – we only have male prisons – so women can't stay overnight in the prison. Therefore, until the court passes the verdict she is free. With men, it's different. You can put them in jail directly. Then the women come and give us full payment. We've only had to do this once. We got the police to handcuff the husband and make two rounds of the neighborhood in the police van. By the evening, his wife had come and paid us the full amount. Now everybody knows not to mess with us."

While Kashf was able to solve its repayment issue quite effectively, at least from the institution's point of view, FMFB described a situation, which clearly got out of the institution's hand. This pertained to a group of defaulting women borrowers in rural Sindh who openly defied their loan contracts and refused to repay, even when threatened with legal action and their case was reported to the local media. While the local newspaper did publish the story, the judge decreed that an arrest warrant could not be issued because the defaulters were women. I asked a senior officer at FMFB to explain this and she said her understanding was that women could not be imprisoned in Pakistan for petty loan defaults. No one in the industry was able to cite any particular legislation in this regard but there is consensus that women's imprisonment is a culturally sensitive matter.

In any case, the legal system often takes years to resolve issues of default and most institutions said they prefer out of court settlements with defaulting clients. In addition, when a group is being formed for the first time, institutions such as FMFB make it a point to relate stories of police and legal action taken against willful defaulters. FMFB continues to have joint liability loans and finds that in most cases the threat of being cut-off from future loans is enough to keep most borrowers from defaulting or even to allow their group members to default.

While most practitioners insist that repayment issues arise for less than two percent of their portfolio, they say that when default occurs the main cause for it is the preexisting debt culture, especially in rural areas. In the words of a senior manager at FMFB: "What do you expect from these small borrowers, when they see their feudal masters not repaying much larger debts to (commercial) banks?" This is an important reason why microfinance outreach has remained mostly limited to urban and peri-urban areas in Pakistan.

Several practitioners complained that corruption was a regular problem within their own ranks, especially at the loan officer level. A senior officer at FMFB said that it was relatively common to find loan officers pocketing the money coming in as repayments. In addition, if an employee was terminated, he or she was likely to disrupt operations by attempting to break up the borrower groups he/she had been working with.

An FMFB officer also described group leader corruption as being especially common in rural Sindh: "sometimes this corruption is willful, while at other times it is due to a genuine need. For instance, it could be that the group leader has collected money from all other group members and instead of depositing it with the Bank he will make an excuse such as "I got robbed on the way to the Bank" which is several miles away from the village. On the other hand it could be that after the money was collected by the leader there was a home emergency and he used up the money for that, in that case we term it as circumstantial default."

Many practitioners described another kind of corrupt practice, referring to it as "putting up a front". In this case an individual indicates that he represents a large group of borrowers, but uses all the proceeds of the loans to line his or her own pocket. Practitioners note that these cases usually occur in collusion with loan officers. From the institution's point of view, such instances of corruption reduce margins, increase the ratio of overdue loans in their loan portfolios and in general, make it hard to operate on a daily basis. Unfortunately, the recent literature on microfinance suggests that corruption is often systematic rather than sporadic in many countries across Latin America, sub-Saharan Africa and Asia, thanks to the influence of the larger political economy and the increase in competitive pressures (Sinclair, 2012).

But institutions such as FMFB and Khushhali Bank, that are especially active in rural areas, insist that all other problems appear minor in comparison to the devastation wreaked by the recent and recurrent floods in the country.

B. (iii) Floods and the Rural Portfolio

The estimated physical damage to the microfinance infrastructure from the 2010 floods is estimated at PKR[23] 34 million (US$ 361,702), including damage to 86 branches, 70 percent of which were located in Sindh and the rest in Southern Punjab. In addition, in flood-affected areas, the value of non-performing microcredit loans reached US$27.6 million. The gross loan portfolio which had been rising by 6.5 percent per quarter, grew by only 2.5 percent in the four quarters following the floods, and the number of active borrowers, which had been rising by an average of five percent per quarter before the flood, rose by only 0.3 percent post floods for the next four quarters (Khalid and Arshad, 2012).

A senior official from Khushhali Bank described a grim state of affairs: “Most of our rural portfolio in Sindh and the majority of our rural portfolio in Southern Punjab was wiped out by the floods”. During the interview conducted in July 2012 he said that 56 percent of the portfolio from Sindh and 86 percent from Punjab had been recovered to

[23] PKR stands for Pakistani Rupees

date. However, the term "recovered" here mostly indicates paying back the older loan by taking out a fresh loan.

FMFB, which maintains a heavy presence in rural Sindh, also suffered serious losses. An FMFB branch manager in Hyderabad, a city in southern Sindh, described the MFB's situation: "Before the floods less than two percent of my portfolio was in default, but after the floods 100 percent of my portfolio has been affected". FMFB officials reported 75 percent loan recovery from areas affected by the 2010 floods. Unfortunately, when the floods returned in 2011, the MFB suffered heavy losses in the rural sector all over again. The branch manager in Hyderabad described the havoc caused by the floods in August, 2011: "First the rains washed over cotton fields ready for picking for 6-7 days continuously in lower Sindh. And then rain fell on parts of the whole country for three days without let-up. With standing water levels as high as 6-7 feet in the fields, nothing could be recovered. Sugarcane can usually withstand rain more than cotton, but in this case even this crop was damaged".

As of June 2012, FMFB had recovered only 50 percent of its loans in flood-affected areas. FMFB officials say for the time being they have curtailed new lending in the region and are now working on developing new loan products and thinking of ways to diversify their existing rural portfolio, for instance by designing rural loan products that serve non-farm activities.

When asked why affected borrowers were not provided loan relief, the MFBs reasoned that the government did not announce any relief measures for the microfinance sector in the wake of the worst floods in the country's history since 1929, which made it hard for them in turn to offer relief to their clients.

The rural portfolio comprises agricultural and livestock loans, which are designed differently from a regular microenterprise loan, in that they require a bullet or a one-time repayment, while regular microloans involve weekly or monthly repayments. This is necessitated by the fact that small farmers and owners of livestock don't have the means to repay before the sale of their harvest or livestock. But such loans are also harder to repay when the entire harvest upon which the interest and principal repayment is due has been lost due to floods or drought.

At the same time, FMFB contends that farmers have been coming into their branches to repay overdue loans on a daily basis. The institution reasons that farmers make these repayments because they know that they cannot get a new loan unless they repay the older one and as the planting season approaches they will be in dire need of credit again. Without farm or weather insurance farmers have little choice but to take on fresh credit each planting season, even when they realize that they are likely to lose all their crops and thus their income the following year as well.

Another issue practitioners face, particularly in rural areas, is the cultural segregation of the sexes. While chapter 6 will detail microfinance's impact on women's empowerment in Pakistan, access to women is an issue that needs special consideration in a political economy context and is discussed briefly in the section below.

B. (iv) Microfinance and Purdah[24]

[24] Purdah literally means veil, but the broader interpretation refers to segregation between the sexes, which is both a cultural and religious phenomenon.

In order to expand outreach to rural women, FMFB's Product and Market Development Officer says that female credit officers are needed for there is a strict culture of segregation in the villages. This, however, turns out to be quite expensive for the institution, since female officers require more security in hard to access areas, adding to the already high cost of operations in these regions. This is one reason why FMFB says it does not set aggressive gender-targets for its portfolio.

But FMFB officers describe distinct cultural differences between the provinces. For instance, even though literacy levels are low across both rural Sindh and Punjab, they say rural women in Sindh are relatively more willing to learn and are more open to new ideas, such as how to improve their livestock's health or milk production, as compared to the rural women in Punjab. One of the officers I spoke to at FMFB felt this was because Punjabis were relatively better off and more repressive of their women than Sindhis. Of course, even if this is true it is very relative. An FMFB branch manager that handled a sizeable portfolio in rural Sindh described the dominant Sindhi culture: "men have their *hukah* (pipe) while women do all the work", and reminded me that honor killings of women are commonplace in Sindh. Nevertheless, FMFB staff contended that in rural Sindh they had been able to form several mixed-gender borrower groups and some of these even had female group leaders. The staff says that they have observed a process of gradual change as villages become electrified and access to television slowly dispels traditional norms.

Moving to the province of Balochistan, the Chief Financial Officer of Kashf Foundation, an MFI that only lends to women, talked about how Kashf has been trying to explore its options there. He described that during their initial visits to Balochistan they realized just how restricted women's economic activity was in Balochistan. Several of the women Kashf's research team met had rarely ventured out of their homes because of the strict observance of purdah, and they realized that introducing gender-targeted microfinance would first require a major cultural shift. Kashf's officer quoted a Baloch saying: "Women's earnings are *haram* (sinful)".

Purdah is similarly strongly enforced in the province of KPK, but outreach there is severely restricted due to the constant threat of Taliban attacks, making the issue of little consequence for the moment.

The situation was quite different in Karachi and Lahore, where I accompanied several male loan officers to the homes of female borrowers, during a time of the day when the men in the household were out for work. Of course, being a female I could have had something to do with their getting access to these homes. At the same time, in the words of a male loan officer: "When it comes to money, *purdah* is no longer an issue". Several female officers disputed this and felt that women were more relaxed with female officers and that they had greater access to them as compared to their male counterparts.

But the familiarity with which the women we visited greeted the male officers does give credence to their claim. This is also corroborated by Lieven's (2011) description of women in Karachi often being more outspoken than their menfolk, especially in Muhajir communities. This is not necessarily the case with more recent migrants, especially those from KPK who live in relatively closed communities in the SITE neighborhood of Karachi. Microfinance officers say that access to women in these neighborhoods remains limited.

Thus, in the overall context of Pakistan's crisis-ridden political economy, microfinance outreach and operations do appear to have been affected. The escalating war along the Afghan border and the ethnic violence in Karachi have led to a sharp slowdown in growth; the recurring floods of 2010 and 2011, particularly in rural Sindh and Southern Punjab, have wiped out entire rural portfolios; the high incidence of corruption in Pakistani society make day-to-day operations a challenge and issues of purdah limit access to women in large swathes of the country. We turn now to a description of how the political economy has affected the clients of microfinance in Pakistan.

C. Political Economy Constraints on Microfinance Clients:

"Most of our clients are running losses because of power outages. They are running losses even though they pay us on time. And because of rising inflation their asset values have eroded, so we can't say that the impact we have made on their lives is real anymore."

- Urban Poverty Alleviation Programme (UPAP) Lahore Area Manager

The economic crisis has affected clients profoundly, severely restricting the benefits access to credit could have otherwise brought them. Kashf Foundation says its clients' are especially vulnerable to food price inflation, since staples such as rice, wheat flour and lentils figure prominently in the household budgets of poor families. During interviews these official describe how due to rising inflation, many clients have had to pull their children out of school. Of course, these are urban clients. In rural areas, branch managers at FMFB and Khushhali Bank say that clients tell them they cannot afford to put their children in school at all, for children provide much needed labor on farms.

When clients were asked about what aspect of the political economy affected them the most, they mentioned several factors at once. The table below presents their responses. Please note that except for the two clients of Tando Allahyar, all others were urban clients. Lahore and Rawalpindi clients have been grouped together since their responses were broadly similar.

Table 17 Microfinance Clients and Political Economy Impacts			
	Karachi	Lahore and Rawalpindi	Tando Allahyar
Total interviewed	36	14	2
Political economy constraints on clients' businesses and overall income:			
Inflation	7	8	
Daily power outages	6	9	
Security situation	6	0	
Un- or under-employment	4	2	
Floods	0	0	2

The table indicates that for Karachi-based clients inflation was the single biggest concern, followed by the power shortage and the city's security situation. For clients based in Lahore or Rawalpindi, the power crisis was the biggest concern, followed by inflation. The clients of Tando Allahyar were rural and only mentioned the floods as a major concern. It should be noted that these concerns were mentioned not just in the context of their businesses and other economic activity, but with regard to their general wellbeing.

The Power Crisis:

The table indicates that inflation and power outages were a major concern for urban clients across the three cities in the sample. A group of shoemakers in Rawalpindi reported that power outages would often last for up to 16 hours a day, and they would have to work by hand at a much slower pace than when working with their machines. A client in Lahore reported three-hour outages three times a day, while a client in Karachi said outages of up to eight hours a day were common.

Several clients stated that while they experienced power outages, it had no bearing on their productivity because their work did not require electricity – most of these were women, engaged either in producing crafts such as jewelry or *masehri* (wedding decorations). Those that were involved in sewing and tailoring work, reported that they would simply switch to working their sewing machines by hand during an outage and because their clients lived close by, sales weren't affected very much even when the city was paralyzed by a strike. Of course, this would affect productivity, but at least the work could be continued, albeit at a slower pace.

In contrast, a couple of clients from Lahore that were involved in welding work would have to stop working simply because their work was completely dependent on their machines. A cold drink wholesaler in Karachi similarly expressed frustration with the high frequency of power outages, since he needed power to keep his refrigerators running so that his drinks could stay cool in the scorching July heat.

Managers from institutions, such as the MFB FMFB, said they regularly felt obligated to provide grace periods to clients that could not repay on time because of the chronic power shortage especially in Lahore and Rawalpindi, or due to the increased frequency of city-wide strikes in Karachi.

Inflationary Pressures:

Clients also reported being weighed down by inflation. Two clients mentioned that taking a loan had become a necessity, due to the high price of supplies and food. A client from Lahore said that she used to be able to save, but thanks to inflation, savings had become a thing of the past.

The Security Crisis:

Relatively speaking, the power crisis and inflation were more prominent concerns for clients in Lahore and Rawalpindi, as compared to clients in Karachi. The security crisis was a significant issue for clients in Karachi was the security situation. Borrowers that depended on middlemen complained that due to the security situation in Karachi, they would often get delayed or partial payment for their work. At the same time, given the severity of the security crisis in Karachi, the number of clients affected by it was surprisingly low.

There are two main reasons for this. First of all, 70 percent of the clients in the sample were home-based workers and felt relatively sheltered, at least as far as their businesses were concerned, from the goings on in the city. They reported being affected only to the extent that a strike or a riot disrupted their trip to the wholesaler in the commercial district. One client who ran a corner store in her own community actually reported an increase in business during such times. She said that when people in the community could not go out of their neighborhood to the larger stores because of a strike, they would have no choice but to come to her store for all their needs.

Another possible reason why the security issue was not mentioned as much during client interviews is that Karachi has been violent for so long that for most residents the situation is now business as usual, as suggested by Gazdar (2011) and Gayer (2013). They have learnt to manage their business and personal lives around the violence and disruption caused by the citywide strikes. This is what Sen calls "entrenched deprivation" describing it as a state of such long-standing deprivation or hardship that it is accepted with non-grumbling resignation (Sen, 1992: 55).

Employment Woes:

Finally, a few clients reported that the male members in their household were either able to find work only sporadically or the factories where they had previously worked had laid them off completely. They blamed the current economic and political climate, as well as the high frequency of power outages for this. These clients said that while this situation made it very important for them to keep their businesses running, lack of a steady wage also made it hard to make timely repayments. This was especially so because inflation had squeezed their margins to a point where making loan repayments from business revenues had become nearly impossible. One client said that due to inflation and because her husband could only find work sporadically, there was no longer enough to eat and her kids often had to be kept away from school. Regularly having to go without food was a common theme across respondents and across cities.

Rural Constraints:

For the rural clients in Tando Allahyar, the most severe constraint was the recurrence of heavy rains and floods. One of them said: "Even though we repaid our loans on time, we did not make a profit this year or the last because our crops failed and the price of our livestock fell."

When asked them about the reaction of the *waderas* (feudal landlords) to their relationship with the microfinance institutions the borrowers said the *wadera* did not mind, in fact he encouraged it.

This was corroborated in interviews with three MFB managers, who managed rural portfolios in Sindh. *Waderas* in Pakistan employ sharecroppers on their land and if these sharecroppers receive credit it is used to buy fertilizer or seeds, which improves agricultural yield on the *wadera's* land.

The advantage to the sharecropper, on the other hand, is that he no longer has to buy inputs on credit. In rural areas, the supplier is able to exploit the sharecropper or *hari* by selling on credit. FMFB officials describe the conditions the supplier places on the farmer. The supplier sells seeds and fertilizer on credit on the condition that the hari will sell the harvest back to him. Since the supplier has a monopoly in the village, he is able to control seed and fertilizer quality. The hari has no option but to buy low quality inputs because he is buying on credit. When it is time to sell the harvest, the supplier employs "*kaccha taul". Taul* refers to the balance used to measure the seed, fertilizer and crops. *Kaccha taul* means incorrect weight, while *pacca taul* means correct weight. The hari understands he is being paid less than what he is due but is powerless to object.

FMFB says its officers have worked hard to break the suppliers' hegemony, not just by providing *haris* with credit, but also by helping them extend the solidarity lending model to buying and selling in groups, rather than on an individual basis. Together they wield more power than when they deal with suppliers individually. At the same time, practitioners say there are limits to what they have been able to achieve. For instance, they explain that the supplier has political connections with ginning mills in the cotton belt of Sindh where FMFB operates. The ginning mills prefer to deal with the supplier than with individual haris.

This suggests that the political economy constraints on rural clients are such that even with the best of intentions, microfinance practitioners are able to achieve only so much. It is not surprising then that barring a few exceptions, most institutions have preferred to stay away from rural areas, where the incidence of poverty is much higher than in urban areas.

The following section reviews the relationship between urban poverty and microfinance by taking a closer look at the experience of Karachi-based clients.

C. (ii) Differentiation in the Karachi Sample:

Outreach in Karachi is second only to Lahore, with 135,426 active clients as of the fourth quarter of 2012. This is not surprising since it is Pakistan's largest city and its financial and economic hub. However, it remains a difficult city to operate in thank to its complex political economy, as detailed in the previous chapter.

First of all, violence and the increasing frequency of citywide strikes disrupt economic activity for both practitioners and clients. Secondly, while *bhatta* (extortion money) is not a big issue for clients, as will be detailed below, it can sometimes become a problem for the institutions. Even though no practitioner in Karachi admitted to giving bhatta, some of their counterparts in other cities said they shuddered at the thought of having to work in Karachi because of having to deal with the extortion mafia and the daily incidence of violence. It was also recently reported that Tameer Bank's mobile banking product Easy Paisa has been used by extortionists to transfer money (Ali, 2012).

