THE DYNAMICS OF MICROFINANCE EXPANSION IN LAHORE

Hussan Bano Burki
Mehr Shah
THE DYNAMICS OF MICROFINANCE EXPANSION IN LAHORE

Hussan Bano Burki
Mehr Shah
Acknowledgements

This publication was funded by the United States Agency for International Development (USAID), the UK Department for International Development (DFID), and the Financial Sector Strengthening Programme (FSSP), a project of the Swiss Agency for Development and Cooperation (SDC). The findings of this report have been jointly researched and authored by ShoreBank International Ltd. (SBI) and the Pakistan Microfinance Network (PMN). The lead researchers and authors are Hussan-Bano Burki (SBI) and Mehr Shah (PMN).

The authors wish to express their gratitude to the research team (Asima Awan, Hina Khawar, and Zainab Hamid) for their dedicated efforts in conducting the field research, with special thanks to Asima Awan for developing the case studies that emerged from the fieldwork.

The authors would also like to thank Microfinance Opportunities, Washington, DC, especially Elizabeth McGuinness, for advice on the research plan.

Finally, this study would not have been possible without input from the microfinance providers operating in Lahore and their willingness to readily (and, on occasion, repeatedly) provide generous access to data. The authors would like to specially thank the study’s participating organizations, and their staff and clients for their help in piecing together the story of microfinance in Lahore.
Acronyms and Abbreviations

BSL  business sarmaya loan
CSC  Community Support Concern
CWCD Centre for Women Cooperative Development
DAMEN Development Action for Mobilization and Emancipation
DFID  UK Department for International Development
EL emergency loan
FMFB The First MicroFinanceBank Ltd.
FSSP Financial Sector Strengthening Programme
GBL group-based loan
GL general loan
MFB microfinance bank
MFI microfinance institution
MFP microfinance provider
NGO non-government organization
NIC national identity card
PMN Pakistan Microfinance Network
PRA participatory rapid appraisal
PRSP Punjab Rural Support Programme
ROSCA rotating savings and credit association
RSP rural support programme
SBI ShoreBank International Ltd.
UPAP Urban Poverty Alleviation Programme
USAID United States Agency for International Development
Abstract

In recent years, microfinance outreach in Pakistan has grown rapidly. Although 66% of total microcredit outreach in the country continues to be rural, a significant proportion of the growth in outreach during 2005–06 has been urban. Much of this urban growth has been concentrated in the district\(^1\) of Lahore; the district accounted for 12% of total microcredit outreach in the country in June 2006.

According to practitioners operating in Lahore, the proliferation and expanded outreach of pro-poor lending institutions in the district has been accompanied by a number of new challenges and undesirable practices among sector players. To assess the accuracy and severity of the issues identified by Lahore-based microfinance providers (MFPs), ShoreBank International Ltd. (SBI) and the Pakistan Microfinance Network (PMN) conducted a joint research study to understand the dynamics of rapid growth in the Lahore market.

Close observation of the dynamics of microfinance expansion in Lahore has shown that, overall, MFPs and their borrowers have benefited from the rapid influx of additional service providers. Anticipated and real competition from new entrants has galvanized MFPs into action, encouraging some Lahore-based MFPs to stake out not only new territory in terms of geographic expansion beyond their home district, but also in terms of additional market segments. Although market segmentation is not yet sufficiently widespread to qualify as wholesale market evolution, it does herald the beginning of the process in Lahore and, hopefully, for Pakistani microfinance as a whole.

For existing borrowers, competition has resulted primarily in more client-responsive credit products for the current market segment being serviced. In a bid to attract and retain clients, organizations have altered the terms, conditions, and attributes of the credit products they offer to the market segment serviced through group-based loans (GBLs). To a lesser extent, borrowers within the GBL market segment also have access to a more diverse range of credit products, such as consumption, education, and housing loans. Some organizations have also begun to offer larger individual loans or small group loans for working capital (as in Latin America). Overall however, microfinance remains largely credit-oriented.

Microfinance expansion is in its early stages in Pakistan, even in Lahore where market coverage is highest and has just touched 13%. Expansion brings with it several benefits: (i) breadth of market coverage as MFPs expand to untapped territory, and (ii) depth of market coverage as new market segments are identified and serviced. At the same time, expansion is accompanied by significant risks of overlapping and the potential descent into unhealthy competition, which can cause a decline in client service, over-indebtedness, and greater risk across the sector. This has not yet happened on a large scale, but that is not reason enough to preclude the need to watch, monitor, and ensure that the positive elements of expansion prevail.

\(^1\) A "district" is a third-tier administrative unit, following a province and tehsil/taluka, respectively.
Contents

Acknowledgements
Acronyms and Abbreviations
Abstract

Introduction

An Overview of Microfinance in Lahore
Lahore District
Estimated Microfinance Market
Microfinance Providers in Lahore
Microfinance Expansion in Lahore

The Dynamics of Microfinance Expansion
Microfinance Branches are Heavily Clustered in Selected Pockets
MFPs have Begun to Identify and Serve New Market Segments
MFPs Originating in Lahore are Expanding to Other Districts
MFPs' Internal Controls do not Always Keep Pace with Expansion Pressures
Marketing has not Kept Pace with the Demands of a Maturing Microfinance Market
MFPs are Adjusting Services to Retain Clients
Some Borrowers are Expanding their Credit Limits...by Borrowing from Multiple Sources

Conclusion

List of Exhibits
Exhibit 1: Rural-Urban Distribution of Active Microcredit Borrowers in Pakistan (2005–2006) 1
Exhibit 2: Location of Lahore District in Pakistan 3
Exhibit 3: Penetration of Top Ten Potential District Markets for Microfinance (Sept. 2006) 4
Exhibit 4: MFPs in Lahore (Sept. 2006) 5
Exhibit 5: Entrance of MFPs in Lahore (1996–2006) 6
Exhibit 6: Microcredit Outreach in Lahore (Sept. 2006) 7
Exhibit 7: Microfinance Branch Network in Lahore (Sept. 2006) 9
Exhibit 8: Degree of Branch-Level Competition among MFPs in Lahore (Sept. 2006) 10
Exhibit 9: Active Borrowers in Lahore by Product Line and Market Segment (Sept. 2006) 11
Exhibit 10: Attributes of Microcredit Product Lines Offered in Lahore 12
Exhibit 11: Expansion of MFPs Beyond Lahore 13
Exhibit 12: Geographical Expansion of MFPs Originating in Lahore 14
Exhibit 13: Factors Perceived by MFPs to Provide a Competitive Edge 19
Exhibit 14: Client Preference versus Risk Management 20
Exhibit 15: Preference Ranking of Microcredit Service Attributes by Active Borrowers 21
Exhibit 16: Decision Options for Borrowers Offered Loan Amount Less than Amount Needed 22

List of Boxes
Box 1: Reported "Group Hijacking" Tactics 15
Box 2: Who are Local Resource Persons? 16
Box 3: Rent-Seeking Behavior by Local Resource Persons 17
Box 4: Need for Larger Loans 23

Annexes
A Microcredit Products and Services Available in Lahore 29
B Case Studies
   B.1 Commission-Based Intermediaries 33
   B.2 Borrowers Borrowing from Multiple Sources 35
C Research Methodology 38
Introduction

Microfinance in Pakistan has evolved rapidly as new entrants, products, and practices contribute to a growing client base. Backed by enabling regulation and sustained commitment by the Government of Pakistan, this upward trend is likely to continue over the next few years. The sector's projected national outreach has been estimated at a minimum of three million active borrowers by 2010, up from 731,000 active borrowers in June 2006.

Although 66% of the total microcredit outreach in Pakistan continues to be rural, a significant proportion of the growth in outreach during 2005–06, as well as new entrants in the sector, has been urban (Exhibit 1).

### Exhibit 1: Rural-Urban Distribution of Active Microcredit Borrowers in Pakistan (2005–2006)

<table>
<thead>
<tr>
<th>Location</th>
<th>Active Borrowers 2005</th>
<th>Active Borrowers 2006</th>
<th>Net Growth</th>
<th>Growth (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Urban</td>
<td>164,272</td>
<td>252,116</td>
<td>87,844</td>
<td>53.5</td>
</tr>
<tr>
<td>Rural</td>
<td>363,003</td>
<td>478,844</td>
<td>115,841</td>
<td>31.9</td>
</tr>
<tr>
<td>Total</td>
<td>527,275</td>
<td>730,960</td>
<td>203,685</td>
<td>38.7</td>
</tr>
</tbody>
</table>


A key area in which this urban growth has been concentrated is the district of Lahore (referred to hereafter as "Lahore" or "the district"). Microfinance outreach in Lahore stood at approximately 90,000 active clients in June 2006. By September 2006, this count had reached approximately 112,547 active clients, i.e., 24% growth over a period of three months. Other districts of Pakistan that account for a relatively large proportion of the total national outreach are: (i) Bahawalpur at 25,124; (ii) Rawalpindi at 21,796; and (iii) Karachi at 21,483 active borrowers as of June 2006. Thus, with an approximate national total of 731,000 active clients, Lahore accounted for 12% of the total microcredit outreach in the country in June 2006.

The proliferation and expanded outreach of pro-poor lending institutions in Lahore has brought with it new challenges; some of the emerging issues are (i) reports of overlapping areas of operation among microfinance providers (MFPs), (ii) the rising incidence of multiple borrowing among clients of different MFPs, and (iii) employee and client poaching. This heralds an important shift for the microfinance sector in Lahore where, until recently, most MFPs did not have to worry about competition. Many enjoyed near monopolies, operating in large, untapped areas in the second-largest urban centre of Pakistan.

As the microfinance sector gears up to expand at the national level, the Lahore market offers a valuable opportunity to study the dynamics of microfinance expansion in an urban market and to forecast the likely impact on the sector at the macro-level should similar dynamics arise in other areas of the country. Given that this is an exploratory study, it is important to be careful when extrapolating its findings to other areas of Pakistan, especially rural areas that may be far removed in geography and market characteristics from urban centers. However, with these caveats in mind, the expanding microfinance sector in Lahore presents an opportunity to identify and study in some detail the effects of its expansion, not only on MFPs and their clients, but also to assess the likely increase in impact as the degree and nature of competition among MFPs gathers momentum and intensity. It is hoped that this exploratory work will help all stakeholders—practitioners, the Government, and funding bodies—foster healthy competition and benefit microfinance consumers across the country.

---

4 A "district" is a third-tier administrative unit, following a province and tehsil/toluka, respectively.
An Overview of Microfinance in Lahore
An Overview of Microfinance in Lahore

Lahore District

Pakistan has a population of approximately 155 million\(^6\) with per capita annual income of US$690 (Rs41,400)\(^7\). The country is divided into four provinces that are subdivided into 122 third-tier administrative units known as “districts”. Lahore, the capital district of the Punjab province (Exhibit 2), ranks second among Pakistan’s districts in terms of population (8,581,893)\(^8\), first in terms of population density (3,566/km\(^2\)), twelfth in terms of the human development index (0.558), and highest among all the districts in Punjab in terms of per capita annual income (Rs29,988)\(^9\). Major industries situated in the district include foundries, steel mills, textile units, and chemical factories. Lahore is also one of the largest software-producing and exporting districts in Pakistan.

Exhibit 2: Location of Lahore District in Pakistan

---


\(^{7}\) Exchange rate: US$1.00 = Rs60.10 (June 2006).


