MICROFINANCE

An Overview – Sep'20

Sep'20

Research Report

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The term "Microfinance" refers to the full set of financial services (small loans, insurance, etc.) offered to low income and underprivileged segments of the society with the objective of financial inclusion and poverty eradication. In developing economies, where a large chunk of population has difficulty in access to commercial credit, microfinance sector serves as an instrumental tool for disseminating loans and capital to the unbanked segment.

Executive Summary:

- Gross Loan Portfolio clocked in at PKR~300bln - June'20, down by ~2% (CY19), majorly attributing to MFIs recording a negative growth of ~7%, while MFBs sustaining a positive growth at ~3%. MFBs' gained market share by ~4% recording at 74% in June'20 (70% CY19).
- Active borrowers stood at ~6.9mln – June'20, a decline of 5% (CY19) with MFIs reducing by ~4% while MFBs gaining by ~7%. MFBs share stood at ~54%, as their average ticket size is higher than MFIs.
- Credit quality continued to suffer on the backdrop of economic fallout due to Covid-19. Regulator's Relief Package to defer outstanding receivables, however, came handy to the sector. PAR>30 days remained under control at ~4.3% (4.8% CY19).
- Fresh disbursements plunged down in 2QCY20 owing to the lockdown situation in the wake of Covid-19. Collections, likewise, fell below ~50%. Most of the outstanding installments due in the months of April and May were deferred to prevent eruption in asset quality.
- With lockdown situation easing in the country, overall disbursements and recoveries have begun to improve. Preference is focused towards securitized lending and repeat customers. Optimal disbursement strategies are necessitated to keep risk profile stable.
- On a positive side, deposit base grew by ~10% clocking in at PKR~294bln, despite the critical scenario. ADR improved to ~75% (~80% CY19) attributed to low portfolio growth.
- Performance indicators represented a distressed outlook with low profitability majorly owing to high provisioning costs.
- Despite situation moving towards normalization, aftermaths are expected to show their signs in the short horizon. Overall KPIs are expected to remain distressed for CY20, particularly for the MFIs where funding avenues are limited.

Key Features

SECTOR AT A GLANCE				
Industry Segments	**June'20**	**Dec'19**	**Regulatory Body**	**Applicable Laws & Regulations**
Microfinance Banks	11	11	State Bank of Pakistan (SBP)	- Prudential Regulations for Microfinance Banks, 2014. - Microfinance Institutions Ordinance, 2001
Microfinance Institutions	14	17	Securities and Exchange Commission of Pakistan	- NBFC Rules, 2003 - NBFC Notified Entities Regulations, 2008
Rural Support Programs	5	6		
Others*	4	4		
	34	**38**		

*Others include organizations whose mainstream businesses are different but are also involved in microlending.

Source: PMN - Microwatch

Loan Book: Microfinance Loans are generally short term in nature with small ticket size. The average rate of return charged on the loans is high due to high operating costs of the players.

Funding: Microfinance Banks regulated by the SBP are licensed to mobilize deposits from the general public and Institutions (FIs and Corporates). While MFBs pitch their growth on the expansion of their deposit base, MFIs and RSPs rely on Borrowings (majorly Commercial) to meet their funding needs.

Assets Overview | MFBs + MFIs + RSPs & Others

Historically, Microfinance has been growing at a fast track with a CAGR of over ~35%. In the recent times, the Industry dynamics have, however, been reflecting a different outlook. Growth in loan portfolio had decelerated substantially in CY19 sliding down to ~11% from a ~36% growth in the previous year. Active borrowers grew modestly by ~5% in CY19 (~20% CY18). Following CY19, the growth indicators had further deteriorated owing to the outspread of the unprecedented COVID-19 pandemic (discussed later in the report). The Industry is also, by design subject to its own systematic risks, which play their part in determining the growth trajectory and credit quality of the Sector. The following factors can be construed to contribute to the changing dynamics of the overall sector growth:

- **Change in External Drivers:** In 2HCY19, changing macro-indicators such as rising interest rates and inflation became a major contributor in constricting the already low disposable incomes of the microfinance borrowers, ultimately impacting their debt servicing capacities.

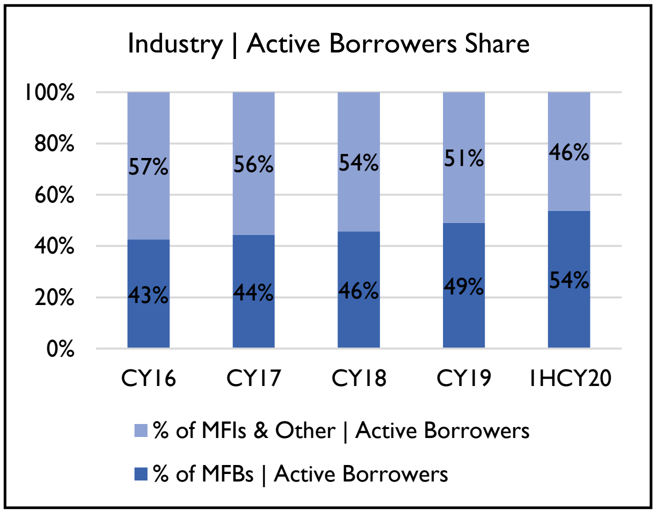
- **Industry Systematic Risks**
  - Product Portfolio Concentration
  - Inherent limitations of the design of the Microfinance Products, e.g., agri-products are aligned with the cash cycle of the farmers but do not offer insurance against weather calamities or other unforeseen circumstances.

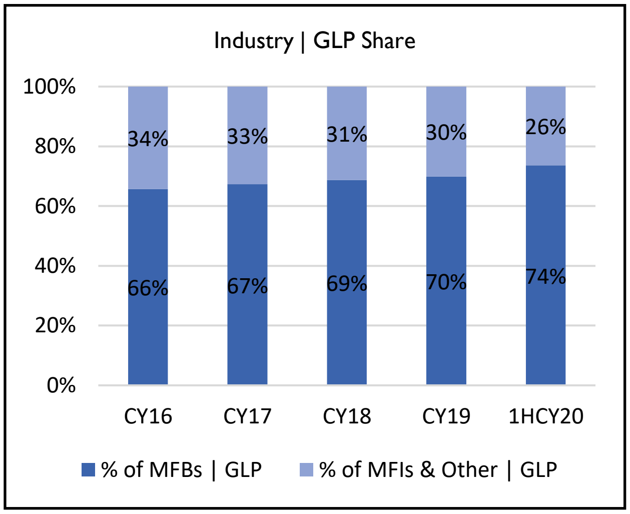
- Inevitable high rates of return.

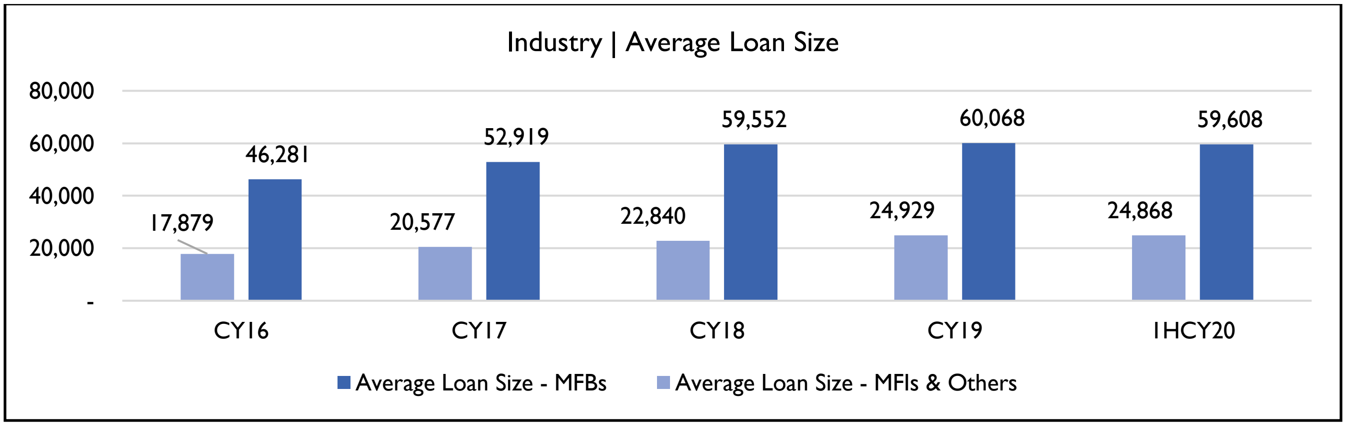
- **COVID-19 Impact:** Discussed in detail later in the report.

