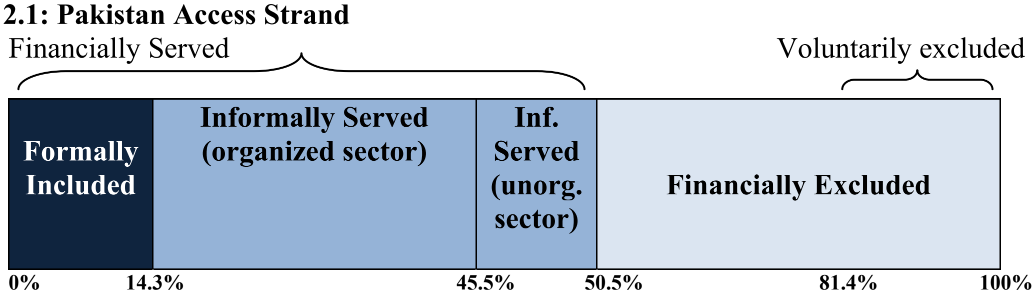
2. Access to Finance: Evidence from the Demand Side[17]

This chapter overviews the detailed findings of the national household survey on individual and household interest, knowledge of, and usage of financial products, including savings, credit, insurance, payments, and remittance services, as well as informal financial products. The average Pakistani household remains outside the formal financial system, saving at home, and borrowing from family or friends in cases of dire need. While only 14 percent is formally included, about 40 percent of the population is completely excluded from formal or informal financial systems. Disparate as formal access might be among rural and urban areas, men and women, income levels, as well as along education and employment lines, interest in financial services is virtually identical. The challenge is to translate financial interest into access. Income and financial literacy appear as key barriers to financial exclusion when controlling for all other characteristics. Other drivers of financial inclusion are employment (formal employment determining formal inclusion), age, education levels, or being the main household income earner. Mobile phone use and access reduce the chances of being financially excluded. The banked in addition enjoy access to collateral while distance is only a marginal deterrent to being banked. An analysis of perceptions of financial services links the popularity of informal finance to its minimum access requirements—in direct contrast to formal finance documentation, creditworthiness requirements, and associated fees that overburden population groups such as women, and low-income or rural populations.

The average Pakistani household saves at home, borrows from family or friends in cases of dire need, and does not use the formal financial system. About 14 percent have access to formal financial services,[18] as compared with 32 percent in Bangladesh, 48 percent in India, and 59 percent in Sri Lanka (World Bank, 2008c). Adding informal finance, the proportion of financially serviced population rises close to 60 percent (Figure 2.1). About 40 percent of the population is completely excluded from both the formal and informal financial system. Not all of these necessarily want to be served, in fact, 18.6 percent do not see the usefulness of being financially served. Of the remaining 22.3 percent, 6.3 percent are employed and could be profitably served, but have remained outside the financial system.

Figure 2.1: Pakistan Access Strand



Source: Pakistan Access to Finance (A2F) Household Survey 2008

The survey data permits us to look at specific access and appeal issues along the lines of several basic financial products, in both the formal and informal sector: banking, savings and investment, borrowing, informal finance and committees, insurance, and payments. The findings show low access to formal products overall. Islamic finance covers less than 1 percent of individuals, mostly high-income urban males. There are 2.5 percent formal borrowers as per the Access to Finance (A2F) household survey, and the corresponding State Bank of Pakistan (SBP) figure for the number of accounts (not clients) per adult

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[17] What this chapter identifies as "demand" is the potential demand arising from characteristics captured through the national household survey and analyzed though an econometric analysis model. It should not be understood as effective demand.

[18] Seventeen percent per SBP figure (Akhtar 2007).

population is 6.3 percent (4.9 million).19 About 1.7 million of the adult population are serviced by the microfinance sector (SBP data)—this is about 1 percent of the population and about 2 percent of adults. About 2.3 percent of people send or receive remittances, and 1.9 percent are insured. Less than 1 percent of the population benefited from mortgages (but 3.5 percent used a loan for those purposes). Pakistan is a cash-based economy—even in the formal sector, income is primarily received in cash.

Few households are formally served, especially rural and lower-income groups and women. Within the informal finance sector, 35 percent of individuals save at home, 21 percent in livestock, and 14 percent use committees20 to place their savings. A third of individuals hold loans or credits, mostly in the informal sector (33.7 percent, which includes 19 percent who borrow from family and friends). Overall, a little over half of the population have formal or informal savings/investments, and 35 percent have credit (Table 2.1). Close to 13 percent of individuals (10.4 percent rural and 17.2 percent urban) have bank accounts. Banking with Pakistan Post, however, is almost equally used among rural and urban households. Another notable exception is in accessing savings for investment in productive activities, stronger in rural than in urban areas.

Table 2.1: Access of to Financing, by Service

Service	% Population Using	Rural	Urban
Savings/Investment	55.4%	55.7%	54.8%
Loan and credit	35.0%	38.7%	28.6%
Banked	12.9%	10.4%	17.2%
Money transfers	2.3%	1.9%	3.2%
Insurance	1.9%	1.7%	2.3%

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Source: Pakistan A2F Household Survey 2008

Several patterns of financial access in Pakistan come out of the national household survey and are presented methodically in the subsequent sections below:

- Rural areas are underserved and less financially literate but display an equal or higher level of interest in financial services;
- Males have better access to financial services than females, though decision making is joint and willingness to learn about financial matters is comparable;
- There are wide provincial differences in financial services, literacy, and access;
- Lower-income groups display significantly lower awareness of and access to financial products, though only mildly lower interest in financial services.

Disparate as formal access might be among rural and urban areas, men and women, lower- and upper-income people, as well as along education and employment lines, interest in financial services is virtually identical! The challenge is to translate financial interest into access. The analysis goes on to suggest specific avenues for capitalizing on the considerable promise for financial expansion. Strong growth rates of financial access measures also point to the country's potential, though they also return the analyst to the current status-quo with very limited levels of access.

The chapter reviews (1) financial access patterns by income, provinces, gender, and other individual characteristics; (2) financial literacy and interest issues; (3) informal finance and committees; (4) banking; (5) savings and investment; (6) borrowing; (7) insurance; and (8) payment and check services.

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[19] SBP Statistical Bulletin June 2008. The differences between SBP statistics and the Pakistan A2F survey statistics are discussed in detail in Appendix A (Calibration). Some differences arise due to clustering of financial services in specific areas, which a nationwide household survey of this size (10,305 households) cannot adequately address. This is the case for microfinance clients and committees (particularly the business committees in bazaars). Other differences are caused by multiple accounts maintained by clients and some double counting of clients among financial institutions (this is the case for bank lending), as well as some stale or inactive accounts (this is the case for Pakistan Post). Differences can further be explained by shortcomings on the part of literacy and understanding on part of respondents.

[20] Committees, an informal mechanism for group saving and lending, are explained in section 2.4 below.

2.1. Variability of financial access is considerable across rural/urban areas, provinces, income, gender, and other population characteristics

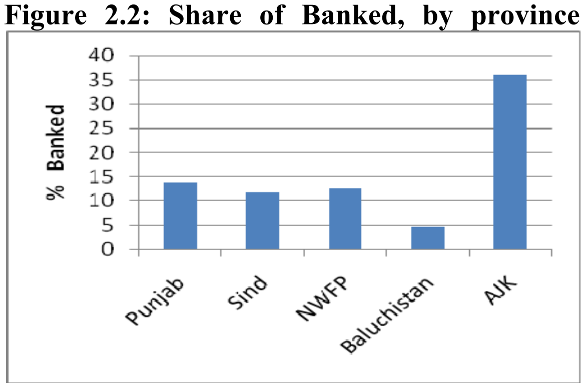
For the median individual, a 32-year old with education up to 4th grade of elementary school, living in rural areas, and employed, joining the government or becoming a farmer reduces his or her chances of remaining financially excluded by a whopping 10 and 9 percentage points, respectively, while joining the corporate sector improves those chances by only 1 percentage point (Annex Table A2.2). Being a woman, on the other hand, reduces one's chance of being informally served by 3 percentage points, and respectively increases the chances by as much to be financially excluded, though gender has no marginal effect on formal inclusion of any economic magnitude (-0.003 percentage points). Every 10 years of age add one percentage point to the chances of leaving the ranks of the unserviced and joining the formally included, though there is no significant effect of age on informal inclusion. Completing primary school improves one's chances of joining the formal financial market by 0.6 percentage points. Moving into urban areas improves one's chances to join the informally served by 8 percentage points but does not affect the chances for formal inclusion. Mobile phone use and access reduce the chances of being financially excluded by 5 and 10 percentage points, respectively.

What are the critical factors for improving access to finance? We segment our findings by analyzing rural-urban, state, gender, and other individual differences.