Lahore consists of urban and rural areas: its densely populated urban core is known as Lahore City; the peripheral belt surrounding the urban core is defined as rural. In recent years, however, administrative boundaries within the district have been redrawn to account for an increasingly populous peripheral belt characterized by a large number of industrial units interspersed with tracts of agricultural land and low-income housing colonies. Thus, as the rural-urban divide has narrowed—diluting the distinguishing features of the rural suburbs—administrative boundaries within the district have been redrawn to establish nine “towns”. Each “town” is governed by a nazim, a locally elected leader.

**Estimated Microfinance Market**

A conservative estimate puts the microfinance market in Lahore at approximately 850,000 potential active borrowers. This makes Lahore the third-largest district-level microfinance market in Pakistan (Exhibit 3), surpassed only by Karachi and Faisalabad at approximately 1,400,000 and 1,100,000 potential clients, respectively.


---

Based on 1998 District Census Report data.
Microfinance Providers in Lahore

The presence of a large, untapped microfinance market in an enabling macroeconomic environment that is politically stable (relative to Karachi, the largest potential market) are primary factors that have contributed to making Lahore a popular locale for microfinance operations. Abundant fertile land, a good irrigation system, and rapid industrialization in the suburbs makes it relatively easy to mobilize clients. Moreover, the economic integration of the rural areas along the periphery of the district with Lahore City (the densely populated urban centre) through a well-developed communications infrastructure has also made it possible for MFIs to spread their operations beyond city limits.

*By September 2006, there were at least 11 MFIs operating in Lahore*

**Exhibit 4: MFIs in Lahore (Sept. 2006)**

<table>
<thead>
<tr>
<th>No.</th>
<th>MFI</th>
<th>Institution Type</th>
<th>Year of Entry</th>
<th>No. of Loan Officers</th>
<th>No. of Branches</th>
<th>No. of Active Borrowers</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Kashf Foundation</td>
<td>Specialized microfinance institution (MFI)</td>
<td>1996</td>
<td>96</td>
<td>24</td>
<td>43,188</td>
</tr>
<tr>
<td>2</td>
<td>Development Action</td>
<td>Multi-sector non-government organization (NGO)</td>
<td>1996</td>
<td>50</td>
<td>10</td>
<td>17,160</td>
</tr>
<tr>
<td></td>
<td>for Mobilization and</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Punjab Rural Support</td>
<td>Rural support programme (RSP)</td>
<td>1998</td>
<td>12</td>
<td>3</td>
<td>3,948</td>
</tr>
<tr>
<td></td>
<td>Programme (PRSP)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(PRSP)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(PRSP)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Community Support</td>
<td>Multi-sector NGO</td>
<td>1999</td>
<td>32</td>
<td>6</td>
<td>7,525</td>
</tr>
<tr>
<td></td>
<td>Concern (CSC)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cooperative Development</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(CWCD)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Centre for Women</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Cooperative Development</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(CWCD)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Commercial financial</td>
<td></td>
<td>2001</td>
<td>N/A</td>
<td>N/A</td>
<td>1,368</td>
</tr>
<tr>
<td></td>
<td>Microfinance bank (MFB)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Akhuwat</td>
<td>MFI</td>
<td>2002</td>
<td>50</td>
<td>8</td>
<td>6,463</td>
</tr>
<tr>
<td>8</td>
<td>Khushhali Bank</td>
<td>Microfinance bank (MFB)</td>
<td>2002</td>
<td>13</td>
<td>3*</td>
<td>11,000</td>
</tr>
<tr>
<td>9</td>
<td>Asasah</td>
<td>MFI</td>
<td>2003</td>
<td>30</td>
<td>7</td>
<td>9,966</td>
</tr>
<tr>
<td>10</td>
<td>First MicroFinance</td>
<td>MFB</td>
<td>2004</td>
<td>N/A</td>
<td>5</td>
<td>8,435</td>
</tr>
<tr>
<td></td>
<td>Bank Ltd. (FMF)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Urban Poverty Alleviation</td>
<td>MFI</td>
<td>2006</td>
<td>36</td>
<td>12</td>
<td>396</td>
</tr>
<tr>
<td></td>
<td>Programme (UPAP)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td><strong>319</strong></td>
<td><strong>86</strong></td>
<td><strong>112,547</strong></td>
</tr>
</tbody>
</table>

*Khushhali Bank operates through three customer centers but has also formed alliances with partner organizations to mobilize additional outreach.

Source: September 2006 data provided by MFIs
Microfinance Expansion in Lahore

As shown in Exhibit 5, on average Lahore has attracted one entrant every year over the last ten years (1996–2006). Depending on an organization’s year of entry into Lahore as a provider of microfinance services, the MFPs have been classified as either “pioneer” MFPs (those who have been present in Lahore for more than five years) or “new entrant” MFPs (those who have been present in Lahore for less than five years).

“Lahore has attracted one entrant every year over the last ten years”

Exhibit 5: Entrance of MFPs in Lahore (1996–2006)

Source: September 2006 data provided by MFPs.
At the time of this study (September 2006), new entrants were contributing a substantial 32% of active microcredit outreach in Lahore (Exhibit 6). This shows that outreach in Lahore has increased at a faster rate with the entrance of new players.

Exhibit 6: Microcredit Outreach in Lahore (Sept. 2006)

- Market share of MFPs with less than 5 years of MF operation in Lahore
- Market share of MFPs with more than 5 years but less than 10 years of MF operation in Lahore
- Market share of MFPs with 10 or more years of MF operation in Lahore

With the accelerating pace of microfinance growth in Lahore, some MFPs have expressed their concern over "intense competition". A preliminary review of the outreach data indicates that coverage in Lahore is shallow at best, with more than 85% of the potential demand still unmet. Overall, the industry has responded "correctly" to the unmet demand for microcredit in Lahore: new players have continued to enter the district (at an average rate of one entrant per year) to plug the gap between supply and demand. Simultaneously, however, existing players have begun to express their disquiet not only with the expected rise in competition over the next few years, but more interestingly, with the fallout from the current situation in the market.

A closer observation of the dynamics of microfinance expansion in Lahore as a whole shows that a number of factors contribute to the seemingly contradictory responses of MFPs in Lahore and those poised to enter the district.
Microfinance Branches are Heavily Clustered in Selected Pockets

MFIs in Lahore often note the parasitic tendencies of competitors in their movement within Lahore, given that many service providers have chosen to begin operations in already-serviced areas rather than untapped localities in the district. Geographic clustering is, therefore, one of the primary factors contributing to the perception of intense competition among MFIs in Lahore.

By September 2006, MFIs in Lahore were operating through a network of at least 86 branches. The average microfinance branch has the human resource capacity to deliver microcredit to approximately 2,000 active borrowers within an average radius of 7 km\(^1\). Exhibit 7 clearly reveals that most MFIs operate in and have expanded into many of the same parts of the district. Circumscribing the upscale sections of the city, these MFIs have clustered more heavily in the southeast, northwest, and northeast of Lahore City. Except for a presence maintained by one organization in the southwestern region of rural Lahore, peripheral areas of the district remain markedly devoid of MFI presence.

"Geographic clustering of MF branches is one of the primary factors contributing to the perception of intense competition in Lahore"
Rough estimates show that the typical microfinance branch or field unit in Lahore competes against three MFPs in any demarcated area (Exhibit 8). Such geographical overlapping of the operational zones of many MFPs is the primary factor contributing to both the perceived and real sense of intense competition among lenders in Lahore.

Tracking MFPs’ expansion within Lahore reveals that most have been expanding to areas where one or more MFP is already present. Expansion patterns of individual MFPs and interviews with their management staff suggest that intra-district expansion plans are driven primarily by client presence (given that low-income households are clustered in these areas). However, within these high-density zones, some MFPs might deliberately choose to target the same households being targeted by competitor MFPs. The primary driver for such behavior could be lower entry cost considerations, resulting from the lower costs of client mobilization where other MFPs have already begun to familiarize and mobilize target households to access microfinance.

As a result of this geographical and operational clustering in Lahore, many potential microfinance clients remain inadequately served or untapped altogether by the network of MFPs. Some of the un-served areas that practitioners themselves identified include Wagah Town along the Indian border, and large sections of the densely populated low-income settlements straddling the railway line crisscrossing Lahore. Other un-served or inadequately served areas visible on the map include the less densely populated peripheral belt surrounding Lahore City as well as densely populated Ravi Town situated in the northwest, across the river bearing the same name.

**Exhibit 8: Degree of Branch-Level Competition among MFPs in Lahore (Sept. 2006)**

<table>
<thead>
<tr>
<th>No.</th>
<th>MFPs</th>
<th>No. of Branches</th>
<th>Branches With More Than Three Competitors</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>No.</td>
</tr>
<tr>
<td>1</td>
<td>Kashf</td>
<td>24</td>
<td>16</td>
</tr>
<tr>
<td>2</td>
<td>DAMEN</td>
<td>10</td>
<td>3</td>
</tr>
<tr>
<td>3</td>
<td>PRSP</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>4</td>
<td>CSC</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>5</td>
<td>CWCD</td>
<td>8</td>
<td>N/A</td>
</tr>
<tr>
<td>6</td>
<td>ORIX</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>7</td>
<td>Akhuwat</td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td>8</td>
<td>Khushhali Bank</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>9</td>
<td>Asasah</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>10</td>
<td>FMFB</td>
<td>5</td>
<td>N/A</td>
</tr>
<tr>
<td>11</td>
<td>UPAP</td>
<td>12</td>
<td>6</td>
</tr>
</tbody>
</table>

Source: September 2006 data provided by MFPs.

**MFPs have Begun to Identify and Serve New Market Segments**

In Lahore, as in the rest of Pakistan, credit has driven the expansion of microfinance. Not only have other financial products generally remained absent from the market in Lahore, credit too has predominantly been packaged and marketed to a single market segment.
Most MFPs in the district provide group-based loans (GBLs) ranging from Rs10,000–35,000 (US$170–580) for the purpose of income generation. These loans are generally referred to by local service providers as "productive loans". Of the total outreach reported for the district in September 2006, approximately 95% was accounted for by the GBL segment (Exhibit 9). Moreover, approximately 60% of GBL borrowers were women.

Although a number of the MFPs began experimenting with new products as early as 2001—consumption loans (also referred to as “emergency loans”, “marriage finance loans”, or “housing loans”) and micro-insurance (primarily "credit life")—most of these early initiatives remained tied to the principle GBL product offered by an organization, falling short of comprehensive product diversification aimed at capturing an altogether separate market segment.

"Although a number of MFPs began experimenting with new products as early as 2001 most remained tied to the GBL product"

Exhibit 9: Active Borrowers in Lahore by Product Line and Market Segment (Sept. 2006)

Over the last 18 months, however, several new approaches have been developed to bring credit to an additional market segment in Lahore. Unlike the typical GBL borrower, this segment is predominantly male and has a substantially larger credit requirement. These larger loans are provided both to individuals and smaller groups (perhaps similar to what has been called the Latin American Solidarity Group) and range from Rs35,000 to Rs100,000 (US$580–1,700) in value. In effect, this second set of larger, business-focused loans will begin to serve a separate segment of the Lahore market, although it currently represents only a small fraction of total outreach. This outreach is accounted for by only three MFPs: an MFB and two specialized MFIs.