Most clients insisted that they did not have to pay bhatta, especially because of the home-based nature of their work. A client from Manzoor colony, an MQM stronghold, who ran a barber shop said that he was bothered only once by bhatta seekers, but when he told them that business was slow they only asked for free haircuts and left. Another client who was hopeful of setting up a small shop at a local hospital said he was not worried about having to pay bhatta since he had political connections. But on the whole, these businesses are relatively small and do not fall under the radar of extortionists.

The 32 Karachi-based clients belonged to 12 neighborhoods from seven of the 18 towns across the city. Table 16 in the previous chapter describes the socio-economic indicators of five of these neighborhoods. These were not the poorest neighborhoods in the city, judging by the fact that nearly 100 percent of the homes in these neighborhoods were *pacca* homes. At the same time, they were not high-income neighborhoods either. In the words of Kashf Foundation's regional manager: "You will not find a single microfinance branch in a comfortable part of town".

The most impoverished neighborhoods covered in the sample were Pahar Ganj and Bhangi Para, from Karachi's District Central and Ibrahim Haidery, a poor fishing community, from District South. The least impoverished neighborhoods were Liaquatabad and Manzoor Colony.

Both Liaquatabad and Manzoor Colony are MQM strongholds, while Ibrahim Haidery, a

Sindhi majority area, has been loyal to the party that just completed its time in office, the Pakistan People's Party (PPP).

While heaps of garbage filled the narrow alleys in Ibrahim Haidery, which was lined on each side by crude "one-storey buildings of mud-brick or concrete" (Lieven, 2011: 317), Liaquatabad and Manzoor Colony were characterized by "tall, narrow and more-solid" (Lieven, 2011:318) apartment blocks. Liaqatuabad also had broad, freshly painted streets in contrast to the Awami National Party (ANP) controlled areas we had to pass in order to reach Liaquatabad. This contrast between MQM strongholds and parts of the city dominated by other ethnic political parties is consistent with findings reported by Lieven (2011) and others, as mentioned in the previous chapter.

Generally speaking, MFBs are located in less impoverished areas, as compared to MFIs, since MFBs target the lower middle classes and MFIs those at or below the poverty line, as detailed in Chapter 1. Tameer Bank for instance operates in Liaquatabad and Manzoor Colony, but does not maintain branches in Ibrahim Haidery, an area where several MFIs operate. Tameer Bank also does not in general draw clients from low-income settlements, such as Pahar Ganj and Bhangi Para, but MFIs such as Kashf Foundation and the Association for Social Advancement (ASA) do.

At the same time, most clients across the various neighborhoods covered in the sample had similar schooling and housing indicators (for details on socioeconomic outcomes across the client sample see chapter 3. For instance, clients from Ibrahim Haidery were as likely as clients from Liaquatabad to send their boys and girls to school and spend extra on after-school private tuition and homework help.

In terms of type of businesses too there does not seem to a be a systematic pattern, clients in one area are just as likely as those from another area to be owners of beauty parlors, sewing and tailoring shops. There were two exceptions: one was Shireen Jinnah colony where all the interviewed clients were involved in the same craft, that is, producing seashell jewelry. They had been engaged in this craft for generations and had taken a group loan from ASA. The other was the fishing community, Ibrahim Haidery, where all the women, except for the group leader, had taken loans for their families' fishing businesses. However, while these were two of the most impoverished communities included in the sample, Pahar Ganj was another area that was just as impoverished, but clients here were involved in different businesses, such as auto-mechanic workshops, embroidery and scrap dealerships.

There are several possibilities why a systematic pattern with regard to these indicators could not be established for this study. First of all, the sample only included 36 clients, which is a small number for an in-depth study, and a larger sample is required to confirm these initial results. Another reason could be selection bias, that is, borrowing households even in impoverished neighborhoods are likely to be more economically active and to have higher aspirations than non-borrower households, which would skew results. This can only be addressed by including non-borrowers in the sample in the next phase of the research.

But it is also true that surviving in the financial and economic capital of the country calls for a different dynamic and families here are more likely to have a higher standard of living, to emphasize schooling and to be more economically active, than those living in smaller towns and villages.

III. Conclusion

The findings from this study suggest that the trends in Pakistan's microfinance sector are broadly similar to what is occurring globally in microfinance. In Pakistan, as in elsewhere, microfinance is a market-based intervention, with little direct government involvement, except for the role played by the State Bank of Pakistan (SBP). The SBP has faithfully served the pro-market agenda, by playing an important role in moving the sector towards the financial mainstream.

Unfortunately, in its zeal to commercialize, microfinance has evolved away from what was originally envisioned as a participatory, poverty reducing and empowering intervention. In addition, there is evidence that not only is microfinance not employing the community's social capital effectively, it may even have damaged existing bonds of trust and engagement. The one exception to this is the MFI Akhuwat, which charges no interest on its loans and emphasizes to its officers the importance of social transformation quite persuasively. These findings corroborate existing studies conducted in other countries and regions that were reviewed in the previous chapter.

The study also suggests that seeking commercial success in microfinance is inconsistent with the participatory and capability enhancing mission of development. At the same time, one of the limitations of this study is that it is unable to comment on exactly what social mobilization and participation has been able to achieve in the past when it was an important component of microfinance operations. This area will be incorporated in the next phase of this research.

At the policy level there is inconsistency with regard to microfinance's mission. The PRSPs and the SBP make it clear that success in microfinance can only come through commercialization and rapid expansion, while the PPAF has introduced social accountability reforms, such as supporting outreach to the most deprived districts in the country. At the same time, the PPAF also lends support to the SBP's call for achieving financial sustainability. The most important reason for this is that there is no systematic analysis of the tradeoffs between commercialization and poverty reduction in the country. In terms of the impact of the political economy on the sector's outreach, the most adverse factor has been the conflict in KPK, Balochistan and Karachi. The recurring floods since 2010 have also significantly damaged the rural microcredit portfolio. Importantly, no real relief has been provided so far to the clients, either by the institutions themselves or by the SBP and the PPAF.

Day-to-day operations are affected by problems of corruption and patronage. Institutions have tried to address this issue by redesigning their products and lending methodologies, but on the whole, the sector continues to be relatively sheltered from the type of loan defaults that are common in the commercial banking sector.

Finally, while purdah or the segregation of the sexes poses some problems for outreach in villages and remote regions of Balochistan and KPK, it is less of an issue in cities such as Karachi and Lahore, where the bulk of microfinance activity is concentrated.

From the clients' perspective, the deteriorating security situation, power outages, rising inflation, unemployment and underemployment, and the recurrence of heavy flooding, have all contributed to squeezing profit margins and limiting benefits from access to formal credit. This may change in the future as micro-insurance products are developed, such as the weather-indexed microinsurance just introduced by the PPAF. At the same time, globally microinsurance take-up rates, especially in rural communities, have been notoriously low (Banerjee and Duflo, 2011) and if this is to be used as a predictor of the success of the Pakistani scheme then the results are likely to be disappointing.

Karachi, the city from which 67 percent of the client sample was drawn, has been the subject of special focus in this essay. Most Karachi-based clients in the sample complained of violence disrupting their lives, but appear to have found either a way to cope with the situation or are experiencing what Sen calls "entrenched deprivation". Karachi is the country's most well-developed city and the study finds that differences in the level of impoverishment of the lower-middle income or upper-poor neighborhoods from which most clients come from, do not result in significant differences between the educational outcomes of clients' children, their homeownership status (see chapter 3 for details) or the type of businesses that they are engaged in.

Since census data shows that the various neighborhoods covered in the sample are not the poorest neighborhoods in the city, it provides further evidence of the fact that microfinance does not target the poorest, and MFBs less so than MFIs. The data also suggests that there remain vast differences in terms of access to basic services, such as education and sanitation, between the different lower-middle class neighborhoods in Karachi. One possible reason for this are differences in ethnic composition, resulting in turf wars over the city's limited resources. This provides one explanation for the continued violence in the city. Thus, Karachi's inhabitants are not likely to experience relief in the near term from the security situation they are faced with and microfinance practitioners and clients have to take this as a given, unless a major political action is taken in this regard.

The obvious conclusion here is that the political economy has a significant impact on microfinance institutions' outreach, the strength of their portfolio, their day-to-day operations, and the wellbeing of their clients as well as the gains that can realistically be achieved with access to formal credit.

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CHAPTER 6

GENDER, DEVELOPMENT AND MICROFINANCE

Development until recently has been understood in terms of an increase in a country's pace of economic growth and from the perspective of a Southern country, of catching up to the advanced countries of Western Europe and North America (Rist, 2006). But ever since the 1990s, thanks to the work of economists Amartya Sen and Mahbub ul Haq and philosopher Martha Nussbaum our understanding, hopes and expectations regarding development have broadened considerably. We now see it as constituting a set of practices that increase the capacity of people to control their own lives (Murphy, 2006:30). This implies that the current definition of development is about individual wellbeing, which cannot be achieved through an increase in income alone.

Such a conceptualization points to the necessity of *change*, *choice* and *power* (Kulkarni, 2011), that is, a successful intervention is one that changes the status quo by increasing people's choices and giving them more power.

By this logic, underdevelopment is a state that requires change because it lacks in choice and power, at least for certain groups. One major source of underdevelopment is the persistence of inequalities between men and women. The United Nations (2009) estimates that despite the advances of the past 50 years or so, women still constitute 70 percent of the world's poor. Perhaps the most startling reminder of gender-based inequalities is what Amartya Sen (1990) has referred to as the "missing women" phenomenon. According to a World Bank (2011) estimate nearly 4 million “missing women” are added to the ranks each year as a result of excessive female mortality from self-selective abortions, early deaths of female infants, maternal mortality and women’s lack of access to adequate nutrition and healthcare (Duflo, 2012).

Correcting these inequalities is now widely accepted to be a major goal of development. This is not just because empowering those without choice and power is good for its own sake, but also because research shows that empowering women positively impacts other development indicators such as the health and educational outcomes of a population, which also leads to higher rates of economic growth (Duflo, 2012). Thus, it is not surprisingly that women’s empowerment has become an important policy goal (Ashraf et al, 2010).

As a development intervention microfinance appears to fit the bill quite neatly as it involves the extension of small sums of money to those that traditionally have not had access to formal financial services, especially poor women. Since more than 75 percent of the sector’s clients worldwide are women, this intervention specifically seeks to address gender based inequalities.

This chapter specifically analyzes the effectiveness of microfinance as a tool for women’s empowerment. The issue under question is the extent to which microfinance provides poor women in Pakistan with the capacity for *change, choice* and *power*. The data for this analysis will come mainly from the qualitative research detailed in chapter 3, but will also include the quarterly microfinance outreach data from the Pakistan Microfinance Network (PMN), described in chapter 2. The analysis will follow the pattern in chapters 2, 3 and 5 and will be comparative in nature. The discussion from the previous chapters should lead us to expect that microfinance institutions (MFIs) are more likely to focus on gender-based inequalities than MFBs, since the former are mainly registered NGOs and on average have a strong social mission while the latter are banking institutions under pressure to breakeven and produce profits.

At the same time, microfinance's growing popularity in the past two decades has led to increased commercialization, which has put pressure not just on MFBs but also on MFIs to consider microfinance a commercial rather than a charitable business, to reduce reliance on subsidies, become operationally more efficient and, at least in Pakistan, to revise their pricing structure upwards (Stephens et al 2006; Ministry of Finance Pakistan 2006). Nevertheless the comparative analysis can inform us of the extent to which institutional structure affects the way microfinance institutions focus on gender-based inequalities, in a country such as Pakistan. But we begin first with a general discussion on the state of gender inequality in Pakistan, which will then serve as a frame for the more specific analysis that is to follow.

Gender Inequality in Pakistan

The UNDP's Gender Inequality Index (GII) captures the multi-dimensional aspect of gender disparities across countries with rankings based on a 0 to 1 scale, higher values indicating higher levels of inequality. The index is based on reproductive health, educational attainment, parliamentary representation and labor force participation. Pakistan is a poor performer with a GII of 0.5733. While this is comparable to the GII's of other South Asian countries such as India, Bangladesh and Afghanistan, the only other region with GIIs that are worse than these countries' is sub-Saharan Africa (UNDP Human Development Report, 2011).

Educational achievement is an important component of gender-based inequality. In Pakistan the national literacy rate is 58 percent, but the female literacy rate is just 46 percent and in rural areas it is even lower at just 35 percent (Ministry of Finance, Pakistan, 2011). A national survey also indicates that two-thirds of ever-married women between the ages of 15-49 have never been to school at all. In rural areas, the proportion of women with no education rises to 76 percent (Pakistan Demographic and Health Survey (PDHS) 2006-07, 2007).

Another important component of gender inequality is maternal health. The same survey indicates that 65 percent of women deliver their babies at home and less than half receive postnatal care. As a result maternal mortality ratio is 276 per 100,000 live births, while regional levels can be much higher. For instance, the maternal mortality ratio for Balochistan is 786 per 100,000 live births. Pregnancy and childbirth result in 20.3 percent of female deaths in the country (PDHS 2006-07, 2007).

Gender inequalities also severely restrict women's access to productive resources and employment opportunities. For instance, women's participation in the labor market in Pakistan is just 22 percent. Of the women that do work, 42 percent are engaged in "marginal" activities and 31 percent in un-remunerated family businesses (Zuberi, 2011). But one of the most disturbing features of female disempowerment is the public and private violence against them. Pakistan, along with its neighbors Afghanistan and India, has the dubious honor of being one of the five most dangerous countries in the world for women and the United Nations estimates that every three minutes an act of violence is committed against a woman in South Asia (Bhalla, 2011).

Private violence includes the killing, burning and maiming of women by household members, while public violence includes rape ordered by tribal leaders, public shaming, acid-attacks, stoning and burying alive (Shah, 2011; Dawn, 2011). In 2011 alone 8539 cases of violence against women were reported, but the great majority of incidents are left unreported for violence against women is considered a "private matter". Women are also hesitant to speak out for fear of humiliation and further violence (Azhar and Hadi, 2012).

The most obviously pertinent aspects of the pervasive gender inequality in Pakistan for microcredit is unequal access to productive assets and low rates of economic participation. Access to credit is expected to expand women's economic opportunities as well as their access to entrepreneurial assets (Wright et al, 1999).

But is microfinance really an effective pathway out of poverty and disempowerment for women? The evidence on this is increasingly mixed (e.g. Karim, 2011; Kabeer, 2005; Guerin and Palier, 2005). This paper analyzes Pakistan's experience with microfinance in relation to women's empowerment, with special reference to differences in institutional structure within the sector. Section I below reviews existing research on the relationship between gender, development and microfinance. Section II presents the quantitative and qualitative findings of the study, and Section III concludes with an analysis of these findings.

I. Literature Review

The two main aspects of the empowerment literature related to women and microfinance are reviewed in this section. The first sub-section delves into the scholarship that links development and empowerment, while the second discusses the specific relationship between microfinance and empowerment.

I.A. Development and Empowerment

The 2012 World Development Report, published by the World Bank, begins with the statement: “Gender equality is a core development objective in its own right. It is also smart economics.” The improvement of gender-based imbalances is expected to increase economic productivity and help achieve better nutritional, health and educational outcomes at the household level, which is why an increased focus on gender is now considered “smart economics” by the IFIs.

The capability approach (1999), reviewed in chapters 1 and 3, views development as a process of expansion of individual freedom, and this has been instrumental in moving the debate on gender and development forward (Fukuda-Parr, 2003). Global development institutions, such as the United Nations and the World Bank, now agree that giving women equal access to the benefits and opportunities that development has to offer is part of their core mission (World Bank, 2011; United Nations, 2009). Broadly translated, this means that removing existing gender inequalities has to be a deliberate part of the process of inclusive development (United Nations Development Programme (UNDP), 2013).

But this global emphasis on gender is a fairly new phenomenon. Women have been largely absent from mainstream development discourse until quite recently (Murphy, 2006: 201). In fact, it was not until the 1980s that women became the “visible” clients of development (Moser, 1993).

Historically, the Danish economist, Ester Boserup’s study *Women’s Role in Economic Development* (1970) was one of the early works that brought to light the central role women play in the economy. Her study was influential in moving the United Nations (UN) to declare 1975-85 as the first UN Decade for Women (Kanji, 2003). Following this, the UN became the first global institution to pay close attention to women’s productive labor and their integration into the economy as a means of improving their status (Kanji, 2003).

It was also the UN that persuaded all 189 of its member countries to agree to focus on eight global development goals in the year 2000, referred to as the Millennium Development Goals (MDGs). The MDGs require a serious effort to improve gender-based inequalities on multiple fronts, including health and education (Murphy, 2006: 201). In fact, Kofi Annan, a past Secretary General of the UN, argues that achieving gender equality is a prerequisite for meeting all other MDGs (United Nations, 2005).

A few years after the UN’s recognition of women’s role in development, the World Bank responded to the call by women’s movements to recognize their continued economic, social and political exclusion. The marker for this was a 1997 speech titled “The Challenge of Inclusion” by World Bank president James Wolfensohn, in which he specifically recognized the importance of including women in development (Bergeson, 2003).

Following this, the World Bank published a report titled “Engendering Development” in 2001. The report echoed the UN’s stance on gender and development using a rights-based approach (Murphy, 2006) and called for policies that would redress the imbalance in "rights, resources and voice" (Duflo, 2012; World Bank, 2001). The report is significant for it talks about addressing gender imbalance both as a social justice issue and as a means of accelerating overall development.

Whether the World Bank has followed this narrative up with the same emphasis in actual practice is subject to a heated debate (Bergeson, 2003). But what we turn to now is a deeper analysis of the relationship between gender and development. Does empowerment follow development or is it development that follows empowerment? Scholars usually argue for one of these two positions (Duflo, 2012).

I.A (i) Gender and Development – Where Does Causality Lie?