Lower access to finance in rural areas might be determined by an indirect income and literacy effect, rather than factors such as time/cost of access, though differences in accessibility are clearly considerable, between urban and rural areas (Annex Tables A2.1, A2.6–A2.10). Interestingly, location in rural areas alone would not hurt or improve one's chances for financing, and an urban address would not improve them either. While formal sources are much more ubiquitous in urban areas, controlling for the effects of income, education, and employment, both locations are equally well served by formal and informal financing.

This suggests that there is nothing inherently "unserviceable" about rural areas. In fact, informal and some formal channels are providing access there quite successfully, and can be easily imitated by various Microfinance Institutions (MFIs) to emulate their success in access provision. Post office access (and interestingly, insurance) is significantly higher for the rural population. What is perhaps inherently harder with rural areas is access to certain instruments such as credit/debit cards, and, curiously, Islamic products and committees.

Figure 2.2: Share of Banked, by province

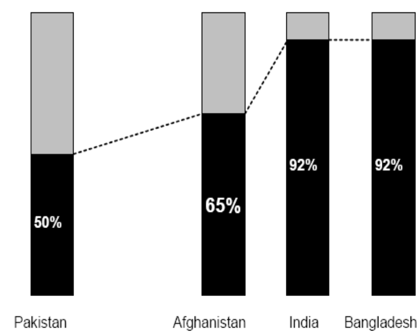


Source: Pakistan A2F Household Survey 2008

Wide provincial differences emerge as to the likelihood of being financially served (formally and informally), as well as banked. Overall, Baluchistan and the North West Frontier Province (NWFP) show lower interest, awareness, and access than other regions. Punjab and Azad Jammu and Kashmir (AJK) lead other provinces (Figure 2.2). Econometric analysis shows that, while provincial effects are observed, income is the main driver of financial inclusion observed in Pakistan states. Half of the population in NWFP and Baluchistan are among lowest two quintiles, while Punjab has the highest population (48.9 percent) among all provinces in the highest two quintiles. However, provincial differences persist after controlling for income. Bank accessibility in Baluchistan might be one reason for low access, though times and cost to getting to a bank is high in AJK as well. There are significant differences among provinces regarding requirements prior to receiving a formal loan. While 79 percent in Baluchistan and 21 percent in NWFP have to provide a co-guarantor, this requirement is quoted by around 50 percent in Punjab, Sindh, and AJK. Differences in financial and banking access are significant (Annex Table A2.3, Panel A).

Women have dramatically less access to the financial sector, with the exception of formal borrowing. There are fewer women with access to banking services (5.5 percent vs. 21.1 percent men), money transfers (1.4 percent vs. 3.3 percent men) and insurance (0.6 percent vs. 3.3 percent men).[21] The same pattern holds for other financial products – generally, women are disadvantaged in access, with the consistent exceptions of Pakistan Post and committee services (Annex Tables A2.9 A2.10). Women remain significantly less likely than men to have access to the financial sector overall, after accounting for the effect of income and other socio-economic differences (Annex Tables A2.1 and A2.6). This overall disadvantage belies a complex picture, however. Women enjoy significantly less access to borrowing (24.7 percent vs. 46.4 percent men), except to formal borrowing. In contrast, women have almost equal access to savings (52.6 vs. 58.5 percent men), though they are significantly more likely to save informally (Annex Tables A2.7 and A2.8).[22]

Figure 2.3: Women & Microfinance



Source: Competitiveness Support Fund (2008)

In the South Asia region, in contrast to Pakistan, microfinance providers have tended to focus on female clients (Figure 2.3). Evidence has accumulated of the link between microfinance for and empowerment of women. Further, financial institutions also tend to find women to be better credit risks. Segmenting female clients by offering them tailor-made products is a promising strategy to catch up with regional neighbors in terms of female access to finance (Box 2.1). Out of roughly 47 million females over the age of 16, it is estimated that potentially 35 million are viable savings clients, and 22 million are viable borrowers.

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[21] Supply-side data show a similar picture. Penetration of the market for credit to women is estimated at 4 percent. The penetration in savings is slightly higher at 9 percent. Response from banks suggests that around 4 percent of the Small and Medium Enterprise (SME) clients and 5 percent of consumer credit clients are women. Approximately 19 percent of long-term interest earning deposit accounts and 1 percent of total current accounts are owned by women. The most recent available financial sector outreach estimate suggests there are currently 4 million women accessing formal financial services (credit and/or savings). Of these, about 3 million women are banking with the traditional financial institutions and about 1 million access services from MFIs.

[22] Specifically note the positive and significant coefficients in Table A2.6 in the regressions of formal versus informal and nonborrowers, and formal versus informal borrowers only. Note also the positive and significant coefficients in Table A2.7 in the regressions of formal versus informal and nonsavers, and formal versus informal savers only.

Box 2.1: Facts about Segmenting Pakistani Female Clients

Women around the globe have been observed to better manage their debt responsibilities. There is no evidence that women offer a less-attractive business proposition than men from the same income category. Women tend to be net savers, and although the average size of a woman's deposit tends to be less than that of a man, women tend to maintain their account with a specific bank for longer while men may shift their patronage for marginal gains. Thus, by ignoring women as a potential and separate market segment with unique demand dynamics, financial institutions may be forgoing potential revenue and profits.

Women tend to have preferences that are distinct from men's. Women's attitudes toward savings are consistent with their desire to learn: women are more likely to follow a budget than men. They are also more reluctant to take debts and are more risk-averse than male respondents. In addition, women tend to prefer convenience above all. Indicative of this may be the fact that the banks think that the share of women among their total borrowing clients increased after the introduction of credit cards. Pakistani women also tend to avoid going to bank branches: thus many women bank through their close relatives. Given the banks' criteria for lending credit only to those (men and women) who are either salaried or have business income, many women including those who may have a secure source of rent income are precluded from the banks' financing including credit cards. Women might also be facing more difficult loan requirements—more women than men (59.8 percent vs 45.3 percent, respectively) cite the co-garantor/co-signor as a condition to receiving formal credit. Being less-experienced banking clients than men, women tend to be more anxious about banking procedures; thus simplified procedures can be an effective selling proposition to women. Finally, women are rarely the main income earners (only 3.6 percent of Pakistani women are), and are largely more exposed than men to receiving irregular income. Over 85 percent of women, being housewives, only receive pocket money as income. It is therefore unsurprising that the poorest quintile in terms of personal (not household) income is three-quarters composed of women and only a quarter by men. As a result, women's transactions will in general be smaller than men's. Women's equal access to mobile communications make mobile phones a promising channel to reach women in terms of mobile banking products but also awareness campaigns on the benefits of access to finance.

Bank Al-Falah is currently marketing a "women's" credit card promoted as "A Credit Card Exclusively for Women." Though a laudable effort to attract a dormant market segment, this card does not differ from a regular credit card offered by the bank itself or any other bank in terms of either the features or the eligibility criteria.

Source: Bank Af Falah website (2008).

Meezan Bank, an Islamic bank, has introduced "Ladies Banking." a dedicated banking section only for women. This new service provides an exclusive banking area as per the *Shariah* (Islamic law) principles for women customers "in a more comfortable environment." Under this initiative, a dedicated customer services officer will provide consultancy for a full range of the bank's services including, 9 am to 5 pm online banking, term certificates, current and saving accounts, consumer financing, and 24/7 banking services.

Source: http://www.meezanbank.com/ladiesBanking.aspx (2008).

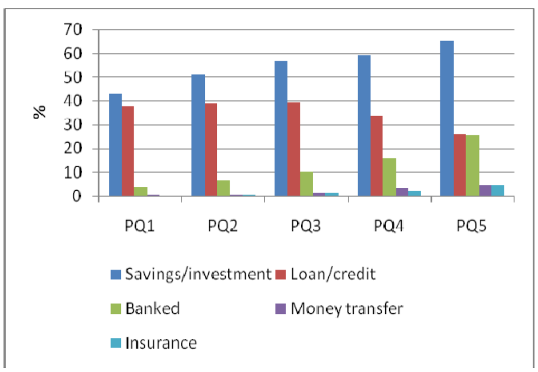
Access increases with **age, an employed status, and education**.[23] **Household heads** are found to have better access to financial services.[24]

[23] The regression analysis on which the discussion is based is in Annex Table A2.2 and more generally in Annex Tables 1-6, which are also discussed in further detail in the following sections of this chapter. The probit and multinomial logit regression frameworks follow the specification of Kumar et al. (2005).

The **sector of employment** also affects access to formal and informal finance, to the extent that government and corporate sector employment augment the probability of financial access, and laborer status diminishes it. Farmers have worse access to the formal sector, but unlike laborers, have better chances of accessing the informal sector than remaining unserved. Government employment is negatively associated with Islamic product use. Surprisingly, laborers and farmers have weaker access to committees than other (better-employed) groups. Belonging to the formal sector in general improves access to financing, especially formal financing. If formal finance specifically is what one is after, add a government job, or employment in the formal/corporate sector, and higher income. A more surprising finding is that the positive effect of age on financial access disappears in the case of Islamic products and committees.

