What Make Microfinance Apexes Work?

By

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ACRONYMS

BoD	Board of Directors
CGAP	Consultative Group to Assist the Poor
CIB	Credit Information Bureau
CSR	Corporate Social Responsibility
EDF	Enterprise Development Fund
IFAD	International Fund for Agricultural Development
MFI	Microfinance Institution
MFP	Microfinance Practitioner
NGO	Non-Government Organization
NRSP	National Rural Support Programme
PMN	Pakistan Microfinance Network
PO	Partner Organization
PPAF	Pakistan Poverty Alleviation Fund
USAID	United States Agency for International Development

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1. Historical Context – Microfinance & Need for Apexes

Issues of job creation, poverty alleviation and sustainable development have challenged, and continue to challenge economic managers of developing countries across the world. Microcredit, or more broadly microfinance, with its promise to deliver all three, thus seemed like a dream come true. Although recent crises and the resulting criticism have caused microfinance to lose some of its "fairy dust[1]", it remains a vital weapon in the war against poverty and financial exclusion.

As a concept, microfinance goes back for centuries. Informal savings and credit groups have been around for a long time, and even formal mechanisms (mostly targeting the rural poor) have existed for decades at least. It was in the 1970s that we see modern microfinance emerging through experiments in countries such as Bangladesh and Brazil, where tiny loans were made mostly to poor women for enterprise purposes. Governments, for a long time also, have been interested in providing formal credit to those who are not catered to by commercial financial institutions. Mechanisms adopted to deliver credit have usually involved setting up specialized public sector institutions or using directed credit mechanisms. For example, in Pakistan, the Agricultural Bank and Agricultural Development Finance Corporation (ADFC)[2] were set up soon after independence in the 1950s precisely to provide farmers with an alternative to informal credit.

Commercial banks were also given mandatory agriculture credit targets. A government-led cooperatives movement was also launched with the promulgation of the 'Establishment of Federal Bank for Co-operatives and

[1]- Borrowing the term from the Microfinance Banana Skins 2011, published by CSFI.
[2]- These were merged to form the Agriculture Development Bank of Pakistan (ADBP) in 1961, which is now known as the Zarai Taraqiati Bank Limited.

Regulation of Co-operative Banking Ordinance' in 1976. Similar trends were seen in most developing countries.

This model was not successful for many reasons. Subsidies, elite capture and political interference created unviable and unhealthy institutions. Government realized that it lacked expertise in providing banking and financial services and this was best left to the private sector. Developing countries began to transition towards financial sector liberalization during the 1980s, with de-nationalization of banks and financial institutions, interest rate liberalization, removal of directed credit and allowing private ownership of banks. Financial liberalization in Pakistan since the 1990s, for example, has resulted in transfer of nearly all banking assets in Pakistan into private hands. At present, over 80 percent of the banking sector's assets are privately owned in Pakistan.

However, the experience of liberalization has shown that private sector banks have little commercial incentive to serve the small borrowers or savers when there is a large unserved upscale market. The current fiscal situation of the government is only aggravating the situation as the commercial banks earn a substantial spread by investing in risk free treasury bills instead of lending to the private sector, let alone going down market. According to the Access to Finance Survey 2007, only 12 percent of Pakistan's population is formally served, whereas 32 percent is tapping into the informal market and an overwhelming 56 percent is financially excluded.

This creates an urgent need for the policymakers to find ways in which to provide access to finance to the marginalized. Microfinance, with its ability to reach the low income in a sustainable manner, is thus an obvious choice for economic managers. The challenges on a practical level in implementing a strategy using microfinance are many: who will provide the services? Where will the money come from? How will it reach the right target market? Governments that have been interested in jumpstarting a microfinance sector in their country have found different solutions to these questions. Some have chosen to go a commercial route (such as Bolivia and Brazil) whereas others have chosen a more 'social' path (such as India).

The former relies completely on private sector to respond to policies and incentives whereas the latter relies on tools such as directed credit and subsidies. There are also some that walk a middle path such as Pakistan. Although space has been created for the private sector through the Microfinance Institutions Ordinance 2001, allowing establishment of privately owned microfinance banks, this was preceded by the establishment of the Pakistan Poverty Alleviation Fund (PPAF), an apex fund for microfinance in 2000. PPAF continues to play a key role in the country's microfinance sector and provides 44% percent of the sector's funding today.

By channeling public money to microfinance through non-government organizations, apexes provide the opportunity to governments to proactively provide access to finance without the perils of being the direct service provider.

