

# Microfinance Sector

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## JCR-VIS SECTOR UPDATE

June 2017

### Industry Performance

Over the past decade, microfinance banking industry has become a significant player in providing access to financial services to the underserved low income population of the country. The industry is characterized by institutions having strong ownership profile, increasing geographical presence and sound asset quality and profitability indicators. The industry is poised to play a pivotal role in meeting the targets of the National Financial Inclusion Policy which aims to increase the number of adults having access to transaction or formal accounts from 10% at present to 50% by 2020.

The industry witnessed continued growth and expansion in outreach during the outgoing year. Gross microcredit portfolio grew by over 60% during 2016; growth is characterized by increasing number of borrowers as well as gradual progression of the same to subsequent higher loan cycle. Deposit base, while continue to depict high concentration levels, have also depicted high growth though average deposit balances continue to remain low.

*Large unsatisfied demand opportunities, an enabling regulatory environment and increasing interest of both domestic and foreign investors have been the main drivers for the healthy development of the sector.*

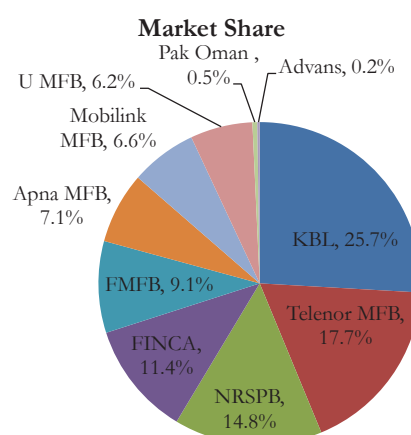
MFBs Key Indicators	2016	2015
Number of branches/Unit	963	788
Number of Active Borrowers	1,943,346	1,458,633
Gross Microcredit Portfolio (Rs. Millions)	89,940	55,697
Average Loan Balances (Rs.)	46,281	38,184
Number of Depositors	20,123,818	10,654,221
PAR>30	1.7%	1.3%
Value of Deposits (Rs. Millions)	120,089	63,089
Average Deposit Balance (Rs.)	5,967	5,922

*Source: MicroWatch, PMN*

In terms of gross microcredit portfolio, Khushhali Bank Limited (KBL) remained the largest provider of microcredit with a market share of 25.7% at end-2016 among Microfinance Banks (MFBs), followed by Telenor Microfinance Bank Limited (17.7%) and NRSP Bank (14.8%). Market share of larger MFBs have declined in the recent years which is taken up by mid-sized players owing to their aggressive expansion.

### Product Portfolio

Some MFBs specialize in group lending methodology while others prefer individual lending especially for Micro Small and Medium Enterprises (MSME). Major sectors in the microcredit portfolio include trade, agriculture, livestock/poultry, services and small scale

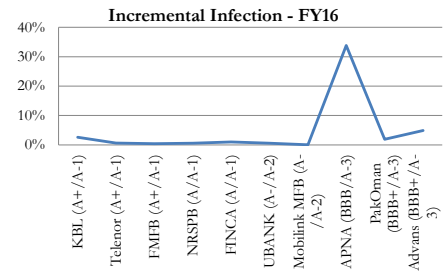


manufacturing. Agriculture and livestock loans are offered mainly under bullet repayment structure while other loans follow Equal Monthly Installment (EMI) repayment. Loans against gold as collateral have witnessed continuous decline following a regulatory intervention of capping gold loans at 35% of total gross loan portfolio.

To keep pace with the borrowers increasing loan requirement, the sector has gradually increased the average loan size. At end-FY16, average loan balance of the sector stood at Rs. 46,281 (FY15: Rs. 38,184). Considerable variation in average loan balance is notable among MFBs with some institutions specializing in higher ticket size loans. Being well below the regulatory limit of Rs. 150,000, large space for growth is available here.