"Some new approaches have been developed to bring credit to an additional market segment in Lahore"

Exhibit 10 lists the common characteristics of microcredit services offered by different MFPs in Lahore. For details of terms and conditions, and product characteristics, see Annex A.

---

12 Based on September 2006 data provided by MFPs operating in Lahore.
Exhibit 10: Attributes of Microcredit Product Lines Offered in Lahore

<table>
<thead>
<tr>
<th>Product Attribute</th>
<th>Large Group Loan</th>
<th>Small Group or Individual Loan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan size</td>
<td>Rs1,000 (US$17) – Rs35,000 (US$580)</td>
<td>Rs35,000 (US$580) – Rs100,000 (US$1,700)</td>
</tr>
<tr>
<td>Purpose</td>
<td>Enterprise loan, consumption loan, refinancing loan</td>
<td>Livestock loan, small business finance loan, working capital loan.</td>
</tr>
<tr>
<td>Loan amount</td>
<td>Depends on length of relationship between client and MFP. Does not necessarily relate directly to needs of borrower.</td>
<td>Depends on client’s cash flow appraisal as well as length of relationship between borrower and MFP. More closely related to needs of borrower.</td>
</tr>
<tr>
<td>Methodology</td>
<td>Disbursed as a group solidarity loan to a “centre” of 4 - 5 groups of 5 borrowers each i.e., a centre of 20 - 25 borrowers.</td>
<td>Disbursed as individual loan or group solidarity loan to a smaller group of 3 borrowers.</td>
</tr>
<tr>
<td>Collateral/guarantees</td>
<td>Large group guarantee</td>
<td>More emphasis on personal guarantee/s.</td>
</tr>
<tr>
<td>Duration of loan</td>
<td>10–18 months</td>
<td>12 months</td>
</tr>
<tr>
<td>Repayment of installment</td>
<td>Forthnightly or monthly, usually as fixed and equal amounts</td>
<td>Fixed and equal monthly</td>
</tr>
<tr>
<td>Effective annual yield (interest + fee)</td>
<td>30–45% for 7 of the 9 MFPs in Lahore 10% and 20% for 2 of the 9 MFPs in Lahore</td>
<td>40%</td>
</tr>
</tbody>
</table>

Source: September 2006 data provided by MFPs for financial service landscape analysis (Annex A).

Thus, a closer look at the Lahore market suggests that the crowding of the GBL segment is another reason for the competitive pressure in Lahore. A market can be at different stages of competition in different towns of the same country, as well as in different market segments of the same town. In the market segment for GBLs in Lahore, competition has continued to intensify in recent years as players entered the market with highly similar credit products. This leads us to recognize the need to explore the nature of “reported” competition in Lahore in terms of specific market segments and locations chosen by MFPs for the provision of their services.

**MFPs Originating in Lahore are Expanding to Other Districts**

The momentum of growth in the GBL segment of the Lahore market and anticipated competition from players already entrenched in the district, as well as from expected entrants, has prompted many MFPs to consider lateral growth outside Lahore.

Demonstrating a decided preference for outreach expansion through the spatial dispersion of existing products rather than through deepening penetration within an existing area of operation via new products, MFPs that began as primarily Lahore-based organizations began to venture beyond the district in early 2002. By 2006, all five Lahore-based MFPs had set up operations in neighboring districts, primarily Kasur and Sheikhupura. Since then, some players have extended operations to as many as nine districts, with one MFP having moved as far as Karachi (Exhibits 11 and 12) in Sindh province.
Interviews with the management staff of these MFPs confirmed that this lateral growth has in large measure been driven by the increasing number of MFPs currently competing for the same GBL segment in Lahore, in addition to the expected increase in future competition, especially from MFBs poised to extend their operations to the district. Thus, the causality between geographic expansion and existing as well as anticipated competition is evident.

"Organizations originating in Lahore began to venture beyond the district in early 2002" 

Exhibit 11: Expansion of MFPs Beyond Lahore

<table>
<thead>
<tr>
<th>No.</th>
<th>Lahore-Originating MFP</th>
<th>Year</th>
<th>Movement out of Lahore</th>
<th>District</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Kashf</td>
<td>1996</td>
<td>2002</td>
<td>Kasur</td>
</tr>
<tr>
<td>2</td>
<td>DAMEN</td>
<td>1996</td>
<td>2005</td>
<td>Sheikhupura</td>
</tr>
<tr>
<td>3</td>
<td>CSC</td>
<td>1999</td>
<td>2005</td>
<td>Kasur</td>
</tr>
<tr>
<td>4</td>
<td>Akhuwat</td>
<td>2002</td>
<td>2006</td>
<td>Rawalpindi</td>
</tr>
<tr>
<td>5</td>
<td>Asasah</td>
<td>2003</td>
<td>2003</td>
<td>Kasur</td>
</tr>
</tbody>
</table>

Source: September 2006 data provided by MFPs.

The proclivity among most MFPs towards geographical expansion also suggests that the next stages of growth for microfinance in Pakistan are more likely to be through replicable expansion to new geographical markets with existing products, rather than through diversification of market segments for deeper penetration. This strategy for growth follows the logic that it is more efficient and less costly for an organization to expand its outreach by replication across broader geographical areas rather than increasing penetration in a given area by introducing new products, tapping new clients, and simultaneously developing new operating systems and methodologies to support the innovations.

"MFPs continue to target Lahore for entry"

Although most MFPs acknowledge that geographical spread brings its own challenges, they also believe that these can be minimized by using the "cookie-cutter approach" whereby a core product is rolled out by rigorously trained staff capable of performing well in a decentralized setting. Thus, as part of its growth strategy for 2006, one of the largest Lahore-based MFPs has established 23 of 28 new branches outside Lahore. Consequently, expanding MFPs have exported their GBL products—tested and refined in Lahore—to these newly accessed areas.

As the traditionally Lahore-based MFPs move out of the district, it is also important to note that organizations that began operations elsewhere continue to target Lahore for entry. Notable among these is the recently arrived Urban Poverty Alleviation Programme (UPAP) and the expected arrival of the Tameer Microfinance Bank Ltd. in 2007.
MFPs’ Internal Controls do not Always Keep Pace with Expansion Pressures

Although it is not entirely clear why MFPs in Lahore continue to cluster in a limited geographic area, the trend is not lost on either MFP management or non-management staff. Frontline staff (branch managers, loan officers) surveyed during the research expressed mounting concerns about increasing competition in the areas their organizations service. As field staff find it increasingly difficult to meet their outreach, recovery, and client retention targets in high-concentration areas where MFPs compete for the same households, field staff across organizations have begun to introduce shortcuts in lending processes. Common shortcuts relate to new client mobilization, identification, appraisal, and monitoring.

Field level managers and staff cite the following shortcuts that are generally in practice across Lahore:

- delegation by field staff of client identification, mobilization, screening, and selection to selected individuals from the borrowing community, and
- “group hijacking” the borrowers of competitor MFPs operating in the same area (Box 1).

Box 1: Reported “Group Hijacking” Tactics

These include:

- posting field staff outside a group meeting of borrowers belonging to competitor MFP to persuade the group to switch patronage,
- offering incentives such as loan approvals for close relatives or offering monetary benefits to key borrowers who lead/manage borrower groups for competing MFPs to persuade them to encourage the group to shift patronage, and
- hiring competitor MFPs’ field staff with the express purpose of gaining access to the borrowers that the staff has already mobilized and built relationships with.

Source: Interviews with MFP management and branch office staff, September 2006.

That field staff across the sector in Lahore are able to short-circuit operational processes put in place by MFPs implies that the internal monitoring systems of MFPs in Lahore are not keeping pace with the rigor of growth. These shortcuts can seriously undermine the internal control measures put in place by an MFP, increasing its exposure to credit risk (loan defaults) and operational risk (staff and client fraud). Such practices can also contribute to unhealthy competition at the field level. Given that only 13% of the potential market in Lahore has been penetrated, these practices are sub-optimal for MFPs as well as their clients and should be avoided.

“MFPs have yet to work out how best to motivate and provide incentives to staff working in high-concentration areas”

The root cause of such behavior among MFP field staff reportedly goes beyond weak or insufficient internal monitoring; most of the field staff who were surveyed placed the onus squarely on senior MFP leadership and management staff, citing the organization’s desire for “quick and easy outreach” as the principal factor contributing to challenging outreach and repayment targets with simultaneously reduced emphasis on risk control mechanisms. The extent to which staff incentive systems or lack thereof contribute to negative staff behavior during periods of growth is beyond the scope of this paper. However, it is worth noting here that MFPs have yet to work out how best to motivate and provide incentives to staff working in high-concentration areas, not only to stem staff turnover but, more importantly, to increase quality outreach to new borrowers.
Marketing has not Kept Pace with the Demands of a Maturing Microfinance Market

Client mobilization by MFPs in Lahore, as elsewhere in Pakistan, is achieved predominantly through direct marketing by field staff who juggle multiple responsibilities: client mobilization, screening, appraisal, loan disbursement, monitoring, and recoveries (Box 2).

Client mobilization and the marketing practices prevalent among MFPs in Lahore rely on the following:
- identification of person/s (often referred to as “local resource persons”) within the targeted community by MFP branch staff who can help identify and mobilize potential borrowers;
- door-to-door promotion by field staff to households identified as potential borrowers; and
- word-of-mouth marketing by members of the community, including local resource persons and borrowers.

Box 2: Who are Local Resource Persons?

The local resource person is a member of the target community. He or she has a strong social network that enables him or her to identify potential borrowers within the community and persuade them to apply for loans from a particular source. Often, the local resource person also has a degree of formal or informal clout within the community either through a position held in the area’s local government or membership of a particular caste.

The local resource person, often referred to as an “activist” by MFP staff (non-staff campaigner for the MFP), can also become a borrower, taking up the role of a borrower “group manager” who forms borrower groups and/or centres for the MFP, helps screen loan applicants, and manages the group’s loan repayment.

In communities where MFPs have operated for some time, the resource person can sometimes emerge from a borrower group, often as its group/centre manager. The experience of managing a group brings the centre manager into prominence within the community, making him or her the first natural contact point for people who want to borrow.

A new MFP, when entering a community where another MFP is already operating, tries to identify the group/centre managers of existing borrower groups to enlist them as their “resource person”, often by luring them with more attractive borrowing terms and conditions.

Source: Interviews with MFP management, branch office staff, MFP borrowers, and local resource persons (September 2006).

The use of the media for marketing is limited largely to printed pamphlets that the MFP staff use during sales calls or deposit with their local resource persons for onward sharing within the target community. So far, only one MFP in Lahore has begun to experiment with a direct marketing strategy: tactics include advertising on walls (chalking), broadcasting advertisements on local cable channels, and using the medium of radio.

Relying on local “resource persons” and door-to-door promotion to market microfinance in a newly entered community is no doubt an effective way of gaining the community’s confidence and mobilizing new clients. However, in Lahore, as an MFP branch begins to mature, marketing tactics continue to rely on direct person-to-person marketing without being complemented by other media. The result is that, as other responsibilities of client appraisal,
and loan disbursement, monitoring, and recovery begin to take up more time, the field staff relies increasingly on its local resource persons to acquire new borrowers and re-attract old ones.