Personal and household income is strongly associated with access to finance, though they have roughly comparable levels of interest in financial matters (45.2 percent of the poorest quintile are interested vs. 51.2 percent of the population on average). The share of the banked population increases sixfold with income levels, from very low levels (3.8 percent) among the lowest income quintile to 25.5 percent for the wealthiest quintile (Figure 2.4). Yet microfinance and informal finance are by no means a privilege of lower-income groups. Microfinance is used four times as much by the richest quintile than the poorest quintile. The lowest income group faces on average four times longer delay in reaching a bank than the highest income quintile (though medians differ less). The lowest income quintile faces higher absolute costs than the highest (median of Rs 36 vs. Rs 26).

Figure 2.4: Product Penetration



Source: Pakistan A2F Household Survey 2008

The upper-income, especially male, population has much higher access to various formal financial products including products such as basic banking accounts. Less than 1 percent of the poorest and second poorest have a basic banking account, as compared with 4.3 percent among the highest income quintile. Credit cards, debit cards, or Islamic finance are reserved for the richer, as almost no one in the two poorest quintiles had access to these products.

The top three income quintiles have a significantly higher access to finance than the lower quintiles. Interestingly, though the top three quintiles do not differ significantly among themselves in the case of access to formal and informal finance, they fare quite distinctly in terms of banking access, which each higher quintile obtaining markedly better access. The bottom two quintiles are never significantly different from each other (Annex Table A2.3, Panel B).

Availability of **collateral** is positively associated with the probability of being financially served, as well as banked. Interestingly, it also has a significant positive effect on access to savings. There might be a substitution effect between access to collateral, and access to Islamic products and insurance, as collateral access is significantly negatively associated with access to both Islamic products and to insurance.

[24] Except in the case of informal financing (see, for example, the significantly negative association with informal borrowing in Annex Table A2.3 and the significantly negative association of age with informal savings in Annex Table A2.4).

2.2. Interest in financial services is strong among all population segments, though financial literacy is lower among rural, lower-income, and female groups

Rural areas are more likely to express interest in financial matters than urban areas, controlling for income. The same is true for those with more education, with employed status, heading the household, in the formal sector, and regularly using a cell phone. Age and gender do not impact interest in financial matters, though they are significant determinants of the willingness to attain access to finance, along with education. The availability of collateral and a government job also significantly positively affect motivation to join the financially served. These findings[25] have important policy implications for financial awareness campaigns, in terms of the selection of relevant audience given limited resources.

In fact, 51.2 percent of the population express interest or strong interest in financial matters (51.7 percent in rural areas; Table 2.2). Nearly two-thirds (60.6) of households follow what is written or said about financial matters, equally in urban and rural areas. Pakistani households get their financial information predominantly from family (41.1 percent) and the media (24.5 percent). Rural areas rely much less on media than urban (18.3 percent as against 35.1 percent), but much more on family (42.1 percent vs. 39.3 percent). This is true also for lower-income groups. Lower-income groups have much less access to and awareness of financial products, though they have roughly comparable levels of interest in financial matters (45.2 percent of the poorest quintile are interested vs. 51.2 percent of the population on average). The most interest in further learning, across income groups and rural/urban areas, focuses on: preparation of a household/personal budget for 33.2 percent of the population, opening of a bank account (26.9 percent), and savings methods (18.3 percent). Interestingly, insurance is not a focus area of interest.

Table 2.2: Financial Literacy

	Mean	Rural	Urban
Interested or strongly interested in financial matters (%)	51.2	51.7	50.2
Follows what is written/said on financial matters (%)	60.6	59	63.5

Source: Pakistan A2F Household Survey 2008

The bulk of Pakistanis make financial decisions with family or spouse, not alone (78.1 percent). The effect is even more pronounced in rural and lower-income groups. While women represent a group that is consistently less financially literate and more reliant upon informal financial sources than men, they express a strong desire to learn about saving and budget planning. Close to 44 percent of women show an interest in financial services, albeit less than men (59.4 percent). The concepts of profit and loans, as well as committees and moneylenders, seem closer to females than other topics. Males enjoy better access to all sources of information. Women get their news primarily from family members, while men rely twice as much as women on the media. In addition, women express a stronger desire than men to be educated in areas that include preparing a personal budget effectively and learning about ways to save money. Women follow a budget and are more likely to save regularly, begging the question of their relative exclusion as savings clients as compared to men. They are also more reluctant to take on debt (59.8 percent) than men (48.2 percent) and are more risk-averse (63.2 percent) than males (51.3 percent).

[25] See Annex Table A2.4 for econometric results supporting this evidence.

Table 2.3: Literacy Measures in Rural and Urban Areas

Heard and do understand (percent)	Mean	Rural	Urban
Loans	89.1	89.2	89.1
Committees	87.9	85.2	92.5
Profit	75.9	76.2	75.4
Interest	74.6	71.8	79.4
Bank	72.8	69.5	78.6
Moneylender	70.6	68.7	73.7
Collateral	43.7	40.7	48.8
Post office saving accounts	21.7	16.1	31.4
Microfinance	21.1	17.7	26.9
PLS/savings account	19.2	12.4	31.0
Insurance premium	15.2	10	24.2
Credit card	12.6	6.2	23.6
Islamic banking	11.6	6.6	20.3
Automated Teller Machine (ATM)	11.3	4.7	22.8
Mobile banking	3.5	1.7	6.5
Swift transfer	3.3	1.9	5.7
Mobile phone banking	3.1	1.2	6.4

Source: Pakistan A2F Household Survey 2008

Household understanding of specific products is fair, with common financial terms being familiar to over half to 90 percent of the population (Table 2.3). Rural areas have lower understanding, consistently, with the exception of the concepts of profit and loans. Only 17.7 percent in rural areas understand microfinance (versus 26.9 percent in urban areas). Rural awareness of post office savings accounts follows a similar pattern. The largest differentials between rural and urban areas are in the understanding of more complex products such as profit loss sharing (PLS) /savings accounts, insurance premium, credit card, automated teller machine (ATMs), Islamic

2.3. The low bank access nationwide is driven by income constraints and the lack of information and financial education.

Of all adults in Pakistan, only 12.9 percent are banked. This ranks low in the region, for example compared with 66 percent in India and 51 percent in Nepal. More than 87 percent are not banked, yet 42 percent of those would like to be.

Older, more educated, employed persons, and main income earners, have a higher chance of being banked.[26] Positive effects on bank access are also at work for individuals who have collateral, are employed in the formal/corporate sector, and enjoy regular cell phone use. Similarly, the three highest household income quintiles are more likely to be banked than poorer households.

Location in rural areas does not have a significant effect on the probability of being banked. In contrast, provinces differ significantly in the probability of their population being financially served, even when informal financing is included. Baluchistan, due to income, geography, and cultural reasons, lags behind in terms of offering its inhabitants financial access.

Income constraints caused by poor opportunities for productive employment/entrepreneurial activities are indeed the main reason for not being banked, followed by lack of information/literacy/awareness. Other reasons (socio-cultural, religious, mobility, high fees, unfriendly staff, product complexity, or delays) are much less cited than personal reasons. Lack of information is more acute among women and the poor non-banked. While savings are well understood (by 86.3 percent of the population), 83.8 percent do not consider bank accounts essential.

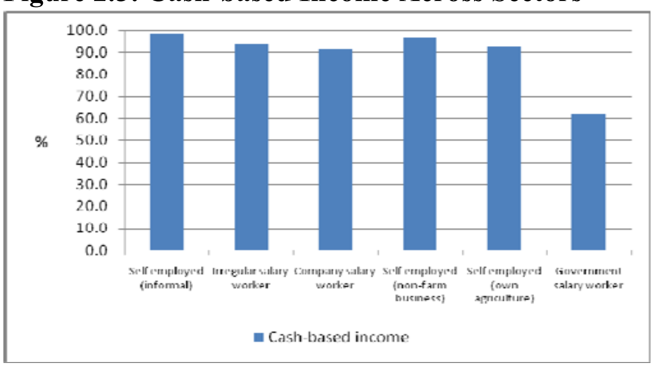
[26] Demand side regression analysis introducing a number of explanatory variables to the probability of being banked shows positive significant effect of age, education levels, being employed, and being the main income earner on the probability of being banked (Annex Table A2.6). The regressions follow the specification of Kumar (2005).

Demand-side evidence points to three main banks by market share: National Bank of Pakistan followed by Habib Bank Limited and Muslim Commercial Bank are the most popular among people with bank accounts, all generating higher usage in urban areas and among men. This suggests a considerable potential for rapid expansion of access to banking.

