

# Fine-Tuning Advans Pakistan products to increase financial inclusion

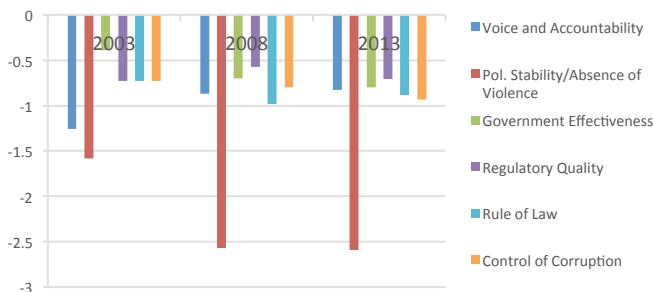
Advans Pakistan

## 1. Development relevance

**Economic and Poverty Context:** The Islamic Republic of Pakistan is a federal parliamentary republic. For years, the country has alternated between electoral democracy and authoritarian military governments. With more than 180 million inhabitants, Pakistan is ranked as the sixth most populous country. Thanks to a young demographic and natural resources, it has a strong economic potential. The economy is mainly based on agriculture (22% of the GDP and 43% of the active population), but also driven by textiles, shipping, and the production of cement and fertilizers. Due to continued security issues, political instability and severe floods such as in 2010, Pakistan's economy is highly vulnerable. The country suffers from low private sector credit, low saving rates and low investment rates leading to underemployment. The government runs large fiscal deficits keeping inflation high and limiting economic growth.

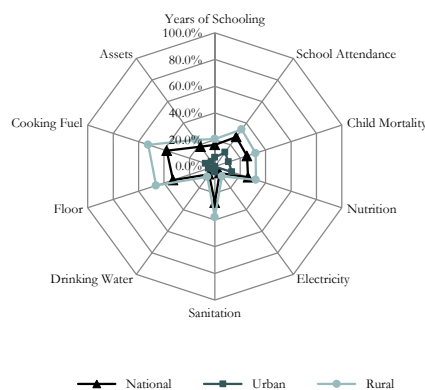
| Economic indicators  |           |
|--|-----------|
| Population (2014, in millions)   | 188       |
| GDP growth (average 2009-2013)   | 4%        |
| Inflation (average 2009-2013)  | 7,7%      |
| Trade balance (% of GDP)   | -7,59%    |
| Foreign Direct Investment (net) (% of GDP)                               | 0,38%     |
| Net official development assistance and official aid received (% of GDP) | 0,9%      |
| Personal' remittances (% of GDP)   | 6,2%      |
| Economic freedom Index (2014)  | 55,2      |
| Poverty indicators   |           |
| GDP per capita (USD)   | 1'257     |
| Multidimensional Poverty Index   | 0,230     |
| National/international poverty rates (2006)                              | 22,3/22,5 |

### GOVERNANCE INDICATORS



**Financial Sector:** Latest available statistics (end of 2013) show that the total outreach of microfinance institutions in Pakistan is of about 2,8 million borrowers and 5,9 million depositors for a total outstanding portfolio of respectively PKR 52 billion (CHF 502 million) and PKR 34,7 billion (CHF 335 million). In 2011, only 1,4% of the population had saved at a financial institution, 1,5% had had a loan from a financial institution during the past year, and 10,3% of the population had a bank account at a formal financial institution. The industry is tiny when compared to the population and to the microfinance development in neighbouring India. With 27,4 million potential borrowers the market is still big. The sector is heavily focused on group lending methodology. Lack of progress was caused mainly due to retrenching after that non-performing loans became an issue in late 2008: MFIs were focusing on the same clients and causing over-indebtedness due to absence of internal controls. Today, 50% of the outreach is through licensed microfinance banks (MFB) that are regulated by the State Bank of Pakistan (SBP), with this number continuously growing. This reveals an increasing professionalism of microfinance players and a strong will of the SBP to improve governance in the sector.

In 2014, Pakistan was one of the poorest countries in the world, with a GDP per capita (PPP) ranking 178<sup>th</sup> out of 229 countries. Pakistan ranks 146<sup>th</sup> in the 2011 UNDP's Human Development Index out of 186 countries, below the regional average. According to the 2013 Doing Business Report of the World Bank, Pakistan ranks 107<sup>th</sup> out of 185 countries in terms of ease of doing business.