Random transit walks and interviews with target communities in high-concentration areas revealed that most MFIs fail to evolve their marketing tactics over time. Consequently, information on access to financial services has become the domain of the local resource persons, often the leaders (tacit or de jure) of borrower groups. This is because the information flow from MIF staff on service availability, product features, and terms and conditions flows down to the resource person’s or a few group leaders in a community, through whom it is expected to trickle down to the larger community. As a result, this practice has placed important aspects of the lending process squarely in the hands of a limited number of non-staff resource persons.

Some of the implications observed in Lahore of relying on local resource persons for the flow of information from MIF to community were:

- In a number of instances community members (both borrowers and non-borrowers from MFIs) identified the borrower group leader/local resource person rather than a specific MIF as the key source of access to organizational credit. In fact, even in some high competition zones target households interviewed were barely aware of the choice of MFIs from among whom they could access microcredit. The study found that, in sampled communities where four or more MFIs operated, on average the households interviewed could accurately name only one MIF, i.e., the organization they borrowed from. Although aware of other service providers, clients often referred to them collectively as “the other loan giving organizations”, indicating limited awareness about alternative service providers.

- Most community members were even less aware of the differences in terms and conditions offered by competing MFIs. Thus, the benefit of increased “choice” to a consumer that competition usually brings was not being realized effectively.

- In communities where multiple MFIs operated, resource persons/group leaders had begun to enjoy a degree of leverage over the MIF because of their power to persuade groups of current borrowers to switch their patronage to competitors.

- Resource persons/group leaders were increasingly using their discretion in putting the opportunity of access to financial services of an MIF in front of the favored members of the community and withholding access from those potential clients who were “out of favor”.

**Box 3: Rent-Seeking Behavior by Local Resource Persons**

They are referred to in Lahore by MFIs as “commission agents”, “activists”, “opportunists”, and “freelancers”. Elsewhere, they are also referred to as “touts”. These men and women are in fact not MIF staff but members of the community targeted by MFIs for microcredit provision. They take up the role of commission-based intermediaries for community members who want to borrow from an MIF.

They promise to provide interested applicants access to loans from an MIF at a commission ranging from 2–10% of the loan amount. Although the commission-based intermediaries are independent of the MIF, its frontline staff often tacitly or explicitly collude with the intermediaries to mobilize applicants, even filling in appraisal forms for applicants, and carrying out loan disbursement and repayment.

The intermediaries identified and interviewed during this study had been or still were leaders (centre managers) of one or more MFIs’ borrower groups. Discussions with these intermediaries revealed that they grew into the role after having been a group leader for long enough to be perceived within their community as the primary source of access to credit from MFIs.

Discussions with MFIs in Lahore revealed that elected community representatives in the local governing council and moneylenders also passed on microcredit applications to MFIs on commission from loan applicants.
Since the main source of revenue from their role as a paid intermediary is the fee/commission a borrower pays on the size of the loan that the intermediary ‘facilitates’, there is high incentive for the former to recommend the same borrower to different MFPs. One intermediary that the research team interviewed was also a group leader and estimated that, in one group of 20 borrowers, she had provided 15 borrowers access to multiple loans from different MFPs on a commission basis.

Commission-based intermediaries were identified in all the areas of Lahore visited during the research (Kot Lakpat, Baghanpura, Bandh Road, and Thokar Niaz Beg), implying significant prevalence of this informal tier across the Lahore market. MFP staff operating in areas where the microfinance operations of multiple service providers are concentrated estimate anywhere from one to three paid intermediaries operating in one target area of radius 8 km. Interviews with some of these commissioned agents revealed that, in some areas, intermediaries in Lahore have demarcated exclusive territories through tacit or explicit collusion. Our discussion with MFPs operating outside Lahore revealed that the existence of these intermediaries is not, however, limited to Lahore; they are also known to exist in very new microfinance markets in other districts of Pakistan.

Why do potential borrowers feel that they need to go through an intermediary to borrow from an MFP? The reason lies in the limited reach that MFPs have to potential borrowers through their marketing and awareness efforts. Although microfinance competition has little to do with the burgeoning of these intermediaries in target communities, the existence of commission-based intermediaries in areas where microfinance competition exists raises credit and operational risks.

Research shows that the increasing pressure on field staff to meet its disbursement targets while continuing to perform the multiple tasks of client mobilization, appraisal, loan disbursement, recoveries, and client retention can tempt frontline staff to recruit commission-based intermediaries to ease their workload. Weak control and internal audit systems of MFPs allow staff to get away with such arrangements.

Finally, there is the direct impact on clients of accessing credit through an additional (albeit informal) tier i.e., the effective cost of credit to the client rises substantially.

*See Annex B for case studies on Commission-Based Intermediaries.*

*Source: Interviews with MFP management, branch office staff, MFP borrowers, and local resource persons (September 2006).*

**MFPS are Adjusting Services to Retain Clients**

Most borrowers in Lahore are concentrated in a few areas that are characterized by densely populated, regularized settlements of low-income households. These settlements, which have access to basic amenities such as water, gas, and electricity, also form the hub of ancillary services to industry in Lahore. Housing colonies are often located behind a network of shops and workshops primarily run by mechanics, carpenters, and spare-parts dealers, etc. A rough assessment of microfinance borrowers in these areas indicate that most of them live on or above the poverty line.

These socioeconomic conditions also contribute to the high concentration of MFP activity in these focus areas, the result being that existing borrowers in areas where MFPs’ operations overlap benefit from the presence of multiple service providers. Furthermore, some borrowers, especially those in their fourth or fifth borrowing cycles, have become more savvy in assessing the terms and conditions offered by different MFPs servicing their area.
Interviews with MFP management and frontline staff in Lahore indicate that competitive pressure to retain current borrowers and attract new ones in high microfinance-concentration areas has prompted most MFPs to adjust their products and processes to better meet client preferences, often by attempting to reduce the transaction and opportunity cost to the borrower. The most common adjustments in service terms and conditions observed were for (i) speedy loan disbursement (application to disbursement period reduced from one month to four days by some organizations), (ii) longer installment periods (monthly instead of fortnightly collection), (iii) terms and conditions requiring a lower cash outflow from the borrower, and (iv) delivery channels that incur lower transaction costs for the borrower. Exhibit 13 lists factors identified by MFP management and field staff that are perceived to lend a competitive edge to organizations and their staff.

"Competitive pressure has prompted a number of MFPs to adjust their products and processes to better meet client preferences"

<table>
<thead>
<tr>
<th>No.</th>
<th>Factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Speedy Loan Disbursement</td>
</tr>
<tr>
<td>1.1</td>
<td>Smaller groups</td>
</tr>
<tr>
<td>1.2</td>
<td>Efficient loan processing system</td>
</tr>
<tr>
<td>1.3</td>
<td>Simple paperwork and documentation from loan applicant</td>
</tr>
<tr>
<td>2</td>
<td>Lower Opportunity Cost to Borrower</td>
</tr>
<tr>
<td>2.1</td>
<td>Monthly instead of bi-monthly group meetings</td>
</tr>
<tr>
<td>2.2</td>
<td>Savings are not compulsory</td>
</tr>
<tr>
<td>3</td>
<td>Lower Transaction Cost to Borrower</td>
</tr>
<tr>
<td>3.1</td>
<td>Process and installment payment easier for borrower</td>
</tr>
<tr>
<td>3.2</td>
<td>Branch office located near target market</td>
</tr>
<tr>
<td>3.3</td>
<td>Borrower does not require compulsory insurance plan</td>
</tr>
<tr>
<td>3.4</td>
<td>Service provided at client’s doorstep</td>
</tr>
<tr>
<td>3.5</td>
<td>Lower interest rate and fee</td>
</tr>
<tr>
<td>4</td>
<td>Range of Services Provided by MFP</td>
</tr>
<tr>
<td>4.1</td>
<td>Insurance for both borrower and spouse</td>
</tr>
<tr>
<td>4.2</td>
<td>Range of financial services under one roof</td>
</tr>
<tr>
<td>4.3</td>
<td>Saving facility</td>
</tr>
<tr>
<td>5</td>
<td>Larger Loan Size</td>
</tr>
<tr>
<td>5.1</td>
<td>Larger first loan</td>
</tr>
<tr>
<td>5.2</td>
<td>Larger increments between loan cycles</td>
</tr>
<tr>
<td>6</td>
<td>Corporate Image and Awareness</td>
</tr>
<tr>
<td>6.1</td>
<td>Perceived as permanent</td>
</tr>
<tr>
<td>6.2</td>
<td>Perceived as trustworthy</td>
</tr>
<tr>
<td>6.3</td>
<td>Target population has a high awareness of the MFP</td>
</tr>
<tr>
<td>6.4</td>
<td>Cooperative staff, especially at the time of repayments</td>
</tr>
</tbody>
</table>

Source: Interviews with MFP management and branch office staff, September 2006
Although adjustments to the terms and conditions offered by MFPs meet client preferences better, they expose service providers to greater risk, unless the risk control lost by weighing the product terms and conditions in favour of client preference are coupled with stronger internal control and risk management measures (Exhibit 14).

Exhibit 14: Client Preference versus Risk Management

**Client Preference Characteristics**
- Larger loan size: Start with maximum amount able to pay
- Longer installment period
- Flexible terms, preferably longer
- Quick loan disbursement: simplification of loan application and loan approval procedures
- Low transaction costs
- Groups de-emphasized or made smaller
- Some flexibility on late repayments
- Diverse products for different needs
- Parallel loans for different purposes

**Risk Management Characteristics**
- Low percent working capital
- Frequent payments, short installment periods
- Standard, short loan terms
- Thorough and comprehensive loan application and approval procedures
- High transaction cost
- Groups mechanisms considered an integral substitute to collateral
- Close follow through on late payments
- Rigid, standardized products
- Some flexibility on late repayments
- One loan at a time


Some Borrowers are Expanding Their Credit Limits... by Borrowing from Multiple Sources

A series of focus groups discussions with active borrowers in high-concentration areas revealed that the overriding attribute against which they rank the microcredit services of competing MFPs is "loan size" (Exhibit 15).
As mentioned earlier, 95% of active borrowers in Lahore are GBL borrowers. The maximum amount lent to a borrower by any MFP as a GBL is Rs35,000 (Exhibit 9) with the typical loan averaging around Rs12,000. The majority of GBL borrowers interviewed felt that the loan they were able to get from any one MFP was inadequate to meet their need for financing. As a result of the mismatch between loan size needed and credit amount available, borrowers in areas where multiple MFPs operate have begun to patch together loans from several MFPs. As of September 2006, frontline staff (loan officers and branch managers) interviewed during the study estimated that as many as 20–40% of active borrowers in high-concentration zones had taken loans simultaneously from more than one MFP. Randomly selected borrower groups from different MFPs in a number of high-concentration areas within Lahore estimated that 50–75% of borrowers in their community were patching loans from multiple MFPs. We can safely conclude that patching loans from different MFPs is a common practice among borrowers of GBLs in high-concentration zones of Lahore, although the sample size was not large enough to estimate the total percentage of multiple borrowing in Lahore.

Although this study was exploratory by design, the research team’s interaction with GBL borrowers in high-competition areas indicated that, in most cases, larger loans were patched together to enhance the existing business of a borrower, i.e., for a productive purpose. Furthermore, the borrowers sampled appeared to be cognizant of their repayment capacity. Indirectly supporting the claims of these clients were MFP frontline staff who did not report a significant increase in delinquency, despite the fact that the research team came across clients who were simultaneously managing as many as five obligations (loans from MFPs and saving installments to rotating savings and credit associations [ROSCAs]) from different organizations all at once.
It is important to state here that, although multiple borrowing per se is not injurious to client or MFP, it is important to recognize and be able to distinguish between "opportunity-driven" and "distress-driven" multiple borrowing. Opportunity-driven multiple borrowing presents positive prospects for both client and MFP. Distress-driven multiple borrowing, on the other hand, can result in over-indebtedness for the borrower and repayment problems for the MFP. The supply-side challenge is the ability to distinguish between the two.