2.3.1. Cash-based economy with high willingness of the non-banked to gain access to bank services

About 41.6 percent of the non-banked population expressed a high desire to own individual bank accounts, growing with income. It is also stronger among men (51.4 percent) and in urban areas. Saving money appears to be the main reason for the non-banked to desire a bank account, equally for men and women (cited by 26.7 percent of the population), and cited twice as often in urban areas (9.4 percent). The security of being able to withdraw money as needed is a stronger concern for women than men (11.4 percent vs. 9.7 percent). Guarding against theft is cited by 3.9 percent on average (twice as much in urban areas). Accessing a loan is still three times less cited than saving as a motive to access the banking sector, and is mostly of interest to men (11.4 percent vs. 4.8 percent women). Making deposits from income is the third most popular reason, again much more popular in urban areas.

Figure 2.5: Cash-based Income Across Sectors



Source: Pakistan A2F Household Survey 2008

Cash dominates the income received in formal and informal sectors. Ten percent of the population receives income in kind. Nearly 16 percent put all or most of their income into their bank accounts. Almost a third don't put any, in particular women (almost 39.2 percent) and rural areas (32.5 percent). The poorest are three times more likely than the richest to not save any income at the bank. New delivery infrastructure represented by electronic transfers represents a non-eligible share of government and salary payments.

Currently, 10.8 percent of government salary payments and 3 percent of payments for pensions are made through electronic transfers. Collecting pensions or salary payments are strong drivers for opening an account. Independently of income and other characteristics, being a government worker increase one's chances to be formally included by 7.5 percent.

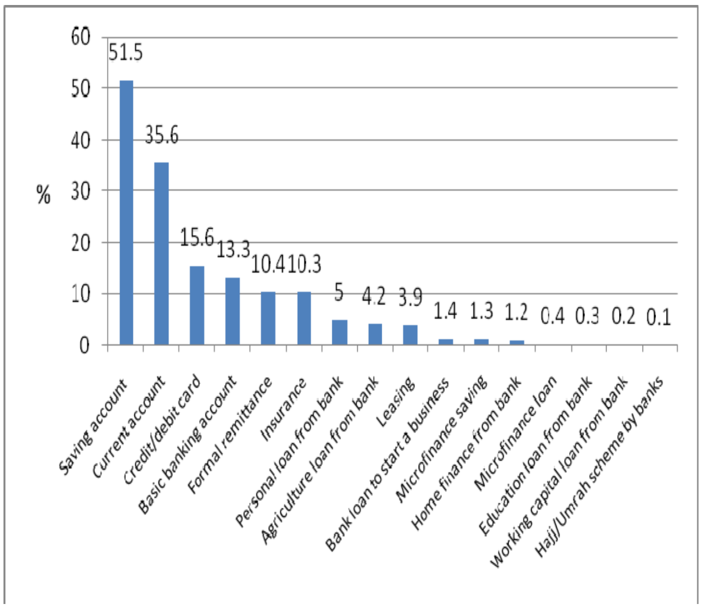
More than half of working Pakistanis are self-employed, in particular among the poor.[27] Adding other informally engaged groups (such as housewives), we find that a considerable majority of the population receives irregular and /or informal earnings. This is a significant barrier to being banked, given current bank service procedures and approach. Credit information availability could permit the use of credit scoring techniques, which would eliminate such barriers to access. Outside of borrowing, such barriers arise due to the small size of the transactions and the high per-account cost to the banking institution. Yet technology advances have gone along way towards resolving this issue — Microfinance Banks (MFBs) internationally report up to 12 percentage points of reduction in intermediation costs attributable to technology improvements.

[27] The self-employed are predominantly male (see Annex Table A2.10), with lower education than the average individual. Those informally employed also tend to be younger, and live in urban areas. The formally self-employed tend to regularly use cell phones, not so the informally self-employed.

2.3.2. Usage and penetration of financial products is limited in range, and not well suited to different market segments

The main products used by the majority of banked population are basic savings and checking accounts (Figure 2.6; savings and borrowing products are discussed in more detail in section 2.4 and 2.5, respectively, later in the chapter). Yet different population segments, such as women, might require products more attuned to their needs, as illustrated in Box 2.1. Saving accounts are held by 8.2 percent of the population and current/checking accounts by 6.5 percent. Card penetration is low (2 percent), with a 10-fold higher penetration of both credit and ATM cards in urban households. These findings are closely associated with the undeveloped ATM infrastructure highlighted in section 1.3.1 of Chapter 1. Cards and savings account are also much more frequent among higher-income males than lower-income groups or women, with the exception of Pakistan Post savings accounts and committees.

Figure 2.6: Product Penetration (as % of banked)



Source: Pakistan A2F Household Survey 2008

A closer look at the determinants of access to specific products such as **credit/debit cards, checks, savings accounts, and current accounts**, further informs the analysis. The probability of holding varying banking instruments increases with age, education levels, and other characteristics that include being the main income earner and being employed. Bank product users are unlikely to be located in rural areas. A position with government, but not with the formal corporate sector, increases the probability of being banked. There is a positive association between specific product usage and the upper income quintiles. Just like for access to banking services, women generally have less access to specific banking products (Annex Table A2.9).

The national household survey data results suggest that **Islamic finance** is a high-end product: the male, richer, urban, household head, more educated, and pertaining to the formal sector population is significantly more likely to use Islamic products (Annex Table A2.10, regression V). Interestingly, Islamic finance is inversely associated with age, employment, and availability of collateral, as well as with employment in the corporate sector. Only a fifth of the population are willing to pay more for Islamic products than a conventional banking product. Women are less willing than men to do so (14.7 percent vs. 26.6 percent).

Access to **Pakistan Post and insurance** services is determined by much the same characteristics as standard banking products — age, education, employment, heading a household, being employed by government, and being part of the formal sector. However, location in a rural area is positively associated with both insurance and post office access, as opposed to standard banking (non-postal) product access.

Informal finance via committees also differs significantly from standard banking access in terms of determining factors. The positive effect of employment is about the only common factor we observe. The committees are oriented toward women, who are significantly more likely to gain access to finance via a rotating saving and credit association (ROSCA)-type scheme. They are further not focused on older groups, and do not cater to other underserved groups such as farmers and laborers. These effects are rooted in the culture and tradition of maintaining committees among married women as a social undertaking.

2.3.3. Chief obstacles to access include heavy documentation, and lack of income and information

The most frequently cited perceptions of formal financial service providers pertain to **requirements for becoming a customer** (associated with 53.8 percent of the population).[28] Commercial banks require an identity document, a permanent address, credit references, and a guarantor. The current requirements for two identity documents on average to open an account in a commercial bank in Pakistan,[29] while not appearing to be a serious hurdle for the population in general, may realistically represent a significant obstacle to being banked for certain population groups, such as women or low-income groups. This places Pakistan as number one in South Asia, better than the South Asia average (2.65 documents required), though below top performers such as Thailand.[30] According to the World Bank (2006a), more-competitive banking sectors are less bureaucratic, as banks that are vigorously competing against each other tend to simplify procedures.

The second most important cluster of issues defining perceptions of formal finance are **personal reasons,** cited by 50.7 percent of the population, including awareness limitations and self-exclusion.[31] Baluchistan highlights the lack of product information as its major obstacle. Lack of information is also more cited by non-banked women and is much higher among the poor. In addition, 5 percent more women than men express no need for a bank account, making it the biggest reason among women for not banking. This perception decreases with income, and might also be related to the awareness of the benefits of financial products, especially among women ("If I don't work, why would I need financial instruments?").

Perceptions on **accessibility issues,** while a minor obstacle overall (4.9 percent),[32] are more acute in rural areas. While an average of 23.2 percent of the population consider that commercial banks are too far away, one-third in rural areas perceive this issue. Committees and informal moneylenders on the other end do not prompt accessibility issues. Very few (6.5 percent) of urban households travel more than an hour to the nearest bank, as opposed to 34.5 percent in rural areas who travel one hour or more (up to two days).[33] Cost to reach a bank is also more cited by rural areas (2.8 percent of non-banked vs. 2.5 percent of non-banked in urban areas). While close to half of the urban population spend Rs 20 ($0.26) or less on

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[28] Specifically, respondents felt that they did not have enough collateral, too much documentation was involved, references were hard to obtain, they did not have an identity document, or did not have enough money, regular income, or sufficient minimum balance to open an account.

[29] World Bank (2008a). While identification documentation penetration is high (80.2 percent on average, though lower for female and poorer income groups), other documents are extremely hard to come by. Electricity bills and household ownership documents are a distant second and third in penetration (12.1 percent and 8.3 percent on average, respectively) and are more frequently possessed by higher-income households (with a large gender divide in favor of men in both instances).

[30] With its top three banks making up less than 45 percent of the banking system assets and, on average, only one document required to open an account, Thailand is an example of a vibrant banking sector.

[31] Personal reasons include lack of information about bank products, preference to deal in cash, no perceived need for being banked, lack of self-confidence, uneasiness in the bank environment, no time to go to the bank, and no knowledge of how to open an account.

