

6. Expanding Access to the Underserved: An Action Plan

A major drive to enhance financial inclusion would involve a joint effort of the State Bank of Pakistan (SBP), national government, private sector, the community, and donors. The best bet of a rapid scaling-up of access is to rely on technology, financial awareness improvements, financial reengineering of processes and products, and an enabling legal and institutional framework.

6.1. The Role of the Private Sector

6.1.1. Access to All Financial Services

Diversifying the product range to increase outreach, lower costs, and manage risks: The road ahead certainly lies in product diversification, with more services and less requirements catering to the mass population of lower-income capacity. Products (savings, insurance, and credit) for old age, children's education, pregnancy and medical expenses, and livestock are a few examples of those that take account of women's needs for life-cycle events. Home-based businesses should be given consideration. Access would also improve with the use of alternative forms of collateral, such as social collateral, compulsory savings, personal guarantees, crops or machinery to be purchased or household assets. Saving products, which are expected to be especially popular, can be built upon traditional saving arrangements and rotating saving and credit associations that women use. Smaller size of products, and bulk service, might better attract lower-income groups. Literacy should not be a requirement to access financial service. Simple policies and procedures that speed the transaction, lower transaction costs for women, and do not preclude uneducated women tend to maximize outreach to women clients. Innovative ways to reach customers such as decentralized operations, operating units located near women clients, use of mobile units, and transactions at clients' doorsteps tend to make banking convenient for women. Female staff will improve approachability for clients and alleviate cultural concerns. 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, client segmentation: Women's abilities to better manage debt, their stronger savings patterns and client loyalty present an untapped profitable client base for the financial and microfinance sectors in Pakistan. Understanding women's needs more precisely, and reflecting those needs in the financial products and the provider's policies and procedures, would ensure an increase in women's access to finance in spite of cultural norms, gender segregation, and low literacy and incomes. Lower loan size and deposit size would permit better matching to women's needs, given their lower incomes. Repayments should be frequent so that installments are smaller and should correspond to women's income cycles. Global experience suggests offering women credit that is untied to specific use, instead allowing the borrower to elect the activity.

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 rural areas.

Reaching out to the rural client, leveraging technology and partnerships: within the Pakistani financial market, partnerships and linkages between different institutions should be developed to facilitate access to remittances and other financial services by the rural poor. For example, commercial banks should explore working with microfinance banks (MFBs) to expand their networks in rural areas. Enhancing outreach via technology solutions can involve a combination of devices to be adopted by banks to enhance outreach as well as “branchless banking” through cell phone and mobile devices. These are very different directions, and each has shortcomings and difficulties. In Pakistan, the banking access infrastructure is particularly weak, as noted in Chapter 1—bank branches and ATMs are low as measured against both the population and area of the country. As demonstrated by the Brazil correspondent banking experience, difficulties in expansion of outreach can also arise due to contractual as well as regulatory and prudential factors regarding agency arrangements (Chidzero et al., 2006). Mobile banking, on the other hand, presents regulatory challenges (as in the case of the Philippines G-Cash and Kenya M-Pesa models), but can be a promising channel to help shift some of the financial flows from informal to formal channels, in particular if combined with other correspondent banking channels. Demand-side results do show us a very high mobile penetration and our economic analysis highlights significant positive linkages between financial inclusion and regular mobile use, as well as informal inclusion and access to a cell phone.

Expanding outreach via mobile telephony, smart cards, and point of sale (POS) devices: Given the wide, relatively equitable, and rapidly growing access in Pakistan to mobile phones, technology has a major potential to become a conduit for access to finance in the country. In addition to access expansion, mobile phones, smart cards, POS devices, and other technology improvements can lower transaction costs, as well as help enhance credit information on a much wider population segment. The simplicity and low cost of these services have enabled poor people to use them easily and successfully in spite of their novelty and recent penetration. This stands in sharp contrast to the complexity and lack of user-friendliness of traditional bank products, and their relative failure to penetrate a wider population range.

