PPAF

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PAKISTAN POVERTY ALLEVIATION FUND

A Catalyst for Change

Reshaping Civil Society Institutions for Sustainable Development

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FOREWORD

Pakistan Poverty Alleviation Fund is a pioneering government sponsored private sector initiative to deploy and manage investments across a wide range of sectors primarily microfinance, but also focusing on small scale infrastructure, health, education, training and capacity building. As an autonomous independent apex entity, the institution works with partner organizations to realize its vision of *"community empowerment through poverty focused development initiatives and interventions at the grass root level."*

Since commencing operations in April 2000, PPAF has emerged as one of the largest institutions of its kind in the world. Over the last eight years, it has had a far reaching impact on civil society organizations in the country and has catalyzed their development and transformation.

While PPAF publishes regular reports on its progress and activities, this report is the output of an externally commissioned exercise carried out by Maliha H. Hussein with assistance and support of the Evalution, Research and Development, and Media and Communication units. It aims to comprehensively document, review and reflect on performance of PPAF in taking the sector forward. Integral to the analysis are outcomes and impact on partner organizations, their communities and poor clients they ultimately serve.

Kamal Hyat
Chief Executive/Managing Director

Introduction and Background

SECTION I

OBJECTIVES OF PPAF

- To empower the poor and increase their incomes, especially women.
- To provide credit to partner organizations and assist them in expanding their poverty targeted microcredit programs.
- To provide grants and loans on a cost-sharing basis for development of small scale community infrastructure.
- To enable accessibility of disadvantaged communities to infrastructure, health and education services.
- To strengthen the institutional capacity of partner organizations and support them in their capacity building efforts with communities.

Source: **Project Documents 1998**

INSTITUTIONAL OVERVIEW

The Pakistan Poverty Alleviation Fund was established by Government of Pakistan as an innovative model of public private partnership, with a special focus on microfinance. Incorporated under section 42 of the Companies Ordinance 1984 as a limited by guarantee company, PPAF is regulated by Securities and Exchange Commission of Pakistan. As an apex organization, the role of PPAF is to act as a wholesaling intermediary, while its partner organizations (POs) retail on lending of funds and implementation of projects. In the last eight years, PPAF has established itself as a leading player in the development sector. It has positioned itself as a professional and highly credible apex institution with a strong and efficient corporate culture. Its partner organizations perceive PPAF as a catalyst which led to exponential growth in the microfinance sector, enabled a more integrated approach to rural development and allowed a long-term perspective to social mobilisation and community empowerment. They also agree that it has transformed them from charity driven organizations dependent on donor financing to organizations with clear business plans for becoming sustainable development partners. PPAF is thus helping to demonstrate how the double bottom line can be achieved for sustained poverty reduction.

ROLE OF GOVERNMENT

The credit for achievements of PPAF is in no small measure due to Government of Pakistan which assumed a substantial risk in launching of this institution. The GoP became promoter and financier of first resort through an endowment fund of $10m (equivalent). The proceeds of this endowment have been invested in government securities. The creation of PPAF was a completely new experiment in the country. It was the first time Government of Pakistan had accepted to pass on its own funds and those it had taken as loans to civil society organizations on this scale. Thus formation of PPAF and its modus operandi signalled the start of a new compact between state and civil society in Pakistan.

There were several completely new and innovative ways which the Government accepted and reflected in the structure and functioning of PPAF. Many apex organizations around the world have typically suffered due to political pressures and motivations which have influenced financing decisions. PPAF did not experience a single case of any such pressures being exerted on its management for influencing the flow of funds. Instead PPAF has based its decisions on the quality and strength of proposals received from partner organizations. While Government is represented on the Board of the PPAF, it is a minority representation. The Government presence has enabled PPAF to acquire credibility, fast track approvals and provide an enabling environment for the apex organization to function. Government's relationship with PPAF has been a key factor in growth and rates of expansion which the apex enjoys and is a model for other public-private sector partnerships.

GOVERNANCE & MANAGEMENT

The Articles of Association of PPAF prescribe a three-tier governance structure, comprising a General Body, a Board of Directors and a management team headed by the Chief Executive. PPAF is governed by a Board of Directors which consists of twelve members, out of which three are nominated by the Government from among Government-nominated members of the General Body, and eight are elected by the civil society members of the General Body (four each from NGO / partner organization and the academic / professional / business categories of members). The main responsibility of the Board is to determine direction and scope of activities of the Company. The General Body consists of 30 members out of which 8 members are nominated by the Government and the remaining 22 members represent civil society. The General Body of PPAF has been vested with powers to give overall policy guidance; consider financial statements of the Company; peruse annual budgets approved by the Board of Directors; consider the annual report prepared by the Board of Directors and appoint auditors.

These governing bodies meet regularly to guide operations of PPAF. The majority of members in both bodies represent the private and NGO sectors. Critically, the Board of Directors has understood its role as that of overall strategic direction, policy guidance and oversight. Considerable autonomy with appropriate safeguards has enabled PPAF to grow into the largest source of public spending for the civil society sector. PPAF's Operational Manual serves as a living document and governs its operations. In addition, strong appraisal procedures, on-site supervision, effective monitoring and evaluation systems and audit procedures are in place to oversee work of partner organizations. It is an indicator of the strength of its management and corporate governance that not a single case of misappropriation or misuse of funds has been reported since inception.