Research suggests that overall economic development plays a major role in reducing gender inequality (World Bank, 2011). On the flip side, interventions that specifically aim to empower women by improving their access to the constituents of development such as health, education and labor market opportunities, have also shown impact on overall economic development (Duflo, 2012).

The traditional view in development has been that reductions in overall poverty result in lowering gender-based inequalities. This is also the view most often associated with institutions such as the World Bank. For instance, the 2012 World Development Report states that gender gaps in primary education have closed, women's life expectancy has outpaced men's, and over half a billion women have joined the global labor force. The Bank contends that this is a direct result of the economic growth experienced across the global South in the past 30 years. The report goes on to stipulate that economic growth will only reduce inequalities where markets and institutions are well functioning and the winds of change brought on by globalization are allowed to penetrate through traditionally subversive cultural norms (2011), which is a controversial claim as pointed out by several prominent scholars (Bergeson, 2003; Nussbaum, 2003).

On the other hand, it is hard to dispute that where the incidence of poverty is higher, gender inequality is more pronounced and poor women experience more disempowerment than non-poor women (Moghadem, 2005; Kabeer, 2005). For instance, female children in Southern countries experience discrimination within the household, but this is usually more pointed when households are poor (Duflo, 2012). Khanna et al (2003) also find that girls are twice as likely to die as boys of diarrhea in the poor neighborhoods of New Delhi, India. Similarly, the condition of public schools for girls in the remote areas of Balochistan, Pakistan's poorest province is so decrepit that many parents have stopped sending their daughters to school altogether (Murtaza, 2012).

In India and Pakistan, gender inequalities are made worse by income inequalities, so that while school participation rates for boys and girls are roughly the same for the top income quintile, the gender gap rises to nearly 5 years for the lowest income quintile (World Bank, 2011). It follows from this discussion that as the incidence of poverty goes down, gender inequality too is likely to improve.

This was exactly the experience in India as the country began to experience a boom brought on by information technology jobs outsourced from the West. This boom led to a rise in demand for educated girls, which in turn increased not only the demand for girls' education as parents suddenly saw real benefit from educating their girls, but also reduced the proportion of underweight girls in the area (Bannerjee and Duflo, 2011).

Similarly, there is evidence that fertility rates decline when the opportunity cost to women's time increases, through the expansion of their economic opportunities (Goldin, 2006; Jensen, 2010).

But research does suggest that the impact of economic growth on gender inequality tends to vary considerably depending on the type of intervention as well as the measure of inequality used in the analysis. For instance, economic growth resulting from the privatization of public services or export led growth can increase rather than decrease gender inequality (Berik and Rogers, 2008). Similarly, there is no apparent relationship between growth and empowerment, when empowerment is measured in terms of life expectancy, maternal mortality or participation in economic and political decision-making (United Nations, 2009).

In addition, despite the rapid economic growth experienced by India and China the problem of missing girls remains acute. In fact, in China the situation has deteriorated overtime, with the female sex ratio worsening from 53 percent of boys to 57 percent of boys among all reported births during the 1990s (World Bank, 2011).

In the same vein, it is argued that growth-promoting policies can sometimes have a negative impact on women's empowerment because the forces that give rise to affluence are not necessarily gender neutral (Kabeer, 2012). The World Economic Forum's 2011 Global Gender Gap Report states that Saudi Arabia with a per-capita income of $16,423 ranks 131th out of 135 countries, while Ghana with a per capita income of only $1,319 ranks 70th.

But turning to the reverse relationship between women's empowerment and development, a growing body of evidence based on field experiments, household surveys, national and cross-national data, indicates that the relationship between empowerment and development is much more robust than the relationship between development and empowerment (United Nations, 2009; Mehra, 1997).

For instance, studies find that educational expansion for women and girls is directly related to higher rates of economic growth, particularly in countries of the South (Klasen, 2002; Benavot, 1989). Breierova and Duflo (2004) find that in Indonesian households where women are more highly educated there are likely to be fewer children. They also find that child mortality is positively correlated to the mother's level of education.

In addition, there is a large empirical literature on the differential impacts of income in the hands of women versus men. Broadly speaking these studies show that income and other productive assets controlled by women are associated with larger improvements in child health outcomes, household nutrition and housing (Duflo, 2003; Thomas, 1990; Thomas, 1993).

All this means that there are multiple pathways through which rising gender equality improves the human capital potential of an economy. This is exactly why microcredit has been considered such an important tool for empowering women. Providing women with access to formal credit is expected to increase their economic opportunities and this, as the World Bank puts it, is "smart economics", that is, not only does it reduce gender-based inequalities it also results in higher levels of economic development. The section below briefly reviews the gendered literature on microfinance.

I.B Conceptualizing Empowerment in Relation to Microfinance

The earliest scholarship on the subject of microcredit undisputedly established it as a pathway out of poverty not just for women but also for the entire household because women as opposed to men are more likely to share their increase in fortune with others (Ackerly, 1995). By increasing their economic opportunities, microcredit was also expected to enhance women's agency both within the household and in the wider community (Cheston and Kuhn, 2002). But early research on the subject assumed that outreach and empowerment was automatically related.

However, by the turn of the century the relationship between microfinance and empowerment began to receive increased scrutiny (Garikipati, 2011; Mayoux and Harti, 2009). We are at a point now where there is no consensus among scholars regarding the actual impact of microfinance on women's empowerment. Kulkarni (2011) contends that the major points of debate are more or less related to the definition and measurement of women's empowerment.

Broadly speaking, in recent years most definitions of empowerment have converged on the idea of *change, choice* and *power*. For instance, both the World Bank (2001) and the United Nations Development Fund for Women (UNIFEM) (2000) define empowerment as a process that enhances choices for women. So where does the disagreement lie?

It has been argued that the existing scholarship on the subject is divided between those that look at empowerment as a *process* and those that view it as an *outcome* (Garikipati, 2011; Kabeer 2001). Garikipati (2011) contends that there has been a traditional emphasis on outcome-related indicators, without a commensurate understanding of the processes that lead to the stated outcomes.

Outcome-related indicators would include measures such as the repayment rate, the percentage of women served and whether or not women are able to take control of their own loans. Kabeer (2001) and Garikipati (2011) argue that it is the processes surrounding these outcomes that should be considered when determining whether or not empowerment has occurred. The discussion below is based on a review of the literature on microfinance and empowerment, broadly segmented into what Kabeer and Garikipati would say are outcome-based studies and process-based studies.

I.B. (i) Empowerment as an Outcome

The most popular measure of success in microcredit has traditionally been the repayment rate. Muhammad Yunus, the founder of the Grameen Bank, one of the most prominent microcredit institutions in South Asia and arguably the world, reported repayment rates as high as 95 percent when he began lending to women in Bangladesh in the late seventies (Yunus and Jolis, 1998). Other studies corroborated his findings (e.g. Aghion and Morduch, 2000; Lapenu and Zeller, 2001). High repayment rates have been used as a proxy for client satisfaction and empowerment, since it is assumed that on-time repayments are a result of effective financial management and successful business practice (Khandker, et al, 1995).

Recent studies, however, paint a more complex picture. For instance, Armendariz and Morduch (2010) provide three explanations for the high repayment rates for female borrowers: women have a higher incentive to repay since they have less access to credit and the labor market than men; women are poorer than men which means that their return on capital is higher so the loan is invested more efficiently; and women are less mobile and easier to monitor than men and tend to place more importance on the social sanctions brought on by defaulting on a loan.

These results are corroborated by others who find that high repayment rates by female borrowers are not as much a result of their economic independence and success as they are a consequence of their lack of choices (Kabeer, 2000) and the threat of “losing face” in the community (Karim, 2011).

A more recent indicator, used specifically in studies of microcredit in South Asia, is related to control of the loan. There is evidence that a good proportion of women lack control or even knowledge of how the loans taken out in their names are used (Chowdhury, 2009; Goetz and Gupta, 1994). For instance, Haq and Safavian (2012) find that beween 50 to 70 percent of female borrowers in Pakistan hand their loans over to male relatives. They also find that when existing male borrowers are unable to take out additional loans they force their wives to borrow on their behalf. Bernasek (2003) in her study of Grameen Bank borrowers finds that even when women initially have control over their loans, overtime they may lose that privilege. This implies that when men are intentionally excluded from the benefits of an intervention, especially one where an important resource such as access to finance is concerned, the results will not be as empowering to women as hoped for.

A complicating factor is that women are not a homogenous group (Kabeer, 2000). They play more than one role and enjoy different statuses at different points in their lives (Rogaly, 1996). For instance, if empowerment is measured as female control over the loan, it may appear positive when the mother-in-law of the female borrower assumes control over the loan even though from the point of view of the beneficiary there has been no improvement in status.

On the other hand, Kabeer (2001) argues that the fact that women are more likely to share their loans with the men in their family strengthens the argument for lending to women as the entire family benefits from such a lending arrangement. In contrast, when men are the direct recipients of loans, they can be expected to prevent their wives from having any share in the income generating activities of the household.

But microcredit has also been shown to cause overwork, fatigue, stress and even malnutrition, especially when women's market access does not expand in line with their access to microcredit. This is often because their other household responsibilities do not lessen when they become employed in businesses within and outside their homes (Ackerly, 1995).

Some studies have also looked at patterns of domestic violence in relation to microcredit. Goez and Gupta (1994) find that violence against women can escalate when women either delay or fail to access credit. Other studies from Bangladesh have corroborated this by indicating that there is an associated increase in the incidence of domestic violence among beneficiary households (Ahmed, 2005; Rahman, 2001). But a South African study finds that intimate partner violence reduces by more than half after a two-year microfinance intervention (Kim, et al, 2007).

Using a separate set of outcome-related indicators Pitt, Khandker and Cartwright (2006) find that microcredit programs in Bangladesh provide women with a greater role in household decision-making, increased access to financial resources, expanded social networks, more bargaining power vis-à-vis the husband and greater freedom of mobility.

Hashemi, Schuler and Riley (1996) come to a similar conclusion when they compare empowerment-related outcomes from participating and non-participating villages. Ashraf et al (2010) also find that as a result of access to an individually held savings product women's decision-making power increases within the household.

Using a broad range of indicators including income, ownership of assets, education and health related outcomes as well as agency within the household, Zaidi et. al.'s survey (2007) finds that access to microcredit decreases rather than increases women's empowerment in comparison to non-borrowers in Pakistan.

There is, therefore, no consistent message at least from the studies that employ outcome-related indicators, regarding microfinance's impact on women's empowerment.

I.B. (ii) Empowerment as a Process

Kabeer (2001) and Garikipati (2011) are right that a study of outcomes without considering the processes that lead to these is meaningless, but their definition of empowerment does not include the lending arrangement itself. Empowerment is usually measured after loan disbursal, but the lending arrangement itself has the potential to affect the processes and outcomes of women's experience with microfinance.

For instance, Agier and Szafarz (2013) in a study on Brazilian microfinance find that while there is no gender-bias in loan denial, women do experience disparate treatment with regard to credit conditions. They find that women's loans are subject to a "glass ceiling" effect and that the gender gap in loan size increases disproportionately with respect to the scale of the borrower's business.

The original lending arrangement promoted by the Grameen Bank and adopted the world over, as a best practices model is group lending. Group lending involves the simultaneous disbursement and collection of loans from a group of borrowers, usually women, who belong to the same community. Since the loan is un-collateralized, the community's social capital is used to ensure timely repayments. Social capital is a community's network of relationships and bonds of trust upon which all non-economic and *informal* economic activity is based. In this particular arrangement, members guarantee each other's loans and in case of delinquency, other members of the group contribute towards the missing payment. Groups are based on trust and members strive to maintain "group solidarity" since continued eligibility for future loans depends on the group's repayment performance (Khandker, 2012).

Loans can also be sequenced so that a few group members receive their loans first and complete repayment before others within the group become eligible for their loans (Bernasek, 2003). In both versions there is strong social pressure on individuals to follow the repayment schedule (Stiglitz, 1990; Wydick, 1999). Thus, it is said that this arrangement replaces financial collateral with social collateral (Ito, 2003).

Early research on the subject provides a rich narrative on how group lending empowers women by creating a support network and peer mentoring among members, especially as the transactions are usually conducted without the intermediation of men (Hashemi, Schuler and Riley, 1996; Bernasek and Stanfield, 1997, Bernasek, 2003) which is especially significant in South Asia where women are seen as the life long dependents of men (Kabeer, Huda, and Kaur, 2012).

Also, as group lending requires attendance at regular meetings, women who might otherwise be socially isolated, are able to defend their attendance as a social and household level obligation. Thus, attendance at such meetings is said to have an intrinsic value of its own (Johnson and Rogaly, 1997) and Osmani (2007) refers to this as empowerment through *mingling*.

On the other hand, in her ethnographic account of women debtors in Bangladesh Karim (2011) provides a detailed account of community-level violence against women debtors. She describes how loan officers threaten delinquents with public humiliation, flogging, breaking into their homes with other community members to confiscate beds, pots, pans and other household items.

The Andhra Pradesh suicides in late 2010 exposed the practices of Indian microfinance institutions to the world. Overindebteded borrowers were driven to take their own lives by drinking pesticides, jumping in a pool or by other means when told by loan officers that only in death would debts be forgiven (Kinetz, 2012). Several officers were implicated for the aggressive and threatening ways in which they tried to exact repayment (Biswas, 2010). Considering the evidence against group lending, Roodman (2012: 178) contends that individual lending is more empowering than group lending.

Moving on to actual loan use, Mahmud (2003) finds that while microcredit has a limited impact on women's access to choice-enhancing resources it does have a powerful effect on women's ability to influence household decisions. But others are more critical. For instance, one study finds that becoming the primary beneficiaries of a microcredit program does little to increase women's inclusion within the household's cash management (Montgomery, Bhattacharya, and Hulme, 1996). Garikipati (2011) in her review of Indian microfinance finds that when women's loans are used for productive assets the process is disempowering to them, since they lack co-ownership of the household's productive assets.

At the same time, women's autonomy varies, often between regions in the same country (Lieven, 2011; Rahman and Rao, 2005; Basu, 1992) or by households within the same community (Gine et al, 2012) and where autonomy is higher at the baseline we can expect better empowerment related outcomes from the intervention.

It is important to note though that even when women are able to set up small businesses through microfinance, these businesses are usually part of the informal home-based sector (Bernasek, 2003). Research suggests that poor women in developing countries, especially in South and East Asia, are mostly engaged in informal home-based work (Doanne, 2007). The following section reviews the nature of women's businesses.

Informal Home-Based Work

The informal sector is characterized by low productivity mainly because of low capital-to-labor ratios, unstable business conditions, lack of social security benefits and no possibility of unionizing for better wage and working conditions (Todaro and Smith, 2012: 333; Bernasek, 2003).

Similarly, home-based work is considered a peripheral economic activity (Zuberi, 2011). It is largely unaccounted for by economic data but a rough estimate puts the number of home-based workers at 50 million in South Asia alone, over 80 percent of whom are women (HomeNet South Asia, 2006). The compensation is piece-rate and the work is often subcontracted through a middleman. Doanne (2007) describes home-based women workers as being at the bottom of the value-chain. Their income is considered supplemental for the household but more often than not they are unpaid workers in the family business.

At the same time, home-based work offers an opportunity to escape the harsh urban realities of many Southern countries, particularly South Asia. Women in contemporary Pakistani cities such as Karachi and Lahore, especially "working-class" women, face everyday social and physical violence. Public spaces such as the factories where they are employed, the public transport they use to get to work, the narrow alleys they negotiate when they leave their homes, expose them to constant sexual and social threats (Ali, 2012; Lieven, 2011).

Home-based work is also an important income diversification strategy. There is a growing literature on how poor households diversify their income. While most of it is focused on rural households and diversification into non-farm activities (e.g. Minot et. al, 2006; Karugia et. al, 2006), there are broad lessons that can be taken from this scholarship. For instance, studies have found that households with multiple sources of income are less likely to suffer from hunger (DeRose, 1998). But research also suggests that the greater the level of household poverty the higher the level of income diversification (Malunda, 2011).

Most importantly, income diversification can have both positive and negative effects. The positives are related to a reduced level of income risk from diversification. It appears that income diversification smoothens both income and consumption patterns in poor households (Dunford, 2012). At the same time, it is often found that when households diversify into too many low-return activities in order to mitigate income risk the result is not necessarily poverty reducing (Malunda, 2011). This is especially true when you consider the low remuneration capacity of informal home-based work.

Thus, empowerment is a complex topic for there is no real agreement on its exact relationship with overall economic development or even how it should be defined and measured. Further, there are several pros and cons associated with increasing women's economic participation through microcredit schemes. These conclusions set the context for the findings from this study. The section below presents key results from the qualitative and quantitative data analysis related to microfinance and women's empowerment in Pakistan.

II. Research Questions and Empirical Findings

The main questions with regard to microfinance and women's empowerment in Pakistan that this study addresses are: (a) To what extent does microfinance offer women in Pakistan the possibility of *change*, increased *choice* and *power*?, and (b) Does one institutional model in Pakistan's microfinance sector have a more empowering impact on women than the other?

The following analysis is based on the qualitative data described in chapter 3, as well as the quantitative data on microfinance outreach described in chapter 2. Empowerment is measured using a mix of outcome and process indicators. Outcome indicators include the following quantitative indicators: number of microborrowers by gender, gross loan portfolio by gender, average loan size by gender, number of savers by gender, and total savings by gender.

Other outcome indicators include control and use of women's loans, incidence of home-based work and extent of income diversification. Process indicators include an analysis of the dominant lending arrangements in Pakistan's urban microfinance sector and the potential impact of recent innovations in the microfinance product portfolio, particularly the gold backed loan.

The trend analysis presented below is part of the outcome-related discussion, while the qualitative findings in the next sub-section include both outcome and process-level indicators of empowerment. Both set of indicators are analyzed using the framework of *change, choice* and *power* proposed by Kulkarni (2011).

II.A. Comparative Analysis of Institutional Data

This section compares the gender profiles of MFI and MFB borrowers. Microcredit portfolio trends are presented first, followed by the trends in savings.