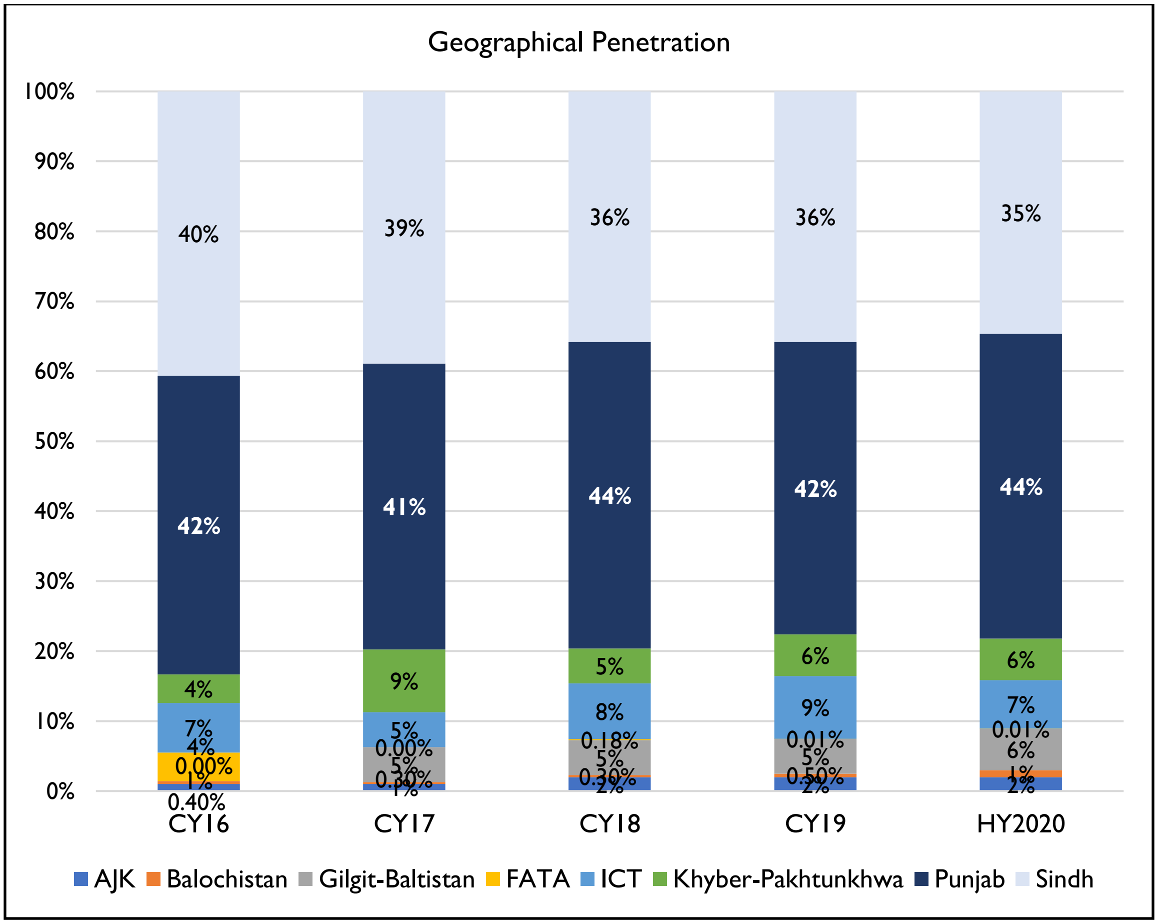
A brief analysis is illustrated in the table and charts below:

GLP (MFBs + MFIs + RSPs & Others)	CY16	CY17	CY18	CY19	1HCY20
Outreach					
Number of Branches	3,220	3,677	4,239	4,036	3,755
Growth (YoY)	9%	14%	15%	-5%	-7%
Gross Loan Portfolio					
Gross Loan Portfolio (PKR mln)	136,943	202,700	274,706	305,754	299,948
Growth (YoY)	47%	48%	36%	11%	-2%
Active Borrowers	4,572,245	5,800,457	6,936,554	7,249,943	6,885,117
Growth (YoY)	22%	27%	20%	5%	-5%
Average Loan Size	29,951	34,946	39,603	42,173	43,565
Portfolio At Risk (PAR>30 days)	1.4%	0.1%	2.2%	4.8%	4.5%

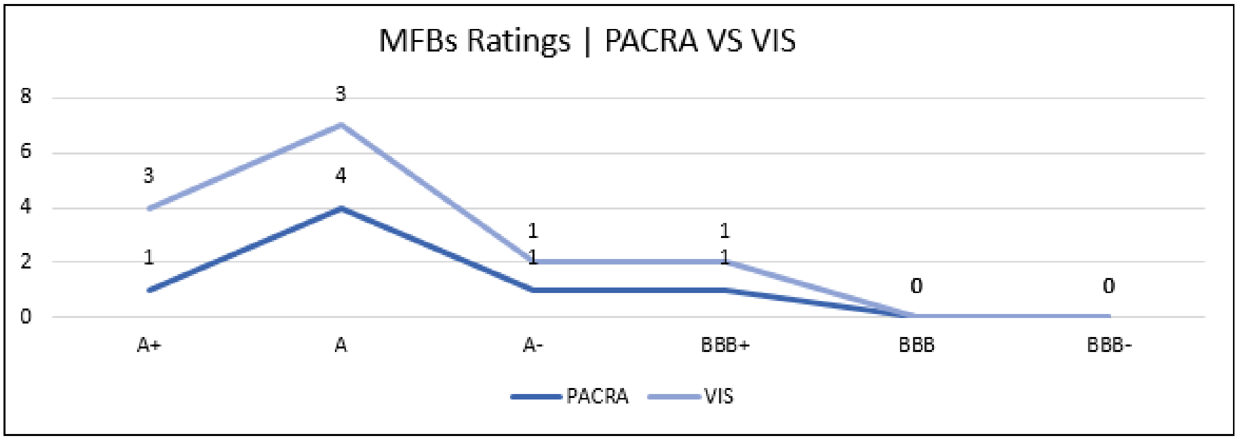


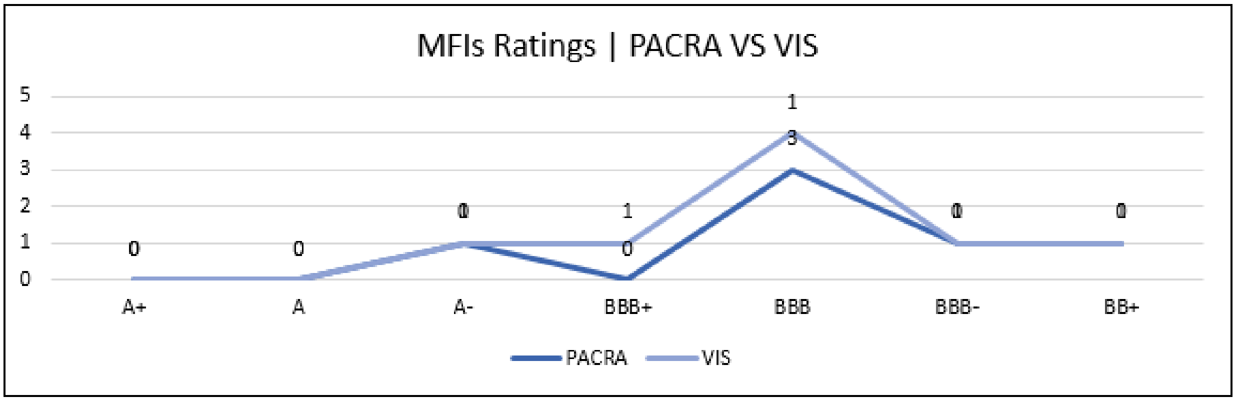






Rating Curve | Industry:





Assets Overview | MFBs

Assets Overview of **MFBs** Sector shall cover the following factors:

- Overview of the Sector Players and their Market Shares in terms of GLP.
- GLP Outreach
- Product Specifications | An Overview
- Asset Quality.
- Markup/Average Returns.