From a small base PPAF has grown into a corporate entity with a core staff of 195. In addition, project staff has been hired specifically for work in the earthquake areas. The first few years were devoted to developing

PROJECT CONCEPT AND DESIGN

PPAF operations and procedures have the following features:

- *Decentralised decision-making;*
- *Simple procedures and clear functional lines for efficient management;*
- *Flexible financing mechanisms subject to a rigorous appraisal process;*
- *Transparent selection procedures and criteria for sub-projects;*
- *Well designed management information systems;*
- *Effective monitoring and evaluation;*
- *Transparent and accountable use of funds with internal and external audits ensuring compliance;*
- *Capacity building of NGOs and community organizations.*

Source: **Project Documents 1998.**

GROWTH IN PPAF STAFF

	2001	2002	2003	2004	2005	2006	2007	2008
Management	25	27	39	42	49	75	120	154
Support	10	11	15	14	15	23	35	41
Total	**35**	**38**	**54**	**56**	**64**	**98**	**155**	**195**

work processes and procedures and incorporating them into its overall operational systems. Today PPAF has a dedicated unit for each component, typically led by a General Manager, with a Manager as his deputy. Four core programme units namely Credit and Enterprise Development, Human and Institutional Development , Community Physical Infrastructure and Health & Education constitute operational components. PPAF has recently added a separate Water Management Centre to facilitate its work in vulnerable/water deficit regions of the country. These units report to the Chief Operating Officer. To manage PPAF's work in earthquake affected areas, a Rehabilitation and Reconstruction Unit has been established. Two field offices in North West Frontier Province and Azad Jammu and Kashmir have also been set up to oversee and supervise onsite reconstruction.

The programme units are supported by functional units such as Finance and Accounts which ensures maintenance of financial records and appropriate financial, accounting and administrative procedures for PPAF and its POs. It also provides support services to other units and facilitates them by channelling resources and ensuring financial discipline. An Internal Audit department regularly reviews partner organisations to ensure transparency, accountability and efficiency of financial operations. The Evaluation, Research and Development unit at PPAF is responsible for assessment and research functions. The Human Resource unit is responsible for human resource development, administration and procurement related matters of the organization. A Media & Communication unit looks after public affairs, external relationship management and media related activities as well as awareness raising regarding activities of PPAF and dissemination of information.

FINANCING & RESOURCES

The resource base of PPAF consists of an endowment from Government of Pakistan (GoP), donor financing and income from investments. The GoP provided an endowment of US$ 16 million equivalent to PPAF. Endowment from the GoP serves as PPAF's equity and the interest income earned supports PPAF's core institutional costs. Its foreign donors have included the World Bank (IDA), International Fund for Agricultural Development (IFAD), United States Agency for International Development (USAID), United States Department of Agriculture (USDA), United States Committee Encouraging Corporate Philanthropy (CECP) and the German Development Bank (KFW). Under its first project, PPAF I (1999-2004), a World Bank credit of US$ 90 million was made available. Half of these funds were dedicated to microcredit and the other half to community infrastructure and capacity building. A follow-on project (PPAF II) was approved in

2004 by the World Bank with a funding of US$238 million. PPAF II was aimed at scaling up operations and researching innovations, while adding education and health as new areas of intervention. The World Bank has also recently approved US$ 75 million for enabling PPAF to continue its support to the social mobilization effort of its POs. PPAF received US$6.32 million from USAID for an enterprise development facility and capacity building and US$26 million from the USDA for projects in drought mitigation and prevention. IFAD has agreed to provide PPAF with funds for a Microfinance Innovation and Outreach Program (US$ 26m) and a Program for Increasing Sustainable Microfinance (US$ 35m) through linkages with the private/financial sector.

PPAF has also received considerable financing (US$293) for reconstruction in earthquake affected areas from multilateral, bilateral and private sources (WB, KFW, IFAD and CECP) for private housing, infrastructure, health, education, disability and livelihood restoration.

Credit funds have been on lent to PPAF by the Government and they have to be repaid to GoP within the time period agreed in its subsidiary financing agreements. The notion that a government created entity would be given more than 50% of its core funds as loans which in turn would assume the risk of disbursing these funds to POs and take on responsibility for returning these loan funds to the Government was a completely novel phenomenon. No other agency in the country dealing with the civil society sector had been given this type of responsibility before. Subsequently PPAF was also provided funds for the reconstruction and rehabilitation in the earthquake affected areas as a partner of choice of Earthquake Rehabilitation and Reconstruction Authority of the GoP.

PPAF has met stakeholders' expectation on development objectives, disbursements and effectiveness. Since inception it has maintained a 100% recovery rate from partner organizations. In addition it has repaid almost US$ 3 million to the Government fully in line with schedule of repayment.

SOURCES OF FINANCING

	Total US$ m
GoP	16
World Bank	641
USDA	26
IFAD	87
KfW	17
CECP	12
USAID	6
TOTAL	**805**

PROGRAMME FUNDS

	US$ m
Grants	569
Loans	220
Endowment	16

CUMULATIVE DISBURSEMENTS

Activity	Disbursements (US$ m)	Share
Lending for Credit & Enterprise	**510**	**56%**
Grant Funding		**44%**
Water & Infrastructure Projects	94	-
Health & Education Projects	7	-
Relief/Rehabilitation & Reconstruction Projects	249	-
Community Trainings (follow Up)	9	-
Sub total	**359**	**-**
Cost of Delivery/Operational Assistance	42	-
Capacity Building/Training	6	-
Total	**917**	**100%**

ACTIVITIES & INTERVENTIONS

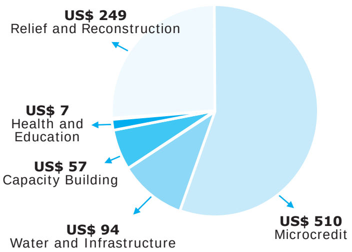
PPAF provides its partner NGOs four types of facilities which consist of (i) extending lines of credit for expansion of poverty targeted microcredit programs and enterprise development (ii) grants for water and physical infrastructure schemes (iii) social sector services (health and education) on a cost sharing basis and (iv) grants to strengthen the human and institutional capacities of POs as well as social mobilization and grass root development.

Apart from these core areas of operation, Pakistan Poverty Alleviation Fund is repeatedly called upon to work with communities suffering from natural calamities and disasters such as droughts and floods. PPAF also assumed responsibility of providing urgent rehabilitation and reconstruction in the aftermath of the 2005 earthquake in North West Frontier Province and Azad Jammu and Kashmir. In order to help communities in vulnerable areas develop cogent survival strategies, PPAF has established a separate Water Management Centre. No other organization in the country dealing with civil society organizations has such a wide spectrum of sectors within its domain of responsibility.