II.A. (i) **Microcredit**

While 75 percent of global microborrowers happen to be women (Reed, 2011), in Pakistan women represent only 57 percent of the total number of microborrowers and account for only 43 percent of the total gross loan portfolio (MicroWatch, 2013). In addition, while 80 percent of MFI borrowers are women, only 25 percent of the MFB borrower group is female. Thus, the gender targets of both groups are quite different from each other.

Chapters 1 and 3 describe the phenomenon of MFI transformations into standalone MFBs. In the Pakistani microfinance sector there are currently three MFBs that were once part of a traditional MFI, namely the Aga Khan Rural Support Network (AKRSP), the National Rural Support Programme (NRSP) and Kashf Foundation. Of these the two most recent spinoffs, that is, NRSP Bank and Kashf Bank, have originated from MFIs that lend primarily to women, but after the spinoff these newly created MFBs have reversed their gender-based lending targets. More than 90 percent of the borrowers at both MFBs are male as of the last quarter of 2012 (PMN dataset).

Figure 1 describes the borrower by gender trend since 2006. It is clear that overtime the female borrowers of MFIs have risen to account for the largest proportion of total borrowers, while the female borrowers of MFBs account for the lowest share of the market. Moreover, the rate of increase in female borrowers at MFIs has been much higher than the rate of increase in female borrowers at MFBs, which has resulted in an increasing divergence between the two groups.

Figure 16 Total Number of Borrowers by Gender and Institution

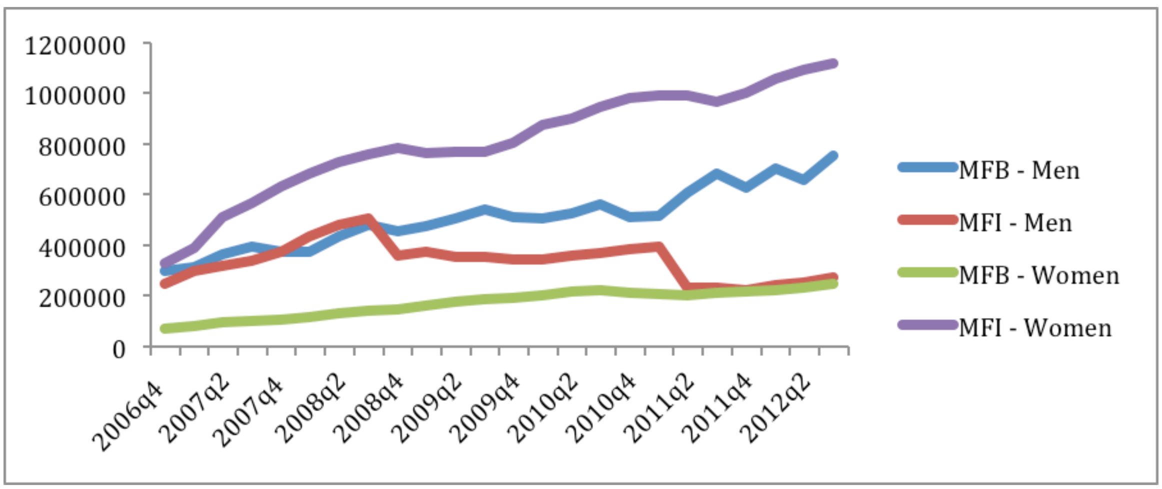


Figure 2 describes trends in the gross microcredit loan portfolio by gender from the second quarter of 2009 to third quarter of 2012. The trend indicates that over time the portfolio accounted for by the male borrowers of MFBs has overtaken the portfolio accounted for by the female borrowers of MFIs as the biggest component of the sector's total loan portfolio. Once again the lowest share of the portfolio is accounted for by the female borrowers of MFBs, followed by the male borrowers of MFIs.

Figure 17 Gross Loan Portfolio by Gender and Institution - Millions of US$[25]

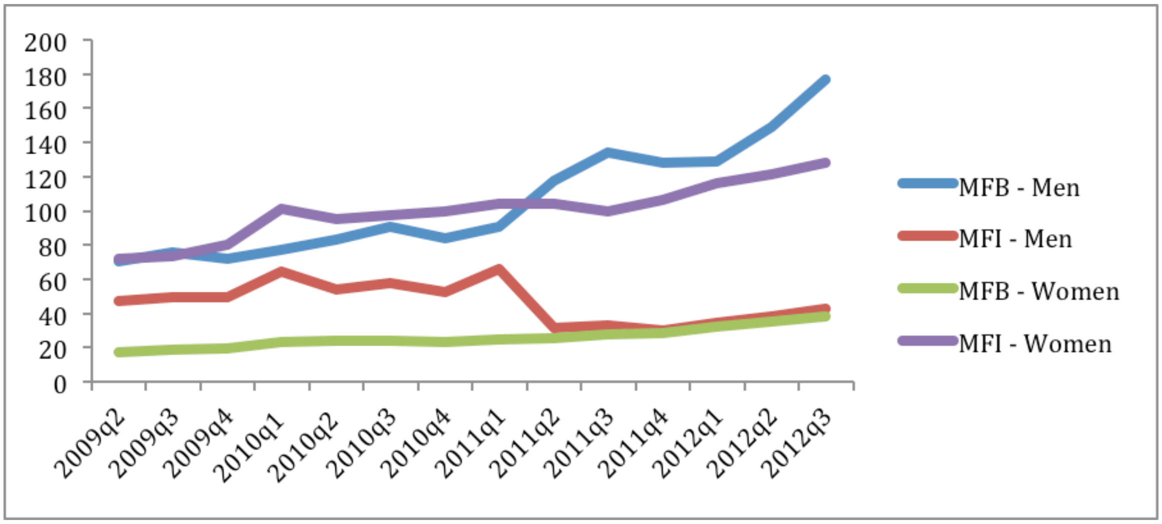


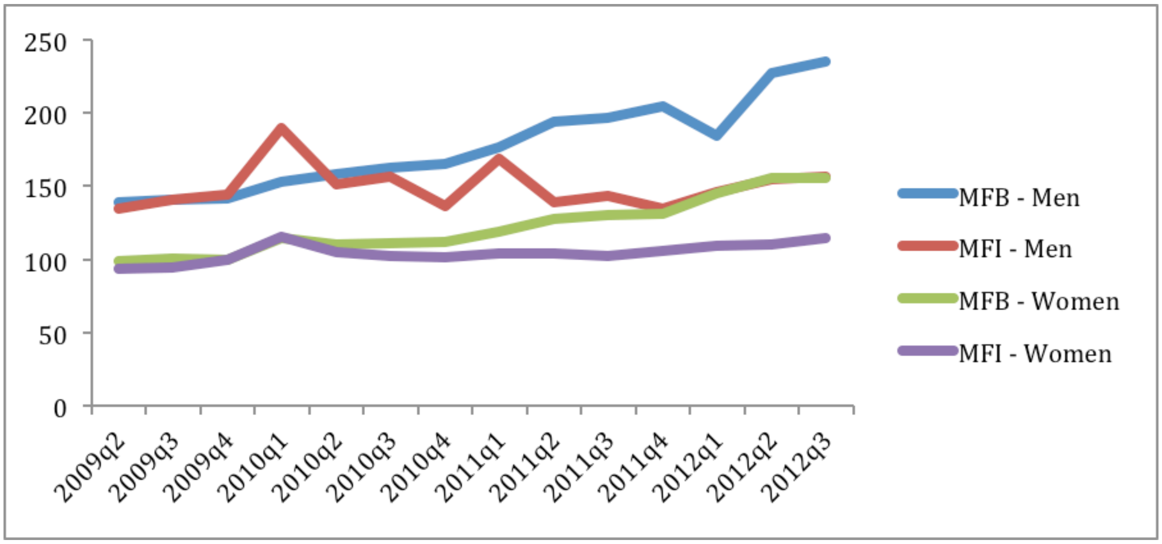
Figure 3 presents the trend in average loan size, which is simply the gross loan portfolio divided by the total number of borrowers in each category. In 2009 when the data on loan portfolios first became available, both MFIs and MFBs offered loans of nearly equal size to each gender. At this time, the average loan for men was approximately US$40 higher than for women for the sector as a whole. As mentioned in the literature review, Agier and Szafarz (2013) found a similar gender gap between the average loan sizes of men and women in Brazil.

However, in the case of the Pakistani microfinance sector the trend in the average loan size by gender takes an interesting turn by the end of the data series in 2012. Figure 3 indicates that while the intra-institution gender gap remains significant overtime, the

[25] US$1=Pakistani Rupees (Rs.) 98.19 as of March 1, 2013

inter-institution gender gap closes almost completely in the case of the female borrowers of MFBs and the male borrowers of MFIs. On the other hand, the gap between male borrowers of MFBs and female borrowers of MFIs has grown rapidly over time, as MFB loan sizes have rapidly increased and MFI loan sizes have continued to remain low.

Figure 18 Average Loan Size by Gender and Institution - US$[26]



What could account for the narrowing of the gap between MFB female borrowers and MFI male borrowers? One factor is the difference in the overall socioeconomic status of MFI and MFB borrowers. MFBs in Pakistan tend to target higher income borrowers, that is, usually those living above the poverty line, while MFIs on average target those below the poverty line. This is a policy driven segmentation (see chapter 3 for details). The implication of the trend observed in Figure 3, however, is that higher income women are comparable, at least in terms of loan size, to lower income men.

One reason for this is that MFBs have stepped up individual lending, as shown in Figure 9 in the section on lending arrangements. Studies indicate that individual loan sizes are

[26] US$1=Rs98.19 as of March 1, 2013

higher than group loans (Lehner, 2009). This is true in Pakistan, where the average group loan for the fourth quarter of 2012 was US$ 135.08[27] while the average individual loan for the same period was US$340.57, which means that the average individual loan is more than twice the average group loan. The trends in Figure 3 make sense for a higher proportion of MFB clients have individual loans, relative to MFI clients. In fact, had there been no gender dynamics at play we would expect both male *and* female MFB clients to have higher average loans than MFI clients.

Interestingly, comparing Figures 1 and 3 we can see that the highest number of borrowers in the sector belongs to the MFI female borrower group, but the lowest loan sizes are also associated with the same group. This has several implications. One is that the female borrowers of MFIs belong to the lowest socioeconomic category since loan sizes are directly proportional to income, as described by MFI and MFB practitioners during interviews, observed during the loan verification process prior to disbursal and detailed in the literature review in chapter 2.

But loan size is also dependent on institutional policy and the particular lending arrangement. Research indicates that group loans are on average lower than individual loans and group lending lends itself particularly well to female rather than male borrowers (Isserles, 2003).

Apart from microcredit, which constitutes the largest component of the microfinance product line in Pakistan, the sector also offer savings products to clients and the wider public. The section below reviews the trends in the savings data.

[27] Rs.100=US$1 as of June 1, 2013

II.A. (ii) Savings

The term microsavings refers to the small denomination savings of poor households. However, the savings data in the PMN database, from which the trend analysis in Figure 4 is extracted, is not exclusively microsavings data. This is because MFBs mobilize deposits not just from their clients but also from the public at large. MFBs compete with local commercial banks for attracting deposits and MFBs such as Tameer Bank offer returns on deposits higher than what most commercial banks offer in order to compete in a market traditionally served by commercial banks (interview Development Director Tameer Bank, 2012). While these savings products are also offered to microfinance clients, they cannot be called "microsavings", because they are neither necessarily small in denomination nor are the borrowers necessarily poor or even near poor.

MFIs, on the other hand, cannot use savings as a funding source and only collect small denomination savings from their own clients or the communities they serve in. Thus, their savings data is truly microsavings data. At the same time, microsavings collected by the MFIs are not necessarily voluntary savings as described in chapter 1, since MFIs such as NRSP ask borrowers to place 10 percent of the loan proceeds in a savings account as a precaution against default. This also means that to a great extent borrowers and savers are the same individuals in the MFI group.

Figure 4 below indicates that savings in the microfinance sector were until recently mainly the domain of the MFIs. However, in the past two years the number of male savers at MFBs has increased dramatically, thanks mainly to the deposit mobilization initiatives introduced by the SBP (State Bank of Pakistan, 2011). By the third quarter of 2012, the number of MFB male savers had overtaken the number of both male and female MFI savers. The number of female savers at MFBs though rising remains significantly low, compared to the other three groups.

Figure 19 Number of Savers by Gender and Institution

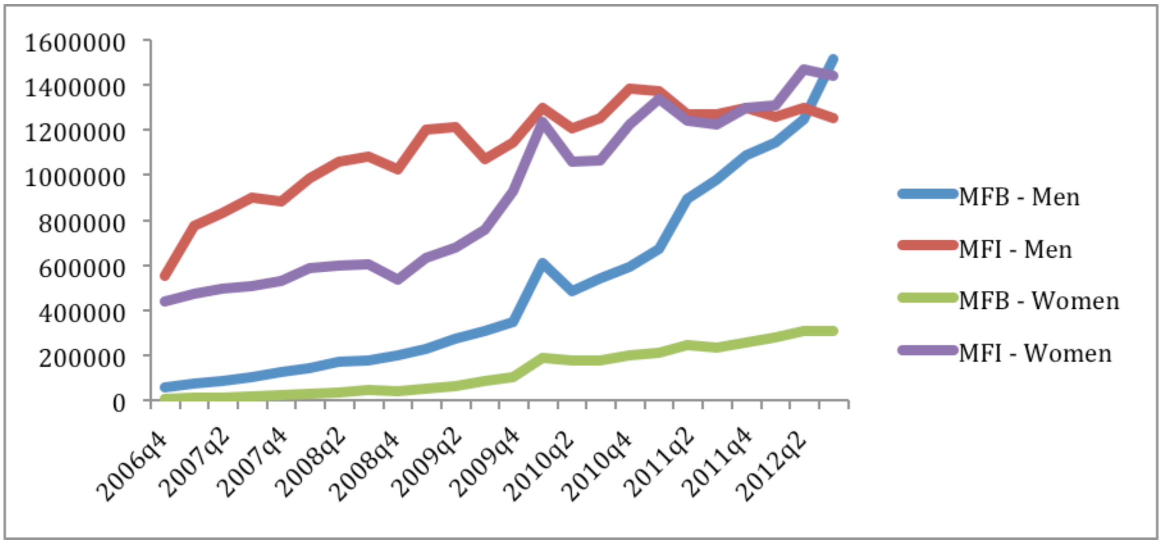
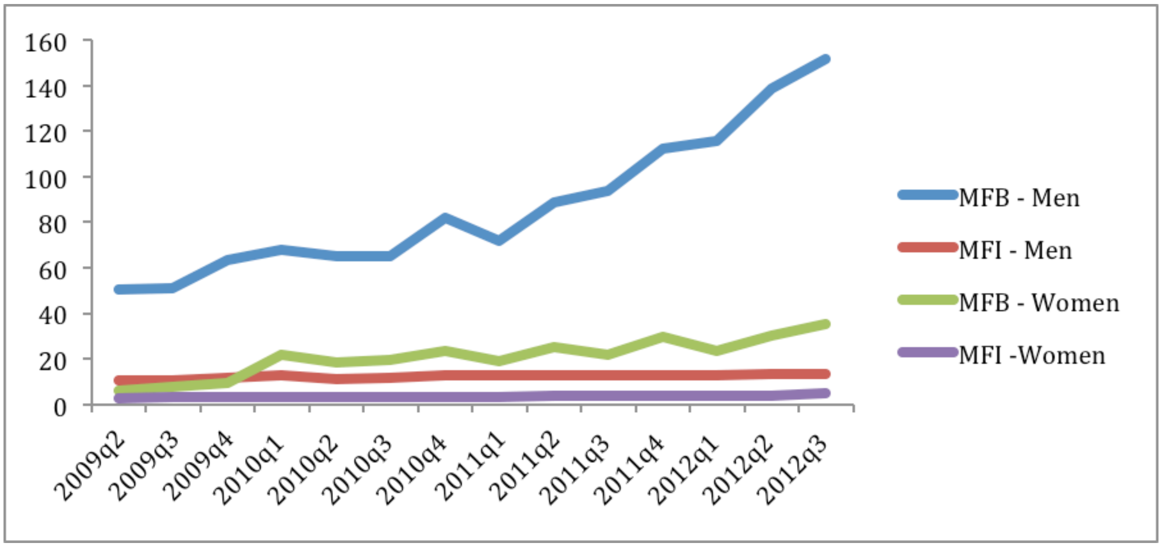


Figure 5 provides the trend in total savings in millions of US$. The picture here is very different. It is clear that since the beginning of the series, that is, the second quarter of 2009, total savings by the male clients of MFBs have been significantly higher than those of all other categories of savers. The value of female savers at MFBs is also higher than those of MFI savers. This clearly shows that while MFI savings are the microsavings of poor households, MFB savings are much higher in value and cannot be considered microsavings. Since we assume that savings are directly proportional to income, this also implies that the socioeconomic backgrounds of MFI and MFB savers are quite different. Here again, we see that in terms of total savings, the female savers of MFBs account for a higher value of savings than the male savers of MFIs. But as we saw with the microcredit data, comparing the gender profiles of MFB and MFI savers is like comparing bats and bees as the socioeconomic status of the two groups differ significantly.

Figure 20 Amount of Savings by Gender and Institution – In US$ Millions[28]



Overall, the quantitative empowerment related outcome indicators suggest that while MFIs target female borrowers and savers, MFBs do not. However, this type of quantitative data paints only a partial picture and at this point we cannot effectively predict the impact of microfinance on women employing the framework of *change*, *choice* and *power*. This is because the literature reviewed in Section I presents an inconsistent message regarding access to microfinance and women's empowerment. We, therefore, need to supplement analysis of the quantitative data with the study's qualitative findings, in order to develop a more nuanced understanding of what this implies for women's empowerment.

II.B. Gender and the Mechanics of Microfinance

The study's qualitative research findings are presented in the following categories: control and use of loans, lending arrangements, and lending against gold. As discussed in Section I, control and use of loans is often considered an outcome indicator. Additionally,

[28] US$1=Rs98.19 as of March 1, 2013

I analyze the lending arrangement, as a process-related indicator. I also consider interview data on the impact microfinance has had on women's agency both within and outside the household. Finally, I analyze the rising popularity of gold-backed loans in the microfinance sector.