In the overall Microfinance Industry, MFBs take the leading Market Share in terms of Gross Loan Portfolio (GLP). However, the market size is still small compared to the Commercial Banks. A brief comparison is shown in the adjacent table:

MFBs Vs. Commercial Banks | Key Features | June'20	Microfinance Banks	Commercial Banks
Outreach		
No. of Banks	11	33
No. of branches (in Pakistan)	1,434	15,598
Loans		
Sector GLP (PKR bln)	221	8,869
GLP Contribution to GDP	1%	21%
Sector NPLs (PKR bln)	14	761
NPL Ratio*	6%	9%
Deposits		
Total Value of Deposits (PKR bln)	293	16,000
Advances to Deposits Ratio (ADR)	76%	55%
Capital		
Equity (PKR bln)	46	1,700
Average Capital Adequacy Ratio (CAR)**	21%	17%

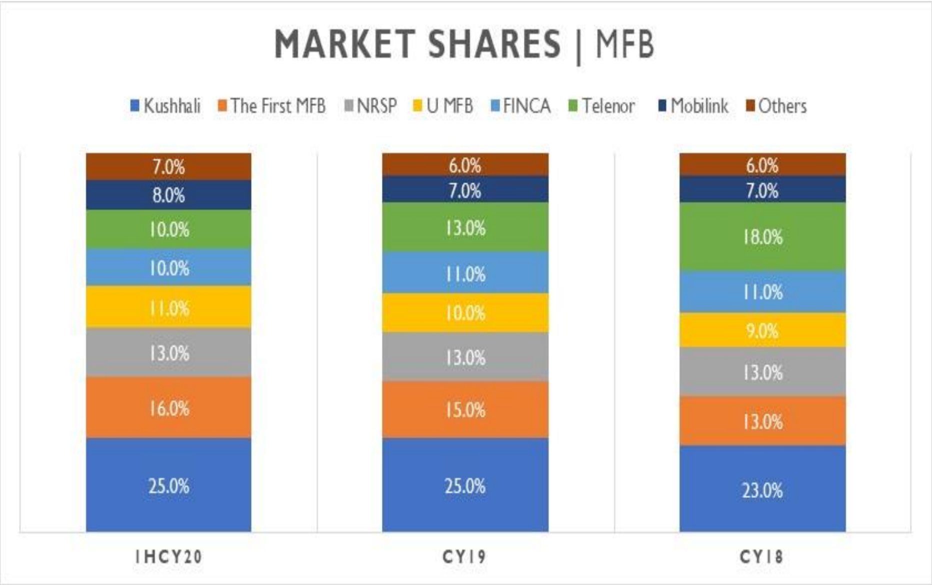
*NPL calculation varies for Commercial banks and MFBs

** Minimum SBP CAR requirement for Commercial Banks is 10% and for MFBs is 15%

Sector Players | Overview and Market Shares

There are total 11 MFBs in the Sector. Most of the Sector players have profound International Sponsorship, either exclusively or in combination with other local or foreign investors. Except Advans and Sindh, all MFBs operate at a nationwide level.

MFBs can be divided into large (market share ~15% or above), mid-tier (share above ~5% to 15%) and small players (share up to ~5%).



Increased Market Shares		
MFB	**CY15**	**1HCY20**
U MFB	2%	11%
First MFB	10%	16%
Mobilink MFB	2%	8%

Reduced Market Shares		
MFB	**CY15**	**1HCY20**
Telenor	22%	10%
Khushali	31%	25%*
Mobilink MFB	16%	13%

**Market Leader*

Share of other players in the Industry GLP has remained largely stable over the years. Small players include APNA MFB (~4%), Advans, Pak Oman and Sindh MFB each possessing a share of ~1% or less.

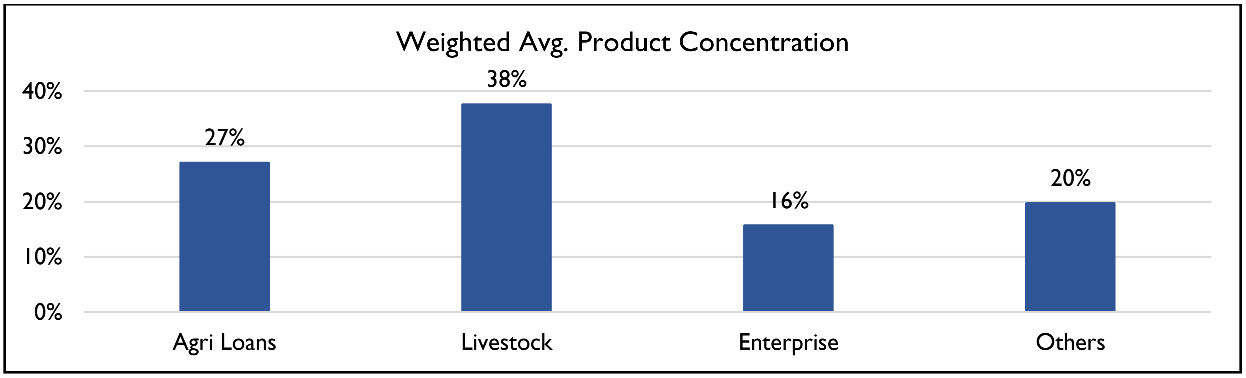
GLP | Outreach:

Microfinance Banks					
Period	**CY16**	**CY17**	**CY18**	**CY19**	**1HCY20**
Outreach					
No. of Branches	963	1,079	1,291	1,424	1,419
Gross Loan Portfolio PKR mln (A)	89,940	136,369	188,613	213,712	220,874
No. of Active Borrowers (Period End) (B)	1,943,346	2,576,942	3,167,214	3,557,846	3,705,417
Average Loan Size - PKR (A/B)	46,281	52,919	59,552	60,068	59,608
Growth Trend (%)					
Branch Network Growth	22.2%	12%	19.6%	10.7%	-0.7%
GLP Growth	61%	52%	38%	13%	3%
Growth in Number of Borrowers	33%	33%	23%	12%	4%
Growth in Average Loan Size	21%	14%	13%	1%	-1%

Product Specifications | An Overview

Product Types:

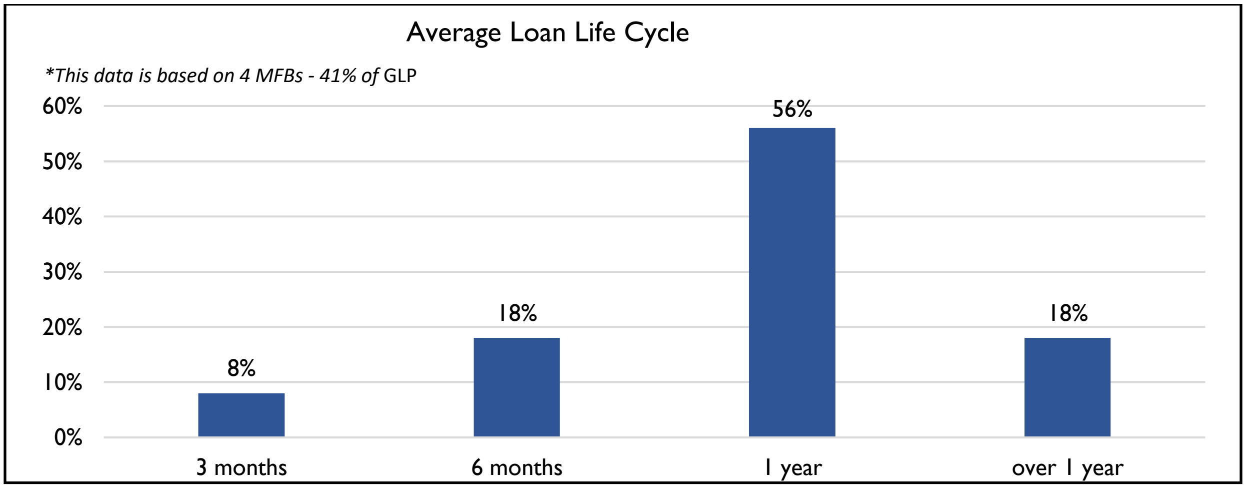
MFBs Loan Portfolio is majorly concentrated in Agri and Livestock loans. Weighted average product concentration of 8 MFBs reflects that ~27% of the Sector's loan portfolio is dedicated to Agricultural lending while ~38% is concentrated in livestock lending.