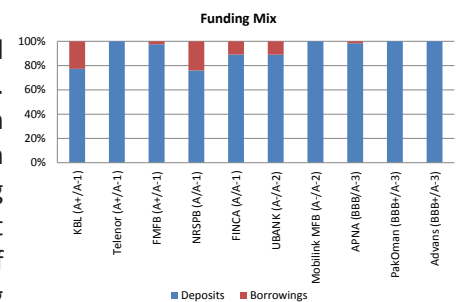
## Risk Management

As the sector is characterized by growing competition, an increasing appetite for risk taking has become evident; thus placing significant importance on risk management systems of the organizations. As per a recent survey finding, natural disaster is considered to be the biggest risk faced by the microfinance sector while competition is considered to be the fastest emerging risk. Asset quality indicators of MFBs have largely remained strong, reflected by manageable incremental infection rates. The year saw substantial losses reported by a relatively new market player resulting from provisioning against microcredit portfolio. While being diversified on a per counterparty basis, the sector remains prone to natural calamities and other economic conditions which may adversely impact borrowers across the board in large clusters. Risk pertaining to natural calamity is further aggravated in view of the non-availability of any meaningful insurance coverage.



## Funding

For funding, most of the MFB rely on deposits while some have also arranged borrowing facilities from local and international lenders in addition to deposits. Over the last five years, deposit base of MFBs have grown over eight folds with growth more pronounced in the last two years. Moderate to high concentration levels in deposit base while being of concern, also requires a corresponding liquidity cushions to be maintained on the balance sheet. Moderation in deposit concentration and granularity of their volumes would remain to be a function of the maturity profile of the MFBs, going forward. Moreover, given the increasing appetite for credit, availability of liquidity will continue to play a critical role in supporting future growth.

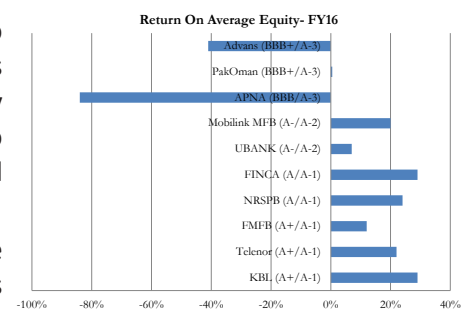


## Profitability

Revenues of the industry have continued their upward trend owing to volumetric growth in the microcredit portfolio. Decline in benchmark rates positively reflected on the spreads in the industry as loan products are largely fixed rate while deposit rates are linked to benchmark rates. In an effort to pass on the benefit of the declining interest rate to the clients, downward revision in loan product pricing has also been noted across the industry.

To an extent the high return on micro credit portfolio, affords MFBs the flexibility to offer better return on deposits; in part, this advantage is however off-set by the high level of overheads experienced by institutions.

Nonetheless, overheads have gradually rationalized while the sector participants are also aiming to digitalize branch banking services which will further improve operational efficiencies. Out of the 10 MFBs covered in this study, 8 posted profitable results during 2016; amongst these, consistency of profitable results has yet to be established by some. Given the differences in deployment of assets in lending activities, return metrics vary considerably across sector participants.



## Net worth

The net worth of MFBs for the period ranges from Rs. 615m to Rs. 5b. Capital Adequacy Ratio also varies significantly across sector participants with some institutions being highly leveraged while others have underutilized capital base.

## Branchless Banking

While some MFBs are already offering Branchless Banking (BB) operations, others are at different stages of launching BB operations. An increasing interest of sector participants has been noted in developing Digital Financial Services (DFS) strategy. MFBs aim to digitalize their existing branch banking services as well as offering customers digital mobile wallets. DFS is expected to improve customer experience while also offering process efficiencies to the institutions.