2. Significance of Apexes as a Funding Mechanism in Microfinance Today

Although microfinance apexes take on different forms, they are generally understood as wholesale financial mechanisms used to channel funds to retail microfinance providers. A CGAP Donor Brief on microfinance apexes (2002)[3] defines an apex as "a second-tier or wholesale organization that channels funding (grants, loans, guarantees) to multiple microfinance institutions (MFIs) in a single country or region. Funding may be provided with or without supporting technical services. Currently, there are at least 76 apexes operating around the world in

[3]- CGAP Donor Brief No. 5 Apex Institutions in Microfinance. 2002.

46 countries, most of which have been established in the 1990s and 2000s (see Exhibit 1[4]). Nearly USD 2.3 billion was channeled through apexes in 2007, according to CGAP, which was 28 percent higher than 2006. In terms of volume of disbursement, apexes in Latin America and South Asia are the largest whereas in terms of numbers Africa has the highest number of apexes (see Exhibit 2). Although the number of apexes is fast growing in Africa, South Asia leads in terms of the ratio of countries in a region that have an apex with six out of eight countries in the region having an apex.[5]

Exhibit 1: Emergence of Apexes over time

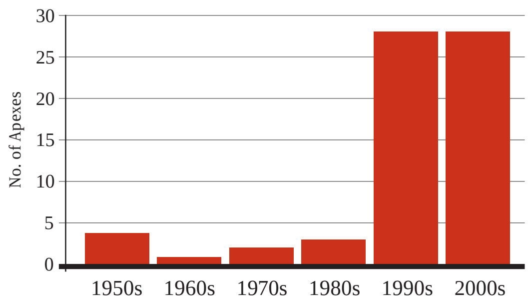


EXHIBIT 2: Regional Shares in Disbursements through Apexes (2007)

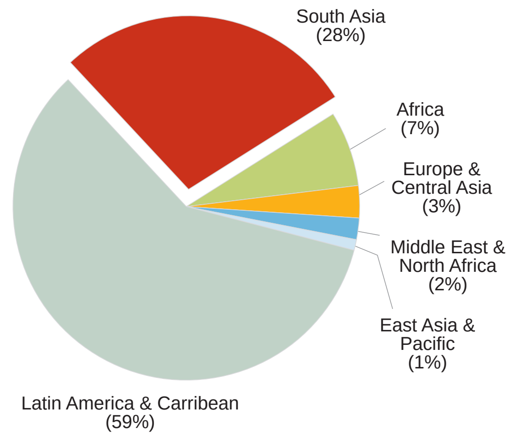


Table 1

	Total Number of Apexes	Total Number of countries	Number of Countries with an apex
Latin America & Caribbean	19	32	10
South Asia	10	8	6
Africa	20	47	13
Europe & Central Asia	9	30	7
Middle East & North Africa	8	19	6
East Asia & Pacific	10	16	4
TOTAL	76	152	46

[4-] Exhibit 1 covers 66 apexes compared to the 76 reported in CGAP's survey due to access to information issues. The objective is to show the trend in emergence of apexes rather than identify exact years of their formation.
[5-] Source: Focus on Apexes, CGAP. http://www.cgap.org/gm/document-1.9.35042/Focus%20on%20Apexes.pdf

3. Why are Apexes so Popular?

Like nearly everything in microfinance, apexes are not without their critics. Yet, if nothing else, the data above shows that their numbers are multiplying and the funds being channeled through them are growing. As will be discussed below, the criticism is not always misplaced; however the truth is that apexes continue to perform important functions within the microfinance sectors. Some of these include[6]:

- Wholesale Financial Intermediation: The primary function of any wholesale fund is to intermediate funds. Apexes do the same – they channel a pool of funds (generally provided by national governments or donors) to retail microfinance providers for on-lending to low-income and/or poor clients. An advantage cited is that apexes can facilitate outreach to poorer clients by focusing on smaller MFIs which may not be able to access funds elsewhere.
- Building the Retail Microfinance Market: Often such funds are created to jumpstart the sector and thus apexes have an institution building role as well. They provide capacity building support to MFIs with the objective of turning them into viable and sustainable institutions that can ultimately access commercial funding instead of relying on apex's lines of credit.
- Bridge Gap between MFIs and Financial Markets: A CGAP paper (2002) on apexes in microfinance observes that most MFIs like their poor clients are not taken seriously, or are seen as uneconomic by domestic and financial markets. Apexes, can thus play an important role in bridging this distance between commercial lenders and the MFIs it funds.

6- Drawn from CGAP Occasional Paper No. 6 Apex Institutions in Microfinance. 2002.