Agricultural lending is usually underpinned to the crop cycles for which the loan is provided to the farmers. Loan book features in agri-lending are, therefore, a derivative of crop seasonality, its output, prices, sale pattern and other related factors.

Life Cycle:

Microfinance loans are generally short term in nature having an average life cycle of one year. Tenor of agricultural loans are usually dependent on the cycle of the crops to which the loan pertains.

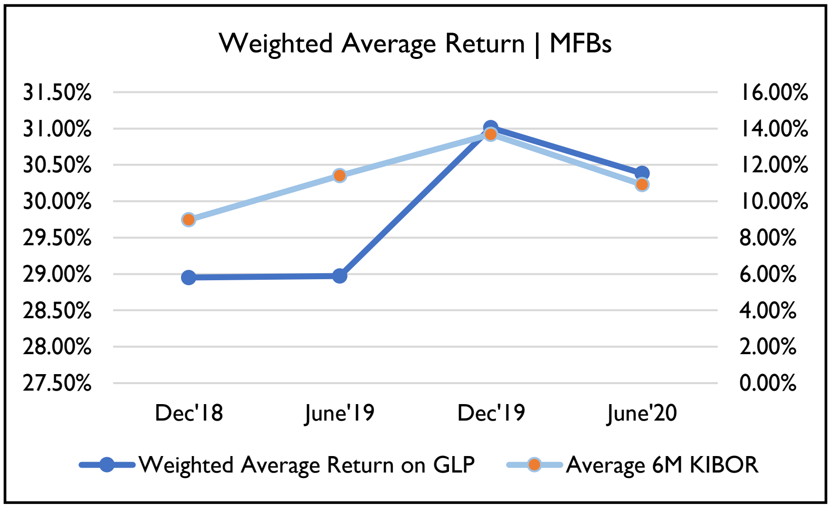


Repayment Patterns

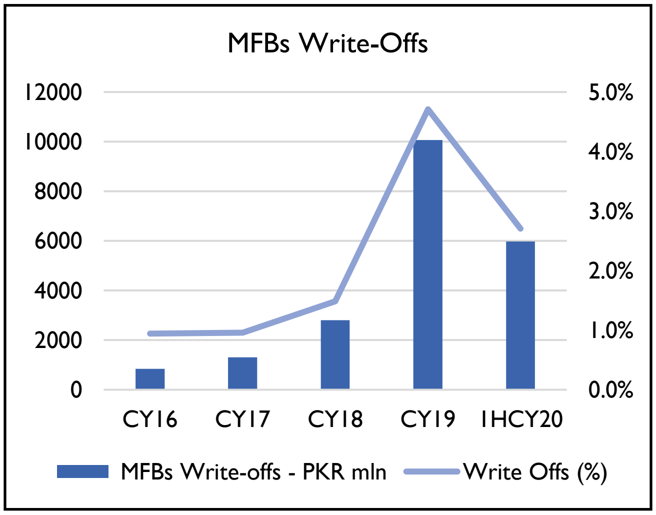
Repayment pattern of MFBs generally comprises Equal Monthly Installments (EMI) and Bullet payments wherein principal and interest amounts are recovered at the end of the loan period. Crop linked financing and some portion of livestock loans usually have bullet repayment design.

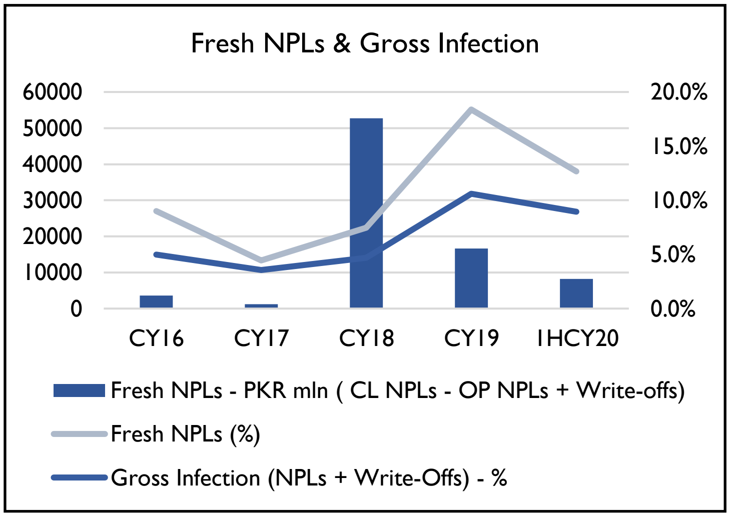
Mark-up/Average Returns:

Based on an analysis of five (5) major MFBs, the weighted average rate of return on loans exists in the range 28% - 32%. Annual Percentage Rate (APR) on individual products generally falls in the range from 35% - 40%. Due to high APRs, players do not have ample room to pass full impact of increase in interest rates to the borrowers. Partial impact of the increased policy rates is absorbed by the Industry to keep secure credit risk. Following March'20, since there have been several spells of policy rate cuts as measures against Covid-19 impact, MFBs rates of returns have reflected likewise adjustments.



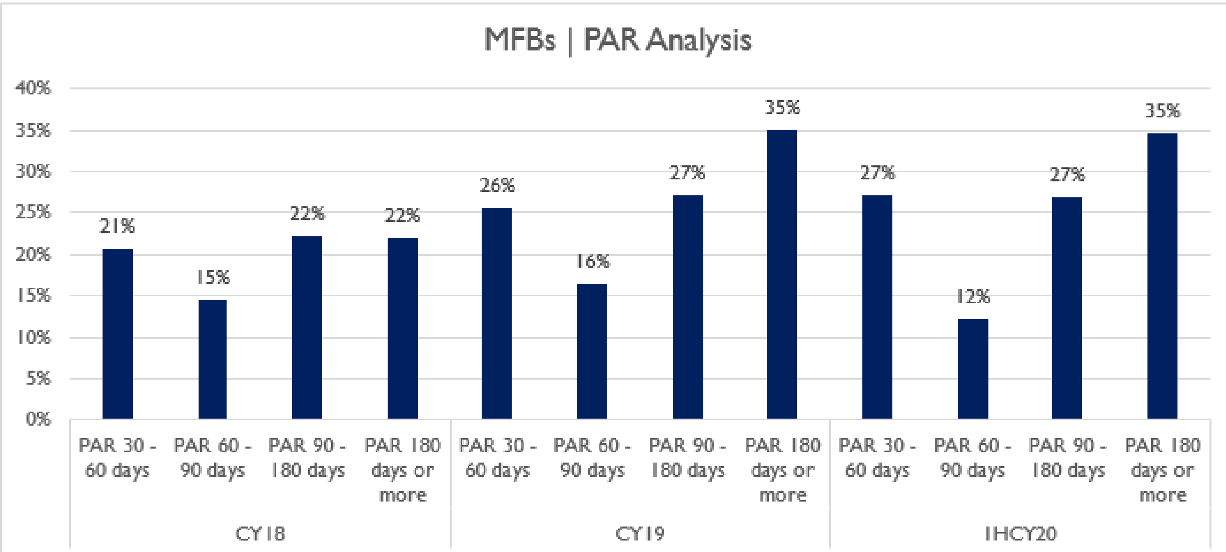
Asset Quality





- Industry write-offs have shown a sharp increase in CY19, representing that most of the loans classified as non-performing in CY18 could not be recovered within the Regulatory timeline of one month over 180 days.
- Written off loans reflect the same pattern in 1HCY20 which depicts that probability of non-recovery within the Infected portfolio has risen thus increasing the credit risk of the Sector.