Interviews with borrowers revealed that, in the short run, a potential borrower requiring a larger loan than that offered by an MFP is likely to take one of three courses of action: (i) forgo borrowing, (ii) take multiple loans, or (iii) postpone fulfilling his or her credit need until he or she graduates through several loan cycles, since all MFPs lend on the "step-credit" principle (Exhibit 16). It appears that the practice of taking parallel loans from different MFPs is driven by a certain rigidity in loan sizes offered as GBLs in general, coupled with the presence of "mature" clients who need to graduate to higher loans but do not meet the eligibility criteria for the individual loan products offered by a few MFPs (Box 4). Driven by this market "ossification", clients have chosen to take the route made available to them by the presence of multiple lenders within the vicinity: accessing multiple credit providers to patch together loans to meet their higher credit requirement.

Exhibit 16: Typical Decision Options for Borrower Offered Loan Amount Less than Amount Needed

Source: Participatory rapid appraisal (PRA) discussion with GBL borrowers in high-concentration areas in Lahore (September 2006).
Box 4: Need for Larger Loans

**Borrower I:** "It costs Rs70,000–80,000 (US$1,167–1,333) to buy a buffalo. MFP X should increase its loan amount to at least Rs50,000 so that I can realistically manage to buy a buffalo by adding my savings and borrowing from relatives."

**Borrower II:** "When I began borrowing from MFP X in 1999, I could look forward to a larger loan amount in the following years. The first few loans I took five years ago hardly amounted to anything. I could not use the money for anything substantial and it was spent in the house. But after that, when I was eligible for a Rs25,000 loan, I clubbed the money together with some of my son’s savings and we bought a rickshaw. Now, my son drives the rickshaw and brings home about Rs200–300 every day, minus the cost of fuel. Until the loan was large enough to fulfill my requirement, it was used up in other household expenditure. Now my second son would like to invest in drilling equipment, which costs Rs 100,000. No credit provider in this area is willing to lend that amount to me. In fact, I have found out from a number of organizations in the area that none of them are willing to give loans in excess of Rs30,000."

**Borrower III:** "I took multiple loans because I needed a larger amount of money. My husband drove a rented rickshaw, and we wanted to buy it so that we could keep for ourselves the amount paid in rent to the owner. For this, we needed Rs50,000 (US$833). I went to MFP X for a larger loan but they said that they could not give me more than Rs25,000 (US$416). The only solution was to take a loan of Rs25,000 on my own name and simultaneously ask my sister to apply for a similar loan in her name. We have both borrowed from MFP X. My husband and I pay the installments on both loans, but my sister submits the installments due on the loan she has taken for me. After this year, when both loans are paid off, our income will rise substantially."

*Source: Interviews and PRA discussions with MFP borrowers (September 2006).*

Multiple borrowing can be as pervasive as the estimates above imply if a large proportion of the market needs as well as has the opportunity to take multiple loans. In Lahore, it seems the market has reached this stage. Although most MFPs have a formal policy of not lending to active borrowers of other MFPs, given that there are currently no formal or informal client information exchange systems in the Lahore market, the effective implementation of this policy is questionable and, if pursued vigorously, would likely lead to borrowers hiding existing loans from lenders. Judging from the reportedly high extent of overlap and pervasiveness of multiple borrowing, it is important for the Lahore-based MFPs to carefully weigh the pros and cons of participating in a formal information exchange mechanism for the sector.
Conclusion

Rapid expansion of microfinance in Lahore has resulted in a number of benefits. Of these, the most noticeable is the increase in microcredit outreach, largely as a result of organizations expanding to untapped areas outside Lahore, but also because some MFIs have shifted toward segmented market penetration in Lahore. Another upside of this expansion has been the push within all MFIs toward more client-responsive processes and greater efficiency in service delivery. Individual MFIs have responded to both elements—client responsiveness and efficiency—in varying degrees depending on factors such as internal capacity and organizational philosophies, etc. The results have, however, translated into lower overall transaction costs for most existing borrowers, e.g., fewer group meetings and additional credit products (including emergency loans, education loans, and housing loans).

At the same time, it can be argued that the push for growth has inadvertently led some MFIs and their staff to begin to “cut corners” in methodology and processes, increasing the overall risk profile of their respective organization. The potential risk for the MFI (and indeed the microfinance sector as a whole) is amplified by the fact that microfinance clients in Lahore are learning to maneuver around the risk-mitigating policies and systems put in place by MFIs. Simultaneously, a limited number of borrowers have developed an undesirable and exploitative middle tier in the credit access process, eroding the benefit from increased competition for clients, e.g., group-leaders-turned-commission-agents charge a fee for providing access to credit, increasing the total financial cost for the end borrower.

To harness the benefits of this expansion in the long run, individual MFIs as well as the microfinance sector as a whole can take several steps to mitigate the accompanying risks, and ensure that further expansion by the sector occurs alongside implementation of healthy practices, benefiting not only the end clients but also protecting MFIs’ individual and collective futures.

Microfinance Providers

Focus Expansion in Untapped Markets

To offset the competitive pressure arising from the geographic overlapping of microfinance operations, MFIs operating in Lahore could pursue further expansion by: (i) diversifying their portfolios to service less competitive market segments in an existing area of operation, and/or (ii) seeking out new un-serviced areas within or outside Lahore. Both options have their pros and cons. The former will enable MFIs to deepen penetration in a locality by meeting the needs of a varied client base, strengthening its local presence. However, this approach will simultaneously require organizations to make substantial investment in research and development and modify organizational procedures, processes, and human resources to service a new type of client and manage new products. The latter strategy will enable organizations to roll out existing products and attain scale more quickly, in addition to mitigating risks of over-indebtedness through multiple borrowing. However, this approach will simultaneously require organizations to strengthen organizational capacity to run decentralized operations across expanded geographies. Both strategies present the opportunity of accessing un-served clients in addition to the advantage of a reduced probability of confrontational behavior between MFIs as a result of sharing a limited market within high-concentration zones.
Invest in More Effective Marketing Capabilities

Knowing the market and its demands is an MFP's first line of defense against competition. Using effective marketing and awareness raising techniques can improve the overall performance of staff by reducing the effort required of each loan officer to mobilize new clients. Moreover, improving awareness among clients on aspects of access, pricing, products, and procedures can, over time, mitigate opportunities for rent-seeking individuals charging an extra price from borrowers, and reduce credit and operational risk for the MFP. It is safe to conclude that MFPs need to invest more in the following marketing areas: (i) analyzing client preferences, (ii) clearly demarcating client segments, (iii) building awareness of products offered, and (iv) positioning one's organization for more efficient access to clients.

Institute Stronger Internal Control Systems

MFPs are strongly encouraged to invest time and resources to strengthen internal control systems, policies, and procedures for sustainable expansion of the organization, both across geographies and market segments. In markets where competitive pressures push MFPs to adjust the terms and conditions of services offered in favor of borrowers' preferences, or where staff begins to feel pressurized to meet its performance goals, maintaining the integrity of the internal control systems (including risk management systems, checks and balances put in place, and strong internal audit) becomes key to efficient and sustainable operations. For example, MFPs may wish to do more to ensure that more than one staff member monitors group meetings, that from time to time the loan portfolios of loan officers are rotated, and that random checks are carried out by internal audits of groups and individual borrowers.

With regard to multiple borrowing, it is not recommended that MFPs prohibit multiple borrowing; this only serves as incentive for borrowers to hide information from MFPs. It is, however, advisable for MFPs to document and be aware when their borrowers are borrowing from other MFPs and that they use this information to mitigate their own as well as their client's risk.

The Collective Microfinance Industry

Build and Coordinate Information Sharing Systems

Information systems, including a credit bureau, for sharing client credit status/history between MFPs can help track (if not minimize) the risk to an MFP from multiple borrowing. In doing so, it can supplement MFPs' internal control systems and balance the observed increase in risk as competitive pressures begin to favor client preferences against risk management principles, and clients discover increased opportunities for parallel borrowing from multiple organizations. This might initially begin as a simple crosscheck system whereby different MFPs can inquire about the borrowing history of specific clients, perhaps through the use of their computerized national identity card (NIC) numbers. This interim solution may be necessary before more advanced complete credit bureau systems are available in Pakistan. Clearly, there is also a need to include more than just MFBs in a single credit information sharing system as both MFBs and other non prudentially regulated entities—specialized MFIs, NGOs and RSPs—lend to many of the same borrowers.

Invest in and Coordinate Consumer Protection Strategies

MFPs and the sector as a whole can also do more in the interests of consumer protection through efficient awareness raising and marketing to ensure that the benefits of growth and competition are sustained over time and that the rising levels of competition not only provide effective choice to borrowers but also increase outreach more effectively. As microfinance expands, it will become more visible and this can raise the costs and risks to borrowers and MFPs from individuals and civil society representatives. There is also heightened danger that expansion pressures will push some MFPs into unsavory disbursement or collection practices
that could damage clients or even the microfinance industry as a whole. Coordinated efforts to legitimately inform and protect consumers will be critical to the sustained long-term expansion of microfinance and retaining its positive public perception.

Today, Lahore is home to the fastest expanding district-level microfinance market in Pakistan. While microcredit provision is expanding rapidly, total market coverage is only 13% in the district. As resident MFPs expand faster and new organizations enter the district, competitive pressure is likely to intensify over the coming years. Measures taken now by individual players and the sector as a whole will determine the ultimate outcome for the district’s 870,000 potential borrowers as well as MFPs.