- Donor Coordination: Having an apex act as the intermediary between different funders (such as various donors, government and CSR sources), life is much easier for both the MFIs and these funders. Apexes ease the pain of coordination with many players.
- Supervision of MFIs: In many countries a large proportion of the microfinance sector remains unregulated. Apexes, being a large stakeholder with a view beyond just financial returns, act as quasi-supervisors in such circumstances. This perhaps remains one of the more controversial roles in the discussion of what an apex should or should not do!

Apexes have taken on various forms to perform their functions. Some are registered as development banks or NGOs whereas others are donor or special government programs.

4. How well are Apexes doing?

Theoretically, thus, apexes create economies of scale, address market failures and decrease inefficiencies. In reality, things are not always this simple. Research has shown that there are some pre-conditions that are necessary for apexes to achieve their objectives and perform their functions effectively. For example, creation of an apex assumes there is a demand for the funds it wishes to channel and this demand is coming from a mass of credit worthy MFIs. In most cases, existence of such a mass is overestimated and instead what we see is a mushrooming of MFIs just because an apex now exists and can provide them access to funds. If the apex is forced to lend to just a few MFIs (the good ones), then it also runs a risk of portfolio concentration. Another advantage of apexes is the economies of scale they generate but this requires a large enough potential microfinance market to warrant the cost of setting up and running an apex. Some drivers of success and failure of apexes are shown in Table 2.

A recent CGAP survey[7] shows there is considerable diversity amongst apexes. Some exist as departments embedded within development banks (Bancoldex in Colombia, Banque Malienne de Solidarité in Mali) while others operate as independent entities with separate governance structures (PKSF in Bangladesh). Missions vary from focusing on financial inclusion to a broader mandate of poverty reduction and employment creation. These differences have important implications for instruments that an apex chooses and the investment strategy that it adopts. Initial findings from the research clearly show areas where apexes have achieved success or remain challenged:

- Apexes have done well in terms of their core function of financial intermediation. They have helped

Table 2

Conditions for Success	Causes of Failure
- Mission clarity and instruments adapted to fulfill this mission and sector dynamics (mature sector requires different tools than a nascent sector) - Independent board and capable management first - A focus on quality in terms of client MFIs - Retaining relevance by adapting to sector evolution and play a positive market development role - Manage an apex portfolio based on performance – strong capacity to monitor institutional performance and assess credit risk	- Politicization of the board - Disbursement pressure from donors or government, which then can lead to market overheating - Lack of internal technical capacity and tools to select, and oversee the performance of the client MFIs - Incapacity to adjust oneself to market conditions and new commercial players - Confusion arising from different donors pushing the apex into different directions

Source: CGAP

7- A CGAP paper on apexes is expected in Fall 2011. The authors are grateful to Eric Duflos at CGAP for sharing some preliminary findings from this research.

sectors achieve scale and expand outreach. They are often the major, if not the only source of funding at the start-up stage and even when growth is picking up.

- Apexes have played a positive role in crowding in commercial funding for microfinance. In nascent sectors, there is little interest amongst commercial banks to lend to MFIs and apexes fill this gap. However, as institutions mature, the share of apex funding in their total debt tends to decrease. There is also evidence of "demonstration effect" whereby commercial banks develop a comfort level about the MFIs creditworthiness through their borrowing history with the apex.
- Many apexes take on the role of building institutional capacity and supporting the development of sustainable institutions but it seems they have had mixed success in doing so. Most apexes tend to overestimate the number of effective retailers that have the potential to become viable and provide sustainable microfinance. Although there is a broad range of experiences in terms of capacity building support by apexes, it generally takes the form of trainings or TA assistance and is mostly funded through donor grants, with the apex's own funds being a very small share. This means that when the donor support is withdrawn, apexes struggle to provide this support. This however remains a key contribution of apexes, especially at the start-up stage.
- Apexes have not really pushed the sector towards innovation. Most apexes remain credit focused, with some exceptions (see Box 1 on Bancoldex's micro-insurance products). Indirectly though, through transformations of stronger apex clients (e.g. NRSP Bank and Kashf MFB in Pakistan) there is an effect on provision of a broader range of financial services.
- Apexes have not been successful in coordinating amongst different donors and thereby reducing reporting burden on MFIs or aligning interests of the different donors.