These technologies have been very successful in promoting payments services worldwide. In Pakistan, given population preferences and needs, it is important to find ways to extend access to savings services as well, via technology gains. International experience points to (1) regulatory methods of promoting savings, such as matching schemes and tax-advantaged schemes, as well as (2) savings methods that have worked for microfinance—doorstep collection schemes and periodic contribution or commitment programs. But if the full potential of this new approach is to be realized, it will need to go well beyond the microfinance sector, where there is already a strong interest in using technology to reach more people and lower costs, and include the banks. So far, commercial banks have not shown much interest.

Experimentation with using mobile telephone networks is just beginning. On the other hand, cards have been in use for many years, though not generally by poor and underserved populations. “As of December 2007 the total number of active cards in the Pakistan banking system stood at 6.7 million, as compared to a total of 16 million personal bank accounts. Of these, 1.7 million were credit cards (25.4 percent) and 4.8 million were debit cards (71.6 percent). ATM-only cards were 0.191 million or 2.8 percent. Ninety-nine percent of the time, these cards were used for withdrawals while only one percent of the transactions were deposits (envelope based). Each ATM had an average of 70 transactions per day, of an average size of Rs 6,127. Until December 2007, there were 2,618 ATM machines (as compared to over 8,000 bank branches), and 52,474 POS terminals across the country. Almost two-thirds (61 percent) of the bank branch network consisted of Real Time Online Branches. One quarter of the total transactions in the system were electronic-based. Although the electronic banking system is growing, it is still in its infancy and its expansion in coming years is a basic premise for the inclusion of the majority of the population” (Lindh de Montoya and Haq 2008).

6.1.2. Access to Microfinance

Improving Microfinance Institutions (MFIs) sustainability and ability to muster commercial funding/savings deposits, and their further integration into the financial system: To create strong, profitable MFIs, the sector needs to improve efficiency, risk management, and profitability, as well as increase reliance on commercial funding and attract deposits. The ultimate goal for MFIs should be to firmly integrate into the financial system. Limiting noncommercial funding for microfinance banks (MFBs) would create competition for funds and a drive for improvements.

A further strategy for the sector would be to refocus from microcredit to microsavings, given the large untapped demand for such products. Besides being the service that poor people want more than any other, savings mobilization by MFBs will also provide a longer-term stable source of funds to grow credit outreach. MFBs need to pay more attention to developing their savings services, especially through strengthening their systems and developing appropriate products.

6.1.3. Access to Small and Medium Enterprise (SME) Lending

Carrying out a thorough bank downscaling program and modernizing SME banking: Key features of the downscaling programs that have worked include:

1. Long-term technical assistance is required to ensure that the necessary substantial changes take place. Lending to small businesses requires profound changes in the way commercial banks operate. Due to its high transaction costs, small business lending is only profitable if done in high numbers with excellent portfolio quality. Banks could benefit from long-term support in this challenging process. Technical assistance to improve lending technology should focus on: reducing transaction costs for both the bank and the client; increasing loan officer productivity (in terms of number of loans disbursed), and maintaining high portfolio quality.

2. Selection of bank advisors and content of the technical assistance are key to success. The technical assistance package should be comprehensive, because the changes that are required are quite substantial. In addition to its scope, the success of the technical assistance program will depend upon three elements: selection of committed banks, selection of consultancy firms with a strong track record, and close monitoring by a fully dedicated and experienced staff. The technical assistance should include redesigning bank products to meet client needs, a robust management information system, and use of staff incentives linked to their performance.

3. A mix of committed banks should participate in the program to create competition among them. Technical assistance should be provided only to those banks that are fully committed to SME lending. Serving such enterprises requires a change in the entire corporate culture and in the way banks operate. Thus, only banks whose investors are willing to engage in such substantive transformations should be offered technical assistance. Often, banks with a large banking network and a focus on retail lending have a comparative advantage in entering this market segment. Smaller banks could also be targeted, however, to act as catalysts. Many countries have developed specialized SME programs in state-owned banks with large networks. However, success usually takes a few years, because the changes required are quite substantial and banks take time in implementing them. It is therefore essential that technical assistance be also given to small, faster-moving private banks that transform at a faster speed but may reach stagnation due to their smaller networks.

4. Performance agreements for banks participating in the program are key. Furthermore, performance agreements should also incorporate terms on the number and volume of loans disbursed and outstanding by a given date, as well as portfolio quality indicators such as keeping portfolio at risk over 30 days to

less than 3 percent. The technical assistance should last at least two years and performance agreements should be monitored on a monthly basis so that timely remedial measures can be undertaken when targets are not met.