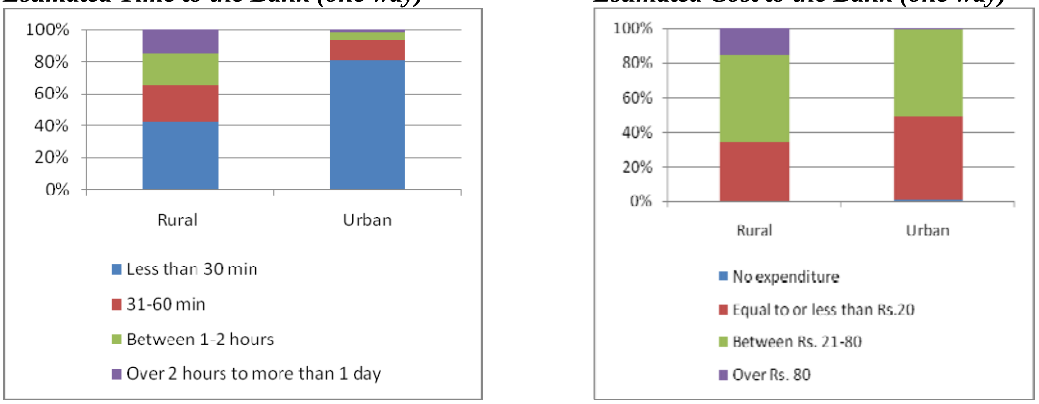
[32] Accessibility issues include the cost and time to reach a bank.

[33] Walking is the most common mode of transportation to reach a financial institution in urban areas (38.9 percent) vs. public transport in rural areas (48.5 percent rural respondents commute to their financial institution by train, rickshaw, tonga, bus, or van). About 43.9 percent of respondents combine other activities while going to the bank; this is true across the income spectrum, though with women a little less, at 36.3 percent vs. 45.9 percent men.

a one-way trip to the bank, over half in rural areas (50.6 percent) have to spend Rs 21–80 ($0.26 to $1) and 14.9 percent incur more than $1 each way to reach a bank (Figure 2.7).

Figure 2.7: Cost of Bank Access

Estimated Time to the Bank (one way) ***Estimated Cost to the Bank (one way)***



Source: Pakistan A2F Household Survey 2008

Service-related reasons for not being banked seem less pronounced (5.1 percent).[34] Fees and lengthy procedures, cited on average by 1.9 percent of the nonbanked population, do not appear as a strong block to being banked. Only about 3.5 percent of the nonbanked point to low returns as a reason for not having a bank account, while about the same proportion of the banked (3.6 percent) list earning income as a reason for being banked. This suggests a weak association between having an account and earning interest on it, consistent with surveys in other parts of the world.[35] The slow service and somewhat onerous documentation requirements of Pakistan Post banks are also frequently cited.

Pakistan ranks near the top for the world in terms of highest opening fees (application fees and other types of fees). While it takes minutes to open an account in many developing countries, Pakistan is among the countries where it takes longer, on average 2.8 days, much beyond the South Asia average of 1.21 days (World Bank 2008a).[36] While developing-country banks are more likely to charge fees, that tends to result in lower financial access, even after adjusting for income.

Socio-cultural reasons such as trust, religion, and cultural barriers to access are also not important overall (8.5 percent of the population) but are very strongly skewed toward women and Baluchistan. Such reasons for not banking are cited by 11.9 percent of the non-banked women (compared with a marginal 1.3 percent among non-banked men) and over 9 percent of the non-banked population of Baluchistan and Sindh. This reason does not appear strongly correlated with income. Religious reasons such as issues with paying or receiving interest, bank mistrust, and issues with corruption are cited by only 2.5 percent of the non-banked.

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[34] Service-related issues explored include: charges and fees are too high; returns are low, hours of operation are inconvenient; long lines at the bank; staff are snobbish and not helpful, speak in complicated terms, do not understand client needs, or give importance to the client.
[35] A survey covering 2,000 urban individuals in Brazil also highlighted a weak association between rates of returns and making deposits. See Access to Financial Services in Brazil, p39.
[36] World Bank (2008a). Banks in South Asia are least likely to charge a monthly maintenance fee for a bank account and charge annual debit card fees, which encourages more access. Eighty-six percent of banks surveyed opened the account within a few minutes of the application or on the same day (World Bank 2006a).

2.4. Informal financial services are perceived as more geographically accessible and less complex, and they are the only financial instruments that the majority of Pakistanis will ever know and use. Informal financial markets are discussed from a supply standpoint in section 3.7. Informal services have fewer requirements and are easier to understand. As noted, informal savings are pervasive (63.6 percent of all savers), be it at home (in cash, gold, or jewelry) or in assets (livestock, land). Ninety-seven percent of borrowers also borrow informally, be it from shopkeepers (77.9 percent of all borrowers) or from friends and family (53.5 percent of all borrowers). Groups that are less targeted by the formal sector—rural areas, women, and the poor—have a higher share of informal savings in total savings. Section 3.7 presents a detailed discussion of supply issues for informal finance, while this section focuses on distinguished characteristics or the informal sector relative to the informal sector and on another popular informal vehicle, the committee.[37]

What can be learned from informal financial systems? Using access to credit as a benchmark, the perception of borrowers is that the informal sector operates with much lower service requirements than the formal sector, in particular in terms of co-guarantor (cited by 4.8 percent vs 46.5 percent), immovable collateral (1 percent vs 27.5 percent) and minimum balances (0.3 percent vs 10.3 percent) conditions (Figure 2.10). Over a quarter (27.5 percent) of the population cite immovable collateral as a condition for formal credit. In rural areas 36 percent cite immovable collateral requirements.

Section 3.7 suggests that informal sources might have some advantages over formal sources. In general, informal sources of credit are more expensive than formal sources, and there is much evidence to suggest that they exploit poor people, but they have the advantages of being available all the time, not requiring documentation, operating outside the purview of formal authorities, and not requiring collateral. Informal markets deal effectively with the higher risk they face from clients, substituting social contracts and client information for immovable collateral that is often not available to the poor, lending only for productive uses (cash lending is frequently done at a 300–400 percent premium), and on average charging only a small premium over the formal sector (23 percent vs 19 percent, Qadir 2005).

Perceptions of service providers give a striking perspective of gaps between formal and informal institutions. Positive perceptions such as absence of legal formalities, of service charges, and of documentation rank are frequently associated with committees or informal moneylenders. Conversely, negative perceptions and constraints are the most frequently cited about formal financial institutions, in particular the need for credit references, documentation, and a co-guarantor.

Focus on committees. Although the concept of committees is widely understood by 87.9 percent of the population, committees rank only as the third savings channel, far behind home saving and saving in assets. They are also only the third most popular borrowing channel, behind shopkeeper loans and family/friends. This is surprising, especially compared with previous studies of limited sample sizes that suggest the majority of Pakistanis are involved in such group schemes. Ballot committees are much more frequently used than other committees (named by 87 percent of committee users) among the committee users.

Committees are not used significantly more by women (14.0 percent) than men (14.5 percent). They do not cater to other underserved groups such as farmers and laborers. Finally, committees are used more

[37] Committees, also called ROSCA, are groups through which participants join contributions to lend to a single member. Members take turns to access committee loans, through an order determined by list, lottery, or auction. By aggregating individual funds and channeling them in a pre-determined order to individual members, committees play an important intermediation function, based on revolving funds. Committees do not require physical capital as collateral. Instead, repayment is based on reciprocity and social pressure.

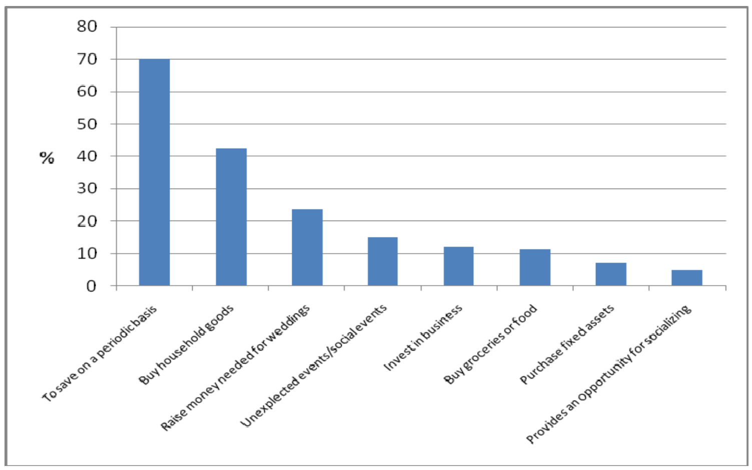
than twice as much in urban areas than in rural areas, particularly in Punjab and Sindh. Their use also increases with income.

Women and urban areas are significantly more likely to participate in committees (last regression in Annex Table A2.9). The incidence of committee participation is also found to increase with education levels and decrease with age. While being employed in the formal or informal sector has a positive incidence on using committees, the professional profile effect on the likelihood of committee participation reinforces their urban nature. Committee participants are more likely to be formal corporate workers.