Box 1

Bancóldex – Promoting Micro-Insurance

Bancóldex is a bank for development that operates in Colombia as a second-tier bank (does not directly disburse resources to entrepreneurs) and instead, uses a network of intermediary institutions such as banks, finance corporations and commercial finance companies as well as credit and saving unions, financial NGOs and employee funds with a quota in Bancoldex (financial intermediaries supervised and not supervised by the Financial Superintendence of Colombia), to meet the credit needs of SMEs in the country.

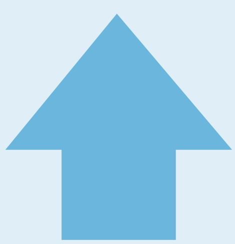
Its Microinsurance Program FUTUREX –LIFE INSURANCE is a joint effort of Government and private sector for low income micro entrepreneurs population. It is sold through Microfinance Institutions –with credit line in Bancoldex. It is a low cost insurance policy that reduces the social vulnerability of micro firms and their families. It offers coverage in case of death, incapability to work, critical illness, burial costs aid, and family ongoing living expenses aid.

The insurance also covers the loan portfolio of the microfinance Institution.

Another product is the FUTUREX –DAMAGES, which covers the micro firms' premises and other property, including home if it is located in the same building, from damages caused by: a) acts of nature b) malicious damage or vandalism c) robbery

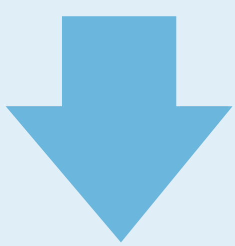
Source: http://www.bancoldex.com/portal_ingles/documentos/812_Bancoldex_corporate_briefing_2011.pdf

Exhibit 3: Success and Challenges for Apexes



Wholesale Financial Intermediation: Apexes are significantly contributed to expansion in outreach

Bridge Gap between MFIs and Financial Markets: Major apexes have crowded in funding from local commercial banks and international investors



Capacity Building of MFIs: Capacity building represents a tiny proportion of apex funding globally

Donor Coordination: Apexes have not been able to enhance coordination amongst different donors

5. Pakistan Poverty Alleviation Fund

It was in the late 1990s that the government of Pakistan realized the need for a sector-dedicated institution for poverty reduction and grassroots development, which would operate as an independent autonomous entity, led by private incentives in support of broader public policy and economic development objectives. The establishment of PPAF was thus a consequence of considerable gap between demand and supply of financial and non-financial services at the bottom of pyramid and lack of robust institutional arrangement to effectively and efficiently oversee the development process. The vision was that this apex would concentrate on quality assurance, cost effectiveness, sustainability and impact through efficient delivery mechanisms based on the participatory development approach. To that end PPAF was launched as a Public Private Partnership in 2000. It is incorporated as a limited by Guarantee Company under the Companies Ordinance 1984, wherein, management and policy supervision rests with an independent BoD, on which the GoP has minority representation. PPAF is under the regulatory superintendence of the Securities and Exchange Commission of Pakistan. With members of BoD having diverse experiences in economic development, banking and finance, academia, corporate sectors and seasoned bureaucrats the stage was set from the inception for an impressive governance structure.

Establishment of PKSF in Bangladesh is often seen as the tipping point in terms of microfinance apexes, which really set the stage for apexes to take a key place within the microfinance infrastructure. However, unlike Bangladesh where the microfinance sector was quite well developed when the PKSF was formed, in Pakistan the sector was quite small. The establishment of PPAF was seen as not only an opportunity to build the microfinance sector, but rather as a one window operation for community support organizations based on the Aga

Khan Rural Support Programme (AKRSP) multi-dimensional approach. Since its establishment, the approach for delivery has been to combine private sector efficiencies, corporate sector rigor, planning and managerial skills with the zealousness and commitment of the development sector. The concentration is not only on financial services - instead a holistic and participatory development approach is followed that combines provision of microfinance, capacity building of partner institutions, water and infrastructure schemes, health and education facilities and communities and livelihood interventions aimed at ultra poor and excluded. With core focus on building sustainable institutions for and of the poor, PPAF has taken the dual challenge of sector developer/market maker and an informal benign regulator of the civil society organizations.

As opposed to conventional methods, the PPAF model is non-prescriptive. The interventions are made through partner organizations (POs) that are non-government organizations. There is however an underlying focus on a community led, demand-driven approach with emphasis on community ownership/'buyin' from identification and preparation to implementation and management of development interventions. The objective is to remain fully inclusive and this 'bottom-up approach' needs to be demonstrated by organizations seeking partnership with PPAF. PPAF believes that social mobilization and instituting community organizations is the bedrock of provision of any service to the underserved and partners should practice it religiously. It is only upon meeting stringent eligibility criteria they are extended financial resources which is followed by technical and managerial assistance, monitoring and feedback. Gender and environmental dimensions are integrated in all interventions as well as performance assessment and evaluations.