II.B. (i) Control and Use of Women's Loans

Analysis of PMN data suggests that as of the fourth quarter of 2012, the ratio of female borrowers to total borrowers did not exceed 33 percent at any MFB, except for Apna Microfinance Bank, which is a small MFB with a branch network limited to the city of Karachi. On the other hand, during the same period, the average MFI ratio of female to total borrowers exceeded 75 percent. In fact, most prominent MFIs such as Kashf Foundation, Bangladesh Rural Advancement Committee (BRAC), Association for Social Advancement (ASA) and NRSP lend primarily to women. But the literature reviewed in Section I indicates that when it comes to women, access does not automatically mean control.

During interviewees, practitioners from all 8 MFIs in the sample admitted that male relatives used the majority of the loans provided to women. The loan verification form used by these institutions includes a section on loan usage and the borrower is asked to put down the name of the household member who will eventually assume control over the loan, even though the loan remain on the female's name in the loan book. Thus, the institution is a complicit part of this type of loan usage arrangement.

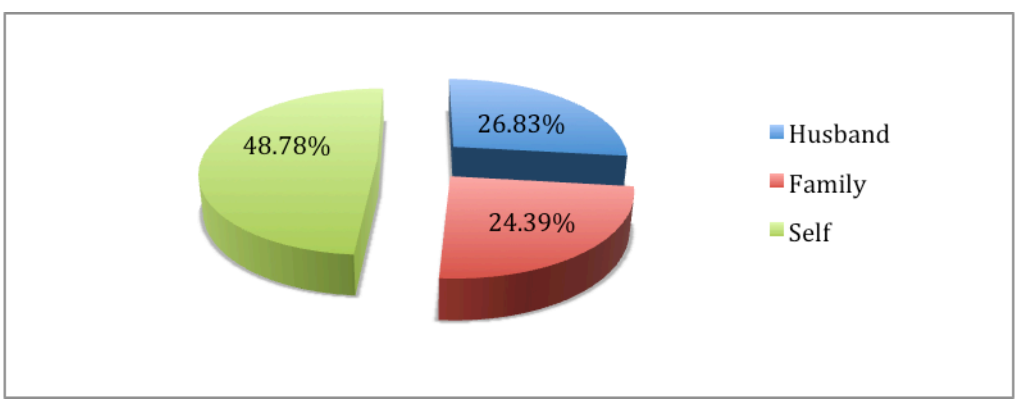
The head of microfinance at the MFI, Orix Leasing, justifies this in the following words: "women are very disadvantaged in our country. They are often seen as worse than cows and buffalos in many villages…we can't change the mindset so quickly. When we disburse the loan we make the men of the family realize that they are getting the loan because of the women. We tell them to honor her because of their ability to get the loan through her."

On the other hand, the head of microcredit at the MFI, Orangi Pilot Project (OPP) argues that this model of loan usage leads to the exploitation and misuse of women for they do not get to use either the loan or to the income generated from it, at the same time, they remain responsible for repayment.

Most female interviewees in the sample, however, did not indicate that this arrangement posed any problem for them. Instead they contended that if the loan was being used to help the household it didn't matter who controlled it. As some women put it "we live in one house, we are all in it together".

But there were also women who didn't know where and how the money from the loan was used. A female borrower in Lahore replied when asked about how the loan was put to use "we don't know, our husbands are the ones who use it". Figure 6 below shows loan use patterns for the 41 female borrowers in the sample:

Figure 21 Self-Reported Loan Usage Pattern Among Female Borrowers



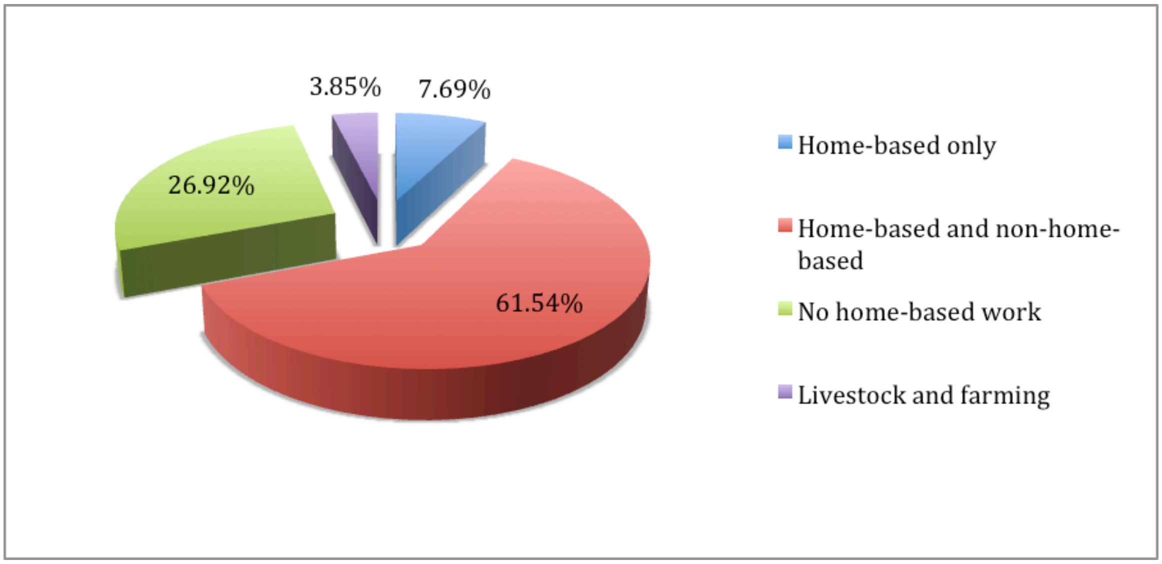
This pattern corroborates with Haq and Safavian's (2012) study described in Section I of Pakistani female borrowers, between 50 to 70 percent of whom report handing their loans over to male relatives. But Figure 6 differentiates loan use by self, husband and family. "Family" here is a reference to home-based businesses that employ more than one household member. This will be discussed in greater detail later in this section.

Recall, however, that Kabeer (2001) describes such a pattern of loan use as reason enough to continue lending to women, since women are more likely to share their loans with the household as compared to men. This corroborates with the account of a male borrower in Rawalpindi in the sample, who said that his wife did not even know that he had taken out a loan. Nevertheless, the loan *was* used to pay for his sister's wedding.

In Karachi, I accompanied a loan officer from a local MFB to a female borrower's home but her husband refused to talk to us saying she was away and he did not approve of his wife taking the loan. Interestingly, the loan was being used for *his* sewing and embroidery business. Both incidents suggest that microcredit does not necessarily empower, when the definition of empowerment includes cooperation and reduction of conflict within the household (Sen, 1987).

Interpreting loan use, however, is more complicated than it appears at first because of (a) the incidence of home-based work and (b) the multiple income streams of poor households. The chart below shows the distribution of borrowers in the sample according to the type of work arrangement.

Figure 22 Work Arrangements in Borrowing Households

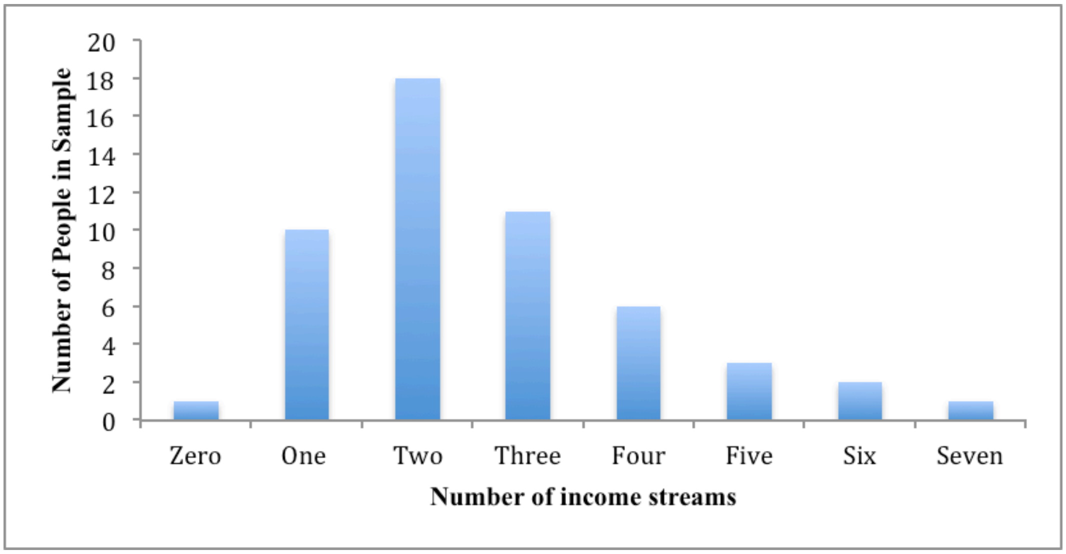


Given that the sample is primarily urban, only 4 percent of the work was agricultural, including livestock and farming. Of the urban sample, 70 percent of the households reported relying either exclusively or partially on home-based work. Of the 27 percent that were not involved in home-based work, most were male. These findings are consistent with the research on home-based work reviewed in Section I.

The question is how do these findings relate to women's empowerment in relation to microcredit? Deeper analysis of the interview data provides several answers. For instance, two female borrowers in Lahore reported handing their loans to their husbands and denied any knowledge of how the loan was being used. These women were also engaged in preparing glucose packets for sale to a middleman, in order to supplement the families' incomes. It is important to note that the loans were not employed in the women's home-based businesses but instead were used to fund their husbands' work outside the home. This is not just because women's work has less value within the household, it is also because women's work brings in less money as compared to men's, at least in the case of these two women.

Nevertheless, Figure 6 indicates that there were a good number of women who reported using the loan for their own or their families' home-based businesses in which they were important contributors. Recall also from Section I that women are not a homogenous category and play different roles within the same household (Rogaly, 1996). The importance of this fact was brought to light during a visit to a borrower's home in a slum in the Korangi neighborhood of Karachi. In this household, the borrower was the mother-in-law while her two daughter-in-laws served as the unpaid employees of the family's home-based business, which consisted of preparing steel clips for commercial use. During the day these young women worked with the material to prepare the clips and at the same time tended to the children, prepared food and received visitors. The mother-in-law was absent during the interview, but this was because she worked as a housemaid elsewhere and was most likely supplementing the household's income with her wages. This also brings up the fact that poor households often depend on multiple income streams. The chart below shows the distribution of income streams across the client sample.

Figure 23 Number of Income Streams



The chart indicates that the largest proportion of households had two income streams but there were also several families with three or more sources of income. The majority of households with multiple income sources had both husband and wife engaged in productive work, as well as any adult children that lived with them, such as the owners of a grocery and dairy shop in a local slum just outside Lahore. The mother and the older son in the family worked at the shop, the husband was employed in a government office while two teenaged girls were engaged in *masehri*[29] work.

There were also several households in which a single adult was engaged in multiple activities. For instance, in one house the only earner was the husband who worked as a medical assistant at a local hospital and also managed a wholesale cold drink business on the side. In another household, the husband worked as a commercial driver while the wife was involved in three different types of home-based work. In others, the wife helped the

[29] Strings of colorful paper flowers used as wedding decorations

husband with the main family business, but was also involved in sewing or *masehri* work on the side.

Clearly impoverished households struggle to make ends meet and one income is insufficient to meet basic household needs. Also, as described in Section I, by supplementing the principal earners' income through home-based work, women are able to diversify income risk in a time of economic uncertainty, rising inflation and unemployment. More than one woman talked about how her son or husband had been laid off from the factories they had worked in, putting severe strain on the household's already meager finances.

But going back to loan use, how exactly is the incidence of home-based work and income diversification related to the question of empowerment? First of all, when the household is engaged in multiple income generating activities, including but not limited to home-based work, it is often the females that are responsible for the lower-paying activity. It is then a rational choice, rather than evidence of a lack of agency, that the loan is used on the activity that generates the most income. But even if the income potential from women's businesses were higher than that of their male relatives' it would not matter, for in Pakistan as in other traditional cultures women are the last to eat, rest, attend school or visit a healthcare facility, so it is natural that even in their economic activities they would put their own requirements behind those of the men in their family.

And if the loan is accessible only to females, which is the case with most MFIs, it will be the wife or mother in whose name the loan will be taken out even though she is not the end user of the loan.

In rural areas, the women are responsible for the household's livestock. Institutions that wish to ensure loan use by women, issue loans against livestock. Farm households keep livestock either for fattening the animal or for dairy production. In both cases it is the women that work with the animals. However, even here loan use can be a complicated measure of autonomy and empowerment. The two rural clients from Tando Allahyar in the sample were both male and had taken out livestock loans. While both confirmed that it was their wives that tended to the cows and goats that they had bought with the loans, the process of purchase and sale of the animals was described as a male-centered activity for it required visiting the local market outside the village. Thus, ensuring that microcredit supports women's work does not necessarily empower them. This is aptly captured by the words of an MFB branch manager in Hyderabad, a city in Southern Sindh, who managed an area in rural Sindh: "men have the *hookah*[30] while women do all the work".

It is, therefore, not easy to determine empowerment through outcome indicators such as access and use of loans alone. This is because access and use is dependent upon the lending arrangements described below, cultural and economic considerations, the nature of home-based work and multiple income streams. It is also important to realize that providing women with economic opportunities has to be weighed against their other household responsibilities.

But what about process level indicators such as agency within the household and participation in the wider community? When female interviewees were asked about decision-making related to children's schooling and the household's cash management

[30]Hookah is a long tobacco pipe used by men in rural areas.

there were varied responses. Some women reported that they alone made schooling choices, while others said it was a joint decision between husband and wife. Similarly, when asked about managing finances, some stated they were handled all the money, while others said it was joint management and a third group said finances were handled by the husband alone.

The relevant question though is whether these women experienced a *change* in the level of agency within the household after becoming clients of microfinance institutions. None of the female interviewees agreed that such a change had occurred. When asked whether they felt that their respect in the wider community had risen as a direct result of the loan, none of the female interviewees responded in the affirmative either, in fact their response most often was an incredulous smile. I had asked this question specifically because two MFI senior managers had mentioned that access to microcredit was directly related to a rise in respect of borrowers in the rural communities they served. It is possible that the conflicting evidence was a result of rural-urban differences, since all female interviewees were city-based.

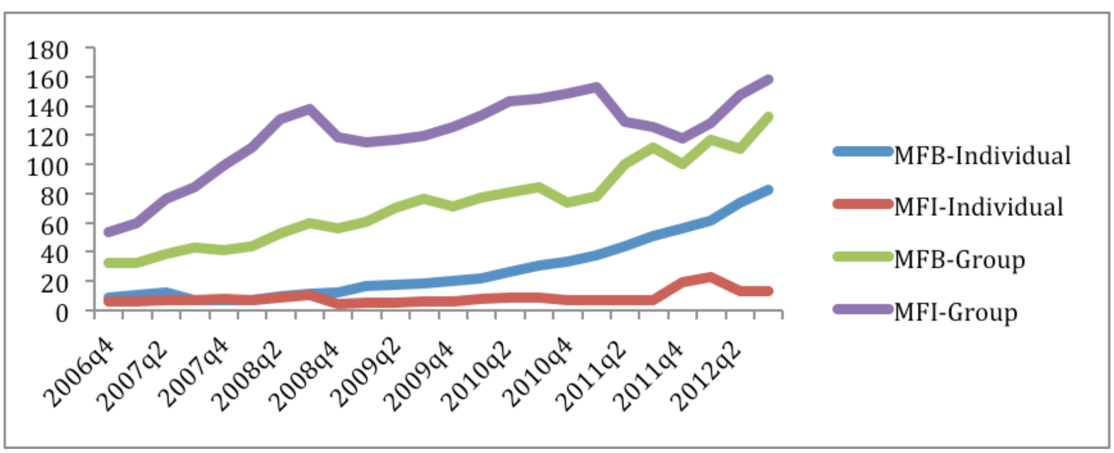
Thus, loan use, whether analyzed as an outcome or a process level measure, does not indicate that female borrowers experienced any level of empowerment. The discussion that follows is related to the lending process and how that can be viewed as an empowering or disempowering process for women.

II.B. (ii) Lending Arrangements

Since its origins in the late 1970s, microcredit has been associated with the Grameen Bank, which as described in Section I, popularized the group lending model. Most microcredit institutions across the global South applied this model with only minor changes, if at all. Pakistan was no exception. In fact, Kashf Foundation, the first institution established in Pakistan in 1996 as a microcredit institution received technical assistance directly from the Grameen Bank. Today, however, the original group lending arrangement is on its way out, at least in Pakistan.

There are several reasons for this. First of all, as microfinance has become commercialized, loan sizes have increased, and MFBs have targeted more men than women and moved to relatively higher income clients. Group lending is generally considered more conducive to small loan sizes, female creditors and the very poor (Khandker, 2012). With the change in clientele and innovation in the microfinance product line, described below, individual lending is catching up to group lending and in the next few years is likely to outpace it in Pakistan. This trend is described in Figure 9 below, which compares the group versus individual gross loan portfolios of MFIs and MFBs.

Figure 24 Gross Loan Portfolio by Lending Methodology and Institution - In US$ Millions[31]



[31] US$1=Rs98.19 as of March 1, 2013

In Pakistan, Tameer Bank was the first MFB to introduce individual lending and it continues to have the largest individual lending portfolio in the sector. Data extracted from the PMN dataset indicates that as of the fourth quarter of 2012, Tameer's individual gross loan portfolio was nearly US$64 million, which is approximately 60 percent of the entire sector's individual gross loan portfolio. Newer MFBs such as Kashf Bank, a spinoff from the MFI Kashf Foundation, have followed Tameer's lead and chosen to focus on individual lending as well.

Another reason for moving away from the Grameen model is the double-edged sword of social capital. In 2008-09, the MFI Kashf Foundation faced a major microfinance delinquency crisis in the province of Punjab, which quickly spread to other institutions (details are provided in chapter 5). But such crises are not unique to Pakistan, Bolivia and Bangladesh had a similar experience in the late 1990s, while the Indian state of Andhra Pradesh experienced it in 2006 and then again in 2010 (Roodman, 2010).