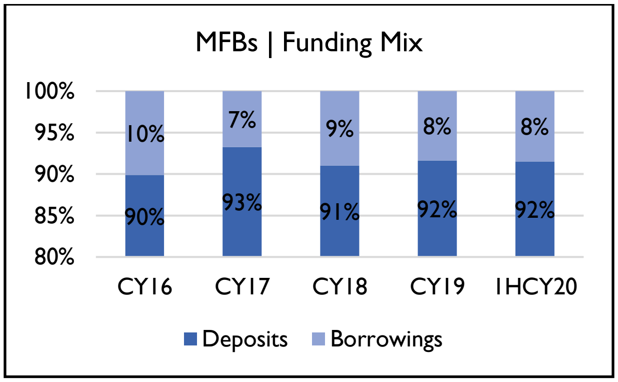
Categorical Classification of Infected Portfolio:



- Level of risk has gone up for MFBs from CY19 onwards as ~62% of the NPLs lie in the period outstanding for more than 90 days. This reflects that ~35% of the portfolio at risk is more exposed to a write-off/loss.
- In CY18, ~44% of the infected portfolio had crossed the 90 days category, while ~22% was the closest to a charge-off.

Funding | MFBs

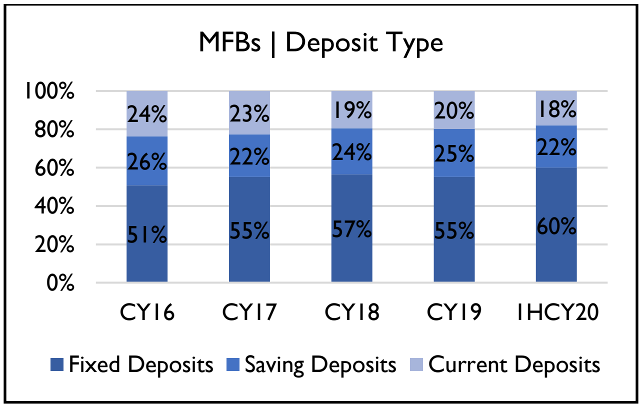
Funding Snapshot					
Period	**CY16**	**CY17**	**CY18**	**CY19**	**1HCY20**
Deposits (PKR mln)	120,089	185,910	238,667	265,837	293,576
Borrowing	13,525	13,415	23,507	24,215	27,241
Total Funding	133,614	199,325	262,174	290,052	320,817
Growth %					
Deposits	93%	55%	28%	11%	10%
Borrowings	24%	-1%	75%	3%	12%
Total	83%	49%	31%	11%	11%
No. of Depositors	20,123,818	27,828,168	32,009,797	44,390,660	49,707,592
Average Deposit Size (PKR)	5,972	6,681	7,453	5,991	5,906
Growth %					
Depositors	89%	38%	15%	39%	12%
Avg. Deposit Size	2%	12%	12%	-20%	-1%

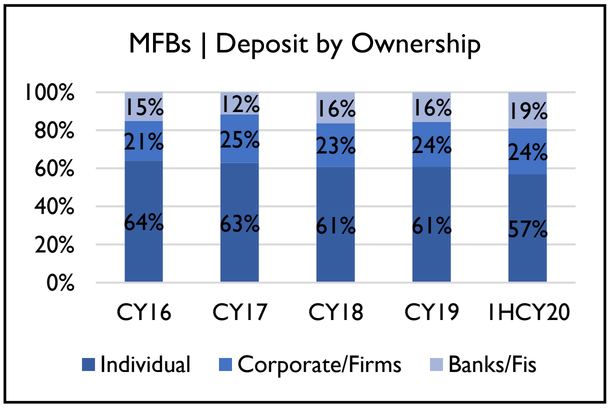


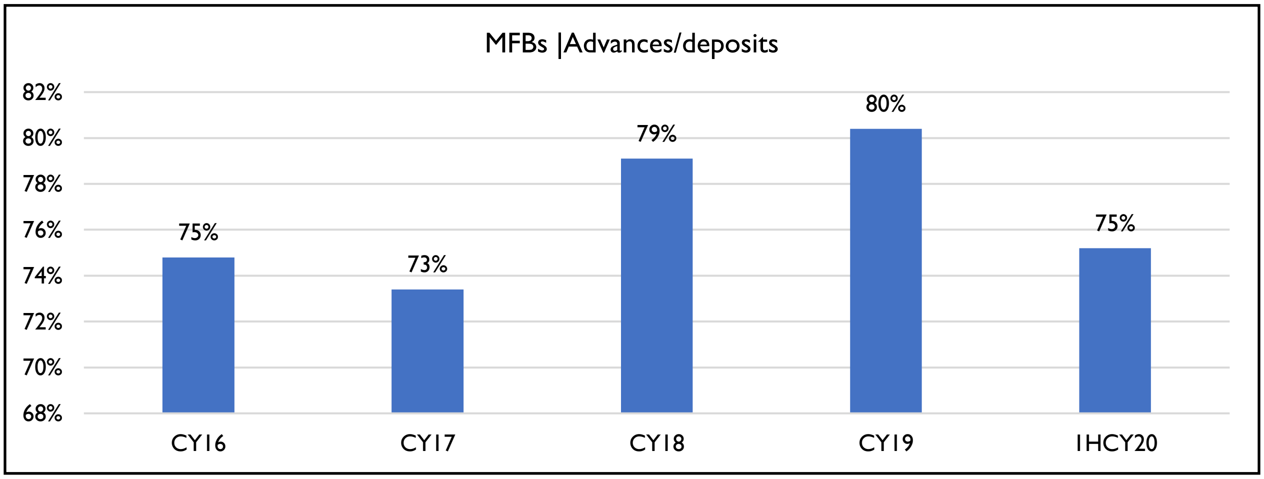
Among borrowings and deposits, MFBs' dependency on deposits to fuel their business growth remains over ~90%.

Deposit compositions play a key role in optimizing the cost of funds and managing profitability.

Deposit Composition:





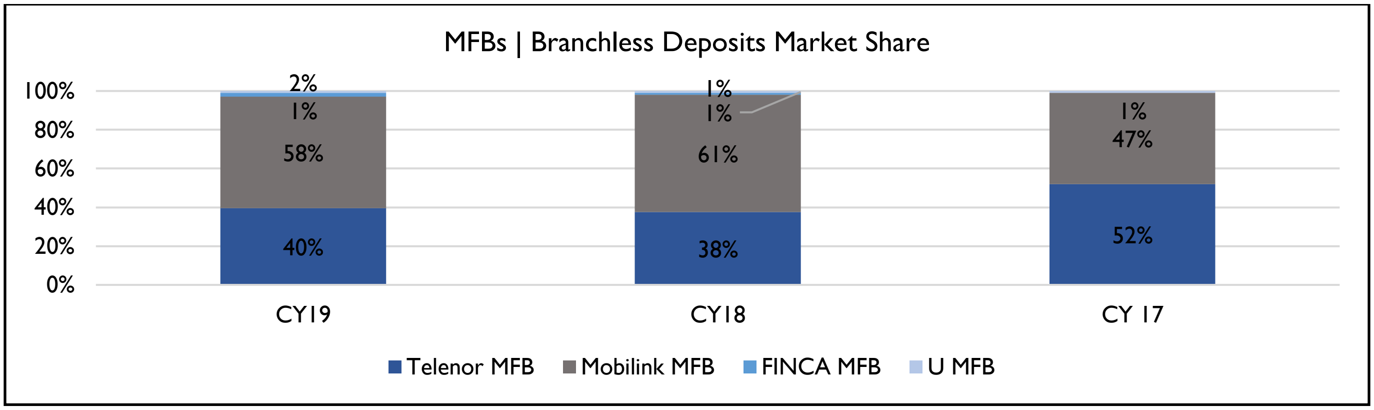


- The Industry's deposit composition has gradually inclined towards high cost deposits, i.e., fixed/term deposits.
- 'CA' % in the total Industry deposits remains below ~20%.
- Deposit Concentration continues to pose risk to the MFBs which are not involved in Branchless Banking.