Committees are mostly used to save as well purchase household goods. Few participate in committees to purchase fixed assets (7.3 percent) or invest into business (12.1 percent) (Figure 2.8), although a slightly larger share than overall formal or informal savers (10.76 percent) list business investment as a savings motive.

Most users participate in only one committee (84.1 percent). Contributions to committees are made monthly. Change in income has the highest impact on changes in payments to committees, with the exception of Baluchistan, where family reasons have the highest impact on amounts paid to committees. While perceptions expressed on the service of committees are very positive, and involve trust, good service, and ease of use, women have an even better perception of committees than the average individual.

Figure 2.8: Reasons for Participating in a Committee



Source: Pakistan A2F Household Survey 2008

2.5. Savings and investment are the most popular financial service, and mostly concentrated in the informal sector

Among financial products, savings and investments, by far the most popular, are used by two-thirds of the population followed by loans and credits, used by one-third. Among those who save, savings are mostly done informally (only 14.9 percent of savers go to formal financial institutions). About 63.6 percent of savers save at home. Committees are the second most popular informal savings channel (25.7 percent) for the savers, as much among women as men (26.6 percent and 24.8 percent, respectively).[38] Saving with family and friends (6.7 percent) is done equally among rural and urban areas, across income groups. Three-quarters of formal savers were also saving informally. This topic will be picked up on in more detail below and in the following two sections, which discuss the interaction of the formal and informal sectors in general and in terms of borrowing specifically.

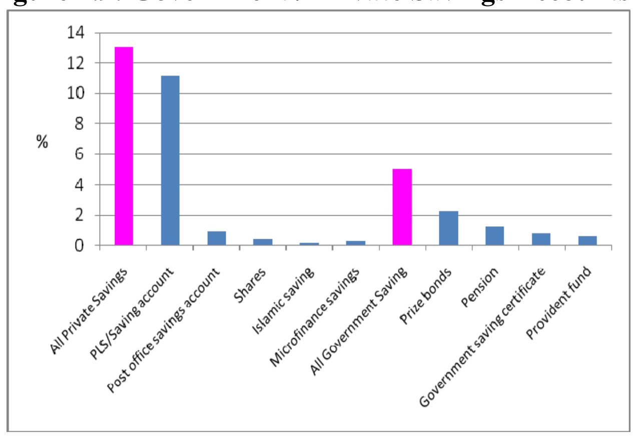
Demand-side evidence links higher income levels to a higher probability of saving, formally or informally (Annex Table A2.8). Rural areas are more likely to hold savings accounts overall, and in the informal sector, while urban areas hold more formal savings accounts. While women's attitudes toward financial services suggest higher savings motives than men, women are excluded from access to most savings channels; all characteristics held constant, women are found less likely than men to be savings account

[38] The figure includes group savings schemes.

holders. Women are found to be more likely than men to use informal savings channels than not save at all.

The other characteristics associated with an increased likelihood of saving include an employed status, education, and being the main household income earner. While age is important for formal savings, it plays if anything a negative role in the probability for informal savings. Government workers are positively associated with savings (and mainly formal savings), while farmers are also positively associated with savings accounts, but upon disaggregating, the effect mainly comes from the informal sector accounts. Finally, laborers have a lower probability to access savings instruments. Regular cell phone users are also more likely to be savings account users.

Figure 2.9: Government / Private Savings Accounts



Source: Pakistan A2F Household Survey 2008

Only a small share of the saving volume is captured in the commercial banking sector. The most popular savings product, the PLS/savings account, is used by only 11.2 percent of savers (Figure 2.9). This proportion increases with income levels (2.1 percent for lowest quintile vs. 19.6 percent for the highest), men (18.6 percent vs. 3.8 percent for women), and urban areas (16.2 percent vs. 8.4 percent for rural). The penetration of post office savings is appreciably less than that of post office remittance products (discussed in detail in Chapter 5). Despite its presence throughout Pakistan and its existing remittance customer base, the Pakistan Post Bank may not be leveraging its relative proximity in some provinces to diversify further into banking and saving products. Post offices and State Life Insurance are the most-used nonbank formal financial institutions for saving, used by 0.7 percent and 0.6 percent, respectively, of those who save, although well behind the banks. Microfinance savings (0.2 percent) and Islamic savings (0.1 percent) represent minor savings channels.

Within the formal sector, government savings (provident funds, pension funds, prize bonds, and government savings certificates) and private savings (PLS/saving account, post office savings account, microfinance, Islamic savings, and shares) products are both popular among Pakistan households who save. Among the private and government saving products, PLS/savings are the most popular with over 11 percent people using them. While the penetration of pensions in annuity grows as income levels increase, the product is most popular in AJK and among men.

Savings is for smoothing consumption, not investment, though rural areas invest more. Reasons for saving seem to revolve around immediate needs such as food, household goods, and medical and schooling costs, in rural and urban areas alike. Marriage and death/disability rank high among saving motives. Longer-term prospects such as retirement and future buying prospects such as land are marginally cited, in particular among the poorest. Saving to invest in or start a business, on the other hand, although overall low, is more common in rural areas (12.5 percent vs. 7.8 percent), irrespective of income. The bulk of rural savers use money to invest in cattle (54.4 percent) or farm land (19 percent). Close to 1.3 percent of savers invest in working capital such as machinery or buying inputs for small businesses. Retirement, pension fund, and life insurance investments are marginal, at 1.2 percent of savers on average.[39]

[39] Regression results confirm and enrich these findings (Annex Table A2.12). While both formal and informal savers are motivated by investment motives, education, and socio-religious reasons, only informal savers are further driven

2.6. While borrowing is mostly informal, a strong aversion to any type of debt is observed

A third of the population (35 percent) have a loan or credit, but only one in 14 received it from the formal sector. Almost half of the Pakistanis (44.9 percent) have never contracted a loan (55.5 percent of women and 33 percent of men). A strong aversion to debt and associated bias against borrowing is observed and shared across gender, rural areas, and income levels (61.3 percent). Religious objections to borrowing, while expressed by a third of the population, do not represent such a significant effect on borrowing as the aversion bias, and come out insignificant in regressions (Annex Table A2.10). To gain an understanding of the extent of borrowing aversion among the population, consider that the most widespread form of borrowing (77.9 percent of all borrowers) is getting goods on credit interest-free from a shopkeeper, which is more a culturally determined practice than a financial transaction. Borrowing interest free from friends and family (53.5 percent) comes in a close second. The use of shopkeepers, as well as family friends, as an informal source of borrowing is substantial among rich and poor, urban and rural areas alike.

All other types of borrowing are rare (including moneylenders, interestingly, at 2.9 percent on average). Personal loans from a bank are cited by 1.8 percent of the borrowers and agricultural loans are cited by only 2.1 percent of rural borrowers. Credit cards usage is reserved to the highest income quintile. Islamic and microfinance loans are sparsely used—0.03 percent of borrowers held an Islamic loan at the time of the survey.[40] About one-fifth of the population are willing to pay more for Islamic than traditional products, less so women than men (14.7 percent vs. 26.6 percent). *Hajj/Umrah* schemes are used only by 0.2 percent of Pakistanis. Furthermore, 3.5 percent of the population bought, built, or renovated their houses with a mortgage or a formal or informal loan.

World Bank (2002) notes the considerable literature that examines the interaction of the informal and formal credit sectors. Some borrowers are found to be simultaneously active in both markets, either because they are unable to get all the credit they need from one sector alone, or because formal lenders might condition their lending on the borrower's obtaining co-financing from other (presumably informal) sources. This is the case in Pakistan, both in terms of savings (see section 2.4), and borrowing (Table 2.4). Borrowers use their dual access more in rural areas (one-third of urban formal borrowers also access the informal sector, vs. more than half of formal borrowers in rural areas), confirming the trend observed in section 1.3.4 suggesting a more credit-constrained rural market.

Table 2.4: Formal and Informal Borrowing

	Urban	Rural	Total
Formal credit holders	2.9	2.3	2.5
Informal credit holders	26.6	37.9	33.7
Formal and informal credit holders	0.9	1.4	1.3

Source: Pakistan A2F Household Survey 2008

Access to credit increases with age, and employed status, and education (Annex Table A2.7). The three highest income quintiles are likely to borrow more than poorer groups. Interestingly, and consistent with previous findings, rural location alone does not exert a negative effect on access to loans. Women are less likely to contract an informal loan, though more likely to contract a formal loan, presumably because

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by household needs and medical, accident, emergency, and old-age provisions. Presumably, formal savers have covered these motives by other financial products. Female, rural, younger individuals, household members other than the household head, farmers, and less-educated individuals are more likely to save informally. In contrast, government employees and regular cell phone users are more likely to save formally.