The loan application process has been overhauled since the default crisis hit the microfinance sector. Every MFI in the sample asks its female borrowers to provide at least one male relative's national identity card and photograph at the time of application. This male is also required to accompany the female at the time of loan disbursal. When questioned about this practice, branch managers and loan officers said that this was important in case of legal action for nonpayment. Officers also stated that it was culturally more acceptable to threaten men with police action in case of delinquency than women.

Group meetings have also been deemphasized over time by several institutions. Institutions such as the UPAP now ask borrowers to come for disbursal and collection on an individual basis to the regional branch office. Borrowers complain that coming to the regional office often requires half a day of travel for them, but from the empowerment point of view this also has other implications. Recall from Section I that there is literature to suggest that group meetings facilitate peer mentoring and the development of a support network among female borrowers.

At the same time, an ex-senior official of Kashf Foundation counters this by saying: “The group lending model can be problematic. The requirement for the group to meet every week or every two weeks is not helpful especially when the meetings are transactional. Its only about exchanging money, it is not an empowering platform, it is *not* producing social capital”.

This was corroborated by female clients in the sample, who expressed frustration with the rigidity of having to meet at a regular time every month or week, as in the case of BRAC. Observations of group meetings also confirmed this. In every meeting I attended the same pattern was observed – A few women would have collected at the designated house before the loan officer would arrive. After waiting for several minutes for those that had not yet come someone would send a child to the neighboring house reminding the women about the meeting. The loan officer would begin the meeting by taking attendance and every client would take a turn to sit next to the loan officer to pay her dues. The meeting would then end with a reminder about the date and time for the next meeting. Only the BRAC meeting included a social mobilization component. The meeting I observed included an oath-taking at the end. The oaths included a commitment to never tell a lie, to educate their female children, to pay close attention to the health and hygiene of the family and to keep their contract with the organization. The entire episode, however, appeared mostly ritualistic.

During interviews most women that had individual loans expressed relief for not being forced into a group loan. They criticized group lending for making people responsible not just for their own but also their neighbor's loan. Clients of Kashf talked about the nature of the group lending arrangement before the crisis hit the MFI. Some mentioned that the group leader would elicit under-the-table payments from them in order to include them in a group, while others reported that when certain borrowers were unable to pay their loans, group members would come and confiscate household items such as television sets.

Thus, in terms of *change, choice* and *power*, the move to individual lending seems to have had an empowering effect on borrowers since it has increased flexibility and reduced the rigidity of the lending arrangement. At the same time, the dynamics of the sector have changed, as more men and the better off are being targeted and the poorest women are being crowded out.

Moreover, the increased commercialization in the sector has reduced the importance of social mobilization, which has long been considered an important vehicle for women's empowerment (UNDP, 2004). Social mobilization has been a strong component of NGO activity in Pakistan since the late 1980s. These NGOs have included the Orangi Pilot Project and most of the rural support programs (RSPs), including the AKRSP and the NRSP – all of which later became important players in the microfinance sector as well. In sharp contrast to the early years, during which social mobilization was considered an integral part of the microfinance intervention, most of these NGOs have since separated their social mobilization activities from their microfinance programs. Cases in point include the creation of the standalone First Microfinance Bank by the AKRSP; the setting up of an independent body called the Orangi Charitable Trust by the Orangi Pilot Project (OPP) (Hasan and Raza, 2012); and the separation of NRSP's social mobilization work from its microfinance activities in 2006 and the subsequent setting up of NRSP Microfinance Bank (NRSP, 2010). This seems to suggest that even institutions that see social mobilization as an important part of their development work, no longer see the value of extending it to their microcredit clients. At the same time new research on social mobilization and community development has found evidence that men and the better off are more likely to benefit from it than women and the poorest (Mansuri and Rao, 2013). Another phenomenon in Pakistan's microfinance sector is the rapidity with which new products and new channels of scaling microfinance services, such as mobile banking, are being introduced. One product that has clear implications for women's empowerment is the gold backed loan.

II.B. (iii) Financing Against Gold

As mentioned earlier, Pakistan's microfinance sector has been referred to as a "laboratory for innovation" (Consultative Group to Assist the Poor (CGAP), 2011). Financing against gold, pioneered by Tameer Bank in 2010 and by the end of 2012 adopted by all active MFBs (Aslam and Azmat, 2012), is held up by the State Bank officials interviewed for this study as one of the most promising examples of product innovation, which rapidly expands the frontiers of financial inclusion. However, gold financing is highly contentious as it can deepen and institutionalize existing gender disparities.

The institutions that offer gold backed loans admit that the primary target market for it are men but that the jewelry used as collateral belongs to the women in the household. Proponents of this type of individual lending contend that it is risk-free for the institution and also greatly reduces processing time. Tameer Bank, which has shifted 80 percent of its portfolio into gold-backed loans, reports that these loans can be disbursed within 3 days while ordinary microcredit takes 21 days from application to disbursal due to the time intensive loan verification process.

From an economic point of view, supporters contend that this product allows gold jewelry to be used as an economic asset in a country where gold is usually the savings product of choice for most people (Aslam and Azmat 2012; Chen and Rasmussen 2011). But such a narrative is highly problematic from a gendered perspective for gold jewelry is usually the only asset a South Asian woman, particularly from the lower socioeconomic classes, can call her own. It is an important part of her dowry, is passed down from generation to generation, and in low socio-economic households is often a woman's only financial security (Ashford and Huet-Vaughn 2000).

It is too soon to know the actual impact of gold-backed loans on women in borrower households since the product is relatively new, but there is danger that hastily taken out loans could end up liquidating jewelry with important economic and emotional value, in households with already limited savings and assets. This can have potentially disastrous intergenerational outcomes for women as predicted by an MFB practitioner, who contends that her institution was reluctant to introduce this product but felt it had no choice given that all others in the sector had already done so. The gold backed loan is perhaps the clearest case of commercial interests overtaking the poverty and empowerment mission of microfinance.

III. Conclusion

This study analyzes the contentious issue of empowerment in relation to microfinance, in the context of urban Pakistan. Empowerment is a difficult concept to measure. Keeping this in mind, I use multiple indicators, both quantitative and qualitative, as well as process and outcome indicators of empowerment, to explore how microfinance affects women's lives in Pakistan.

The findings presented and discussed in Section III, lead to the clear conclusion that microfinance has not empowered women in any meaningful way in Pakistan. In fact, there is real danger that if the sector continues to evolve the way it has recently, microfinance will disempower rather than empower Pakistani women.

This assessment is based on several findings. First of all, while women's access to loans may have increased thanks mainly to MFIs, their use and control over these loans has not increased proportionately. This implies that blocking men from benefiting directly from an important resource, such as access to formal credit, is not an effective way of empowering women.

The study also finds that the size of women's loans, and in the case of MFBs, the ratio of women's loans to total loans continues to be much less than men's. If empowerment requires a reduction in gender-based inequalities, then clearly this has not occurred.

In addition, the women included in the client sample do not believe that a significant change in their relative economic or social position within or outside the household has occurred in relation to their microfinance experience.

In terms of the institutional structure, MFBs on average are more concerned about profit making than their NGO counterparts, the MFIs. This means that MFBs tend to target men and the better off. However, as mentioned above, in the case of women access is not the same thing as use and control over credit. MFI women's loan sizes are also the lowest in the sector. Due to differences in socioeconomic backgrounds, MFB loan sizes for women are comparable to MFI loan sizes for men, but this has to be viewed in light of the fact that MFB's lend mainly to men while MFIs on average lend primarily to women.

In terms of the lending process, it appears that individual lending arrangements are more flexible and borrowers prefer them to group lending. At the same time, individual loans are geared towards wealthier borrowers, who are also more likely to be men rather than women.

Moreover, divorcing social mobilization from microfinance activity at the largest MFIs is a clear sign that commercialization is fast replacing the original intent of microfinance as a poverty reducing and gender empowering intervention, though recent research has indicated that civil society led social mobilization activities are not as empowering for women as they are for men.

But perhaps the most alarming development to date is the rapid rise in popularity of the gold backed loan in the MFB sector. This product has the potential to threaten women's meager savings and assets, as well as their agency and position in already vulnerable households. In spite of this, gold backed loans have become a significant growth driver in the sector's loan portfolio, with full backing from the State Bank of Pakistan. By the end of 2012, every active MFB in the sector had introduced this loan and is currently banking on it to reduce its exposure to risk in an uncertain political economy.

Thus, donors, policymakers and practitioners need to critically assess the impact of the microfinance sector on women's position within the household and the larger community. There is a need to systematically compare the benefits of growth inducing and risk reducing strategies in the sector against the dangers they pose to women's already vulnerable status in a country like Pakistan.

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CHAPTER 7

CONCLUSION

This research was set out to study the effectiveness of microfinance as a tool for financial inclusion, poverty reduction and women's empowerment. The study emphasizes that context matters, which in this case includes the global development discourse, Pakistan's official development paradigm, and its current political and economic conditions.

The study also sought to analyze how microfinance's evolution from a modest NGO-led development program to a commercialized financial venture worth more than $70 billion globally (Sinclair, 2012) has influenced its social mission, practice and outreach, and how policy and institution level changes have in turn affected the experiences of the clients of this intervention.

The literature on microfinance is fraught with controversy and empirical studies often present conflicting evidence. More importantly, the concern for poverty and empowerment has been pushed to the side in recent scholarship in favor of research on the most effective and innovative ways to expand outreach rapidly (e.g. Banerjee et al, 2012; Miles and Nugroho, 2013). When it comes to conceptualizing poverty, the new emphasis is on the variability rather than the inadequacy of income, which, it is claimed can be overcome through access to short-term and renewable formal credit contracts. For instance, Karlan (2007) argues: "Being poor is not just about having too little income. It is about having insecure income." Thus the legitimacy of microfinance is sought in the variable income streams of the poor, which access to formal financial services is expected to smooth out. This is a major shift in the microfinance narrative. From an intervention that was until recently believed to solve the twin problems of poverty and women's disenfranchisement (Khandker, 2003), microfinance now claims to provide only a temporary Band-Aid to the poor.

And yet the interest and investment in microfinance continues to rise. From the World Bank, the UK's Department for International Development (DFID), the United Nations Development Program (UNDP), the United States Agency for International Development (USAID) to private social investment funds, the microfinance sectors across the global South have an impressive and varied list of "partners". In 2012, the International Finance Corporation (IFC), the World Bank's lending arm, had commitments of nearly $2 billion across 75 countries in microcredit projects alone (World Bank, 2013).

The scholarship on microfinance has played a major role in this, for it promotes the continued growth of the industry without paying enough attention to the actual value it provides to its clients and their communities. This study has sought to refocus attention on the original objectives of the microfinance mission, for providing the poor with access to finance is a worthy goal of development only if it substantially enhances the capabilities of the poor.

This research provides empirical evidence on each of the three stated objectives of microfinance, that is, financial access, poverty reduction and women's empowerment using the capabilities framework. What follows is a synthesis of the findings presented in previous chapters. The theoretical and policy implications of these findings are presented in the sections that follow the next section.

I. Synthesis of Empirical Findings

The most important empirical findings of the study were summarized in chapters 2, 3, 5 and 6. This section synthesizes these findings to provide answers to the study's main research questions. The first question this work addresses is whether microfinance, especially in its commercialized form, serves as an effective tool of financial access, poverty reduction and women's empowerment. The second question is whether microfinance is indeed the ideal development intervention, as often claimed by its proponents (Rankin, 2002; Elyachar, 2002).

Microfinance and Financial Access

The microfinance literature refers to the poor as the "unbanked" and describes their precarious lives as being made more precarious by a lack of access to formal sources of finance (Collins et al, 2009). But the scholarship on informal finance documents a vast network of credit, savings, insurance and money transfer services available to the poor (Udry, 1994; Bouman, 1995; Suleri and Savage, 2006). This was confirmed during interviews as clients reported that it was routine to borrow from neighbors, friends, and family when the need arose. In addition, purchases for household use were often made on store credit, while business inventory was regularly bought on merchandise credit. Client interviews, in fact, suggest that microcredit clients may experience a rise in informal borrowing, for many reported being unable to make repayments on time unless they borrowed from friends, family or even their own clients. For savings, the poor as well as the non-poor in Pakistan regularly contribute to rotating savings and credit associations (roscas) that are locally called "committees". While the State Bank of Pakistan (SBP) and the Pakistan Microfinance Network (PMN) have tried to make the lending process in the microfinance sector as transparent as possible and it is true that formal arrangements tend to be more reliable than informal arrangements, microfinance is not as flexible as informal financial services. And flexibility is an important criterion for poor households, for emergencies, such as a sudden illness or death, can plunge them deeper into poverty. When it comes to formal financial services, microfinance does fill a need for those that fall outside the traditional purview of commercial banks, but the current microfinance penetration rate in Pakistan is only 9.24 percent (MicroWatch, 2013). Between 2004 and 2008, the sector's annual compound growth rate was no less than 67 percent (Chen et al, 2010), but growth fell thereafter unable to pick up pace again. Reasons for faltering growth and in places the complete wipeout of existing microfinance portfolios include violent conflict, major natural disasters, an economic downturn, and in certain regions a culture of extreme gender disparity. But just as economic growth in Pakistan has nearly always been exclusive rather than inclusive, growth in the microfinance sector has also been unequal thanks mainly to the rapid rise in commercialization.

Commercialization has a complex relationship with the access to finance agenda. The literature on commercialization predicts that commercially run microfinance institutions will be able to expand outreach faster than traditional NGOs (Schmidt, 2010). Pakistan's development policy also states that the goal of commercialization is to expand the outreach of microfinance institutions and reach those without access to formal sources of finance. The country's Poverty Reduction Strategy Paper (PRSP) describes the microfinance banks (MFBs) in Pakistan as vehicles of commercialization and urges the

SBP to encourage microfinance institutions (MFIs) to shed their NGO status and transform into MFBs.

The econometric analysis in chapter 2, however, demonstrates that commercialization in Pakistan has not resulted in expanding outreach to the poorest districts, in fact the MFIs, which are mainly NGOs, are much more likely as a group to operate in rural and remote regions. At the same time, MFBs and MFIs are certainly not a homogeneous group. MFBs such as Khushhali Bank and the First Microfinance Bank (FMFB) have a heavy rural presence, while others such as Tameer Bank, Kashf Microfinance Bank and Apna Microfinance Bank are mainly restricted to urban areas. Not surprisingly Khushhali and FMFB are much more focused on their social mission than the others. But Tameer is the growth driver in the sector and is widely considered the industry’s best practices model. Tameer’s outreach strategy, which has been adopted by newer MFBs, has resulted in crowding out the poorest, women borrowers, and those living in rural areas.

MFIs are also a heterogeneous group, with Akhuwat Foundation’s zero-interest model at one end of the spectrum and Kashf Foundation and the Bangladeshi MFI, Association for Social Advancement (ASA) at the other end. While Akhuwat is only concerned with poverty alleviation and social change, Kashf and ASA pay at least as much attention to their finances as they do to their social mission.

Econometric analysis reveals a great deal of heterogeneity in MFI outreach. Clients of the rural support programs (RSPs) constitute 50 percent of the MFI sector’s active clientele. There are currently 11 RSPs in the country, spread throughout the rural areas of Pakistan. When the MFIs are taken together as a group their pattern of outreach indicates a strong tendency to locate in the most vulnerable districts of Pakistan. But when the RSPs are removed from the analysis, the results indicate that MFIs are no longer sensitive to socioeconomic disparities between districts.

In addition, loan sizes in the MFI sector are often too small to make much of a difference in the lives of their clients, especially when it comes to meeting the capital requirements of their businesses. For instance, clients with welding shops complain that they cannot buy lathes and other welding equipment from their loans. Similarly, even the RSPs agree that their rural clients are unable to purchase livestock from the livestock loans they provide them unless they can borrow additional amounts informally.

The next argument made by microfinance's proponents is that access to formal services allows the poor to overcome poverty, or at least takes the edge off of it (Khandker, 2003). The following section discusses the empirical findings related to this contention.

Microfinance and Poverty

Empirical studies on microcredit have demonstrated that the pressure to earn profits has moved the sector towards a wealthier target market. The present study confirms this, but also finds that the upstream move is primarily policy driven, at least in the case of Pakistan where the SBP has played and continues to play a major role in guiding the microfinance sector's evolution from traditional NGOs to commercialized entities. The SBP's policy focus has in turn been influenced by the changing emphasis in global microfinance, particularly as envisioned by the World Bank.

The findings suggest that the poorest, women and those living in remote rural areas have been crowded out by the better off, men and city dwellers, especially those from the largest cities in Pakistan such as Lahore and Karachi. This is especially true for MFBs and less so for MFIs. But the sector is in a rapid transformation phase, as more MFBs are established each year and the largest MFIs are transform into MFBs to take advantage of the incentives provided by the SBP, such as a five-year tax holiday and access to specialized institutional grants. This means that MFIs themselves are being crowded out of the microfinance sector.

While most MFBs argue that they are commercial entities and their greatest concern is the financial bottom-line, MFIs point to their non-profit status and indicate that client wellbeing rather than earning profits is their main concern. Nevertheless, not every MFI is able to translate its social objectives into actual practice. For instance, the National Rural Support Programme, one of the largest MFIs in the country with a strong focus on poverty alleviation, asks its borrowers to pay a few days before the due date so that it does not have to deal with pass due accounts, without considering how such a practice would affects its clients.

The majority of the clients do not agree that microcredit has made a significant impact in their lives, though there are some true success stories where families have been able to recover from major crises through their continued association with microfinance institutions. On the other hand, clients also report being humiliated when unable to make payments on time by loan officers knocking on their doors until the neighbors come out, having to go without meals in the days leading up to repayment, and asking friends and family to help them with loan repayments.