## Sector Developments

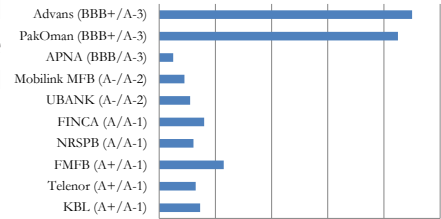
Some of the key sector developments that took place in the year 2016 include

- Re-estimation of the microfinance market in the country
- Establishment of Pakistan Microfinance Investment Company Limited, a private sector investment finance company
- ASA Pakistan, a microfinance institution, plans to acquire microfinance banking license
- Acquisition of 50.1% stake in Pak-Oman Microfinance Bank by Lanka Orix Leasing Company PLC

## Future Outlook

While the microfinance sector has grown at a fast pace in the recent years, its share in the financial sector of the country remains small. Nonetheless, the sector is expected to play a pivotal role in increasing financial inclusion, livelihood creation and sustainable economic growth. Growth outlook on the sector remains positive; the lead here would be taken by those having sound risk assessment policies and infrastructure strength for greater access to funding sources. Growth by itself may however, not necessarily continue to drive ratings upwards in the sector.

Networth to Total Assets - FY16



	Khushali Micro-finance Bank	Telenor Micro-finance Bank	First Micro-finance Bank	NRSP Micro-finance Bank	FINCA Micro-finance Bank	U Micro-finance Bank	Mo-bilink Micro-finance Bank	Apna Micro-finance Bank	Pak Oman Micro-finance Bank	Advans Micro-finance Bank
Ratings	A+/A-1	A+/A-1	A+/A-1	A/A-1	A/A-1	A-/A-2	A-/A-2	BBB/A-3	BBB+/A-3	BBB+/A-3
Outlook	Stable	Stable	Stable	Stable	Stable	Stable	Stable	Stable	RW-Positive	Stable
Rating Company	JCR-VIS	JCR-VIS/PACRA	JCR-VIS	JCR-VIS/PACRA	JCR-VIS	JCR-VIS	PACRA	PACRA	JCR-VIS	JCR-VIS
<i>Amounts in Rs. Millions unless otherwise mentioned, all amounts are as of end Dec, 16</i>										
Total Assets	33,773	36,304	16,878	26,452	15,618	10,592	14,233	13,554	1,260	685
Microcredit Portfolio (net)	22,939	15,835	8,183	13,127	10,082	5,528	5,856	5,484	428	208
Deposits	21,179	27,830	12,237	16,922	11,070	8,110	10,306	12,347	149	21.5
Net Worth	4,937	4,586	3,831	3,204	2,433	1,122	1,231	694	1,072	615.2
Profit/Loss After Tax	1,272	895	316	685	631	72	230.8	-735.5	7	-205.9
Number of Active Clients	556,787	385,417	220,493	325,520	132,880	118,160	91,747	50,096	19,727	2,922
Average Loan Size (Rs.)	41,547	41,372	37,202	40,766	76,279	47,197	64,677	127,698	22,105	72,590
Number of Branches	139	74	159	97	105	75	35	120	29	5
Incremental Infection (%)	2.6	0.66	0.4	0.59	1.0	0.6	0.06	33.8	1.9	4.9
Cost of Funds (%)	7.5	5.1	5.4	8.6	7.6	8.9	3.8	7.9	5.7	4.6
Liquid Assets to Total Deposits & Borrowings (%)	26.3	63	60.5	51.1	31.8	49.2	67.8	47.1	4.9	17.6
Capital Adequacy Ratio (%)	20.2	31	39.4	18.6	20.6	17.6	n/a	6.8	122.3	114
Net Worth to Total Assets (%)	14.6	12.6	22.7	12.2	15.6	10.6	8.6	5.1	85.0	89.9
OSS (%)	128.7	136.6	121.3	165.9	138.5	107.5	124.7	42.0	107.7	36.9
Spreads (%)	16.6	15	14.6	15.6	24	15.2	11.8	11.5	16.4	12.1
Return on Average Equity (%)	28.6	21.6	11.8	24	29.1	6.7	20.1	-84.1	0.6	-40.9

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