[40] We do not quote microfinance loan figures due to a suspected survey bias as discussed in Appendix A (Calibration). Instead we go with official SBP figures, which put microfinance clients at 1.7 million.

women's responsible money management habits are taken into consideration in the formal financial sector. Overall, women seem to be less likely to borrow than men, mainly as a self-expressed preference. Heading a household also improved one's chances to access financial services. Positive effects on access are also at work for groups that have collateral, and are employed in the government or as a farmer. Laborers face significantly lower access to loans. Those who enjoy regular cell use or have access to a cell phone are significantly associated with borrowing. It is worth noting that informal borrowers are likely to have access to s mobile phone but not regularly use it, as opposed to formal borrowers, who tend to be significantly associated with regular cell phone usage.

Table 2.5: Purpose of the Loan (% of all borrowers)

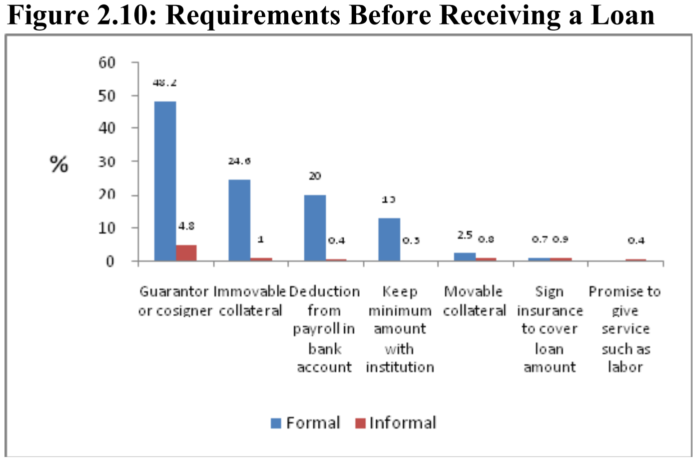
	Formal			Informal		
	Urban	**Rural**	**Total**	**Urban**	**Rural**	**Total**
Personal loans	1.7	2.2	*3.9*	24.2	61.8	*86.0*
Business/farm loans	0.4	2.4	*2.8*	3.5	13.5	*17*

Source: Pakistan A2F Household Survey 2008

Notes: Personal loans include: loans to buy food or goods, meet expenses of a dowry, wedding, Hajj/Umrah, unforeseen emergency costs (hospital, childbirth, funeral), buy or build a house, travel, buy luxury items/durables, and pay utility bills. Business loans include loans to buy goods for agriculture or business, productive assets, meet expenses of business.

Like saving, borrowing is used in a majority of cases to attend to personal needs (decreasing as income increases) rather than to invest in a business. Rural areas borrow much more than urban, and tend to use the loan much more for productive purposes than for consumption (Table 2.5).[41] While formal borrowers take loans for various investment purposes (agricultural, nonfarm, and housing investment), informal clients borrow exclusively for household needs. Borrowing for personal needs decreases as income increases, while borrowing to invest is positively correlated to income. Relative to their borrowing portfolio, men borrow more for productive activities than women. On average, one-fifth of those who borrowed (19.1 percent) ever missed a payment, the poorest more than twice as frequently as the richest (25.9 percent vs. 11.9 percent).

Figure 2.10: Requirements Before Receiving a Loan



Source: Pakistan A2F Household Survey 2008

In addition to credit requirements (see section 2.7), chief obstacles for borrowing include a general aversion to debt, religious bias, and a significant likelihood of getting rejected. Almost a third of Pakistanis consider that interest rates go against religious principles (twice as many as those who think that interest rates are not a problem). These views, although shared throughout income groups, are strongest among the highest income groups and men (43.8 percent versus 25.2 percent for women), suggesting that they are not the major obstacle where financial access enhancement is relevant among the poor and women. In addition, religious attitudes are only one part of the negative perceptions toward credit, dwarfed by the general aversion to being in debt, which is pervasive across gender (58.1 percent for men and 64.2 percent for women), location, and income divides.

[41] Regression analysis demonstrates similar patterns (Annex Table A2.13).

Onerous and complex credit requirements are a considerable obstacle to formal credit. The most frequently cited formal loan requirements are a guarantor (46.5 percent), movable collateral (27.5 percent), and automatic payroll deduction (20.3 percent). Informal requirements are minimal to nonexistent (Figure 2.10). Over a quarter (27.5 percent) of the population cite immovable collateral as a condition for formal credit. In rural areas, 36 percent cite immovable collateral requirements. Collateral conditions are much less cited than for informal loans.

Table 2.6: Factors Considered before Taking a Personal Long-term Loan

(% of formal, respectively informal, borrowers)	Formal Loan	Informal Loan
Likelihood that the loan will be granted in the amount needed	51.4	28.0
Getting the loan approved as soon as possible	43.0	16.6
The affordability of the monthly installment	36.4	14.5
Their interest rate charges	28.4	10.4

Source: Pakistan A2F Household Survey 2008

The likelihood of being approved is an important factor considered before taking a personal long-term formal loan. Diverse as formal and informal loans are, borrowers are preoccupied with the same issues: successful outcome, speed, affordability, and rates, in that order (Table 2.6).

Three-quarters of formal borrowers applied within the past 12 months (76.6 percent). Rejection rates were at about 10 percent, and higher for rural areas (11.4 percent) and for women (17 percent) (Table 2.7). About 41.4 percent of the existing formal borrowers whose applications were rejected are confused about the reason for their unsuccessful applications, suggesting service issues on the part of the banks. Other reasons cited for unsuccessful applications include existing over indebtedness, absent credit history, insufficient assets, and lack of existing accounts.

Table 2.7: Rejection Rates for Existing Borrowers (% of all formal borrowers)

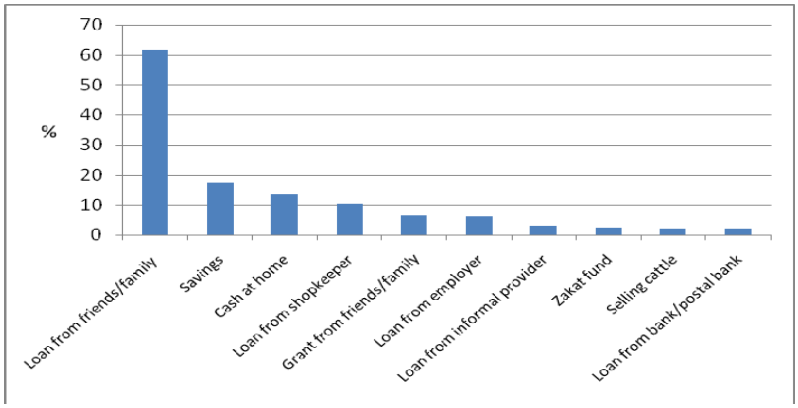
	Population	Urban	Rural	Men	Women
Existing borrowers with loan application in past 12 months	76.6	81.9	74	76.9	75.8
Share of loan applications in past 12 months which were rejected	7.8	6.6	8.4	6.2	12.9
Rejection rates	10.2	8.1	11.4	8.1	17.0

Source: Pakistan A2F Household Survey 2008

Emergency payments are a feature of the lives of urban and rural, rich and poor; informal borrowing is the usual response to such exigencies. Emergency payments not covered by regular income affect rural and urban areas equally. The poorest households (15.4 percent) as well as the richest ones (12.1 percent) had to make an unanticipated emergency payment in 12-month period prior to the survey. Emergency payments are more than twice as often linked to involuntary than voluntary payments (70.1 percent vs. 35 percent of emergency payments). Involuntary payments linked to health issues dominate (48.9 percent of the population had emergency medical expenses in the past year). Religious and social purposes (wedding celebrations were financed by 22.4 percent of Pakistanis in the past year), score the highest among voluntary payments.

Households that made an emergency payment used informal borrowing most often, such as loans from friends/relatives for more than half of the affected households (67.1 percent), loans from shopkeepers (10.3 percent) or cash from home (13.4 percent) for an emergency payment. Formal borrowing sources were little mentioned by these households. Savings are also a way to mitigate emergency expenses and are ranked second in sources of funding (17.1 percent) after loans from friends/relatives.