6.1.4. Access to Remittances

Reducing informality: Informality will decrease upon the introduction of efficient, low-cost, easy-access, user-friendly, and trusted remittance services, without prohibitive identification requirements.

Developing new technology-based remittance models: New technologies, such as branchless banking, offer significant potential to reduce transactions costs and therefore allow new business models for previously unreached areas where traditional bank branch models are unviable. Banks and mobile phone companies should continue working to implement viable models, following on existing efforts such as United Bank Limited's services for paying bills, transferring money between customers, and buying phone cards; Bank Al-Falah's mobile banking product with Warid Telecom, and the remittance venture of Etisalat's (UAE)-Smart (Philippines).

Expanding Pakistani bank presence and remittance service provision abroad: The limited presence and outreach of Pakistani banks abroad is the main problem they face in increasing remittances through their networks. Foreign banks are more easily accessible to remittance senders abroad, but these may provide a slower or more expensive remittance service to Pakistan and may not have significant outreach in rural areas. New measures should be taken to increase outreach abroad, particularly in the major remittance source countries. These could be new partnerships, or new innovative ways to reach customers. Habib Bank Limited managed to gain market share by reaching out to the workers in the Middle East. A similar strategy could be followed in all countries where a sizeable Pakistani worker community exists. Once these workers, who are the main senders, are part of the process and a system is set up to fit their needs, the volume of remittances will grow further. Moreover, if they are given incentives or bonuses based on the amount they remit, they will become more diligent with sending money. One caveat to keep in mind is that the literacy level is low and so paperwork should be kept to a minimum and technology interfaces should not be excessively complex. In addition, the recipients of remittances are generally women or older groups, for whom convenience is most important. For this group, models that are based on doorstep delivery would be most suitable.

6.2. The Role of the Public Sector

6.2.1. Access to All Financial Services

Creating awareness of the benefits of access to financial services: Further gains in financial literacy are critical, though more critical is the presence of awareness of financial services to promote trust in the sector, as well as information about services and products available. A national awareness campaign can support financial inclusion, especially for women, as well as encourage people to open savings accounts. There is still a large number of people who do not have any account at all. Awareness-creation and trust-building could be forged through social mobilization and mass media.

Strengthening institutions (SECP, Credit Investment Bureau (CIB), Pakistan Post): Access to finance growth will be accelerated by an integrated financial system, and a strong regulatory framework. Stronger institutions (including SECP and CIB) are a major part of a rapid increase in financial inclusion.

Among the important features of a complete financial system is a well-functioning national-level credit bureau for credit referencing. By establishing a credit history and thus a potential collateral substitute, a credit bureau can be instrumental in providing access to finance for groups that may not have cash or

asset collateral required to access a loan but have a stellar credit history to present to the bank. All commercial banks, development financial institutions, leasing companies and MFBs are currently reporting to CIB on all borrowers irrespective of the size of loan. For the NGO-MFIs, a special CIB has recently been developed and SBP allows MFBs to share credit history of their borrowers to MF-CIB. Consolidating these achievements and assuring the full usage and functional availability of the accumulated data, can place many more potential borrowers within reach of some access to finance. To facilitate the creation of a credit history for small and medium enterprises (SMEs), SBP should also ensure that the credit bureau collects information from utility and telecom companies. Finally, to facilitate SME lending monitoring, SBP should amend reporting requirements for SME portfolios to include volumes and number of loans in four sub-brackets (Rs <2M, Rs 2-6M, Rs 6-25M and Rs 25-75M).

A more efficient Pakistan Post is a must (following the successful examples of Brazil and China), to capitalize on its significant network and strong outreach in rural areas. The Government of Pakistan (GOP) should explore ways to improve remittance and other services and speed up the automation of postal branches. 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 many other continents, PPSB should be placed under the supervision of SBP.

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. Indiscriminate subsidies, especially focused on interest rates, can be detrimental to the expansion of the sector, as they not only distort prices but crowd out efficient institutions and products. The GOP 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.