The current political economy has placed an additional strain on borrowers, particularly the ongoing conflict in various parts of the country, the economic meltdown, the chronic power shortage, and the recurrence of major natural disasters. This has meant that the majority of the poor are unable to save or make ends meet. Interviews with clients, and branch and loan officers confirm that most clients are worse off now than they were a few years ago and that these conditions are largely to blame for this. But even more discouraging are the findings related to microfinance and women's empowerment in Pakistan.

Microfinance and Gender

Despite the fact that microcredit has always been associated with the expansion of women's opportunities, the empowerment rhetoric is surprisingly low key in Pakistan's microfinance sector. This is most likely related to the pervasive gender disparities present in the country, discussed in detail in chapter 6. In terms of microcredit, women constitute just half of total active microcredit clients in Pakistan (MircoWatch, 2013), as opposed to the 75 percent global average (Reed, 2011). Within this sector, only 25 percent of MFB microcredit clients are female, while 80 percent of MFI microcredit clients are women (PMN database, 2013). Moreover, average microloans for women are much smaller than for men, especially when offered by MFIs.

For MFIs, however, the biggest gender related issue is not so much the lending amount as it is the use and control of loans. Men control the majority of the loans provided by MFIs to poor women, usually with the explicit knowledge of the institutions. The loan application form, in fact, asks the female borrower to provide the name of the end user of the loan.

But the analysis of this finding from a gendered perspective is made complicated by the reality of informal work arrangements and the multiple income streams of the poor.

Impoverished households struggle to make ends meet and one income is usually insufficient to meet basic household needs, due to which the household engages in multiple income generating activities, including but not limited to home-based work. Generally speaking, it is the females in the household that are responsible for the lower-paying activities and it can be a rational choice, rather than evidence of a lack of agency, that the loan gets used on the activity that generates the most income. Moreover, if the loan is only accessible to females, which is the case with most MFIs, the loan has to be in the name of the wife, mother or sister even though she is not the end user of the loan. But even if the income potential from women's businesses were to be higher than their male relatives' it would not matter, for in Pakistan as in other traditional cultures, women are the last to eat, rest, attend school or visit a healthcare facility, so it is natural that even in their economic activities they would put their own requirements behind those of the men in their family.

Another factor to consider is that most home-based businesses employ multiple family members, but because most MFIs lend primarily to women the loan has to be in the woman's name even though patriarchal family patterns determine that the oldest male in the family serves as the business owner.

It is, therefore, not surprising that none of the women in the sample report any improvement in their self-esteem or agency as a result of the microcredit experience, either within the household or in the wider community. In fact, most interviewees found the very idea of empowerment through microcredit quite incredulous.

When societies are segregated, expanding outreach is a real issue for microfinance institutions. The culture in Pakistan is not homogenous and regional differences can be stark. Broadly speaking, women in Karachi are by far the most outspoken and least concerned about *purdah* or segregation, while the women in the remote and rural regions of the country are often required to maintain strict segregation. Therefore, MFIs that lend primarily to women find it easiest to operate in the cities. And institutions such as FMFB, which have a large rural presence, confirm that for the most part they have abandoned their gender targets.

But perhaps the most alarming aspect of the rapid commercialization in the sector is the sudden rise in popularity of gold backed loans, which are collateralized loans offered by all active MFBs in the country. Most MFBs in my sample admit that the loans are targeted at men, but the collateral asked for is gold jewelry, which is often the only asset women in poor households can call their own. The stock of gold jewelry in poor households though meager is usually passed down from one generation of women to another and is high in both emotive and economic value.

Given these findings it is clear that microfinance, at least the way it is currently practiced in Pakistan, is not an effective tool for financial access, poverty reduction or women's empowerment. But does it fit the general criteria of a successful development intervention, that is, is it participatory, market-driven and financially sustainable?

Is Microfinance Participatory, Market-Driven and Financially Sustainable?

Global institutions, such as the World Bank, contend that development should be viewed as a participatory process, one that is led by community development NGOs and private rather than state actors (World Bank, 2002). In addition, the intervention should be sustainable, that is, it should not need long-term donor support. When microfinance first rose to prominence in the 1980s and 1990s it appeared to fit the criteria perfectly (Khandker, 2003; Armendariz and Morduch, 2010).

But the empirical findings of this study suggest that the situation is more complex than what the mainstream literature had suggested. In Pakistan, microcredit was first introduced by community development NGOs such as the Orangi Pilot Project (OPP) and the Aga Khan Rural Support Program (AKRSP), but as the sector commercialized and expanded in scale, the community development component was deemphasized. By now even the older institutions such as OPP, AKRSP and the National Rural Support Program (NRSP) who consider community development a core part of their operations have separated their microcredit operations from their other activities.

At the same time, new research suggests that donor driven participatory development projects are never as effective as when participation and collective action occurs organically within communities (Mansuri and Rao, 2013). One of the limitations of this study is that it has not been able to study the importance of community development in communities where MFIs combine their microcredit operations with social mobilization, with the exception of the MFI Akhuwat – the zero interest microcredit provider. This research finds that Akhuwat continues to encourage its poor borrowers to make regular charitable donations as a form of spiritual purification. Client interviews demonstrate that Akhuwat has been successful in fostering a spirit of brotherhood among its past, present and future clients. But the topic of participatory development is broad and requires a more exhaustive and detailed study.

Finally, field research in Lahore indicates that the repayment crisis of 2008-09 that ripped through the microfinance sector in and around that city destroyed the affected communities' existing social capital, causing deep rifts between neighbors who had formed groups to receive loans. This suggests that when things go wrong, microcredit can actually destroy rather than build a community's social capital, as is often claimed (Feigenberg, Field and Pande, 2010).

The second criterion for a successful development intervention, at least as far as the World Bank is concerned, is that it should require as little government intervention as possible. The microfinance sector in Pakistan is a near perfect example of an industry shaped by private institutions for the MFI sector is led by NGOs, while MFBs are privately run banking institutions. Khushhali Bank was the only MFB that was set up as a quasi-public sector institution, established through the Khushhali Bank Ordinance in the year 2000. But in June 2012 it was also sold to a private consortium of local and foreign investors. The SBP is the only state actor that plays a major role in the industry, and it too restricts itself to promoting the financial sustainability, risk reduction and expansion of the sector.

But the market-driven approach has led to a dilution in the industry's social mission as discussed earlier. The majority of the MFBs are less concerned than public sector entities about setting and achieving social and developmental goals, as demonstrated by the comparison with Khushhali Bank. Until its sale in 2012, Khushhali had the largest branch network in the country, with branches in 72 out of a total of 113 districts, many of which were the most poorest in the country, and a mode of outreach that involved partnering with local community organizations in each district.

The final consideration is sustainability. Financial sustainability and expanding outreach appear to be the sector's top priority at the present moment. It is because of this that the

SBP modified prudential regulations for the MFBs in 2010 and allowed them to offer gold backed loans, which it refers to as a zero-risk product. At the same time, by the time the interviews were completed in July 2012 most MFBs had not achieved breakeven, with the exception of Tameer Bank. Nevertheless, other MFBs such as Kashf Bank, reported that according to their estimates the achievement of sustainability was only one or at most two years away.

MFIs, on the other hand, are considered much less likely to become sustainable institutions by the SBP. According to the SBP, MFIs operate inefficiently and their cost to revenue ratios are too high, though MFIs argue that their costs are high because they operate in rural and remote regions where the cost of operating is higher and the focus on their social mission makes it difficult for them to charge high rates of interest. At the same time, while MFBs are required by the SBP to maintain extensive records of their operations, there is often a lack of transparency in MFI operations, which makes it hard to know the truth behind these claims. But it is true that institutions such as Akhuwat have made no attempt to become financially sustainable and depend entirely on donations and volunteers, rather than generating revenues through interest and hidden fees. On the other end of the spectrum are MFIs such as ASA, which claim to have achieved full financial sustainability thanks to their signature bare bone, no frill operations and a tight control over their finances, but also because they collect sizable interest on their loans. It is important to note here that the average interest rate in the sector is 35.9 percent (Shorebank International, 2011).

When it comes to financial sustainability there is no simple definition. While ASA and Tameer Bank claim to have achieved breakeven, both institutions receive credit from the

PPAF, which bears below credit market interest rates. Tameer, like the other MFBs, also has access to institutional strengthening funds as well as other grants and incentives that typical MFIs do not, which implies that sustainability is a grey area. These facilities are provided by the UK's DFID, the IFC and the Asian Development Bank and work in a manner similar to the donor funding some of the more prominent MFIs such as Kashf Foundation receive.

Thus, broadly speaking microfinance, at least as it is practiced in Pakistan, is not a participatory and financially sustainable intervention. It is, however, driven by market-forces and this may be more problematic than beneficial from the point of view of the borrowers, particularly women and those living in rural areas.

II. Theoretical Implications

The idea that access to formal credit should be considered a basic right of the poor and that only through commercialization and strengthening the global as well as the local market for microfinance investments can this end be achieved is basically an extension of the "democratization of finance argument" (Aitken, 2013). The latest scholarship on microfinance appears to be headed in this direction (e.g. Ogden and Morduch, 2013; Ledgerwood, 2013).

However, the empirical findings of this research suggest that such an argument has more to do with furthering the global financialization agenda than concern for the poor, their poverty or their marginalization. Financialization is defined as the reduction of major aspects of social life into financial asset streams (Aitken, 2013). The use of gold jewelry in microcredit transactions is a perfect example of this for it transforms a social object of high emotive value into a financial asset. The stated purpose of which is to expand the formalization of the informal economy at the bottom of the pyramid, while fostering economic growth.

The empirical findings of this study make it clear that access to microfinance does not reduce informal borrowing or increase the opportunities and capabilities of the poor, particularly women and the rural poor. This makes it difficult, if not impossible, to conceptualize the real purpose of "financial inclusion" and to justify the continued expansion of microfinance.

Another important conclusion drawn from the present work is that the political economy is a potent force that can change the direction of an intervention, even if it is strictly market-based, and can significantly reduce or increase its effectiveness. The results demonstrate how the spectacular growth of microcredit in the mid-2000s turned into near negative growth because the sector has been unable to deal with rising levels of conflict, an economic downturn and the recurring incidence of major natural disasters in the country. A related point is that while the literature on microcredit and conflict suggests that microcredit can jumpstart conflict-ridden societies by spurring entrepreneurship and economic rebuilding (Nagarajan and McNulty, 2004; Manalo, 2003; Doyle, 1998), the empirical findings suggest quite the opposite.

Finally, the gender related findings demonstrate that empowerment is hard to measure and even harder to analyze. The research on empowerment has suggested that simply measuring the outcomes of female-targeted microcredit is insufficient and process level indicators should also be employed when measuring empowerment (Kabeer, 2005; Garikipati, 2011). However, this literature has not recognized that the lending process itself can be empowering or disempowering to women. The evidence from Pakistan suggests that the lending process deemphasizes women's agency, particularly in gender-targeted microcredit arrangements. The process serves to maintain rather than oppose the pervasive gender disparities in the country, by explicitly allowing women to hand over their loans to men, insisting that women be accompanied by men at disbursement, and requiring men to be the guarantors of women's loans.

III. Policy Implications

This study has several policy implications but all of them stem from the basic finding that microfinance was found to be neither a pathway out of poverty or disempowerment. While the SBP and microfinance practitioners in Pakistan are unlikely to be surprised by these results, microfinance continues to hold promise for many at the global level. International institutions such as the Microcredit Summit Campaign, the Grameen Foundation, the Foundation for International Community Assistance (FINCA) and Kiva.org have been fundamental in promoting and maintaining the rhetoric on poverty and empowerment in the global arena. FINCA recently announced plans to increase its stake in Pakistan, arguing that access to microcredit is "life changing" as it expands the economic opportunities of the poor. In the context of Pakistan, FINCA's CEO predicts that microcredit will also serve to bring peace and reduce the current conflict in Pakistan, as well as its overspill in the rest of the region and the world (2013).

Putting aside such grand illusions, there is doubtless a demand for credit among poor households in Pakistan. However, microfinance institutions are currently unable to meet this demand. First of all, existing arrangements are inflexible and not designed with the poor in mind. The poor continue to turn to informal sources of finance, which meet their needs much better, even if they are at times pricier and less reliable.

But even if microfinance institutions were able to meet the financial needs of the poor, it is clear that access to finance is not going to solve the problem of poverty and disempowerment. If scarce donor dollars have to be employed in Pakistan, this research finds that it would be better to spend them in income generating schemes. Most urban borrowers in the sample identified a lack of formal sector jobs as the biggest hurdle to their wellbeing. Similarly, in rural areas the recurring floods have put a severe strain on household budgets and there is a need to diversify farm incomes. Of course, it is also imperative to bolster the sagging rural infrastructure and find ways to mitigate the risk of crop and livestock damage, especially in the vulnerable districts of KPK, Sindh and Punjab.

With regard to commercialization, this study finds clear evidence that even the access to finance agenda has not been served by commercial entities because a concern for profit-making has resulted in moving the market upstream, away from the poorest, those living in rural and remote areas, and women. Commercialization has in fact weakened the microfinance sector's original emphasis on the poor and women by taking resources and focus away from traditional microfinance institutions, that is, the MFIs towards MFBs, which openly admit to placing profits before people. This implies that the existing policy of promoting commercialization in the sector is misplaced and needs serious reexamination.

For the Pakistani microfinance sector this will be a difficult path to take since the current thrust is promoting commercialization in the sector. The PPAF has also recently joined hands with the SBP to provide soft loans to MFBs and the expansion of the branchless banking initiative has prompted the entry of several local and foreign private corporations into the MFB sector. Nevertheless, there needs to be a systematic assessment of the benefits and costs of commercialization. For instance, allowing gold backed loans to take over MFB microcredit portfolios is a marked departure from the very idea of microcredit. The use of this product has serious implications from both a gendered and non-gendered perspective. Increasing the debt levels of already vulnerable households while taking gold as collateral, which has a high emotive and financial value in Pakistan, is highly problematic as discussed above and the policy needs careful reconsideration.

The introduction of microsavings, microinsurance and branchless banking has expanded the product lines of microfinance institutions considerably. But these products have not been designed with the needs of the poor in mind and have been unable to either expand the opportunities of the poor or reduce their constraints. For instance, MFBs are allowed to take deposits from the public at large, which often means that they prefer to attract a higher-end clientele for their deposits, neglecting the needs of the poor in the process. MFIs, on the other hand, are unable to use deposits to fund their operations and use client savings mainly as a precaution against default, which means that the savings they collect are for the most part involuntary.

Similarly, credit life insurance offered to microcredit borrowers is primarily a risk reduction strategy for the institutions. In cases where health insurance is offered borrowers are unclear about the conditions of use and at present health insurance does not include outpatient services. Weather-indexed insurance in rural areas is still in a pilot phase and needs to be expanded after a careful examination of its impact on rural households. But the main policy implication here is that there needs to be a serious reassessment of the existing microfinance product line keeping the needs of the borrowers as the central focus rather than institutional risk-return profiles.

Finally, the violent conflict, the economic collapse, frequent power breakdowns, and the increased incidence of natural disasters have reduced business margins at the bottom of the economic pyramid and in the words of the poor "credit is no longer a choice but a necessity". At the same time, as since economic prospects become worse over time, access to credit is no longer an opportunity to build bigger and better businesses but rather just a temporary Band-Aid for the poor.

IV. Future Research

There are two primary components to expanding this research in the post-dissertation stage. The first has to do with addressing the limitations of the present study, while the second constitutes developing a larger research agenda.

In the first stage, the econometric model can be improved with the inclusion of additional district-level indicators such as gender, branch distance from the center, and the availability of other financial services, formal as well as informal, in each region. In addition, a smaller study that may not include every district, but uses more direct indicators of borrower poverty and socioeconomic status, can provide a more detailed and accurate view of how commercialization has impacted the financial inclusion initiative in Pakistan.

The qualitative study can also be strengthened, specifically by increasing the client sample and covering at least some of the areas left out during fieldwork. These areas include Balochistan, Khyber Pakhtunkhwa (KPK), southern Punjab, northern Sindh, and the northern regions of Gilgit-Baltistan and Kashmir. Moreover, the present study has been primarily restricted to urban areas and interviews with practitioners made it clear that rural microfinance is very different from urban microfinance, which implies that the next stage of this research should cover the rural areas of Pakistan in order to build a more complete picture of the microfinance experience in the country.

In terms of developing a broader research agenda, there are two future studies that would be natural extensions of the present one. The first involves an exploration of gold backed loans, using the theoretical construct of financialization, but expanding it to incorporate a gendered perspective.

The second study would focus on the impact of civil conflict on microfinance operations and how this has affected the clients of microfinance. This study would build on the existing literature on conflict and microfinance. In the first stage, the focus can be on civil conflict and the fieldwork would focus on Karachi, the country's largest and most diverse city, but one that is currently suffering from intense civil conflict. Karachi has the second highest concentration of microcredit clients, but has recently experienced a negative rate of growth in microfinance outreach. Chapters 5 and 6 include a mini-case study of Karachi's experience with conflict and microfinance.

These studies will contribute to a growing body of critical literature on microfinance. To date, however, the issues related to collateralized microcredit, and conflict and microfinance have been largely unexplored by academic scholarship. While these studies would employ a multi-disciplinary conceptual framework, the critical literature on financialization will serve as the primary anchor.