Figure 2.11: Sources of Funding of Emergency Payment

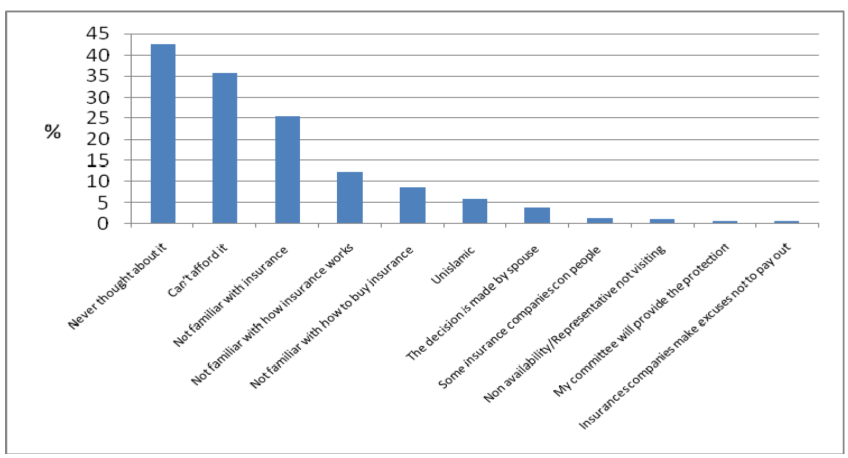


Source: Pakistan A2F Household Survey 2008

2.7. Insurance is little used, though demand is high for life and viable crop insurance products. Insurance is used by only 1.9 percent of the population. Its penetration is higher in urban (2.3 percent vs 1.7 percent in rural) areas and among the upper income groups (4.6 percent vs. 0.3 percent for the lowest income quintile). Formal insurance channels are more used than informal ones. Life insurance is virtually the only product (used by 90.8 percent of insurance beneficiaries). Reasons for not having insurance point more toward literacy issues about concept/benefits rather than about using insurance (Figure 2.12). State life Insurance is the most popular entity among insurance companies (serving 71.4 percent of clients), followed by employer insurance schemes (11 percent), Adamjee Insurance (5.2 percent), EFU General Insurance (3.4 percent) and New Jubilee Insurance (1.4 percent).

Insurance is reserved for higher income groups. Age, education, employed status, a government job, and belonging to the two highest income quintiles all individually increase the incidence of being an insurance holder. Interestingly, rural areas are significantly positively associated with being insured, though of course they also profess the highest insurance needs (for crop/life insurance).

Figure 2.12: Reasons for not having insurance (% of uninsured)

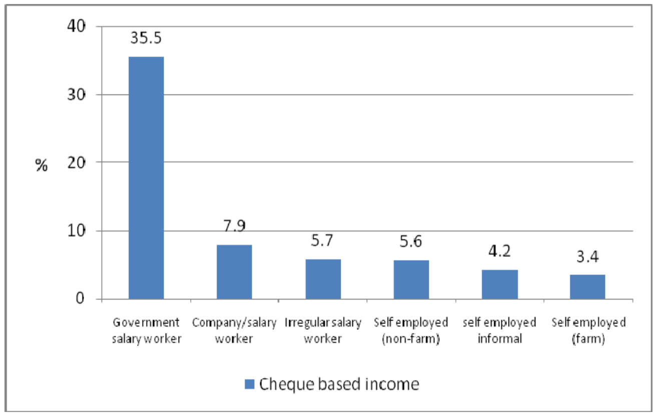


Source: Pakistan A2F Household Survey 2008

2.8. Little use of check services beyond government payments.

More than twice as many people in urban areas know how to write a check as people in rural areas, and three times as many men as women. Baluchistan appears to be the least-proficient province, corroborating earlier financial literacy results.

Figure 2.13: Means of Receiving Income



Source: Pakistan A2F Household Survey 2008

About a third of the check-proficient population (33 percent) had cashed a check in the month prior to being interviewed. Rural/urban and gender divides are consistent through proficiency and usage. Eight-four percent of check users have cashed checks themselves at a bank or a Pakistan Post bank, while 17.2 percent have cashed checks through someone else. Possible reasons for the weak uptake of checks as payment infrastructure include widespread fees: a third of those who cashed a check in the month preceding the survey paid fees for this service. Wide province differences exist — from 20 percent in NWFP to 38.1 percent in Sindh pay fees for check-related services.

Income and education, employed status, age, availability of collateral, heading the household, and working in government are significant determinants of using checks. Check users also tend to be regular mobile phone users. Women are less likely to use checks.

The little uptake of checks can be linked to the cash-based nature of the Pakistani economy. The literature finds that other factors underlying little check usage internationally include high fees, delays in check clearance, physical distance from bank branches, and reliability of check as a payment instrument given the inherent disincentive to write bad checks, as well as trust in the system. Existing measures set by SBP to encourage check usage include provisions in the Negotiable Instruments Act to categorize bounced checks as a criminal offence, as well as tax measures involving the withdrawal taxes on cash. Recommended next steps would include that SBP launches further awareness campaigns on these new provisions.

2.9 Suggested strategies for expanding access to finance for the underserved

A major drive to enhance financial inclusion would involve a joint effort of SBP, the national government, private sector, the community, and donor efforts. The best bet for a rapid scaling-up of access is to rely on technology, literacy gains, financial re-engineering of processes and products, and an enabling legal and institutional framework.

► Way Forward for the Private Sector

Diversifying the product range to increase outreach: The road ahead certainly also lies in **product diversification**, with more services and fewer requirements catering to the mass population of lower-income capacity. Smaller size of products, and bulk service might better attract lower-income groups. Market segmentation and product diversification can also lower costs and help banks' risk management. Policymakers and banks would note the importance of the market for financial products targeting heads of households, given the finding that being a household head has a significant impact on financial access.

This potential is particularly of interest in rural areas as well as clusters of urbanized rural migrants into bigger cities.

Reaching out to the female client: **Women present an untapped potential financial client base for Pakistan.** Better managers of their debt responsibilities and more loyal clients, women are also more assiduous savers. Yet products and procedures are not customized to the specificity of women's needs. Focusing on women has been a profitable proposition in international microfinance experience. The private sector has started to segment female clients in Pakistan by offering them tailor-made products. This is a promising business proposition and strategy for increasing access to finance.

Learning from the informal financial sector's success: The gap between the popularity of informal finance and limited formal financial sector outreach, combined with the perception gap between a heavy procedure-driven formal sector and informal sector with minimum requirements, calls for **learning from informal financial systems and developing linkages with the informal sector.** Strengthening financial infrastructure, by expanding credit information bureaus and other payment systems, would allow banks to lower binding requirements such as guarantors and immovable collateral, therefore attracting new customers among women, the poor, and residents of rural areas.

Reaching out to the rural client: **Household survey evidence suggests that there is nothing unserviceable about rural areas.** In fact, the larger use of savings for productive use in rural areas and positive association with insurance and post office financial products represent an untapped opportunity for commercial services.

Leveraging technology**: Technology can be used** as an enabler of cost reductions within financial institutions as well as for innovative applications for service delivery. Further cost reductions thanks to the use of technology within banks would allow expansion of the customer base by decreasing fees and increasing the quality of product and services. The positive association between access to formal financing and regular mobile phone use carries potential for new services among an existing customer base. The significant association between the informally served and mobile phone access unleashes opportunities to tap into a new formal customer base already operating in the informal sector.

► Way Forward for the Public Sector

Creating awareness of the benefits of access to financial services: **Further gains in financial literacy are critical.** Awareness-creation and trust-building could be forged through **social mobilization and mass media.**

Stronger institutions (including SECP and Credit Information Bureau) are a major part of a rapid increase in financial inclusion. More efficient post office banking is a must (following the successful examples of Brazil and China). Given the significant developmental potential of Pakistan Post to enhance financial access, it needs modernization in operations and regulations. Following most success cases in East Asia, as well as other continents, PPSB should be placed under the supervision of SBP. This is the case in China, Philippines, Thailand, and Sri Lanka,[42] as well as about half of the countries with a separate postal bank in Africa, almost all countries in Europe and Central Asia, and a considerable number of countries in Latin America, as well, including Argentina and Brazil.

Creating an enabling environment for expanding access to the underserved: Regulations should keep up with the needs of the sector and technological developments, to enable expansion. Simultaneously, an enabling environment should go hand-in-hand with a carefully chosen government presence.

[42] Not in Indonesia, where half of postal services are under private sector provision.

Indiscriminate subsidies, especially of the interest-rate variety, can be detrimental to expansion of the sector, as they not only distort prices but crowd out efficient institutions and products. The government should resist populist perceptions that low interest-rate funding can serve a developmental purpose. Even more detrimental are state-owned institutions created to promote financial access. In addition to weak evidence in the case of Pakistan that such institutions actually improve access (for example, SME Bank), these efforts waste valuable public resources that could more usefully be deployed elsewhere, and eliminate the level playing field for market participants.

In sum, while financial access is low, and mostly limited to informal financial services, interest in finance outstrips effective access rates considerably. Poverty and lack of information on financial services predicate lack of interest—the perception of irrelevance of the financial system to the everyday lives of a considerable share of the Pakistani population. Several groups seem particularly excluded, though market studies suggest they could be viable customers if the formal financial sector adopts appropriate services and instruments to reach these groups—residents of rural areas and women in particular. In testimony to the commercial viability of these client segments, informal finance seems to be capable of profitably serving such groups at a reasonably lower premium than formal services. Income, employment, education, and being the head of the household have a significantly positive impact on financial access, a finding with significant policy implications. The following chapters will focus on three such services, and attempt to point to potential areas of development and access expansion, putting information on demand and supply together—microfinance, small enterprise finance, and remittance flows.