% of Population MPI Poor & Deprived OPHI

**Partner financial institution:** Advans Pakistan Microfinance Bank Ltd (Advans Pakistan) was incorporated as a limited liability company in April 2012 and granted a licence to operate as a MFB in the province of Sindh in June 2012. Headquartered in Karachi, Advans Pakistan opened its doors to the public on January 2013 and has since then opened 3 additional branches throughout Karachi, the country's economic and financial capital.

Advans Pakistan's mission is to provide microfinance services adapted to the needs of micro and small Pakistani entrepreneurs, with a focus on urban areas. The range of products offered addresses the "missing middle" existing between clients served by commercial banks on the upper end and clients served by microfinance providers via group lending methodology on the lower end. Contrary to most other MFIs, it focuses on cash-flow based individual lending and offers relatively large loan amounts, with Advans Karobar Sanwaro (micro-loan) and Advans Ba-Ikhtiar (enterprise loan) amounting respectively from PKR 10'000 (around CHF 90) to 150'000 (CHF 1'400) and from PKR 150'001 to PKR 500'000 (CHF 4'600). The bank provides current accounts, saving accounts and term deposits, along with chequebooks. As evidenced by the low average deposit balance (around CHF 50), its deposit products are well adapted to the low-income population, with no entry barriers, good quality of services and limited fees. Since the launch of operations in January 2013, 1'412 loans have been disbursed and 2'639 deposit accounts opened. Based on an in-depth market study carried out in Q1-Q2 2014, the bank is considering the introduction of various additional services such as ATM cards, domestic transfers and mobile banking. It was awarded the "Pricing Transparency" Award from the Pakistan Microfinance Network and the Microfinance Transparency Initiative.

| Advans Pakistan                   | 2013 (Jan) | 2013 (Dec) | 2014 (May) |
|-----------------------------------|------------|------------|------------|
| <b>Total assets</b> (USD)         | 8'345'185  | 7'728'317  | 6'853'925  |
| <b>Gross loan portfolio</b> (USD) | 609        | 451'462    | 560'411    |
| <b>Total deposit value</b> (USD)  | 131        | 105'109    | 136'063    |
| <b>Total number of clients</b>    | 34         | 1'690      | 2'616      |
| <b>Total staff</b>                | 57         | 114        | 132        |
| <b>Total number of branches</b>   | 1          | 3          | 4          |

## 2. Intervention approach and additionality

**Key constraints to up-scaling:** To reach its objectives and increase financial inclusion, Advans Pakistan had and has to overcome following key constraints: Lack of knowledge and local staff with preliminary basic skills in MSME cash-flow based lending methodology; Security measures currently in place making it difficult and costly to oversee operations at branch level; Geographical isolation from other Advans greenfields hindering cross-fertilization; Adaptation of Advans model to Pakistan and, more broadly, to the Asian market.

**Intervention approach:** The following priorities were defined in order to increase and fine-tune Advans Pakistan's offer:

- **Improving productivity of existing microloan products** by reviewing the microlending process as well as improving service. This included a revision of all documents related to microloans as well as training and coaching of credit officers (COs) and branch managers on the new methodology. Training included decision-taking in view of reducing the loan process duration.

Furthermore, the recruitment process and the inception training were revised. 10 officers received a reviewed training program (with focus on practical training), before receiving the core training on the appraisal process. 35 officers were then recruited (of which 2 women) and joined in May 2014, receiving the new inception training program. In addition, branch managers were trained to strengthen COs' supervision and coaching.

- **Launch of a new Enterprise Loan** up to PKR 500'000 (CHF 4'600) in order to better serve clients. The new product was launched based on a market study followed by a successful pilot phase (October 2013 to January 2014) and training of COs on the new product.
- **Adapting the collection and recovery process** used in Advans' network to the Pakistani context. This included revision of related documents, definition of new policy rules and procedures as well as the development of guidelines and training material for branch staff.

Following a review of the organizational set-up, all branch and head office staff involved in recovery processes have been trained and coached. The Recovery Unit composed of 3 staff at the head office (end of May 2014) now manages the portfolio of clients reaching 90 days delay in order to bring these clients back to a regular payment pattern. Furthermore, the bank contracted a call centre to handle reminder calls to borrowers. This allows staff to focus on more strategic, high-value tasks, including field recovery.