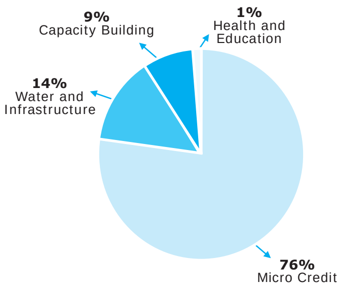
From initiation of activities in 2000 to the end of June 2008, PPAF had disbursed a cumulative total of US$917 million to over 70 partner organizations. On a cumulative basis it has disbursed US$510 million for credit, US$94 million for water and infrastructure schemes, US$57 million for capacity building/training, and US$7 million for health and education, along with US$249 million for relief , rehabilitation and reconstruction in the wake of the earthquake of 2005.

Microfinance is a core business line of PPAF and its share makes up 76% of cumulative disbursements (of core operations excluding earthquake). This is followed by community infrastructure schemes at 14%, capacity building at 9% and health and education at 1% of total disbursements. A review of PPAF operations indicates that while it started off by giving similar amounts for credit and grants, its loans for credit have quickly outstripped its grant operations. What is significant about PPAF's disbursements is that all credit funds are extended as loans to PPAF and PPAF in turn on lends to its partner organizations. While many organizations have intermediated grants funds, no other organization has ever taken the financial responsibility to disburse loan funds to the fledgling NGO sector on this scale before.

BREAK UP OF DISBURSEMENTS (AMOUNT)



BREAK UP OF DISBURSEMENTS (%)



TRENDS IN ANNUAL DISBURSEMENTS

US$ m

FY	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007	2007-2008
Microcredit	5.53	10.92	21.89	24.26	48.52	60.97	98.45	124.32
Water & Infrastructure	3.49	5.37	4.42	12.77	9.32	13.45	16.18	18.25
Capacity Building	0.94	3.51	3.29	3.4	6.27	6.49	7.06	6.45
Social Sectors	-	-	-	-	-	1.32	1.35	2.37

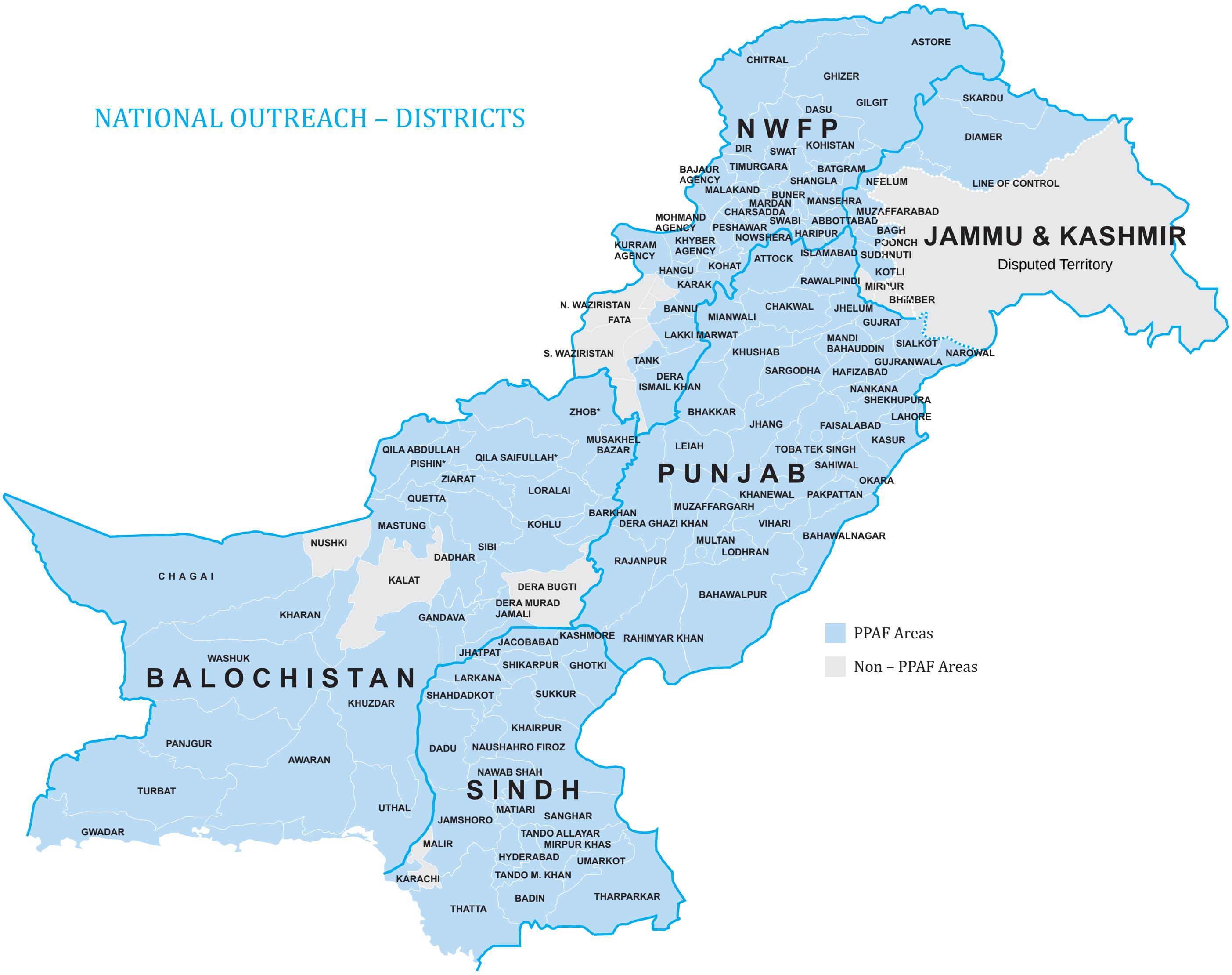
GEOGRAPHICAL DISTRIBUTION

PPAF resources and funds have been deployed equitably across urban/rural settlements, provinces, regions and areas. Overall, its financing has been deployed in 39,000 villages in 129 districts across the country. About 56% of the resources have been deployed in Punjab, 27% in Sindh, 7% in North West Frontier Province 6% in Balochistan and 4% in Northern Areas and Azad Jammu & Kashmir. Additionally, PPAF was also given dedicated responsibility for 34 union councils for housing reconstruction and rehabilitation in earthquake affected areas.