6.2.2. Access to Microfinance

Refocusing on microsavings: International experience shows that government savings promotion models can be considered, including awareness-raising, matching schemes, and tax advantaged schemes. ***Encouraging positive public perceptions on accessibility and safety would help.***

6.2.3. Access to SME Lending

Creating a complete and well-functioning secured transactions regime: Security interests over movable assets should be easy and allowed on most assets and by every entity (both physical and juridical persons). Priority rankings should also be clearly defined among those who might have claims on property offered as collateral. The new secured transactions regime should also include a place (such as a registry) for making priority interests publicly known and enforcement of security interests for all assets should be fast and cheap.

Continued promotion of initiatives aimed at proving a demonstration effect of bank downscaling. These include attraction to the market of an institutional investor that has a track record in SME lending. This should ideally be achieved by selling SME Bank or giving controlling rights on its board to an institutional investor. To stimulate competition in the market from the very beginning, the GOP could also support long-term technical assistance programs for selected banks. As illustrated by the China SME

lending program, for this program to be successful the government needs to ensure correct market incentives are in place.

6.2.4. Access to Remittances

Bringing informal remittances into the formal system, particularly on the domestic front: The high share of banks in the international remittance market in Pakistan indicates that increasing bank accounts should help increase remittances through formal channels. Currently, the minimum account balance of Rs 10,000 (with the exception of basic banking accounts) is prohibitive for a large segment of the society. To encourage people to open bank accounts, uncomplicated paperwork and less stringent balance requirements are needed. Banks currently handling remittances can credit accounts within 24 hours; however, delivering money or sending money orders by Pakistan Post creates unnecessary delays, and the banking sector loses customers to Money Transfer Organizations and informal means of transfer. An enabling environment for the private sector, encouragement for opening of bank accounts, as well as improved postal office efficiency will have an additional effect to continue attracting remittance flows to the formal sector. Advances in technical and financial literacy will matter, as well, with appropriate education to alert people to the benefits of formal systems and how to use them.

Supporting remittance services of Pakistani banks abroad: Further encouragement for Pakistani banks might be required to continue to boost international remittances and forge alliances with international banks. One strategy would be to set the reimbursement rate through partner banks higher than remittances coming solely through Pakistani bank networks.

Pakistani missions abroad could do a survey of options available in their respective markets and disseminate the information to immigrants on the cheapest and best sources of money transfer. For example, the Mexican mission to the United States (USA) publishes such information. A further successful policy carried out by the Mexican embassy in the USA is that it has issued a type of identification card (*Matricula Consular*) for their immigrants, and with this card Mexican immigrants in the USA can open bank accounts. Perhaps the GOP can discuss something similar with the U.S. and other authorities.

Promoting the structuring of international flows into investments: Channeling remittance flows directly into investment in the tradable sectors of the economy has been pursued successfully in the international experience, to counteract loss of international competitiveness associated with elevated remittance flows. International good practices include packaging remittances with payment services (such as Bansefi in Mexico). Successful policies to structure international flows into investments have also focused on organizing and targeting Diaspora networks rather than actual remittances flows. At the macro level, Diaspora bonds issues (for example, in Israel, India, and Ghana) or securitization of future remittances flows (in Brazil, Salvador) have been used, although securitization has proven costly. At the micro level, governments have facilitated targeted Diaspora funds.

6.3. The Role of Public-Private Partnerships

A concrete way to make progress in expanding access to the underserved is to form public-private working groups on microfinance, small enterprise finance, and remittances. This would enable a dialogue between the government and private companies (banks, MFIs, Exchange Companies, Money Transfer Organizations, as well as telecoms and other market participants where relevant) to tackle key challenges in the sector. Priority themes should include, among others, legal and regulatory issues, market transparency, competition and cost, and research and data issues. On branchless banking, the private sector has yet to fully respond to recent SBP regulations, and public-private discussions could focus on

barriers to recent SBP regulatory incentives, as well as review the Payment and Electronic Fund Transfer Act, a possible data privacy or security law to facilitate e- or m-payments, and the branchless banking regulations providing for bank-nonbank partnerships and use of agents in money transfer services. The United Kingdom has had a successful experience in this regard with a Public-Private Working Group on Remittances, which led to the creation of a private sector-led U.K. Remittances Task Force. The World Bank has also convened a similar group at the international level, bringing together key actors from the public and private sectors. Pakistan can draw on this considerable experience.