Although it is difficult to be objective if the author is the CEO, in what follows we endeavor to carry out a critique of PPAF in light of what literature describes as pivotal roles of microfinance apexes.

When PPAF started its operations the microfinance sector was almost non-existent in Pakistan with paltry 60,000 clients. At various stages of development of the sector, PPAF has transformed its strategy, based on the requirement of the phase. In the beginning PPAF undertook an extensive analysis of the situation with the World Bank and this resulted in a plan that consisted of three important areas of focus from 2000 to 2004.

First and foremost on the agenda was augmenting institutional capacity of the existing and new players in the sector. For that, a thorough strategy envisioning exercise was conducted with every partner organization based on which funds for trainings and exposure visits and assistance for business planning and preparation of operational manuals was provided. Second and concurrent was the provision of funding for on-lending to the partner organizations based on a thorough analysis of their ability to manage funds and demand from the field. To support the expansion of branch network capital and operational grants were also offered. Last and most challenging task was total metamorphosis of the sector from a charity mindset to inculcating professionalism by introducing international best practices and pricing the funds offered to partners. This resulted in a deliberate controlled growth phase on the one hand and on the other enhanced visibility of the sector nationally and internationally.

Box 2

PPAF at a Glance

- Present in 129 districts through 99 Partner Organizations, with financing deployed in 91 districts
- 31.6 million impacted by credit and 15.8 million by infrastructure, health and education
- 4.7 million microcredit loans, with a market share of almost 45% in the sector
- 844, 539 active clients, of which 48% are women
- 73.5% rural coverage
- Total Assets of USD 278 million
- Debt/Equity – 67:33

Source: PPAF

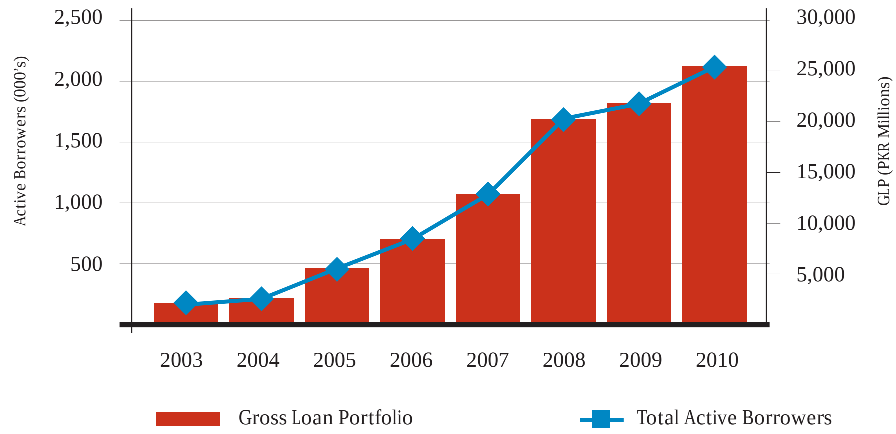
The concept of sustainable operations was at the core of the plan. The interest rates charged to MFIs were intentionally kept lower than market rates to stimulate growth and strengthen the financial health of the small organizations. The surpluses thus generated resulted in growth in branch network and provided cushion in case of defaults as the sector was in the initial stages of learning curve.

By early 2005 some of the institutions became quite strong and demonstrated ability to manage large sums of funding. Simultaneously, the community organizations formed through social mobilization and hard and soft investments since inception of PPAF, resulted in demand for financial services and especially microcredit for their members. PPAF responded to the situation and not only increased the credit limits but also offered longer term loans to the partners based on the rigorous due diligence process. During the next three years it undertook numerous steps to mitigate risks and strengthen the sector. The eligibility criteria for accessing large amounts of funding became more stringent and for critical indicators like OSS and PAR, benchmarks were set and monitored regularly. The institutions that met the following conditions were offered larger amounts of funding: sound financials, strong microcredit operations, solid loan portfolio management culture and systems, capable management including credit management, separate books of accounts for microcredit operations, separate audit of microcredit operations, an automated loan tracking system to monitor portfolio performance and reporting, portfolio at risk > 30 days < 5%, Operational Self-Sufficiency > 100%, Risk Coverage Ratio > 100%.