RESOURCE DEPLOYMENT – OUTREACH

	2001	2002	2003	2004	2005	2006	2007	2008
Partner Organizations	13	29	38	42	56	68	70	75
Districts	35	60	84	95	97	108	111	120
Villages /Locations	2,463	4,223	8,650	13,054	19,863	23,354	27,578	39,000

NATIONAL OUTREACH – DISTRICTS



CHANGING SECTOR ORIENTATION

In 1999 most NGOs were running their microcredit programmes from outright donor grants. The sector was not at a stage where it was considering loans to finance its programmes. There was little consideration given to the source of funds that would fuel future growth. By and large no NGOs were reporting any financial cost on borrowings because they did not incur any cost on this account. While there is considerable debate around what constitutes sustainable interest rates, what is often forgotten is that PPAF was the first organization which changed the expectations that NGOs could only operate with grants. Prior to PPAF, the POs had not taken loans to finance their lending operations. PPAF thus brought about a significant shift in the institutional mindset of these organizations, subsequently reflected in organizational culture, appraisal criteria, staffing pattern, financial systems and monitoring and evaluation.

The establishment of PPAF signalled a paradigm shift in public policy regarding who should provide financial services for the poor. The government identified microfinance as a powerful tool for poverty alleviation in its Poverty Reduction Strategy Paper. Prior to PPAF, the main instrument designed for service provision for the under-served and/or priority sectors had been the directed credit schemes administered through nationalized commercial banks and specialized financial institutions. With the establishment of PPAF, it was clear that the Government was willing to (i) invest in a public-private sector approach to microfinance (ii) give considerable autonomy to PPAF to test this approach and (iii) use NGOs as the main vehicle for delivery. The approach was all the more significant as prior to this the Government attitude towards NGOs had seemed, at best, ambivalent.

The establishment of PPAF was followed shortly by the approval of the microfinance policy framework in 2000 and marked the continuation of the reforms of the microfinance sector. The diversification of the microfinance markets was facilitated through the promulgation of the Khushali Bank Ordinance 2000 and the Microfinance Institutions Ordinance 2001. The policy clearly saw microfinance as a sustainable commercial activity run by the private sector along with the government providing enabling policy support under the supervisory framework of the State Bank of Pakistan. The regulation was designed to support three potential sources of growth in the sector. These included (i) transformation of microfinance institutions (MFIs) into microfinance banks(MFBs), (ii) the establishment of new MFBs, and (iii) encouraging downscaling of commercial bank operations and offering microfinance services. While it was clear that the entry of microfinance banks would be

Today the microfinance sector in Pakistan has developed low-cost delivery mechanisms with a per-borrower cost of delivery which is among the lowest in the world.

Source: Pakistan Microfinance Network

encouraged due to the substantial reduction in the seed capital requirements and simplification of the licensing procedures, supervisory regulations and disclosure standards, what was not clear was what would encourage MFIs to convert to banks and the incentives for commercial banks to downscale.

In the last three years PPAF has spent more than US$ 6 million every year on capacity building of its POs. This is more than the contribution from any other agency for this purpose.

MOVING TOWARDS SUSTAINABILITY

There was little conception of working towards sustainability in microfinance when PPAF first started its operations. For many years the main providers in the sector were NGOs which started microfinance as one of their many activities. They initiated microfinance more as an instrument for social mobilization than as a sustainable financial product. Some of the leading organizations had not properly separated out their microfinance operations from their other operations or assigned notional costs to their microfinance operations. The leading microfinance practitioners are now beginning to transform their microfinance programmes. They have all either already separated their microfinance programmes from other services or are in the process of doing so. PPAF now requires its large Partner Organizations to maintain activity-based accounts for their microfinance operations. These steps will not only improve transparency in the sector but will also result in improved performance of microfinance providers (MFPs) by giving a complete and accurate picture of their financial and operational health and performance.[1] It is part of the same orientation that has made the MFIs conscious of the costs of their operations. Pakistan has made considerable progress over the last decade (1996 – 2006) in bringing cost of credit delivery to globally competitive levels and managing loan repayments at regional benchmark. Today the microfinance sector in Pakistan has developed low-cost delivery mechanisms with a per-borrower cost of delivery which is among the lowest in the world.[2]

In 1999, the leading PMN members at that time[3] were reporting an overall operational self-sufficiency ratio of 173% mainly because of the returns from their other investments and sources of income and not because of their microfinance operations. Increasingly, NGOs have separated out the cost of their microfinance operations from their other programmes and today those organizations for which comparative data are available show that they have moved from an average operating self-sufficiency ratio of 27% in 2000 to 89% in 2008.[4] Today, the PMN reports an overall Financial Self Sustainability of 67% for the sector as a whole.[5]

[1] Performance Indicators Report 2007.
[2] Pakistan Microfinance Network.
[3] These included AKRSP, SRSC, SAFWCO, Sungi, Kashf and OPP.
[4] The data compares three MFIs namely Kashf, DAMEN and SAWFCO.

TRAININGS FOR PO STAFF

Training Events	**1,180**
Number of Staff	**12,859**
Men	8,312
Women	4,547

TRANSFORMING INSTITUTIONS

Since promulgation of the Microfinance Ordinance most NGOs are not yet in a position to transform into banks although two are close to doing so. This implies that while a supportive regulatory environment is essential for the growth of the sector, on its own it is not sufficient. One of PPAF's most significant contributions has been that it has brought a few of its leading partners to be positioned to transform. The fact that these two MFPs (NRSP & Kashf) have received the bulk of PPAF's cumulative funds and the major share of its capacity building funds has no doubt been responsible for enabling them to reach this stage. Kashf is among the first to recognise that it had never envisaged such a rapid expansion when it was first established. For NRSP, PPAF is the primary source of funds, while for Kashf PPAF helped the organization embark on its high growth trajectory in its early years.