---

13 Given that many borrowers are patching together loans from multiple lenders, the actual penetration is likely to be less than 13%.
Annexes
### Annex A: Microcredit Products and Services Available in Lahore

<table>
<thead>
<tr>
<th>Product Attribute</th>
<th>MFP A</th>
<th>MFP B</th>
<th>MFP C</th>
<th>MFP D</th>
<th>MFP E</th>
<th>MFP F</th>
<th>MFP G</th>
</tr>
</thead>
<tbody>
<tr>
<td>Application to disbursement time</td>
<td>20–25 days</td>
<td>15 days</td>
<td>10–15 days</td>
<td>30–45 days</td>
<td>21–35 days</td>
<td>10 days</td>
<td>8 days</td>
</tr>
<tr>
<td>Collateral/ guarantee required</td>
<td>General loan (GL) and emergency loan (EL) = social collateral Business sarmaya (capital) loan (BSL) = 1 personal guarantee</td>
<td>No collateral/group guarantees SBF = 1outside guarantee</td>
<td>Group guarantees</td>
<td>Group guarantee Individual lending = 2 guarantors</td>
<td>Group guarantee</td>
<td>Group guarantee</td>
<td>Group guarantee</td>
</tr>
<tr>
<td>Duration of loan</td>
<td>GL: 1 year EL: 6 months BSL: 1 year</td>
<td>12 months</td>
<td>12–18 months</td>
<td>18–24 months</td>
<td>&lt; Rs15,000: 1 year &gt; Rs15,000: 15–18 months</td>
<td>10–12 months</td>
<td>11 months</td>
</tr>
<tr>
<td>Repayment periodicity</td>
<td>GL: bimonthly in 1 year EL: bimonthly in 6 months BSL: monthly</td>
<td>General clients = bimonthly Good clients = monthly</td>
<td>Monthly</td>
<td>Monthly</td>
<td>Monthly</td>
<td>Generally = equal monthly Agricultural loan = paid back all at once (bullet) Livestock loan = equal monthly or bullet</td>
<td>Monthly</td>
</tr>
<tr>
<td>Grace period</td>
<td>None</td>
<td>None</td>
<td>Productive loan = 1 month Others = none</td>
<td>None</td>
<td>10–12 days</td>
<td>None</td>
<td>7 days</td>
</tr>
<tr>
<td>Product Attribute</td>
<td>MFP A</td>
<td>MFP B</td>
<td>MFP C</td>
<td>MFP D</td>
<td>MFP E</td>
<td>MFP F</td>
<td>MFP G</td>
</tr>
<tr>
<td>-------------------------</td>
<td>--------------------------------------------</td>
<td>--------------------------------------------</td>
<td>--------------------------------------------</td>
<td>--------------------------------------------</td>
<td>--------------------------------------------</td>
<td>--------------------------------------------</td>
<td>--------------------------------------------</td>
</tr>
<tr>
<td>Loan size</td>
<td>GL: Rs6,000-35,000</td>
<td>Protectiveloan:</td>
<td>Rs8,000–12,000</td>
<td>Enterprise loan:</td>
<td>Min. amount:</td>
<td>Working capital</td>
<td>Rs10,000–30,000</td>
</tr>
<tr>
<td></td>
<td>EL: Rs2,000–4,000</td>
<td>Rs3,000–8,000</td>
<td>Rs13,000–18,000</td>
<td>Rs500–25,000</td>
<td>Rs1,000</td>
<td>loan: Rs3,000–10,000 (1st cycle)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>BSL: Rs50,000–100,000</td>
<td>Productive loan:</td>
<td>Rs19,000–25,000</td>
<td>Liberation loan:</td>
<td>First cycle max.:</td>
<td>Asset purchase loan:</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Livestock finance:</td>
<td></td>
<td>Education loan:</td>
<td>Repeat max.:</td>
<td>(Rs3,000–10,000 (1st cycle)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Rs30,000–70,000</td>
<td></td>
<td>Rs500–20,000</td>
<td></td>
<td>Agricultural loan:</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>SBF: Rs26,000–50,000</td>
<td></td>
<td>EL: Rs500–5,000</td>
<td></td>
<td>(Rs3,000–10,000 (1st cycle)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Microleasing: up to Rs150,000</td>
<td></td>
<td>Housing loan:</td>
<td></td>
<td>New product loan:</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Savings: min, account of Rs50</td>
<td></td>
<td>Rs5,000–100,000</td>
<td></td>
<td>(Rs5,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Insurance: outstanding loan + Rs3,500 in</td>
<td></td>
<td>Marriage loan:</td>
<td></td>
<td>Max. loan:</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>case of death</td>
<td></td>
<td>Rs10,000–20,000</td>
<td></td>
<td>Rs30,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Health loan:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Rs500–20,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Access requirement</td>
<td>GL = group meetings</td>
<td>Group membership, weekly meetings/</td>
<td>NIC number/ group membership</td>
<td>NIC number only</td>
<td>5 weeks compulsory savings</td>
<td>NIC/current address should be permanent</td>
<td></td>
</tr>
<tr>
<td></td>
<td>BSL = none</td>
<td>savings account/ guarantees</td>
<td></td>
<td></td>
<td>For repeat borrowers, 60% of business of</td>
<td>address/two family members cannot be in</td>
<td></td>
</tr>
<tr>
<td></td>
<td>EL and savings available for active GL</td>
<td></td>
<td></td>
<td></td>
<td>the previous cycle must still be</td>
<td>the same group</td>
<td></td>
</tr>
<tr>
<td></td>
<td>clients</td>
<td></td>
<td></td>
<td></td>
<td>functioning</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Insurance available to GL clients and their</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>main income earners</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product Attribute</td>
<td>MFP A</td>
<td>MFP B</td>
<td>MFP C</td>
<td>MFP D</td>
<td>MFP E</td>
<td>MFP F</td>
<td>MFP G</td>
</tr>
<tr>
<td>-------------------------------------------------------------</td>
<td>--------------------------------</td>
<td>--------------------------------</td>
<td>--------------------------------</td>
<td>--------------------------------</td>
<td>--------------------------------</td>
<td>--------------------------------</td>
<td>--------------------------------</td>
</tr>
<tr>
<td>Price</td>
<td>GL: 36% SBF: 40%</td>
<td>GL: 37%</td>
<td>33%</td>
<td>10%</td>
<td>30%</td>
<td>20%</td>
<td>45%</td>
</tr>
<tr>
<td>Effective interest rates (include nominal interest plus other fees)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Late payment penalties</td>
<td>Rs50 per day up to a maximum of 1 loan installment amount</td>
<td>Payments have to be made by 11am After 1pm late fee: Rs100 After 2pm late fee: Rs200</td>
<td>Built in the interest rate, the longer the payment is delayed the more the interest that accumulates. Daily interest.</td>
<td>None</td>
<td>None</td>
<td>Have to pay interest for the extra days taken</td>
<td>Rs100</td>
</tr>
<tr>
<td>Prepayment incentives</td>
<td>None</td>
<td>None</td>
<td>None</td>
<td>None</td>
<td>Service charge (interest) decreased</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Promotion</td>
<td>Through loan officers, door-to-door, word of mouth</td>
<td>Prospecting, word of mouth, group meetings</td>
<td>Social mobilization/ group meetings</td>
<td>Word of mouth/at mosque/current clients considered best marketers</td>
<td>Field visits/door-to-door visits/savings meetings</td>
<td>Prospecting in new area, at group meetings/word of mouth</td>
<td>Prospecting in new areas/group meetings/word of mouth</td>
</tr>
<tr>
<td>Advertising</td>
<td>Brochures</td>
<td>Brochures</td>
<td>Brochures</td>
<td>None</td>
<td>Brochures</td>
<td>Brochures</td>
<td>Brochures/ repayment schedule print-outs</td>
</tr>
</tbody>
</table>

The Dynamics of Microfinance Expansion in Lahore
<table>
<thead>
<tr>
<th>Product Attribute</th>
<th>MFP A</th>
<th>MFP B</th>
<th>MFP C</th>
<th>MFP D</th>
<th>MFP E</th>
<th>MFP F</th>
<th>MFP G</th>
</tr>
</thead>
<tbody>
<tr>
<td>Place of disbursement of credit by MFI</td>
<td>Cheques issued at community center</td>
<td>Branch</td>
<td>Field office</td>
<td>Mosque/church/religious center</td>
<td>District office (bank used: First Women Bank) “Borrowers Card” issued at field office</td>
<td>Group meetings</td>
<td>Branch office</td>
</tr>
<tr>
<td>Place of repayment by borrower</td>
<td>Deposits made at local bank For BSL pilot testing, repayments to be made at the branch</td>
<td>Branch</td>
<td>Field office</td>
<td>Mosque/church/religious center</td>
<td>Field office: received in cash and receipt issued</td>
<td>Group meetings</td>
<td>Preferred at branch office. At some branches, deposit slips are given at group meetings which members fill and deposit money in banks.</td>
</tr>
<tr>
<td>Slogan/vision</td>
<td>Vision: “A prosperous world with financial services for all”</td>
<td>&quot;Asah: hum sab ka&quot; Slogan for 2006: “Think and get success”</td>
<td>None</td>
<td>&quot;Uplifting the poor through interest-free financing&quot;</td>
<td>None</td>
<td>None</td>
<td>None, however, in the process of developing one</td>
</tr>
<tr>
<td>Corporate image</td>
<td>Reliable, trustworthy, convenient, efficient</td>
<td>Trustworthy</td>
<td>Socially responsible, want to help people improve their economic activity/standing</td>
<td>Helping society fulfill its responsibility of assisting the less fortunate</td>
<td>Want to help people stand on their own feet</td>
<td>Backed by the Government of Pakistan</td>
<td>Good customer service/cares about community</td>
</tr>
<tr>
<td>Product image</td>
<td>Minimal paperwork, commitment to repeat loans for needy borrowers, speedy disbursement</td>
<td>Beneficial for improving economic status</td>
<td>Most economical loan in the microfinance market, no interest, low service charges</td>
<td>Smaller groups/savings remain with group members and are not taken by the MFI</td>
<td>Decreasing interest rate</td>
<td>Business counseling included, provide training</td>
<td></td>
</tr>
</tbody>
</table>
Annex B: Case Studies

B.1 Commission-Based Intermediaries

Batool Bibi

Batool Bibi of Thokar Niaz Baig is familiar with a number of MFPs operating in the area and well-acquainted most of the resident women. This has made her a useful link between MFPs and their clients. So far, she has facilitated the formation of six or seven centers for MFP A, three centers for MFP C, one center for MFP D, one for MFP E, and two for MFP F. For MFP B alone, she has helped form five or six groups comprising 15 women each.

Commission Charged

She claims that she does not receive any payment from the MFPs for her services, and recalls that she had claimed no payment for the first group she had helped form (comprising 15 women from Bakar Mandi). Thereon, she has formed many groups, charging Rs200 per borrower.

Areas Covered

Batool Bibi not only covers the area in which she lives, she also travels at her own expense to nearby towns where her neighbors’ relatives live. She persuades them to form borrower groups too, and connects them to nearby MFPs. She undertakes the cost of accessing and gathering these potential borrowers, who then pay her Rs200 each when they are finally awarded their loan.

Career Prospects

Batool Bibi keeps the MFP’s forms with her but does not fill them in for borrowers. When asked whether she would like to accept employment with the MFP, she initially appears confused since she cannot take such a step without discussing it with her family. However, she feels she could do the job quite well and would expect a salary of around Rs5,000. She says the job would involve chasing repayments, pleading with clients, and being reprimanded by staff for late repayments. In her own words, “The institutions give so much money; they should also know that if the agents are not out in the front, how will the institution work?”

Ground Realities

Describing the hard times she has faced while working for MFPs, she recollects an incident where one of MFP B’s staff member left the institution, apparently taking some money with her. Since Batool Bibi was in charge of the groups, she was held responsible for the confusion whereas it was the staff member who had collected the repayments who should have been held accountable.

Competition Viewed by an Agent

With her diverse experience with different MFPs in her area, she thinks that MFP A has the largest client base in spite of being new. Stating the reasons for its success, Batool Bibi says, “They don’t even take a week [in disbursement], on the other hand, MFP B takes a whole month.”

14 Real names have not been quoted due to the expectation of confidentiality established between the interviewer and the research team.
MFP A gives out bigger loans and larger increments in each successive cycle. She believes that these attributes help MFP A maintain its popularity even if it is known for its stringent rules and strict staff.

Concerning the reward for her work, she narrates, “These people do not even offer me a glass of water. I have worked with ‘MFP X’ for six months, collected loan installments, and introduced new members. I have done a lot of work for this institution, but I don’t know how it will deal with me. It has been four months, and they haven’t given me a loan.”