The period between 2005-2008 witnessed sizable growth of 182% in the sector and it became more conspicuous in every quarter (Exhibit 4). However, the prominence was not without perils and unfortunately this was also a period of stagflation in the country. A small number of partners experienced deterioration in the quality of the portfolio due to economic slowdown, political interference and high growth rates. PPAF had to respond to the situation both at the macro and institutional level. At the macro level, it joined hands with Pakistan Microfinance Network, the national association of MFPs in the country, on the vital initiative of Credit Information Bureau to mitigate risk that was prevalent due to over-indebtedness. It held meetings with the important stakeholders including central bank to find solution for the challenges of the sector.

Due to ample liquidly and financial strength it acted as the lender of the last resort by providing sufficient funding and rescheduling repayment of two large organizations. Consequently, the sector was able to recover from the crisis quickly and without much damage.

Exhibit 4: Expansion of Microcredit Outreach in Pakistan



Nevertheless, since 2009 PPAF has further enhanced the level of institutional building and introduced support for array of intervention ranging from product innovations, business plans, PO's assessments, PO's ratings, external audit support through auditors on the QCR list, operational support for 2-3 years to strengthen POs internal audit, monitoring and compliance departments for better risk management, training and exposures of PO staff and BoD, and MIS and FIS of the organizations. It also supported international and local trainings, exposure visits and workshops for different POs to enhance their capabilities for designing and running effective organizations as well as dealing with operational and governance issues. Throughout its existence, PPAF has closely worked with leading policy makers in the sector such as the State Bank of Pakistan (central bank) and Ministry of Finance to ensure consistency and alignment of its own strategy with that of the broader stakeholders. This interaction has increased with time as the sector has matured, transformations have taken place and PPAF opened up its credit lines for microfinance banks.

The success of PPAF model in relation to key apex roles can be gauged from the following analysis:

Wholesale Financial Intermediation

PPAF started its operations with an endowment fund of USD 10 million, provided by The Government of Pakistan and USD 90 million approved by the World Bank as PPAF I project. USD 45 million was allocated for microfinance and the remaining amount was for institutional building and small scale infrastructure schemes. Following the completion of the first projects, the World Bank Implementation Completion Report rated the performance on PPAF I as highly satisfactory. This was followed by the two additional projects by the World Bank amounting to USD 488 million out of which USD 178 million was specifically earmarked for microfinance. Based on the model and performance, other donors have also funded PPAF. IFAD has been another significant partner of PPAF for the last six years in microfinance and has provided USD 61 million. Similarly PPAF negotiated funding with USAID for enterprise development facility, primarily focused on the missing middle. PPAF thus played the role of a wholesale fund for microfinance successfully by bridging the gap between the donors and the retailers and provided a platform to the donors, to park their funds with the conviction that PPAF would make sure that these are utilized efficiently and effectively. As of June 2011, PPAF has a footprint in 91 districts of Pakistan through 99 partners, has a grassroots network of 297,000 community organizations and has funded 4.7 million loans.

At the same time PPAF is not interested in monopolizing the sector. In 2000 the amount of funding provided by PPAF comprised 85% of the total sector. However, with the passage of time with institutional strengthening the partners have accessed other sources and the market share of PPAF has dropped to 45% in 2011.

Two of its largest partners have transformed a significant part of their operations into microfinance banks. This also depicts that PPAF has built the capacity of the organizations to become more sophisticated organizations in regulatory terms and access numerous sources of funds. To fulfill the demand of the sector, there is a room for diversifying the sources of funding and PPAF is planning to market itself in the near future to crowd-in additional funds from Social Investors, Patient Capital and even commercial financiers in the long run.

PPAF is actively involved in the Credit Information Bureau along with PMN and feels that this would contribute significantly in mitigating risk of the sector. As a positive CIB, which provides information not just on defaulting clients but also those that have taken on a loan, this database will play a crucial role in preventing over-indebtedness.

Institutional Building of Service Providers

The extremely small size of the sector and service providers in the beginning, warranted an active role of PPAF to strengthen it. Not only has the PPAF helped expand the amount of funding to provide services to the underserved but has also strived to instill professionalism and changed the paradigm within NGOs wherein, microfinance was considered a grant supported activity that cannot become self sustainable. For the first time interest rates were charged that were sequentially increased to Karachi Interbank Offered Rate (KIBOR) for large size partners that now comprise 80% of the funding. Preparation and audit of accounts based on international standard and best practices resulted in disclosure of true and fair picture of the organizations. Support for business plans and manuals and training at every level of the management brought clear vision and operational finesse to the partners. Although the benchmarks have been tightened over the years, but at the same time incentives and capacity has been built to achieve them.