HUMAN RESOURCE DEVELOPMENT

Another indicator of the fledgling nature of the sector when PPAF first started its operations was the number of credit officers employed in the microfinance sector just prior to the establishment of PPAF. In 1999 this totalled 100 staff of which 65 were with just two organizations – Aga Khan Rural Support Programme (AKRSP) and the Sarhad Rural Support Corporation (SRSC). Today the leading NGO MFIs and the Rural Support Programmes (RSPs) have between them more than 9,000 personnel. PPAF has contributed more than US$ 40 million to capacity building in the sector up to the end of June 2008. In the last three years PPAF has spent more than US$ 10 million every year on capacity building of its POs.

Sustainability is not just about financial soundness, but competent human resources are also critical to long-term viability of institutions. Although Pakistan has some top-level universities and training establishments, MFPs find it difficult to attract and retain good staff, especially middle management willing to work in rural areas. Qualified accountants are not easy to find, graduates with the managerial, strategic thinking skills, and the judgment necessary to open and manage branches and lending, are rare. Some multi-service institutions are staffed with middle management that comes from social service backgrounds and lack financial management experience. The human resource investment of PPAF in the sector has been enormous. PPAF has held more than 1,180 training events over the last eight years and trained 12,859 PO staff members. Of these 8,312 were men while 4,547 were women. PPAF provided capital and technical assistance to a core

[5] Performance Indicators Report 2006. Pakistan Micro-Finance Network.

group of emerging MFPs in the country, which laid the foundation for growth of the sector at an early stage, because very few MFPs were savings based, and commercial banks did not have significant appetite for lending to emerging MFPs.

SHARE OF THE MARKET

In 1998, prior to PPAF operations, the microfinance sector was at a nascent stage. There were a handful of NGOs involved in the sector with the total number of 65,000 active borrowers[6]. The total loan amount disbursed in 1999 by the major NGOs was just under US$ 4 million. Over the last 8 years, PPAF has been instrumental in increasing outreach by injecting over US$ 510 million into the sector. By the end of December 2008, the sector had 1.7 million active borrowers and PPAF held a share of 38% of the total microfinance market in Pakistan. An analysis of the trend of PPAF disbursements shows that its microfinance operations have grown at exponential rates over the last eight years. The main growth in the microfinance sector today comes from PPAF supported MFPs.

PPAF had extended financing to 48 (that includes 3 new young partners under IFAD-MIOP) partner organizations up to the end of December 2008. Concurrent with loans, PPAF also provides an average operating assistance to the partner organizations of about 10 percent of the loan amount which is subsequently declined according to individual PO circumstances. One of the key roles of PPAF is to undertake a risk assessment of its partner organizations and formulate careful selection criteria for them based on demonstrated track record, outreach, focus on the poor and capacity to sustainably deliver on their stated targets. Cumulatively, PPAF has enjoyed a quality credit portfolio, with a loan repayment rate of 100 percent. PPAF has played a critical role in the microfinance industry by providing an impetus to the sector, by increasing its implementation and absorptive capacity, by fostering entry of new players, and by providing financing for the exponential growth in the sector. PPAF supports organizations which provide a major share of the total coverage in the sector today. Without its support many of its partner organizations would not have been able to emerge as potential leaders in the field. Many are now poised for rapid growth and are expected to be key vehicles for alleviating poverty in the country.

DIVERSIFYING PRODUCTS & SERVICES

PPAF has helped a number of organizations modify their financial products thereby serving the financing requirements of its clientele more adequately. The Pakistan

[6] USAID 'A Decade of Microfinance in Pakistan' 2006.

microfinance market is dominated by one financial product (credit) and most MFPs use a methodology inspired by the Grameen or rural support model. Clients make do with institutions that nearly all offer an identical service, typically a small loan with six- to eighteen-month tenor and group/peer guarantees. PPAF helped to diversify the choice available for the poor. For example, for Kashf Foundation (KF), PPAF helped to almost double the size of its loans from an average of US$ 47 to US$ 82 in 2000 and even today the average size of the loans that KF extends from PPAF financing is US$ 237 compared with US$ 160 from other sources. This is particularly significant when one notes that the larger loan sizes have been assessed to have a far higher potential compared with smaller loans. PPAF also ventured into the high pay-off enterprise development loan in which it has attempted to serve the middle market segment where loan requirements ranged from US$ 500 to US$ 1500. PPAF has recently initiated another credit window which offers its partners the opportunity for innovation and pilot testing of ideas for diversifying the range of financial products and approaches under the IFAD-financed Microfinance Innovation and Outreach Project focused on rural areas of the country.

As a result of enhanced capacity through the various projects supported by PPAF, POs are able to introduce a number of innovative new products and services like savings, insurance, housing longer tenor loans, and have also been able to introduce Islamic microfinance and risk sharing instruments in different areas.

PORTFOLIO CONCENTRATION

With PPAF as the major contributor, the microfinance industry has grown more than nine times, even though coverage is still small. While some POs are still dependent upon PPAF, the dependence of others has been highly variable and has shifted dramatically over the years. An analysis of the top eight partner organizations of PPAF indicates the constantly evolving nature of their microfinance operations.