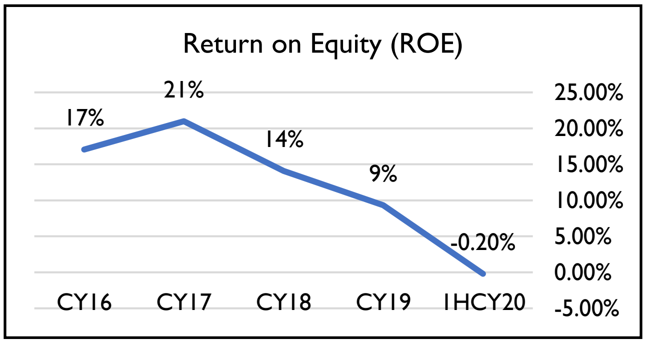
- Average ADR has improved from ~80% to ~75% in 1HCY20, owing to a low GLP growth in comparison to Deposits.

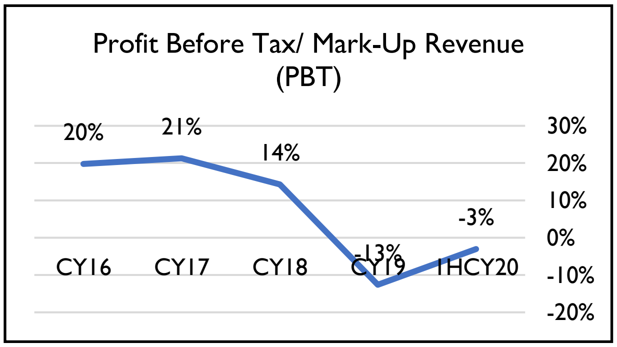
Branch and Branchless Deposits

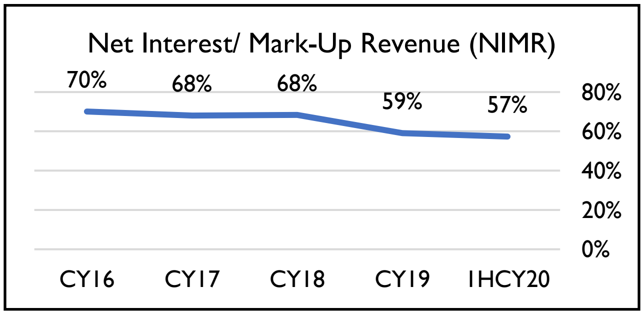
Branch and Branchless	CY16	CY17	CY18	CY19	1HCY20
Branch Deposits (PKR mln)	111,703	167,289	193,530	237,932	258,563
Branchless Deposits (PKR mln)	8,470	18,621	45,026	28,005	35,329
No. of Deposit Accounts | Branch	8,096,801	8,795,319	10,316,664	11,579,520	11,712,727
No. of Deposit Accounts | Branchless (PKR)	14,994,449	22,189,398	24,976,938	36,062,751	41,174,421
Avg. Deposit Size | Branch (PKR)	13,796	19,020	18,759	20,548	22,048
Avg. Deposit Size | Branchless (PKR)	565	839	1,803	777	858

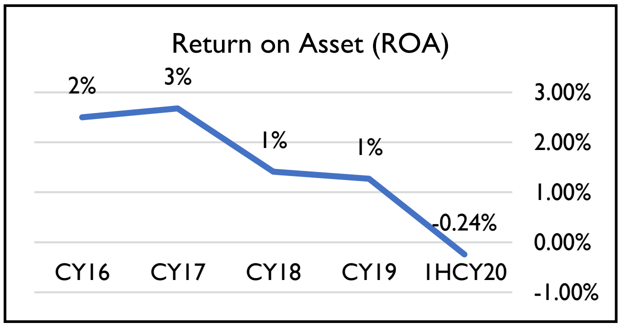


MFBs | Performance



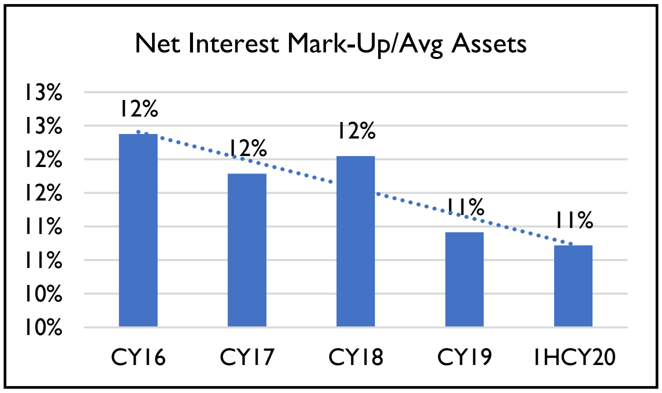


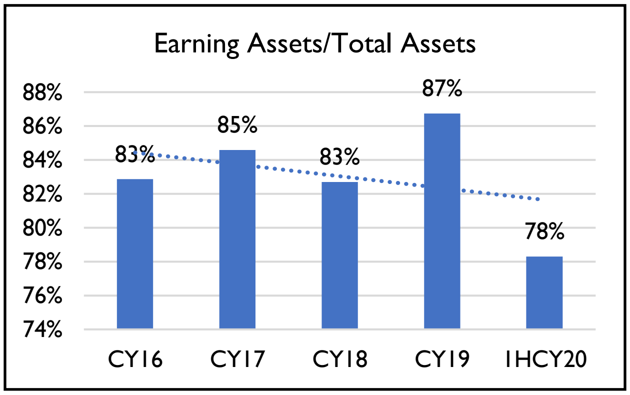


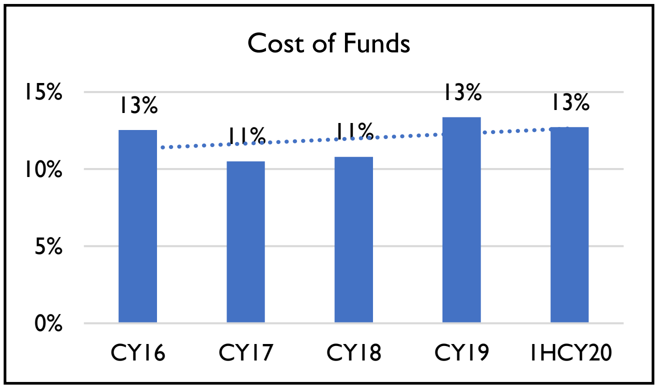


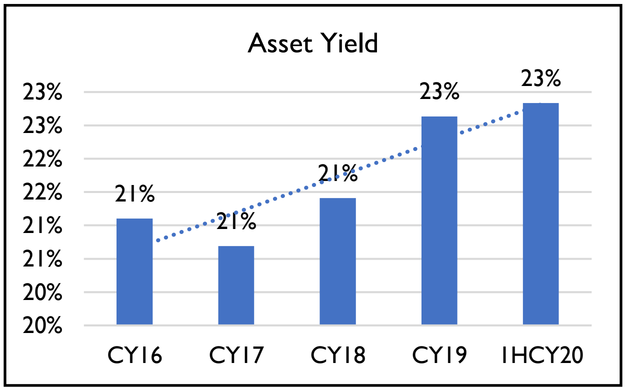
- Low Profitability in the Sector is majorly attributed to high provisioning costs against low credit quality and elevated operating costs. NIMR remained relatively stable owing to rising interest rates till 1QCY20.
- Performance in branchless banking also remained distressed for the two major players, Telenor and Mobilink.

MFBs | Efficiency Ratios:



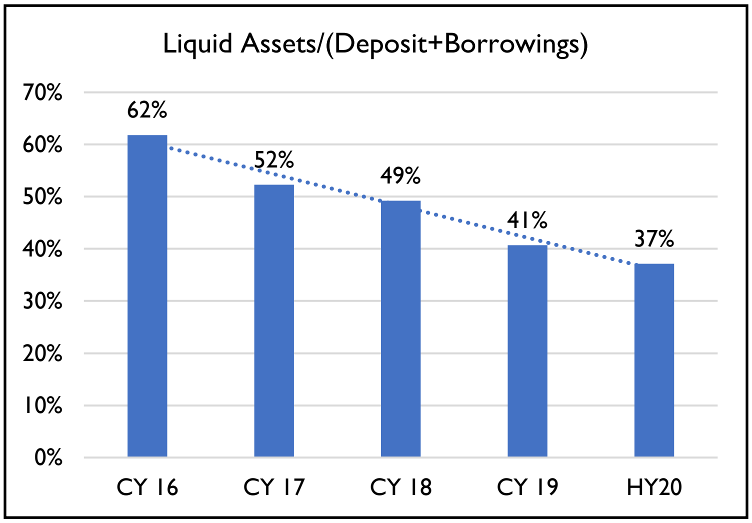






- Similar to a downward trend of Average Returns on GLP in 1HCY20, cost of funds has also reduced. NIMR, therefore, remains largely stable in 1HCY20 at ~10.7% (CY19: ~10.9%). On the other hand, asset yield curve shows a positive trajectory. This is more likely attributed to the reduced pace of growth in the overall asset base of the Industry.