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APPENDIX A

STATA OUTPUT

I. Levin-Lin-Chu Unit Root Test for Stationarity of Economic Perceptions:

```
. xtunitroot llc dpercep

Levin-Lin-Chu unit-root test for dpercep
----------------------------------------
Ho: Panels contain unit roots             Number of panels  =    113
Ha: Panels are stationary                 Number of periods =     21

AR parameter: Common                      Asymptotics: N/T -> 0
Panel means:  Included
Time trend:   Not included

ADF regressions: 1 lag
LR variance:     Bartlett kernel, 8.00 lags average (chosen by LLC)
------------------------------------------------------------------------------
                    Statistic      p-value
------------------------------------------------------------------------------
 Unadjusted t       -56.8256
 Adjusted t*        -35.4555        0.0000
------------------------------------------------------------------------------
```

II. Principal Component Analysis:

a) Health status:

```
factor noisypregtet noisyimmun noisydelloc, pcf mineigen(0.5)
(obs=2486)

Factor analysis/correlation                        Number of obs    =     2486
    Method: principal-component factors            Retained factors =        2
    Rotation: (unrotated)                          Number of params =        3

    --------------------------------------------------------------------------
         Factor  |   Eigenvalue   Difference        Proportion   Cumulative
    -------------+------------------------------------------------------------
        Factor1  |      2.16765      1.57390            0.7225       0.7225
        Factor2  |      0.59374      0.35513            0.1979       0.9205
        Factor3  |      0.23861            .            0.0795       1.0000
    --------------------------------------------------------------------------
    LR test: independent vs. saturated:  chi2(3)  = 2932.76 Prob>chi2 = 0.0000

Factor loadings (pattern matrix) and unique variances

    -------------------------------------------------
        Variable |  Factor1   Factor2 |   Uniqueness
    -------------+--------------------+--------------
    noisypregtet |   0.9247   -0.0269 |      0.1442
      noisyimmun |   0.8001    0.5661 |      0.0393
     noisydelloc |   0.8200   -0.5220 |      0.0551
```

```
    ------------------------------------------------

. predict health1 health2


Scoring coefficients (method = regression)
    ----------------------------------
        Variable |  Factor1   Factor2
    -------------+--------------------
    noisypregtet |  0.42659  -0.04530
      noisyimmun |  0.36911   0.95347
     noisydelloc |  0.37829  -0.87925
    ----------------------------------
```

b) **Educational status**:

```
factor noiseprimenroll noisy_femattend noisylit, pcf mineigen(0.5)
(obs=2486)

Factor analysis/correlation                        Number of obs    =     2486
    Method: principal-component factors            Retained factors =        1
    Rotation: (unrotated)                          Number of params =        3

    --------------------------------------------------------------------------
         Factor  |   Eigenvalue   Difference        Proportion   Cumulative
    -------------+------------------------------------------------------------
        Factor1  |      2.46061      2.06294            0.8202       0.8202
        Factor2  |      0.39767      0.25595            0.1326       0.9528
        Factor3  |      0.14172            .            0.0472       1.0000
    --------------------------------------------------------------------------
    LR test: independent vs. saturated:  chi2(3)  = 4907.79 Prob>chi2 = 0.0000

Factor loadings (pattern matrix) and unique variances

    ---------------------------------------
        Variable |  Factor1 |   Uniqueness
    -------------+----------+--------------
    noiseprime~l |   0.8772 |      0.2305
    noisy_fema~d |   0.8834 |      0.2195
        noisylit |   0.9543 |      0.0894
    ---------------------------------------

. predict education
(regression scoring assumed)

Scoring coefficients (method = regression)

    ------------------------
        Variable |  Factor1
    -------------+----------
    noiseprime~l |  0.35651
    noisy_fema~d |  0.35903
        noisylit |  0.38781
```

c) **Housing Utilities**:

```
factor noisytoilet noisyelectrify noisycookingoil noisytapwater, pcf
mineigen(0.5)
```

```
(obs=2486)

Factor analysis/correlation                        Number of obs    =     2486
    Method: principal-component factors            Retained factors =        3
    Rotation: (unrotated)                          Number of params =        6

    --------------------------------------------------------------------------
         Factor  |   Eigenvalue   Difference        Proportion   Cumulative
    -------------+------------------------------------------------------------
        Factor1  |      2.06025      1.12235            0.5151       0.5151
        Factor2  |      0.93790      0.40393            0.2345       0.7495
        Factor3  |      0.53397      0.06609            0.1335       0.8830
        Factor4  |      0.46788            .            0.1170       1.0000
    --------------------------------------------------------------------------
    LR test: independent vs. saturated:  chi2(6)  = 1808.83 Prob>chi2 = 0.0000

Factor loadings (pattern matrix) and unique variances

    -----------------------------------------------------------
        Variable |  Factor1   Factor2   Factor3 |   Uniqueness
    -------------+------------------------------+--------------
     noisytoilet |   0.8128   -0.2071    0.0244 |      0.2959
    noisyelect~y |   0.7924   -0.1911    0.4802 |      0.1050
    noisycooki~l |   0.8007   -0.0189   -0.5422 |      0.0645
    noisytapwa~r |   0.3615    0.9264    0.0935 |      0.0025
    -----------------------------------------------------------

. predict housing1 housing2 housing3
(regression scoring assumed)

Scoring coefficients (method = regression)

    --------------------------------------------
        Variable |  Factor1   Factor2   Factor3
    -------------+------------------------------
     noisytoilet |  0.39449  -0.22081   0.04576
    noisyelect~y |  0.38460  -0.20376   0.89935
    noisycooki~l |  0.38865  -0.02012  -1.01547
    noisytapwa~r |  0.17546   0.98769   0.17508
    --------------------------------------------
```

III. **Cragg Double Hurdle Model (including parameter estimation)**

```
**craggit routine for estimating the impact of education**

.  craggit w urbanpop health1 health2 housing1 housing2 housing3 dpercep
education, second(mfb_avloan urbanpop health1 health2 housing1 housing2
housing3 dpercep education) het(mfb_avloan)

Estimating Cragg's tobit alternative
Assumes conditional independence

Number of obs   = 2486
                                                  Wald chi2(8)    =     254.91
Log pseudolikelihood =  -18590.57                 Prob > chi2     =     0.0000

------------------------------------------------------------------------------
             |
             |      Coef.   Std. Err.      z    P>|z|     [95% Conf. Interval]
-------------+----------------------------------------------------------------
```

```
Tier1        |
    urbanpop |   5.807517    .385545    15.06   0.000     5.051862    6.563171
     health1 |   .0298455   .0535265     0.56   0.577    -.0750645    .1347556
     health2 |   .0361642   .0427213     0.85   0.397     -.047568    .1198964
    housing1 |  -.1821038   .0617621    -2.95   0.003    -.3031553   -.0610524
    housing2 |   .0132549   .0344351     0.38   0.700    -.0542367    .0807464
    housing3 |   .1603585   .0408912     3.92   0.000     .0802132    .2405038
     dpercep |  -.2776277   .3921177    -0.71   0.479    -1.046164    .4909089
   education |   .1711063   .0572307     2.99   0.003     .0589363    .2832763
       _cons |  -.5409626   .0659512    -8.20   0.000    -.6702246   -.4117006
-------------+----------------------------------------------------------------
Tier2        |
    urbanpop |   6295.169   1162.473     5.42   0.000     4016.764    8573.574
     health1 |   3019.854   395.6563     7.63   0.000     2244.381    3795.326
     health2 |  -1346.815   263.2143    -5.12   0.000    -1862.706    -830.925
    housing1 |   320.4638    345.611     0.93   0.354    -356.9213    997.8489
    housing2 |  -1991.854    203.882    -9.77   0.000    -2391.455   -1592.252
    housing3 |  -340.1535   254.2527    -1.34   0.181    -838.4795    158.1725
     dpercep |   2366.707   2137.812     1.11   0.268    -1823.329    6556.742
   education |  -1318.905   427.4035    -3.09   0.002    -2156.601   -481.2099
       _cons |   10585.35   315.2702    33.58   0.000     9967.429    11203.27
-------------+----------------------------------------------------------------
sigma        |
       _cons |    6132.38   254.7204    24.07   0.000     5633.137    6631.622
------------------------------------------------------------------------------

.  predict x1g, eq(Tier1)

.  predict x2b, eq(Tier2)

.  predict sigma, eq(sigma)

.  gen IMR=normalden(x2b/sigma)/normal(x2b/sigma)

.  ** to calculate the marginal effect of independent variable on dependent
variables probability**

.  gen prob_education = [Tier1]_b[education]*normalden(x1g)

.  su prob_education

    Variable |       Obs        Mean    Std. Dev.       Min        Max
-------------+--------------------------------------------------------
prob_educa~n |      2486    .0494089    .0212457   1.45e-07   .0682615

.  ** to calculate the conditional marginal effect of independent variable on
the value of y**

.   gen dEyyx2_education=[Tier2]_b[education]*(1-IMR*(x2b/sigma+IMR))

.   su dEyyx2_education

    Variable |       Obs        Mean    Std. Dev.       Min        Max
-------------+--------------------------------------------------------
dEyyx2_edu~n |      2486   -1142.146    138.6343  -1318.893  -230.9162


. ***end craggit routine***
```

IV. **Cragg Double Hurdle Model Bootstrap Routine**

```
. program define APEboot, rclass
  1. preserve
  2. craggit w urbanpop health1 health2 housing1 housing2 housing3 dpercep
education, second(mfb_avloan urbanpop health1 health2 housing1 housing2
housing3 dpercep education)
  3. predict bsx1g, eq(Tier1)
  4. predict bsx2b, eq(Tier2)
  5. predict bssigma, eq(sigma)
  6. gen bsIMR = normalden(bsx2b/bssigma)/normal(bsx2b/bssigma)
  7. gen bsdEy_dxj=[Tier1]_b[dpercep]*normalden(bsx1g)*(bsx2b+bssigma*bsIMR)
+[Tier2]_b[dpercep]*normal(bsx1g) *(1-bsIMR*(bsx2b/bssigma+bsIMR))
  8. sum bsdEy_dxj
  9. return scalar ape_xj=r(mean)
 10. matrix ape_xj=r(ape_xj)
 11. restore
 12. end

. bootstrap ape_xj = r(ape_xj), reps(100): APEboot
(running APEboot on estimation sample)

Bootstrap replications (100)
----+--- 1 ---+--- 2 ---+--- 3 ---+--- 4 ---+--- 5
..................................................    50
..................................................   100

Bootstrap results                               Number of obs      =      2486
                                                Replications       =       100

      command:  APEboot
       ape_xj:  r(ape_xj)

------------------------------------------------------------------------------
             |   Observed   Bootstrap                         Normal-based
             |      Coef.   Std. Err.      z    P>|z|     [95% Conf. Interval]
-------------+----------------------------------------------------------------
      ape_xj |   2000.659   1925.521     1.04   0.299    -1773.293    5774.611
------------------------------------------------------------------------------

. estat bootstrap, all

Bootstrap results                               Number of obs      =      2486
                                                Replications       =       100
command:  APEboot
       ape_xj:  r(ape_xj)

------------------------------------------------------------------------------
             |    Observed               Bootstrap
             |       Coef.       Bias    Std. Err.  [95% Conf. Interval]
-------------+----------------------------------------------------------------
      ape_xj |   2000.6591   128.9787   1925.5212   -1773.293   5774.611   (N)
             |                                      -1504.945   5868.373   (P)
             |                                      -1816.892    5642.72  (BC)
------------------------------------------------------------------------------
(N)    normal confidence interval
(P)    percentile confidence interval
(BC)   bias-corrected confidence interval

. di normalden(2000.651/1925.5212)
.23253428
```

APPENDIX B

INTERVIEW SAMPLE DETAILS

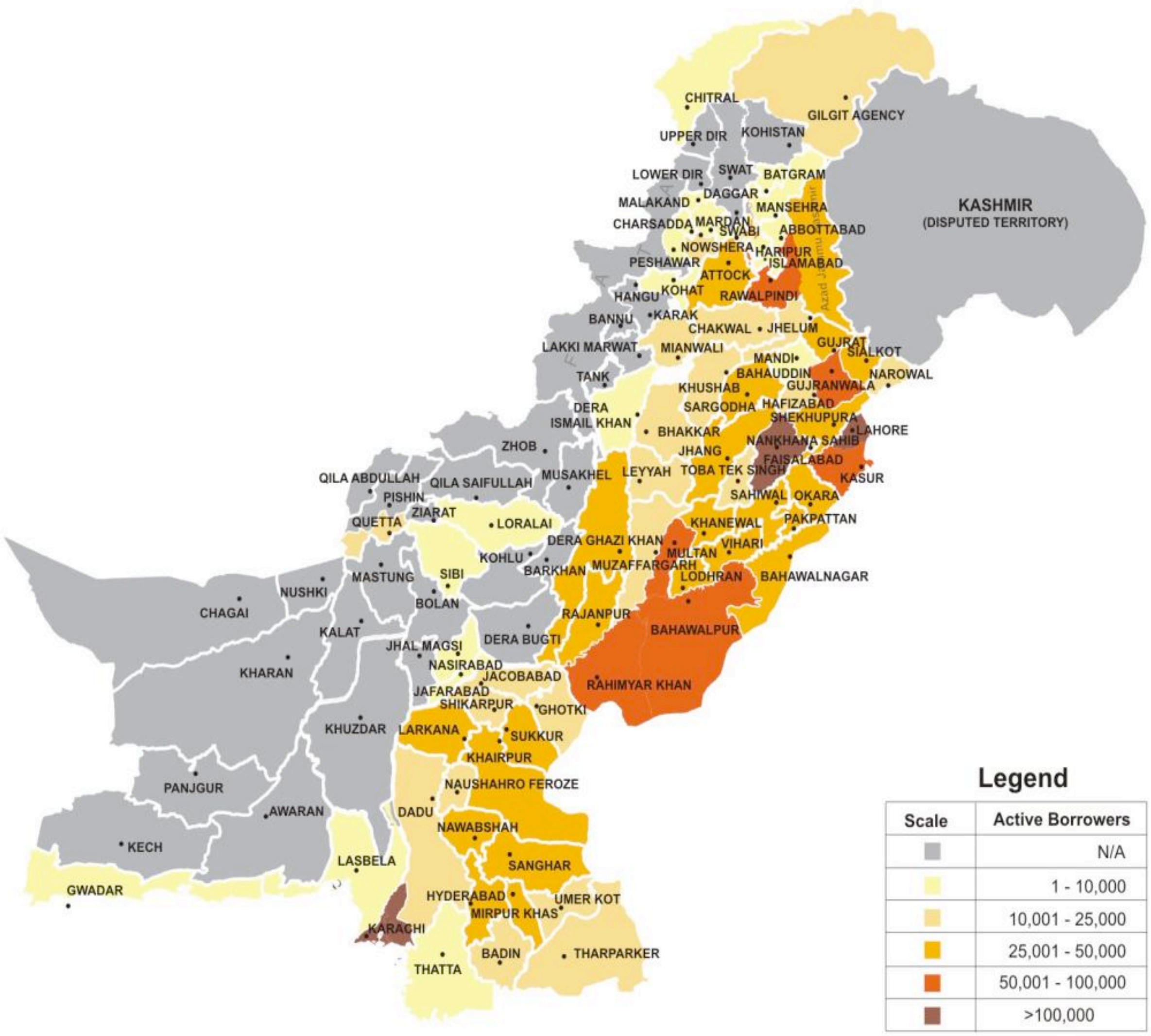
Details of Interview Sample		
Institution	**Designations**	**Location**
I. Key Informants		
State Bank of Pakistan	• Director, Microfinance Unit • Senior Joint Director • Senior Manager with field experience in managing MFBs	Karachi
Pakistan Poverty Alleviation Fund	• General Manager • Associate Financial Services Group • Recently retired Director	Islamabad
International Finance Corporation (IFC)	Investment Officer	Karachi
Independent Consultant	Engaged by UK's Department for International Development	Over the phone (stationed in Geneva)
Pakistan Microfinance Network	• Chief Operating Officer • Research Associate	Islamabad
National Rural Support Programme (NRSP)	• Program Coordinator • Director Finance	Islamabad
NGO Resource Center	Founder and Director	Karachi
II. MFIs		
Urban Poverty Alleviation Programme (subsidiary of NRSP, Pakistan)	• Regional Directors – Sindh and Districts of Lahore • 2 Branch Managers • Loan Verification Officers • 2 Loan Officers • "Auditor" – responsible for conducting surprise branch visits	Karachi and Lahore
Kashf Foundation	• Regional Director Sindh • Director Finance • Ex-Director • Officer, Gender Sensitization Unit • Research Manager • 2 Branch Managers • Accountant	Karachi and Lahore

Details of Interview Sample		
Institution	**Designations**	**Location**
	• 2 Loan Officers	
Association for Social Advancement (ASA) (subsidiary of ASA Bangladesh	• Chief Executive Officer (CEO) • Chief Operating Officer • Regional Branch Manager • Auditor • Loan Officer	Karachi
Bangladesh Rural Advancement Committee (BRAC) (subsidiary of BRAC Bangladesh)	• Regional Manager • Area Manager Karachi • Branch Manager • 2 Loan Officers	Karachi and over the phone
Orangi Pilot Project's (OPP) microfinance operations	Director Microcredit Program	Over the phone
Orix Leasing	• Regional Head • CEO • Director Microfinance Program	Karachi and over the phone
Thardeep Rural Support Programme	• Executive Director • Director Microfinance	Over the phone
Akhuwat	• Founder and Director • Manager Program Expansion • Assistant Manager Program • Loan Officer • 3 officers in training	Lahore and over the phone
III. MFBs		
Tameer Bank	• Executive Director Sales, Distribution & Business • Group Executive Director • Head Product Development • 2 Branch Managers • 2 Loan Officers	Karachi
First Microfinance Bank (FMFB)	• CEO • Ex-Chief Financial Officer • Manager Product Development • Regional Head Sindh	Karachi, Islamabad, & Hyderabad

Details of Interview Sample		
Institution	**Designations**	**Location**
	• 2 Branch Managers • 2 Loan Officers	
Khushhali Bank	• Head Operations • Area Manager - Karachi & Hyderabad • 2 Branch Managers • 5 Loan Officers • NGO Liaison	Hyderabad, Rawalpindi and Islamabad
Kashf Bank	Head Business Banking	Lahore
IV. Clients		
Tameer Bank, FMFB, UPAP, Kashf Foundation, ASA and BRAC	36 urban, active clients	9 low-income towns inside the city of Karachi
UPAP, Kashf Foundation & Akhuwat	13 urban, active clients	Lahore
Khushhali Bank	1 urban, active client.	Rawalpindi
Khushhali Bank	2 rural, active clients	Tando Allahyar

APPENDIX C

MICROFINANCE OUTREACH MAP



Source: Microwatch (2nd Quarter, 2012). Quarterly Bulletin of the PMN

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