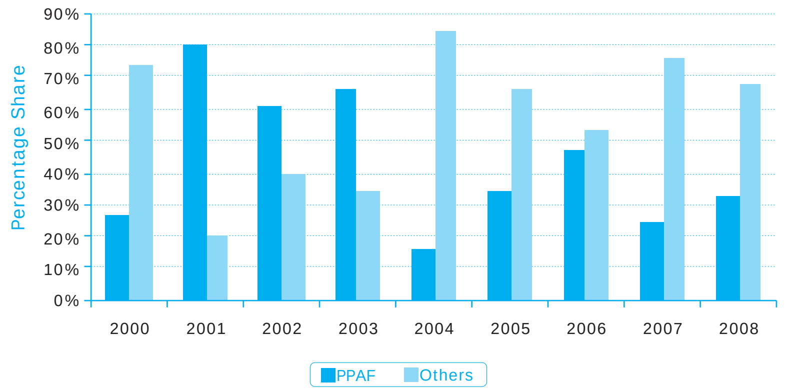
LEVERAGING FOR GROWTH

A general criticism levied against apex organizations is that they discourage borrowing from commercial sources by making large amounts of subsidized funds available to MFPs. PPAF has often faced the same criticism. In the case of Kashf, PPAF has helped to leverage its growth so that today it is able to borrow from the commercial market. Historical data shows that from 2001 to 2003, PPAF was the major source of funds for Kashf. Kashf had disbursed US$33 million last year from which PPAF's share was only US$ 8 million. The case of Kashf Foundation illustrates that for those POs which have the equity base to seek other sources of

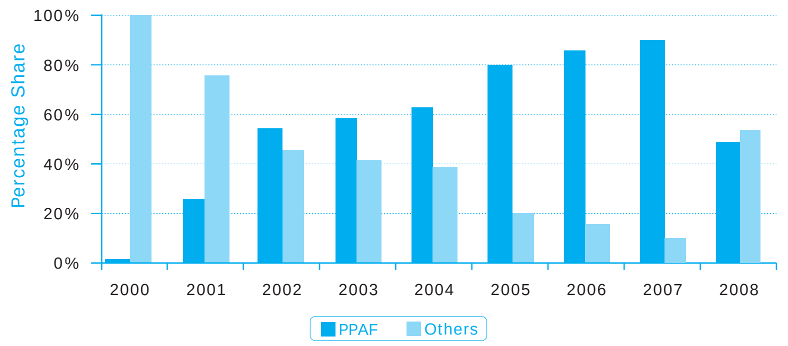
LENDING PARTNER ORGANISATIONS

PO Name	Credit Outstanding(US$m)		Active Clients(No.)	
	PPAF	Others	PPAF	Others
NRSP	47.50	4.33	325,731	30,756
KF	16.37	31.01	127,342	207,940
DAMEN	4.07	-	36,897	-
TRDP	3.82	0.01	29,629	33
CSC	2.66	-	17,075	-
PRSP	2.45	5.47	28,850	47,248
SAFWCO	2.03	0.03	19,925	172
BRAC	1.77	1.51	13,513	15,687
TOTAL	**80.67**	**42.35**	**598,962**	**301,836**
Share	**66%**	**34%**	**66%**	**34%**

Kashf FOUNDATION



NATIONAL RURAL SUPPORT PROGRAMME



funds PPAF has not discouraged them from borrowing from these sources. In fact to the contrary, Kashf Foundation has capitalized on PPAF contributions to raise debt and equity, and has signed a US$ 8 million Commercial Loan Facility, with a consortium of commercial (local as well as foreign) banks. This is the first local currency loan syndication for an MFI in Pakistan and will provide innovative and diverse funding to support Kashf's significant growth plans. Additionally, long-term financing through a Privately Placed TFC issue - the first private placement for a micro finance institution in Pakistan has already been structured. For others which have had a smaller equity base and are unable to borrow sufficient amounts to fuel their rapidly growing portfolio, PPAF has enabled them to finance their growth itself. From annual disbursements of US$ 10 million in 2000, NRSP (focused on the more risk prone rural areas), was disbursing US$ 73 million in 2008 predominantly with PPAF funds.

ACCESSING COMMERCIAL FINANCE

In the past, PPAF has primarily worked with non-government organizations and has only supported one or two commercial institutions which have sought its assistance in developing innovative microfinance products for the poor. PPAF is currently designing a new approach in which it plans to play a catalytic role in the sector. For the future, PPAF's strategy is to graduate those from among its partners who have developed a sustainable strategy and a financially sustainable business plan to the next level. With financial assistance from an IFAD, PPAF sees an opportunity to use its available resources to intermediate credit enhancement arrangements with the commercial sector banks rather than providing loans directly to the POs. These arrangements are seen as potentially including equity investments, guarantee funds, syndicated loans, bond issues and other mechanisms to minimise and share risk to enable its POs to borrow from commercial sources.

PPAF believes that this approach would help to direct commercial credit to those which have appropriate risk appetites to grow. It would also reduce the debt burden of the country as POs would have access to commercial credit rather than subsidized donor credit. For instance, an organization like BRAC, which has recently developed a large expansion plan for coverage to all parts of the country, will need PPAF help to access commercial credit. Such an approach by PPAF would open up many other opportunities to facilitate sustainable growth of the sector. This inclusive approach by PPAF will enable it to promote rapid growth of the sector, profit from the favourable regulatory framework, foster partnerships with different sector players to capitalize upon their strengths, and enhance its own professional capacity to play this leadership role. This strategic shift will help to address some of the key issues in the sector.

FROM CHARITY TO BUSINESS PLANNING

PPAF has led the culture change in the microfinance sector; it has moved microfinance from being a charitable activity to a business activity. Prior to this the main reason for the attention which microfinance received from GoP, donors, and the Pakistani civil society was that it was perceived as a kind of charitable activity which through social transfer payments would help reduce poverty. PPAF has moved the sector to a different paradigm and promoted it as a business model. It has done this by moving NGOs from a grants based orientation to a financial intermediation one word. Along with that PPAF has also moved them to a graduated interest rate policy which is moving closer and closer to market based interest rates. NGOs can currently obtain loans from PPAF at 8% interest rates while banks and leasing companies providing microfinance services can obtain them at 10%. The PPAF policy of not charging purely market based interest rates, stems from the premise that it would be unrealistic to expect that NGOs can move to this position overnight. PPAF believes that by investing these funds initially it can help its POs build their capital base and gradually be able to access capital markets.