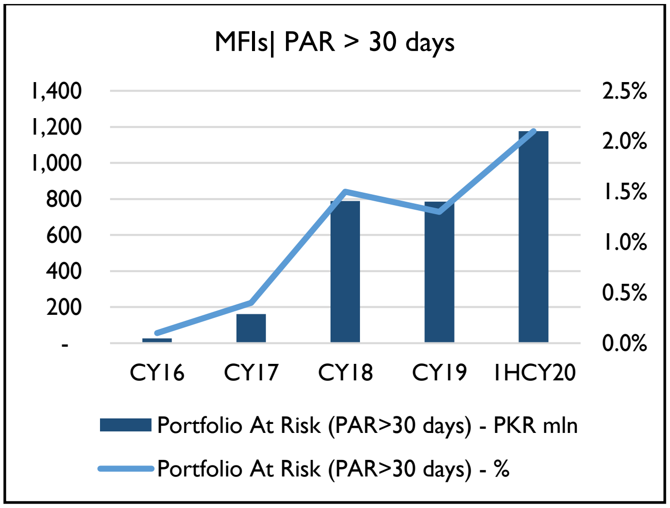
MFBs | Liquidity:



- Liquidity profile is on a declining trend, dropping from ~62% in CY16 to ~37% in 1HCY20. This calls for cautious management strategies.
- Earning Assets as a % of total assets have dropped from ~87% in CY19 to ~78% in 1HCY20.

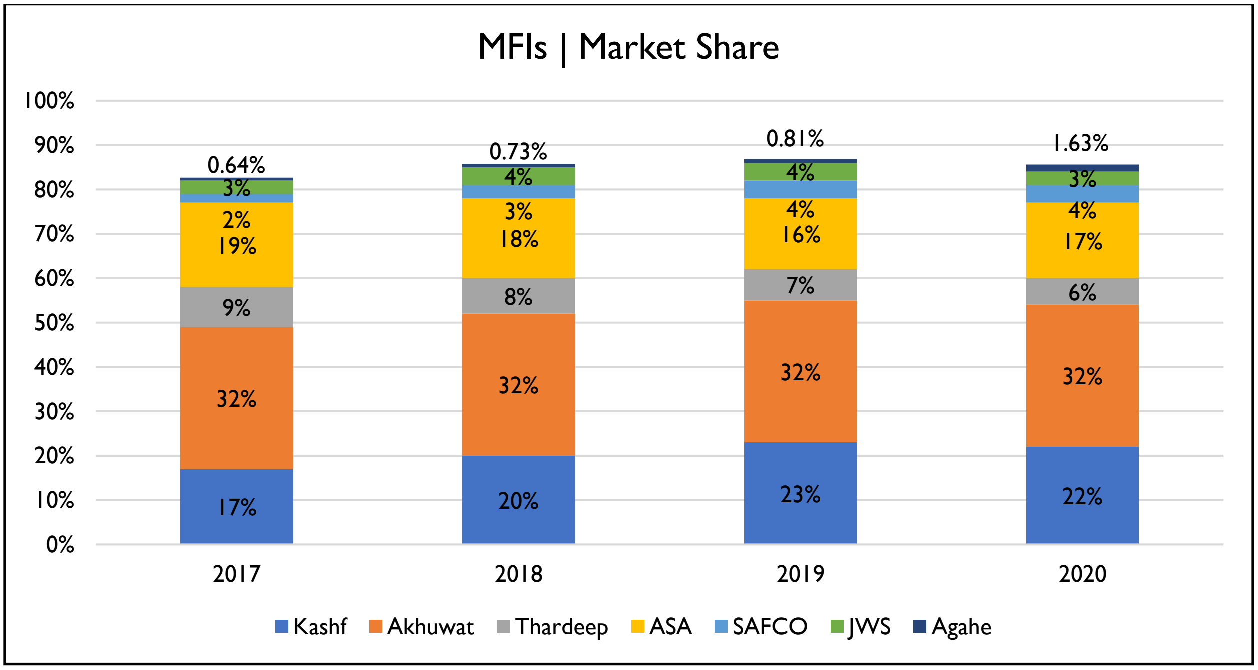
Assets Overview | MFIs

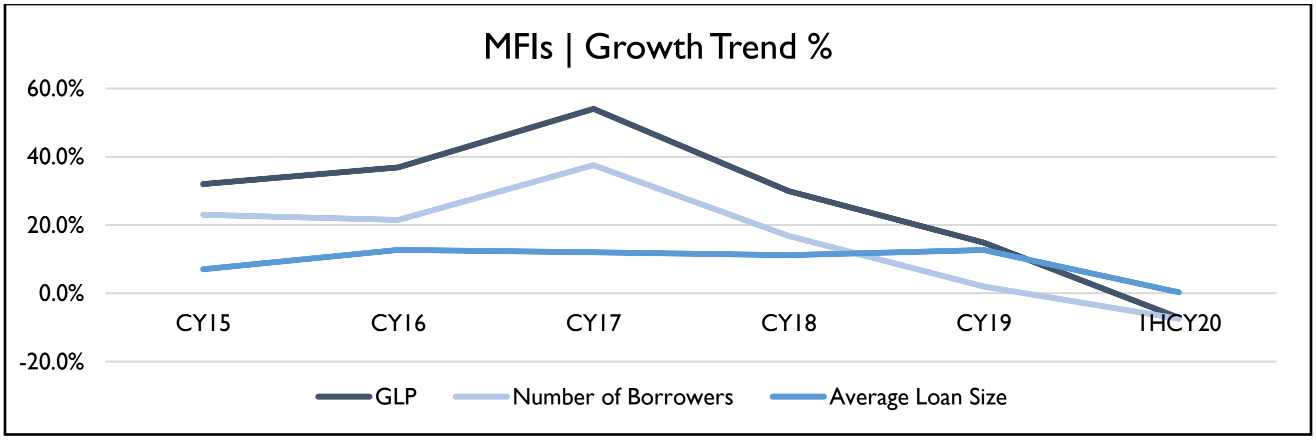
Microfinance Institutions					
Period	**CY16**	**CY17**	**CY18**	**CY19**	**1HCY20**
Outreach					
Number of Branches	1,214	1,421	1,763	1,870	1,859
Loan Portfolio					
Gross Loan Portfolio PKR mln (A)	26,264	40,449	52,548	60,363	56,025
No. of Active Borrowers (Period End) (B)	1,500,092	2,062,994	2,410,285	2,457,043	2,273,860
Average Loan Size - PKR (A/B)	17,508	19,607	21,802	24,567	24,639



Like MFBs, MFIs' asset performance has also deteriorated over the past couple of years, owing to the similar factors attributed to the MFBs. During 1HCY20, MFIs' GLP has displayed a sharp decline of ~7% due to reduced net disbursements amid Covid-19 situation.