**Additionality:** In the longer term, the intervention will contribute to the formalisation of the local economy. Most SME have had no previous banking relationships and produce little, often unreliable financial information. In order to build trust and offer tailored financial services, the bank's staff spends a significant amount of time with each client, reconstructing cash-flows, helping clients understanding their business and supporting their formalisation.

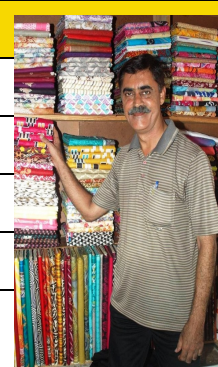
### 3. Results achieved

#### 3.1. Client level

Advans Ba-Ikhtiar, the new enterprise loan, was launched on the backdrop of businessmen showing keen interest in getting loans of higher amounts. The target group encompasses larger micro-entrepreneurs or small enterprises in a wide range of sectors such as retail, wholesale and small industry (22% in production, 58% in trade, and 20% in services, i.e. among enterprise loans there is a slightly higher part of "trade" compared to micro-loans (50%) explained by the fact that wholesaler are certainly the easiest target for officers at early stages).

| Overall Outreach : Advans Pakistan                       | 2013 (Jan) | 2013 (Dec) | 2014 (May) |
|--|------------|------------|------------|
| Number of active borrowers                               | 2          | 886        | 1192       |
| % of female active clients                               | 11,3%      | 16,2%      | 16,4%      |
| Women as % of active borrowers                           | 0%         | 16,3%      | 16,4%      |
| Average loan balance (CHF)                               | 290        | 484        | 447        |
| Number of savings & deposit accounts                     | 33         | 2'083      | 3'227      |
| Women as % of active depositors                          | 15,1%      | 16,1%      | 16,4%      |
| Average deposit balance per account (CHF)                | 4          | 48         | 40         |
| <b>Clients according to income level</b>                 |            |            |            |
| <b>Break-down of Portfolio per Outstanding Loan Size</b> |            |            |            |
| < 1'240 CHF  | 100%       | 79,4%      | 65%        |
| [ 1'240 ; 4'760 CHF ]                                    | 0%         | 20,6%      | 35%        |
| <b>Break-down of Deposits per Deposit Size</b>           |            |            |            |
| < 125 CHF  | 92%        | 91,6%      | 97,5%      |
| [ 125 ; 1'250 CHF ]                                      | 8%         | 7,9%       | 2,1%       |
| ]1'250 ; 12'370 CHF]                                     |            | 0,4%       | 0,4%       |

| Client Profile fact sheet   |  |
|---|--|
| Name of client:   | Mr. K.   |
| Business name and activity:   | Dupatta Mahal / Material shop  |
| Number of employees:  | 2  |
| Date of first loan/contact:   | 29/4/2013  |
| Which Advans products does the client use? (deposits and loans):    | Advans Ba-Ikhtiar (enterprise loan)  |
| How has the Advans Loan transformed the client's business activity? | Mr. K.'s banking relationship with Advans Pakistan began in April 2013 with a first micro loan of PKR 100'000 (ca. CHF 963). The loan allowed him to obtain more supplies and increase income. After this, Mr. K. was able to upgrade to a larger Ba Ikhtiar Loan, which was double the amount of his first credit. Mr. K. is confident that thanks to the extra stocks bought with the loan, he will be able to maximize sales and further expand activities, especially during the run up to the Islamic Feast of Eid. |
| Why would the client recommend Advans?                              | Mr. K. especially appreciates the friendly customer service and that his relationship with the bank is based on mutual understanding and trust. Mr. K. finds the staff highly motivated, well trained and supportive which, for him, sets them apart from staff of other banks.  |



#### 3.2. Partner financial institution level

**New/improved products:** After receiving approval from the SBP in July 2013, Advans Pakistan was the first MFB to launch an enterprise loan on October 1, 2013. The bank's willingness to promote this product is a quite unique positioning in the Pakistani market, where the "ticket" remains historically low (typical microfinance loans are capped at PKR 150'000 and average ticket ranges around PKR 30'000/ CHF 275). The collateral requirement is the same as for the bank's microloan.