TRENDS IN INTEREST RATES

PPAF has begun to link its interest rates to the interbank rate in order to gradually move its largest POs towards sustainability. PPAF mandates that its POs charge clients interest rates that fully cover costs and fix rates that are not less than the long-term deposit rates. It believes that each PO must, based on a viable business model, determine its own trajectories of growth and yields. Passing on subsidies (to end users) means that institutions forgo the opportunity to become strong enough to raise commercial capital or intermediate funds, and to grow independently of donor funds. PPAF believes that subsidies can skew the credit culture because clients are not exposed to the real cost of obtaining credit. Although it may seem morally attractive to pass subsidies to clients, it actually prevents a larger number of people from accessing services in the long run, because institutions cannot expand significantly without using initial subsidies to build their own capacity. Well-structured, smart subsidies invested well can yield ongoing returns, not just a one-time resource transfer. A historical review of interest rates in the microfinance sector shows that interest rates have become less distorted and are approaching market based levels.

One of the key challenges in the sector in Pakistan is that most MFPs do not charge their clients interest rates that are high enough to enable them to cover their costs and grow their portfolio at the same time. A look at average operating expenses of PMN members compared with revenues generated from loan portfolio (yield on portfolio) suggests that MFPs are not pricing their loans appropriately.[7] On one hand, average operating expense ratios of the leading MFIs are basically in line with the region's overall low ratios at 22.4 percent compared with 22.8 percent for all of Asia. On the other, revenues generated from loan portfolio (i.e. yield on portfolio) are low for leading MFIs compared with peers in Asia on average.[8] While PPAF has not directly tried to dictate interest rates, the fact that it requires POs to pay interest rates on funds it lends them has impacted PO policy on interest rates together with the incentives to move to market based pricing. The precondition of raising yield on portfolio for sustainability and growth of the microfinance sector in general and for individual microfinance providers in particular, is fully recognized and accepted across the industry by key policy drivers. Thus it is anticipated that in the next few years the pricing structure of most of these organizations will shift towards sustainability. There is preliminary evidence to suggest that this is beginning to happen.

[7] Pakistan Microfinance Network.
[8] Pakistan Microfinance Network.

EVALUATION & IMPACT

Pakistan has witnessed rising trends in levels of absolute poverty during the 1990s, peaking at 34 % in 2001. In the period of 2001 to 2005, this trend was arrested and poverty declined to 24%, measured on a head count basis[9]. Plotting HIES/PSLM data for 2005-06 gives a nominal poverty line of approximately Rs. 950 per adult equivalent per month (based on an intake of 2,350 calories per adult per day required for subsistence). The distribution of population falling above and below this line gives an estimated indication of the incidence of poverty in Pakistan.

Some research assert that most MFIs do not reach large numbers of very poor people. Some studies show that there are limits to the use of credit as an instrument for poverty eradication, including difficulties in identifying the poor and targeting credit to reach the poorest of the poor. Added to this is the fact that many people, especially the poorest of the poor, are usually not in a position to undertake an economic activity, partly because they lack business skills and even the motivation for business.[10] The Microcredit Summit asserted that internationally 58 % of the micro-clients represented the poorest. From a host of surveys which include some of the largest PPAF POs it appears that at least 50% of the clients receiving loans can be classified as poorest.

Following the World Bank standard for defining the poor as those with an income of US $1 per day per person, a major PPAF PO (Kashf) assessed that 89% of its clientele spend less than $ 1 per day per head.

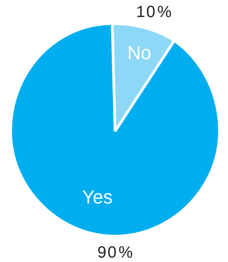
The microfinance sector had an active base of 1.7 million borrowers at the end of December 2008 of which PPAF was the largest single source of financing, held a share of about 45%. There are a number of case studies available in Pakistan to show the impact of microfinance on the lives of the poor. Some NGOs and RSPs have conducted regular studies to show the impact of microfinance on their clients. However, the most extensive, representative and statistically significant national level studies to date were commissioned by PPAF. The first was conducted in 2002 and covered 1800 households and a second study was conducted in 2005 with a sample of 3000 households. These studies reported: “there is adequate evidence to suggest that on the average low income households who borrowed from PPAF POs are better off today that they would have been if they had not borrowed.”[11]

In answering the simple question regarding the perceived benefit of the loan from PPAF sources, 90% of the borrowers responded positively and indicated that the loans had benefited them. In addition 86% of the borrowers

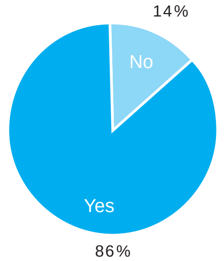
POPULATION & POVERTY BANDS

2005-06	% Population
Non-poor	20.9
Quasi non-poor	36.3
Vulnerable	20.5
poverty line	
Poor	16.4
Ultra poor	5.4
Extremely poor	0.5

DID THE PPAF LOAN BENEFIT YOU?

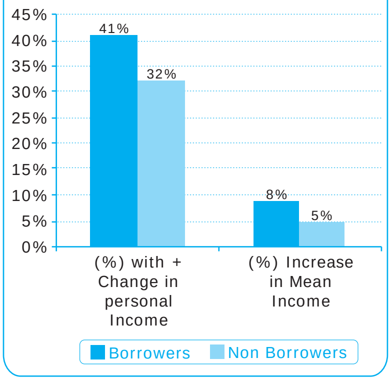


WILL YOU TAKE ANOTHER LOAN FROM PPAF?

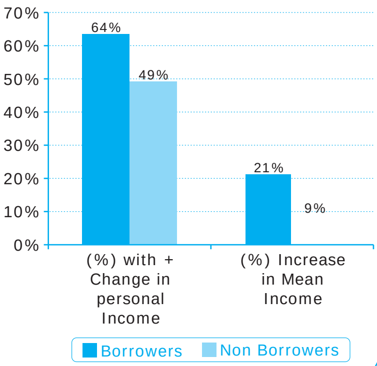


[9] Pakistan Economic Survey 2007-08
[10] PMN. Impact of MicroCredit on Poverty and Gender Equity. 2003.
[11] PPAF MicroCredit Financing. An assessment of Outcomes. 2005.