**Sarah Mushtaq**

Sarah Mushtaq is known in her area for her public relations both with residents and MFPs. She knows all the institutions operating in her area. “We go to MFP A as well as MFP B. Now there is MFP C too. There are three or four more institutions out there.” About her own loans, she states, “I have borrowed from MFP A and MFP B. I’ve been taking loans from MFP A for the last six years. Now I have one from MFP B too.” MFP B made use of her public relations skills, appointing her center manager for five groups comprising five women each. She also serves as MFP A’s center manager for 25 women.

**Agent’s Role in the Lending Process**

Sarah recalls her early days as an agent: “Women would initially come to me [as potential borrowers]. We would then meet a staff member from MFP B, and persuade her that this could be a center. She would approve on condition of my own. I would do so because we are all like one family.”

Sarah now meets potential borrowers, points out their needs, persuades them to take loan, and then completes the MFP’s forms for them. She follows this exercise for both MFPs. In MFP A’s case, the organization itself contacted Sarah. “They selected people with good records [as agents], and then asked them to help.”

Since Sarah brings people to the MFPs, their staff treats her better than they treat other borrowers. She is asked to act as guarantor for new borrowers and collect their repayments for the MFP. She is aware of the consequences if somebody’s repayment is delayed, “If someone won’t pay, I’d be questioned and made to pay for them.” She also plans to contact MFP C and offer her services to them but feels she is currently too involved with MFP B.

**Agent’s Compensation**

She charges new borrowers Rs200–300 for each loan from either of the two MFPs: “It’s only a one-time payment. I keep this amount with me and add it to people’s installments if they are short of money.” Normally, she retains this amount as a service charge, claiming it as compensation for the time and money she spends in traveling and assisting borrowers in taking loans.

Sarah is aware that she gets a great deal of the MFP’s work done and the staff member at MFP B acknowledges her services by discounting Sarah’s repayment. “She (credit officer) says she’ll reduce my installment to half if I submit all my center’s installments in time. That is the incentive.” When asked whether she plans to take up a job with one of these MFPs, Sarah appears quite willing to do so. She says she would accept the job at a minimum salary of Rs3,000.

**Competition among Agents**

Sarah has rivals in her area too. “There are three of us: Razia, Hameeda, and myself. We often quarrel with one another. I had a heated argument with Razia once. It happens all the time. Whatever is written in our fates has to happen one day.” All three women are well known in the vicinity. People refer their relatives and friends to them as well.
Choices Available

The residents of her area, she believes, have a wide menu of institutions to choose from. "Most of them borrow from MFP A. With MFP B, they can only borrow more when their earlier loans have been cleared. So they sometimes borrow from MFP A and sometimes from MFP C."

Sarah is quite clear on MFP A’s being more popular than MFP B among her center members at the latter. When asked why they have borrowed from MFP B, she explains, "They are borrowing from both MFP B and MFP A. I’ve told you earlier that poor people like us are compelled to borrow money to survive. Our needs have no end."

She says that people borrow from multiple MFPs when they find it difficult to repay their earlier loans.

B.2 Borrowers Borrowing from Multiple Sources

Talat Nazir

A small home-based shop in the southern suburbs of Lahore speaks volumes of Talat Nazir’s entrepreneurial abilities. This unnamed but profitable shop sells cottonseed oil cakes and groceries to its community. Cottonseed oil cakes, which are used in animal fodder, make up a major chunk of her inventory. All day long, Talat manages her shop’s transactions like any vigilant businesswoman. She also manages her home and four children: two sons and two daughters.

Talat’s first encounter with microfinance was through MFP Z, five years ago. She took a loan of Rs5,000, but this small amount simply went toward household consumption. She then had some trouble taking loans in later cycles because her record with MFP Z showed some late repayments. She was not responsible for these delays herself as it was her parents who had borrowed against her card. Talat worked around the problem by borrowing against her neighbor’s card—a fairly common practice—and is quite regular about her repayments against this card.

This led her to look for other avenues, on which she discovered MFP Y. Talat took her first small loan from MFP Y while still owing repayments to MFP Z because the latter had refused her application for a bigger loan. Instead of using MFP Y’s first loan, she passed it on to a friend. When she was promoted to the bigger loan cycle, she borrowed Rs10,000 from MFP Y and invested the money in her shop.

With her initial smaller loans from MFP Z, she bought cloth for sale door-to-door: "I bought cloth because it was Eid. I did not earn much on selling it because women were apt to bargain a great deal." Her husband, who works at a nearby garment factory, did not like her idea of door-to-door selling and suggested she establish her own shop at home. This is when Talat started looking for bigger loans. "I asked MFP Z for a larger loan, but I was told I could only get it once my earlier installments had been fully paid. That is why I took the other loan from MFP Y because I was short of money. One cannot build a shop with Rs4,000." Multiple borrowing was the only choice Talat was left with. Ambitious as she was, she was certain her shop would be able to pay back enough for the repayments.

Talat had participated in the local ROSCA with her savings of about Rs300 per month. After getting some money from the local ROSCA, she added her MFP Y loan to it and finally started her shop. It is evident from the way she talks about her finances that she handles her shop inflows and outflows quite deftly. "Of the daily sales at my shop, I put aside Rs100. I use the rest, Rs300 or 250, for shop goods. For oil seed cakes, I keep apart Rs1,000 separately. Whatever is left goes toward children’s sweets, about Rs300 or 400."
Her efforts are already bearing fruit and her shop is earning enough to cover her repayments to MFP Z, MFP Y, and ROSCA. She maintains separate accounts for installments and ROSCA payments and buys inventory with the rest of the money. She uses only Rs800–1,000 of her husband’s income if she is ever short of money for repayments. If the inventory level increases as she has planned, Talat is sure she will soon be able to make sufficient profits while paying all the installments and expenses from the revenue.

Talat is fairly satisfied with her new experience with MFP Y. Her only objection is toward the bimonthly meetings. “MFP Y has a meeting twice a month, which lasts from 10 am to 2 pm. This affects my shop since I have to close it down, which I dislike having to do. I sit at my shop from morning till evening. Whatever I save is wasted in the one day I have to go to MFP Y,” she complains.

When asked if she knows other women around her who have taken multiple loans, she says, “Yes, many have because one side only gives us Rs10,000 and people who want to start a bigger business cannot do so with only Rs10,000.” She also added that people do not usually take multiple loans for household consumption. She says she needed multiple loans for her business, which she knew would be able to pay for itself. Her center members are unaware of her multiple borrowing but some of the staff at MFP Y knows. She has never told anyone at MFP Z about her new loan from MFP Y after being warned by a neighbor that MFP Z did not entertain multiple borrowers. She still believes MFP Z suits her better because of their less frequent meetings. Also, since she is in a more mature loan cycle with MFP Z, she expects to get a bigger loan from the MFP this time around.

Now that her shop is running smoothly, Talat wants to increase its inventory by taking another loan, this time of Rs20,000 from MFP Z. She thinks she has more space than her stock needs and could utilize it effectively for more inventories. Her take on this is very businesslike, “I take care of the shop whole day long, so I want my shop to be filled up all the time. I don’t want any customer to go empty-handed.” Microfinance services are clearly raising this ambitious woman’s aims and hopes.

Zainab Yasin

Pakistani society is generally perceived as male-dominated, but Zainab Yasin’s home affairs indicate clearly how some women are in complete control of their domain. Zainab controls the entire economy of her household. With five sons and two daughters, she has her hands full with her children’s healthcare and education, and utility bills and money matters; her husband works out of town at a textile mill in Rawalpindi and visits home only once a week. The family’s income is entirely at Zainab’s disposal and she spends it as she sees fit.

Zainab’s family is considered better off than most people in the area. Her husband has spent fifteen years in Dubai earning for his family. Both Zainab and her husband have accounts at Habib Bank where they keep their savings. Zainab says she manages to save about Rs10,000 a month. Her children are also earning members of the household. She speaks fondly of them: “One of my daughters is doing her BA and learning to use a computer. My sons have all matriculated. Some are working, and some have continued studying, although they too work and earn. One of my sons is in Grade 10; he works at a petrol pump in the evenings and earns about Rs3,000. Another son works at a Toyota showroom, making car number plates.”

The fact that Zainab had more than one regular source of income encouraged her to delve into multiple borrowing. She eventually took up and managed her portfolio of loans from both MFP Z and MFP Y.

Zainab’s relationship with MFP Z goes back to the organization’s early days. She took initial loan of Rs 5,000, of which she says, “I did nothing with it, and it was simply consumed at home. Then I took a loan of Rs10,000 because my son had had a serious accident. I sold my jewelry too and spent the small amount on his treatment. Then I took a loan of Rs20,000 and we bought an auto rickshaw. It earns very well, up to Rs300 to 400 a day.”
When asked whether the rickshaw purchase was her own decision or her husband's, Zainab says emphatically, "It was my decision and my son's. My husband didn't even know about it since he works in Rawalpindi." She is now repaying the last installments of her latest loan of Rs20,000 from MFP Z and plans to borrow Rs50,000 for her husband to set up his business with. She also plans to invest her ROSCA earnings in the business, because her husband has decided to leave his job and establish a general store.

Her last loan was worth Rs20,000, so she should logically be upgraded to the Rs25,000 bracket. However, she is quite firm in her demand for a larger loan, "I want Rs50,000. If they can't give it to me, I won't borrow from them at all."

From the household consumption of her earlier smaller loans to the rickshaw purchase to now establishing a business, Zainab's portfolio is moving toward more constructive use. Five years after her first loan, she states, "I don't leave my loan card unused. I either use it myself or, if some brother or sister needs it, I borrow money for them. Then I collect their installments and pay here."

There are other MFIs operating in Zainab's area. She has heard about the MFP X but not about MFP Y. She explains that she has been a client of MFP Z and later of MFP Y, where she had borrowed on behalf of a neighbor who needed funds for her daughter's wedding. Zainab is halfway through her first loan cycle with MFP Y and is interested in taking bigger loans from the organization. Occasionally, she has to pay her neighbor's installment if delayed, and recovers the amount from her later. Her multiple income sources mean that Zainab is better off than her neighbor.

The only thing that bothers Zainab is the monthly or bimonthly meetings. She has friends among MFP Z's as well as MFP Y's staff and manages to skip most meetings. Instead, she simply gives her installments to friends who deposit them at their offices. However, she is very regular about her payments and has never missed a single one in the last five years.

She approves of multiple borrowing as long as loans are repaid on time. She says that some women in her area have been able to invest multiple loans in business and repay them from their earnings, but that some use up their loans in household expenditure and then become trapped in repayments.

Zainab's own center at MFP Z does not know about her other loan from MFP Y. MFP Y staff however, are aware of her relationship with MFP Z, in spite of which they have appointed her group leader of five women's group. She collects her group's installments and submits the amount. Her fellow group members have also taken multiple loans. They are not worried about each other's guarantees because they have been neighbors for years and trust each other. The only point of friction among them is the duty of payment at the bank. They have to divide the fare among themselves and need a volunteer to go and pay every time. Sometimes, this turns into a debate but they eventually manage a consensus. Zainab claims that MFP Z is better in this regard than MFP Y since it collects payments at its office and does not require its clients to go to the bank. It also holds meetings less frequently, which suits the women.

Zainab is not familiar with the idea of commission agents as she took her loan directly from MFP Z and MFP Y. She is indifferent to the various MFIs and only concerned with loan size, as she wants a larger loan for her husband's business so that he is not compelled to stay away from home to earn a livelihood.
Annex C: Research Methodology

This annex describes the research methodology used by SBI and PMN to gauge the extent, nature, and impact of rapid microfinance expansion in Lahore.