Market Share of MFIs:





Assets Overview | RSPs & Others

Rural Support Programmes (RSPs) & Others					
Period	**CY16**	**CY17**	**CY18**	**CY19**	**1HCY20**
Outreach					
Number of Branches	1043	1173	1,185	742	477
Gross Loan Portfolio PKR mln (A)	20,739	25,882	27,465	31,679	26,689
No. of Active Borrowers (Period End) (B)	1,128,807	1,160,521	1,157,847	1,235,054	1,057,172
Average Loan Size - PKR (A/B)	18,372	22,302	23,721	25,650	25,246
Credit Quality (figures in PKR mln)					
Portfolio At Risk (PAR>30 days) - PKR mln	496	123	204	868	895
NPLs (Period End)	2.4%	0.5%	0.7%	2.7%	3.4%
Growth Trend (%)					
Branch Network Growth	-5.3%	12.5%	1.0%	-37.4%	-35.7%
GLP Growth	14.5%	24.8%	6.1%	15.3%	-15.8%
Growth in Number of Borrowers	6.1%	2.8%	-0.2%	6.7%	-14.4%
Growth in Average Loan Size	7.9%	21.4%	6.4%	8.1%	-1.6%

COVID-19 | The Effects & Aftermath

Effects: The unprecedented outbreak of Covid-19 has cast multi-faceted impact of varying degrees on different sectors of the economy; Microfinance is no exception. The Industry was already undergoing a depressed performance cycle and slowdown in growth prior to the advent of Covid-19. This was mainly attributed to changing market indicators. Consequently, the debt repayment capacities of the borrowers were reduced which led to over indebtedness in the sector and rise in infection ratios. Additionally, unfavorable weather conditions for crops including untimely rains, drought in Thar region and delayed offtake of sugarcane crop in the first half of CY19, also contributed to the deterioration of asset health and pressured the profitability margins of the players. Nonetheless, these issues were expected to subside over the course of time had there not been the untimely outbreak of Covid-19 which had impacted the country on health and economic fronts.

The Impact of Covid-19 and consequential lockdown on the Microfinance Sector is manifold. One factor affects the other. The following three risks can be identified as the key risks that had surfaced in the out turn of the situation:

Recovery Loss	Reduced Disbursements	Funding Constraint
Deterioration in Credit Quality	Business Compression	Liquidity Shortfall

The turbulence had begun with a downfall in loan recoveries. Within a month of Covid-19 spread in the country, a nationwide lockdown approach was adopted. Though it was the need of the hour, the decision had come with its own compromises. Barring essential industries, most of the businesses and supply chains were largely disrupted. Repayment capacity of microfinance borrowers was stringently reduced which was initially expected to erode the credit quality of the industry. However, Regulator (SPB) Relief in the form of allowance of deferment of loan repayments came handy to the masses (salient features mentioned later in detail). On the other hand, the deferment relief also served as a support to the Industry players to prevent erosion of their loan quality.

The decision to defer outstanding installments has resided with the Industry players. Different players had followed different strategies to defer their outstanding receivables. The decisions were largely based on factors such as recovery cycles, prediction of future receivables, acceptable profitability contractions, and management of liquidity crunch.

While this had secured the asset health to a good extent, other pertinent issues remained unresolved. MFBs therefore, had to take shrewd decisions based on developing an acceptable trade-off to sail through the storm. Since the actual cash inflows had fallen drastically for the earlier months of lockdown – April – May and continued to remain low thereafter, disbursements were, likewise, brought down by varying levels to sustain a liquidity equilibrium. Business compression, however, was not the solution. An optimum level of business activity is a must to remain sustainable in the market. Under a contracted recovery environment, business momentum could only be fueled through appropriate funding. To the Industry's fortune, deposit withdrawals - another major risk on the funding side, did not intensify the risks as was initially anticipated.

Going forward, MFBs may intend to increase their dependence on commercial sources of funding to meet their needs if deposit growth does not suffice. To conclude, the Industry has begun to head towards re stabilization. Disbursements have partially resumed and are expected to improve in the coming days. With the reopening of businesses, demand is expected to revive. Reduction in Interest Rates during Covid-19 times may act as a demand stimulator, while recovery patterns are also reflecting betterment. Nonetheless, it is important to state that challenges still do exist and may befall if there is an unanticipated obstacle to the expected normalization. Optimal disbursement strategy is the key to sustenance. Amount deferred by each bank, actual and anticipated cash inflows, available sources of funding to prevent business congestion and bearable profitability levels are some of the essential drivers in reaching to a sustainable business plan for the short term.

The following statistics have been used for analysis purpose:

Monthly Disbursements (as a % of regular disbursements) | 2QCY20 | MFIs ~27%

Monthly Recovery Rate (as a % of outstanding receivables**)) – 2QCY20**

~30% - 35%

- Monthly disbursement rates had sharply fallen for April and May, for most of the MFBs and MFIs. An improved trajectory was witnessed in June and onwards. As of Sep'20, disbursement rates have gone up by ~65% for most of the Industry players.
- Recovery rates had drastically fallen below ~30% in the first two months of the lockdown. The situation reflected a comeback in June'20 onwards. Monthly average recovery patterns have now re-bounced to over ~50% for the overall Industry.

Note: For calculation of simple average monthly disbursements from April-June, a sample of 4 MFIs and 2 MFBs has been used.

Salient Features of SBP's Deferment Relief Package:

- Microfinance banks, upon a written request of an obligor received before June 30, 2020, will defer repayment of principal loan amount by one year; provided that the obligor will continue to service the mark-up amount as per agreed terms & conditions. The deferment will not affect the credit history of the obligor and accordingly will not be reported in the ECIB as restructuring.

- The financing facilities of such borrowers, who are unable to service the mark-up amount or need deferment exceeding one year, may be rescheduled/restructured upon their request. If the rescheduling / restructuring is done within 90 days of the loans being past due, such financing facility will continue to be treated as regular and reported in the ECIB accordingly.

- Microfinance banks shall not classify the financing facilities of such borrowers who have requested for deferment or rescheduling/restructuring, unless the payment obligations are past due by 90 days. If the deferment or rescheduling/restructuring is not executed successfully within the specified period of 90 days past due, such financing facilities be classified as "Doubtful" as per prevailing instructions of Prudential Regulations for micro financing.

- The instructions on rescheduling / restructuring and classification of loans will stand expired on March 31, 2021, and afterwards prevailing instructions will be applicable.

The same deferment package has been provided by the SECP to MFIs. Moreover, the time period for receiving written requests from borrowers was later extended to 30th Sep, 2020.

In addition, SBP Relief Package for microfinance banks, which included deferment of principal and restructuring of microfinance loans to deal with the adverse implications of the ongoing Covid-19 pandemic have now been expanded with three measures. First, the relief measures that were earlier available from Feb 15, 2020 have now been allowed to borrowers who were regular on December 31, 2019. Second, to facilitate MFBs the provisioning requirements have been extended by 2-months; and third, client's consent through recorded lines has been allowed to facilitate the customers to avail the relief package.

Other Regulatory Updates:

SBP enhances loan limits and expands relief measures for microfinance borrowers (Dated – Aug 10, '20).

- **Housing Finance:** SBP has enhanced the limits for housing finance and microenterprise loans up to Rs3 million from the existing limit of Rs1 million for borrowings from the microfinance banks.

- **General Loans:** The maximum size of general loans has been enhanced from Rs150,000 to Rs350,000.

Conclusion & Outlook

Industry Outlook: WATCH | Developing

Key Drivers for Outlook:

- Based on an extrapolation of the current statistics, the Industry's GLP growth is expected to remain subdued. While MFBs are expected to make a growth of 5% -8% for CY20, the MFIs segment is foreseen to remain under more distress and may remain constricted to ~3% or lower.

- Fresh disbursements are expected to remain low. From the current scenario, focus is more inclined towards repeat loans and securitized financing (e.g. gold back loans), and the same trend is expected to continue in the short term.

- Though, asset quality has been protected through deferment allowance by the Regulators, *true infection* ratio is still expected to grow, bearing the borrowers' sentiments and current market conditions.

- Average ticket size is expected to increase further for MFBs due to SBP's enhancement of limits for general and housing loans. This would reduce processing cost per borrower - a benefit to the MFBs. On the other side, average exposure per borrower would also increase for MFBs.

- Growth in liquid investments is expected to remain limited. On the other side, borrowing mix, may grow on the funding side of MFBs that are not involved in branchless banking. Highest liquidity risk lies for smaller MFIs whose access to funding avenues are limited.

- Profitability of the Industry is expected to remain under pressure, owing to increased credit risk. On the contrary, reduced interest rates and inflation are expected to cool off the impact to certain level.

Disclaimer: The above conclusion is based on PACRA's independent analysis of data gathered through various public and In-house sources and may be subject to variations, depending on the behavior of driving factors. The samples selected in historical analysis do not cover 100% of the population in some cases and may produce different results on a different sample size.

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