Those partners that are interested to get registered under Companies Ordinance form their status as welfare NGOs are encouraged and funded for conversion.

In order to further strengthen the partners and as part of PPAF's mandate as sector developer, equity injections have been approved for twelve small and medium organizations, based on a rigorous criteria. The infusion of equity into organizations that are currently highly leveraged reduces liquidity risk and reduces dependence on lenders. This can yield enhanced growth and intuitional maturity as the improved financial position owing to reduced leverage would attract a diverse range of investors leading to a generation of cash flow.

Innovation and Product Development

With growth, the sector and institutions started attaining maturity. This was an ideal time to experiment and innovate. PPAF assisted and capacitated its partners to undertake Enterprise Development Facility (EDF) which was intended for the missing middle, a huge market which was neither served by the microfinance institutions for attracted much attention from the commercial banks. This was followed by an equally novel program Microfinance Innovation and Outreach Program (MIOP) designed jointly by IFAD and PPAF to support innovative products and delivery mechanisms to improve the outreach in rural and less penetrated area. The program gave new perspective to the sector by encouraging the MFIs to think out of the box, wherein they offered one-size-fits-all type of loans and design products based on the demand of their clients. More than 25 new products and delivery methodology have been introduced and majority of these are now being up-scaled. Most of these products are structured after negotiations with the borrower keeping in view their business requirement.

In order to promote innovation and state of the art technology PPAF has recently collaborated with United Bank Ltd. for its "Omni" Dukaans and Tameer Micro Finance Bank "Easy Paisa" to pilot a Branchless Banking Project aiming to help PPAF Partner Organizations in expanding outreach and lowering delivery costs. The project is currently being piloted with 5 Partner Organizations catering to approximately 30,000 microfinance clients set out in remote and rural areas.

Crowding-in Commercial Funding

Cognizant of the huge un-satiated demand and limited resources PPAF understands that commercial funding could be a huge potential source of funding for the sector in the medium term. This resulted in conceptualization of another program with IFAD-funded Program for Increasing Sustainable Microfinance (PRISM), which is directed for creating linkages with capital markets and convincing them to initiate lending to microfinance institutions in the country. The process required patience and long deliberations with the banks due to their initial reluctance, but success finally came and over the last two years 10 transactions involving 4 banks and 8 MFIs amounting to USD 29 million have been negotiated and completed. What has been very encouraging is that banks have lent to some very small and medium size organizations although their legal structures may not be ideal for commercial funds. Track record of these organizations with PPAF provided the required comfort for closure of the transactions. PPAF is now in the process of allocating its own funds for guarantees and security to attract additional funding to meet the demand of the sector.

6. Lessons from the PPAF Experience

With over ten years of experience, PPAF has come a long way as has the microfinance sector in Pakistan. There have been valuable lessons learnt along the way that feed into PPAF's strategy and can be equally relevant for apexes around the world. Some of the important lessons are discussed below.

1. Apexes need to evolve in order to stay relevant

   Apexes such as PPAF which are created when the microfinance sector is nascent have to take on the role of sector developers. Those that manage to execute this responsibility well have to learn to evolve themselves as the sector develops if they are to remain relevant. In case of PPAF, a greater focus was placed on institution strengthening and capacity building at the initial stage. As partners grew stronger and more confident, PPAF began to focus on sustainability and viability by moving towards market-based pricing and crowding in commercial funding for the sector. Going forward, PPAF plans to spin off its microfinance operations into a more specialized arm. It also plans to work with the commercial players in the sector such as the microfinance banks. Instruments have also evolved from the initial basic lines of credit to more sophisticated partial guarantees and CPs. Thus evolution has to be in both what apexes do and how they do it.

   Today, PPAF continues to play an important role in the sector. Its initiatives such as the partnership on the Credit Information Bureau, focus on client protection, role in credit enhancement and push for innovation are very much in line with the needs of Pakistan's microfinance sector.

2. Being multi-dimensional positively affected the microfinance portfolio of PPAF

   PPAF believes and follows inclusive

participatory development approach and understands that microfinance alone cannot be a panacea for impacting poverty which manifests in diverse forms and settings. Consequently, every intervention and interaction with the communities is demand based. This, on the one hand, assists communities according to their requirement and on the other hand results in reducing cost of the project as it is partly funded by them. The end result is ownership of the communities, an extremely important element for sustainability and maintenance of any intervention. More importantly, these intervention in community infrastructure and water schemes, livelihoods for ultra poor, health and education facilities based on social mobilization contributes in the priming the market for microfinance and especially for those who might be excluded without these interventions. The process of involvement, consultation and ownership even in provision of microfinance services builds a strong relationship with the communities and translates into discernibly reducing the risk of microfinance portfolio. The approach has also allowed PPAF to work with the different levels of the poor. The ultra-poor can be built up to access microfinance through programs of small grants and asset transfers as well as providing basic infrastructure (such as access to water) that frees up time, especially in the case of women, to undertake economic activity.