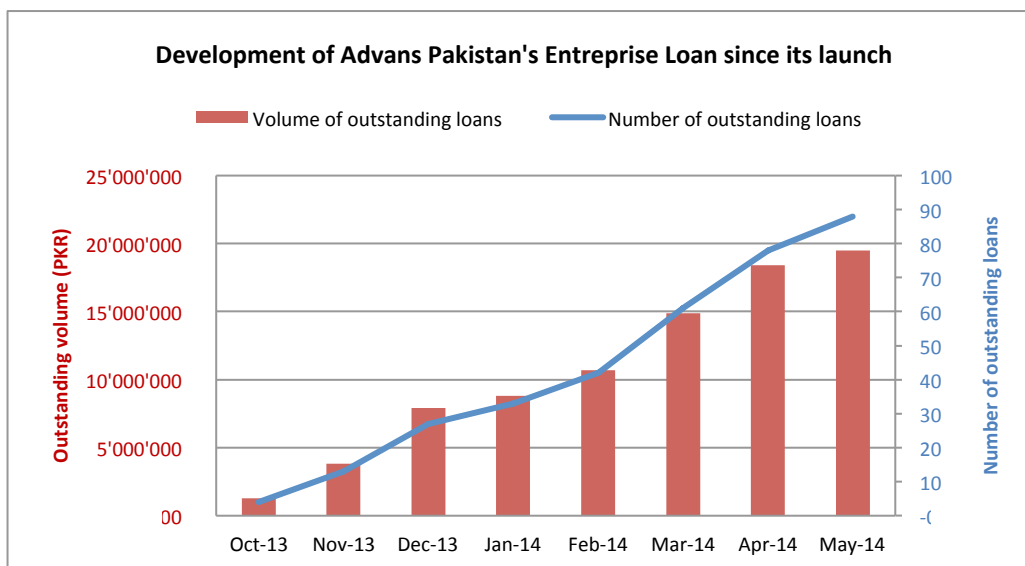
At the end of May 2014, Advans Pakistan had a portfolio of 1'192 active loans for an outstanding loan portfolio of CHF 530'000. The introduction of the Ba-Ikhtiar enterprise loan has significantly contributed to the growth of the loan portfolio. As of end of May 2014 and only 7 months after its launch, it represented 35% of the bank's gross outstanding loan portfolio with a total of 88 loans disbursed amounting to PKR 23'530'000 (CHF 216'120) with one loan disbursed to a female client

(PKR 210'000 / CHF 1'920). These results were lower than budgeted due to staff turnover. With 5,5%, the PAR 30 at the end of May 2014 is higher than expected, but better than the PAR of micro-loans (Karobar Sanwaro: PAR 30 as of 31/02/2014 was 12,75%).

| Key performance indicators   | Q1 2013 | Q2 2013 | Q3 2013 | Q4 2013 | Q1 2014 |
|------------------------------|---------|---------|---------|---------|---------|
| Capital Adequacy Ratio       | 1'399%  | 1'160%  | 1'083%  | 1'050%  | 950%    |
| Operational Self Sufficiency | 38,1%   | 37,9%   | 36,4%   | 43,1%   | 32,0%   |
| Annualised Write-off         | 0%      | 0%      | 0%      | 0%      | 3,0%    |
| Clients drop-out Rate        | 0%      | 0%      | 1,5%    | 1,6%    | 2,8%    |
| Number of staff              | 87      | 110     | 98      | 114     | 108     |
| Number of client officers    | 18      | 30      | 41      | 32      | 32      |

A challenge is to get COs and branch managers used to the higher loan amount compared to micro loans. Risk is perceived as high, generating unease in terms of potential PAR. The whole challenge for the management has been to explain that this product can be marketed at a large level in a sound manner, as it has been the case in all other Advans affiliates.

The SBP supports Advans Pakistan as it appreciates the bank's clear positioning and it wants to bring more players to serve a segment that was not served until recently. At the same time, microfinance regulations limit enterprise loans to 40% of the gross loan portfolio. Thanks to the promising start, Advans Pakistan managed to obtain a waiver for an 18 month period from the SBP to increase this limit to 55%. The long-term perspective for this product is to represent a share of 40% of the portfolio.