GALLUP SURVEY I (2002)



GALLUP SURVEY II (2005)



were reported to be satisfied with their experience and expressed a desire to borrow again from the same partner organization.[12]

The surveys commissioned by Pakistan Poverty Alleviation Fund were external third party exercises with treatment and control groups that tested 18 hypotheses on monetary and non-monetary indicators to nationally represent the microcredit portfolio; the sample covered 100% of PPAF POs. They undertook a detailed assessment of change in both personal and household incomes/expenditures and found that on the whole around 41% of borrowers and 32% of non-borrowers experienced positive change in their personal income over the period under study. The difference between the two groups was found to be statistically significant. The increase in the mean income of the borrower group was proportionately higher (8%) compared to the non-borrowers (5%). Survey by Gallup (2005) notes that there is "overall improvement in the income as well as personal and business assets of PPAF borrowers". This survey noted that 64% of those who had borrowed in contrast to 49% of the non-borrowers experienced positive change in their income. The increase in the average personal income of the borrower group from previous to current year was 21% for the borrower group and 9% for the non-borrower group.[13]

Based on GoP data and statistics it is estimated that at the top end of the spectrum, incomes will have to be increased by 5 to 30 percent to move 15% of the population above the poverty line. The most likely prospect for the move out of poverty is for the group of households in this category just below the poverty line. Roughly 17% of the population will need an increase of between 30 to 75 percent to move them above the line and

INCREASE IN INCOME REQUIRED TO MOVE OUT OF POVERTY

Income Category	Percentage Population in the Category	Percentage Increase in Income Required to Get them out of Poverty
Rs 4,000 to Rs 5,000	14.65%	5% to 30%
Rs 3,000 to Rs 4,000	16.95%	30% to 75%
Rs 2,000 to Rs 3,000	14.73%	75% to 162%
Rs 1,000 to Rs 2000	5.47%	152% to 424%
Less Than Rs 1000	0.71%	> 425%

Source: Pakistan Integrated Household Survey.

[12] PPAF MicroCredit Financing. An assessment of Outcomes. 2005.
[13] PPAF MicroCredit Financing. 'An Assessment of Outcomes'. 2005.

WOMEN CLIENTS OF PARTNER ORGANISATION

- **65%** of the women clients were ***married*** when they were ***under 18 years of age***. Hence at the time of marriage these women are ***extremely vulnerable*** and are totally dependent on their husbands and in-laws for financial support.
- **62%** of the respondents were ***illiterate***, **17%** barely knew how to ***read and write*** and only **21%** had achieved ***education greater*** than the ***primary level.***
- **50%** of the women did not ***play any role*** in ***deciding*** whether ***they can or cannot work outside the house***.
- **40%** of the women indicated ***not playing any role*** in ***family businesses.***
- **57%** were ***homemakers*** and ***did not work outside the house.***
- **43%** of the women were ***involved*** in ***paid labour*** of which ***30% worked outside the house***, and about ***13% worked inside their houses.***
- **53%** of the respondent women felt that the ***role*** of the women was to ***run the household*** and ***take proper care of their children.***
- **95%** of the women thought that the ***role*** of women could be ***further improved*** by giving them ***access to better education.***

Source: Study of Kashf's Current Client Profile. January 2005. Kashf . Poverty Assessment 2006.

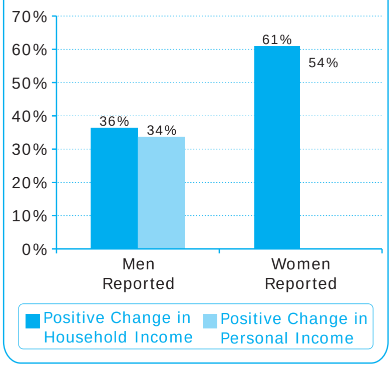
about 20 percent will need an increase of between 75 percent and more than 400 percent to get them to the poverty line. Kashf (based at Lahore) in its surveys indicates that the average income of Kashf clients rose by 30% in one year. Its last impact survey also claimed that its loans have helped a substantial number of households rise above the poverty line, not just in absolute terms, but also as compared to non-clients; as many as 32 percent of client households below the poverty line last year, have moved above the poverty line this year.[14]

While most MFIs maintain that they do not discriminate against women and offer the same accessibility to women as they do to men, there are others who cater predominantly or exclusively to women borrowers. There is a wide divergence in the number and amount of loans that have actually been given to and through women. MFIs increasingly prefer to look at households as their client rather than making the decision based on gender. Some, while targeting households, give loans only through women. Others focus on entrepreneurs and the working poor and have found it preferable to work with men. According to MicroWATCH, women made up 47% of the active borrowers in Pakistan at the end of September 2007. This is well below the figures in other countries where the sector is often dominated by women.

The impact assessment commissioned and externally conducted by Gallup on behalf of PPAF on the microcredit clients of PPAF found that when results

[14] 'Impact Assessment of Kashf'. Arjumand and Associates. DFID. December 2003.

GENDER DIFFERENTIAL IN HOUSE HOLDAND PERSONAL INCOMES



are disaggregated by gender, the impact reported by women was far greater than that reported by men. An analysis of the change in borrower's household income shows that while 36% of the male borrowers reported a positive change in household income as many as 61% of the women borrowers reported an increase in household income. Similarly, 34% of the men reported a positive change in personal income compared to 54% of the women who reported such an increase. The study also reported change in personal social status by gender. This comparison found that in each case women reported a higher increase in all respects compared with men, especially in mobility and solicitation of advice in property and other major household decisions. The greater impact reported by women is consistent with findings from other countries which also report a more significant impact of loans provided to women on key households indicators.


SINGER

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