Research Hypothesis

Expansion in Lahore has enhanced outreach, benefiting microfinance clients in terms of greater access, lower cost, and greater choice of products.

Research Questions

Nature of Expansion
- What is the nature of expansion in Lahore?
- How do MFP management and staff in Lahore perceive the nature of this expansion? Is the resulting competition viewed as complementary or confrontational?

Supply-Side Dynamics of Expansion
- How do MFP management and staff in Lahore perceive the current and future impact of rapid expansion on:
  - The microfinance sector?
  - Their organization?
  - The customer?
- How does the situation affect MFPS' decisions in terms of:
  - Microfinance products offered?
  - Location strategy?
- How do the pressures of increasing competition affect the procedures followed in borrower mobilization, borrower screening and approval, and disbursement of loans?
- How pervasive is multiple borrowing among microfinance borrowers in high microfinance concentration areas?
- Does multiple borrowing pose any risk for the MFP?
  - Does multiple borrowing lead to over-indebtedness?
  - Does indebtedness lead to inability to repay?

Demand-Side Dynamics of Expansion
- To what extent are microfinance clients in Lahore aware of the choices (in terms of products and services, terms and conditions) made available to them by competing MFPs?
- How do clients choose between MFPs?
Scope of Research

Lahore District
The study was limited to exploring the dynamics of microfinance expansion in the district of Lahore. All the MFPs and clients involved in this study were Lahore-based. The study did, however, assess the increasing trend among MFPs to move beyond Lahore.

Focus on Areas with High Concentration of MFPs
From preliminary data collected from MFPs on the location of their microfinance operations in Lahore, we found that most of the microfinance operations of 10 or so MFPs are concentrated in a few areas of the district. It is these areas where MFPs are concentrated that pressures of competition are felt by their field staff and management. The study thus focuses on the demand- and supply-side dynamics of expansion in those areas of Lahore district where microfinance operations are highly concentrated.

Microcredit Focus
Microfinance in Lahore, as in Pakistan as a whole, predominantly implies microcredit. The study therefore focuses on the supply and demand for microcredit.

Exploratory vs. Quantitative
The study of microfinance expansion in Lahore was designed to identify and explore the issues and dynamics of microfinance in the district. The focus of the study was more on qualitative output that could become a basis for future, more in-depth research. The study was designed less for quantitative verification of behavioral dynamics of microfinance expansion in Lahore. The quantitative focus of the research was on longitudinal data:
- the number of new microfinance entrants in Lahore over the period 1996 to 2006,
- the rate of branch rollout over 1996 to 2006,
- geographical concentration of microfinance operation in Lahore,
- number of microfinance products offered by each MFP, and
- terms and conditions offered by competing MFPs in Lahore to attract new clients and retain old ones.

Research Structure and Tools
The study was carried out in three stages:
- preliminary branch and product data collection from MFPs,
- interviews with MFPs’ management and staff, and
- interviews and participatory rapid appraisal (PRA) exercises with clients.
## Stage 1: Preliminary Data Collection from MFPs

<table>
<thead>
<tr>
<th>Research Question</th>
<th>Questions Asked</th>
<th>Research Tool</th>
<th>Methodology</th>
<th>Sample Strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>What are the trends in supply of microfinance in Lahore for the period 1996–2006</td>
<td>Total number of branches in Lahore for each year</td>
<td>Tool 1: Data collection template</td>
<td>Data collection through e-mail</td>
<td>MFPs in Lahore with more than 1,000 active borrowers</td>
</tr>
<tr>
<td>Which areas in Lahore have high microfinance concentration?</td>
<td>Names and addresses of new branches added and old branches shut down in Lahore each year Area name covered by each branch Name of competitor/s in the area of each respective branch Which MFI was the first entrant in the area competed for?</td>
<td>Tool 1: Data collection template</td>
<td>Data collection through e-mail</td>
<td>MFPs in Lahore with more than 1,000 active borrowers</td>
</tr>
<tr>
<td>What types of products and services have been introduced by MFPs during 1996–2006</td>
<td>Number of products offered each year Name and product attributes</td>
<td>Tool 1: Data collection template</td>
<td>Data collection through e-mail</td>
<td>MFPs in Lahore with more than 1,000 active borrowers</td>
</tr>
<tr>
<td>What is the financial service landscape for microcredit in Lahore?</td>
<td>Amount, methodology, and terms and conditions for each product being offered by an MFP Active clients at the time of the study for each product</td>
<td>Tool 1: Data collection template</td>
<td>Data collection through e-mail</td>
<td>MFPs in Lahore with more than 1,000 active borrowers</td>
</tr>
</tbody>
</table>
## Stage 2: Interviews with MFP Management and Staff

<table>
<thead>
<tr>
<th>Research Question</th>
<th>Questions Asked</th>
<th>Research Tool</th>
<th>Methodology</th>
<th>Sample Strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>How does the management of MFPs in Lahore perceive the nature of microfinance</td>
<td>The management’s view on the degree of competition in Lahore currently and in the</td>
<td>Tool 2: Management interview guide</td>
<td>Face-to-face, semi-structured interview</td>
<td>President/CEO/COO of 6 MFPs competing in Lahore</td>
</tr>
<tr>
<td>competition? Do they see it as complementary or confrontational?</td>
<td>near future.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>How does the management of MFPs in Lahore perceive the current and future</td>
<td>Perceived impact/lack thereof on markets, products, pricing, promotion, human</td>
<td>Tool 2: Management interview guide</td>
<td>Face-to-face, semi-structured interview</td>
<td>President/CEO/COO of 6 MFPs competing in Lahore</td>
</tr>
<tr>
<td>impact of microfinance expansion on:</td>
<td>resources, innovations, costs, and loan quality. The degree to which management</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• The microfinance sector?</td>
<td>has taken account of the competition in decisions regarding market identification,</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Their organization?</td>
<td>product, pricing, and technology over the last ten years</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• The customer?</td>
<td>Positioning of MFI in light of competition</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>How does the competition (current and perceived future competition) affect</td>
<td>Management’s awareness of the strengths and weaknesses of its competitors</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MFPs’ decisions in terms of:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Microfinance products offered?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Location strategy?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>How does the field staff of MFPs in Lahore perceive the nature of microfinance</td>
<td>Frontline staff’s awareness of competition, Frontline staff’s perception of the</td>
<td>Tool 3: Guide for interviews with field</td>
<td>Face-to-face, semi-structured interview</td>
<td>Interviews with branch managers and field officers operating in areas where</td>
</tr>
<tr>
<td>competition? Do they see it as complementary or confrontational?</td>
<td>impact of competition, incidence of MFP’s response to competition</td>
<td>officers</td>
<td></td>
<td>microfinance is highly concentrated. Staff from 6 branches in high-competition</td>
</tr>
<tr>
<td></td>
<td>Competitive advantages as perceived by point of view of frontline staff,</td>
<td></td>
<td></td>
<td>areas were interviewed.</td>
</tr>
</tbody>
</table>
## Stage 3: Demand-Side Research

<table>
<thead>
<tr>
<th>Research Question</th>
<th>Questions Asked Regarding</th>
<th>Research Tool</th>
<th>Methodology</th>
<th>Sample Strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>To what extent are microfinance clients in Lahore aware of the choices (in terms of products and services, terms and conditions) made available to them by competing MFPs? How do clients choose between competing MFPs?</td>
<td>Participatory rapid appraisal (PRA)</td>
<td>Relative preference ranking: Describes perceptions of providers and financial services; measures products against competition, and analyzes product features and client preferences.</td>
<td>Group of 6 to 8 mature microfinance borrowers in 3rd or higher loan cycle belonging to the same MFP, from high competition areas</td>
<td>9 PRA groups organized by 6 leading MFPs of Lahore: 7 groups of women borrowers, 2 groups of men borrowers.</td>
</tr>
<tr>
<td>How pervasive is parallel borrowing by microfinance borrowers in high microfinance concentration areas?</td>
<td>Assessment of: - MFP management - MFPs field staff management - Borrower groups organized for PRAs</td>
<td>Questions asked of management, field staff, and borrower groups at or near the end of the main interviews or PRA discussion.</td>
<td>Face-to-face, semi-structured interviews</td>
<td></td>
</tr>
<tr>
<td>Does parallel borrowing by microfinance borrowers from different MFPs pose risk for the MFPs? - Does parallel borrowing lead to over indebtedness? - Does indebtedness lead to inability to repay?</td>
<td>Assessment of key resource persons: - MFP’s field staff management - Center managers</td>
<td>Relevant questions asked of field staff during interviews in Stage 2 and of the PRA groups during the discussion. Tool 5: Interview guide for interviews with the center managers</td>
<td>The center managers were identified from amongst the PRA groups and were taken aside by the assistant moderator for individual interview focusing on the impact of parallel borrowing.</td>
<td>Estimates from all field staff interviewed; 5 PRA groups and 3 center managers.</td>
</tr>
<tr>
<td>Is the use of community resource persons as third-party agents for borrower mobilization increasing the risk to MFPs?</td>
<td>Tool 6: Guide for interviews of freelance agents mobilizing borrowers for commission.</td>
<td>Interviews with the agents were arranged through MFPs.</td>
<td>Interviews with 4 agents</td>
<td></td>
</tr>
</tbody>
</table>
Assess effective choice available to potential borrowers in high competition areas by testing how many MFI's operating in the target area potential borrowers recall.

Random Transit Walk


2 random walks, interviewing 30 people in all.

Source of Access to Credit

Awareness of MFIs operating in the area

Community Support Concern (CSC)

Development Action for Mobilization and Emancipation (DAMEN)

Punjab Rural Support Programme (PRSP)

Urban Poverty Alleviation Programme (UPAP)

Participating Organizations

Research Question

Methods

Sample Strategy

Questions Asked Regarding

Research Tool
Organizational Overview

The Pakistan Microfinance Network (PMN) is an association of organizations engaged in the provision of retail microfinance services. The PMN’s mission is to support retail microfinance providers (MFPs) to enhance their scale, quality, diversity and sustainability in order to achieve inclusive financial services. The PMN serves the microfinance sector through four core functional areas: capacity building, promotion of financial best practices, promotion of an enabling environment, and knowledge management. The PMN represents 19 of the largest microfinance providers in Pakistan. These include 13 NGOs, a commercial bank, four microfinance banks, and a leasing company.

Widening Harmonized Access to Microfinance (WHAM) is a project sponsored by the United States Agency for International Development (USAID) to expand outreach of credit services to the “missing middle” of micro and small enterprises (MSEs) and improve the overall effectiveness of microfinance in Pakistan. To achieve these goals, WHAM, through ShoreBank International Ltd, provides technical assistance to upscale microfinance institutions and downscale commercial banks, and engages in range research and awareness building initiatives for overall strengthening of microfinance industry. WHAM began in 2005 and continues through 2008.

ShoreBank International Ltd. (SBI) is the consulting arm of USA-based ShoreBank Corporation and part of the family of ShoreBank companies (the “ShoreBank Group”) dedicated to working with financial institutions globally to create access to capital for underserved clients and to generate economic wealth within target markets. ShoreBank International’s branch office in Pakistan—registered with the Securities and Exchange Commission of Pakistan (SECP)—is the implementing partner for the USAID-funded WHAM project.