**Improved productivity of the existing microloan products:** COs' productivity for micro loans and service have improved. The duration between the first contact with the client and the moment a file is considered "ready for loan committee" has been reduced. COs have gained a better understanding of risk (client and financial risk), resulting in a more efficient and effective appraisal. Furthermore, the number of incomplete files presented to the loan committee has been reduced and the loan decision process is faster today. Productivity has increased from September to December 2014 with 4,63 loans disbursed per CO for the month (compared to 1,73 in July 2013 due to Ramadan, after which productivity increased to 3,17 in September and up to 4,63 in December).

All actions haven't borne all their fruit yet, but the trend is progressively improving as shown in the table below. One of the main obstacles remains staff turnover, despite recent improvements thanks to recruitment of staff with a greater appetite for field work and training which involves more time in the field to test new hires and their motivation (see chapter 4). Turnover, which has been slightly higher than 50% among COs in 2013, remained high in Q1 2014 (peak of 13,3% drop out in February), but has decreased since then (5,1% in May).<sup>1</sup>

|          | Number of loans disbursed per CO | Volume of loans disbursed per CO |
|----------|----------------------------------|----------------------------------|
| May 2013 | 2,0                              | PKR 116'060                      |
| May 2014 | 3,3                              | PKR 246'167                      |

**Set-up collection and recovery process:** All actions aiming at improving the collection and recovery process are starting to yield results in terms of both portfolio follow-up and defaulters management. As

<sup>1</sup> As of date of issuance of this report, the annualized dropout rate measured by August 2014 end stands at 43%, but the monthly rate has now fallen consistently to 3,4% to 3,6% a month).

of end of May 2014, the Recovery Unit received payments from 43 of the 66 active clients it was in charge of. As shown in the tabular presentation of arrears migrations below:

- Since September 2013, Advans Pakistan's portfolio entering the PAR was divided by 2,25
- Since the creation of the Recovery Unit, the deterioration rate for loans having between 91 and 120 days delay decreased by 300 basis points

Like for productivity, one of the main obstacles hindering the overall improvement of all portfolio quality indicators remains staff turnover.

| Portfolio Deterioration | Current to 1-30d | 1-30d to 31-60d | 31-60d to 61-90d | 61-90d to 91-120d | 91-120d to 121d+ |   |
|-------------------------|------------------|-----------------|------------------|-------------------|------------------|---|
| Average Q4 2013         | 12,07%           | 22,18%          | 45,68%           | 70,32%            | 86,94%           |   |
| Average Q1 2014         | 11,20%           | ↓ 14,02%        | ↓ 30,81%         | ↓ 53,11%          | ↓ 63,72%         | ↓ |
| Average Q2 2014         | 5,40%            | ↓ 24,60%        | ↑ 47,45%         | ↑ 60,37%          | ↑ 57,25%         | ↓ |
| Overall Average         | 8,72%            | 19,63%          | 39,86%           | 58,25%            | 63,42%           |   |



#### 4. Lessons learnt and further challenges

Advans Pakistan faces two major challenges:

- 1) Due to security conditions, international experts cannot spend as much time in the branches as needed to train and coach staff to implement the Advans model. As a consequence, one of the main challenges is the promotion of Pakistani managers to supervise and coach staff intensively. Early 2014, two Pakistani managers were appointed as (i) Network and Sales Manager, responsible for direct supervision of the branches and (ii) Deposit Manager, to supervise the development of deposit activities and the launch of new financial services.
- 2) Staff turnover had critical impacts on commercial development. Turnover hinders productivity growth as it takes several months for a CO to fully handle the loan process analysis. It means also a time-consuming process in terms of portfolio transfers, which usually impact portfolio quality. Despite recent improvements, staff turnover remains an issue.

Over the past months, Advans Pakistan has implemented a series of organisational changes building on the lessons learned during its first year of operations. Additional developments will be made on the loan product range and on the use of alternate delivery channels in order to address the market needs and sustain faster growth. Advans Pakistan decided to focus during 2014 on bringing the existing network to a satisfactory level of productivity while maintaining a good portfolio quality, with a limited expansion plan in terms of new branches.