3. Selection of partners: what works as a criterion and what does not
   In PPAF's experience, selection of organizations as partners should be driven by commonality of vision and mission. PPAF is non-prescriptive and neutral in terms of the model and methodology that an MFP chooses to adopt. However, in order to work with PPAF, the institutions have to demonstrate a commitment to the double bottom line i.e. social returns and a desire to be sustainable. PPAF looks for clarity in the vision of an organization, even if it is a multi-sectoral organization, to ensure that microfinance is a totally distinct instrument compared to grants based activities. As an institution builder, PPAF is willing to invest in its partners but the desire to improve and professionalize has

to be there. This model-neutral approach with a focus on values and commitment to "good microfinance" has allowed PPAF to nurture the sector while also acting as a grassroots economic developer.

At the heart of PPAF's investments into partners is an understanding of the institutions' needs. These are assessed through a SWOT analysis. In addition, PPAF looks for a transparent and strong governance structure, which includes a close look at the Board's composition. Without a committed Board that reflects the values of inclusiveness and double bottom line, it would be impossible to create the effective "pass-through" organizations with lean and cost effective structures required to stimulate and strengthen microfinance.

Not only does PPAF make effort to understand strengths and weaknesses of its partners, but also goes an extra mile in trying to understand needs of the end clients. Again, as the PPAF model is not just about pushing out loans, the PPAF staff is required to spend time in the field and interact with the microfinance clients. In PPAF's experience, this investment in partners and their clients has a high pay-off for an apex.

4. Sustainability of apexes themselves

Becoming sustainable as an apex is not a very challenging task. What is challenging is to stay true to the envisioned values and remaining sustainable. This largely depends upon the governance structure and the human resource capacity of the apex. Unless an apex is able to make financial decisions transparently, independently and without any political influence, its sustainability will remain questionable. Despite being a public-private partnership, PPAF has not sought any budgetary support from the government in the last 10 years. This independence, coupled with the oversight of an effective Board, has been instrumental in PPAF's success.

Given its holistic approach, PPAF uses its surplus/profits to fund its grant work. In wake for the 2010 floods, for example, PPAF spent Rs. 250 million (USD 2.9 million) on flood related activities. This year again, PPAF has earmarked Rs. 200 million (USD 2.4 million) for reconstruction and rehabilitation work.

5. As market developers, apexes implicitly complement the role of regulators
   In the process of developing the market and institutionalizing best practices, even if this is from the point of view of protecting its own portfolio, apexes end up complementing the work of regulators. In case of PPAF, this role has paid off in the recent microfinance crisis in South Asia as the sector in Pakistan has not been hit as drastically as India. Closely monitoring the partners, rolling out the CIB and focusing on key principles of microfinance has helped protect PPAF's portfolio as well as the partners.

   Other areas where PPAF has played the quasi-regulator role include promotion of consumer protection practices and institutionalization of best practices in accounting and audit. These functions are usually performed by regulators but in sector such as Pakistan where a large part of the market remains unregulated, apexes can successfully play this role. By carefully choosing its 'supervision' areas, collaborating closely with the associations, networks and regulatory agencies, and using microfinance banking regulations as benchmarks (where they exist) apexes can successfully complement the role of regulators.

6. Good governance is the key
   As it advocates for transparency and professionalism within its partners, PPAF internalizes the value of good governance. As mentioned earlier, without a balanced and independent Board that provides active oversight and guidance, PPAF would not have been able to deliver against its mission. Independence from political interference and the ability to make financial decisions freely have been vital for PPAF's sustainability and performance.

7. Work closely with sector stakeholders
   Although apexes are financial intermediary, as this paper and other literature on such wholesale mechanisms shows, their role tends to be much broader and bigger. In

order to effectively perform this role, apexes need to interact closely with other important players who drive the sector. These include policymakers, donors and associations.

To conclude, just like any successful institution, a microfinance apex works if it remains true to its values and the values of microfinance. Practicing good microfinance i.e. maintaining a balance between social and financial returns, knowing the clients and developing a partnership with MFPs instead of an agent-client relationship are at the heart of an apex's success.

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