Pakistan Microfinance Network

Gearing Towards Microenterprise Lending

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MicroNOTE

EXECUTIVE SUMMARY

Microenterprise lending in Pakistan has been low when compared to the total microcredit portfolio, with over 116 thousand microenterprise loans (as compared to 6.5 million microcredit loans) as of June 2018 . Despite the passage of more than six years since microenterprise lending was allowed by the State Bank of Pakistan, outreach is still low, and the sector is yet to reach its potential.

This note examines the importance of MSMEs in the context of Pakistan's economy, the regulatory and policy environment in place and discusses possible strategies which could be undertaken to improve lending and expand outreach to reach its potential in Pakistan.

This paper borrows from the 'MSME Strategy Workshop' organized by PMN in which various aspects of MSME lending were discussed in detail by the leading practitioners including the status of lending to the sector by MFPs, the challenges faced by players and the landscape of MSMEs in the country.

INTRODUCTION

Micro, Small and Medium Enterprises (MSMEs) are crucial for the prosperity of a developing economy as they contribute considerably to the economic growth and poverty reduction of the nation . MSMEs are labor intensive, and as with any labor-intensive sector, growth in the sector may have beneficial (social and economic) impact on many people. Typically, MSMEs represent more than 60% of an emerging country's GDP with over 70% of the total employment in low-income economies (Munro, 2013). Whereas, in middle-income economies, these make up 70% GDP and 96% of total employment respectively (Munro, 2013). The contribution of Micro, Small and Medium enterprises to the economy of Pakistan highlight their importance (Afraz, Hussain, & Khan, 2013) as they account for 90 percent of total economic enterprises and make up about 30 percent of the GDP. They also contribute over 25 percent of earnings in export and employ 78 percent of the non-agricultural labor force In Pakistan.

Globally, the MSME Market presents an immense opportunity to help achieving financial inclusion. and in Pakistan it represents a great challenge as commercial banks have not been able to provide much needed capital and services for a sector representing over 90% of the enterprises in the country. The lower end of MSMEs has remained an unbanked segment for long as financial institutions have traditionally been reluctant to lend to that segment. It remains an untapped market and provides an opportunity for financial institutions to expand their footprint to this segment. Hence, there is a need to understand the current landscape, regulatory challenges, and propose solutions and way forward.

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Defining MSMEs

One of the major challenges of the sector globally as well as in Pakistan is the definition of MSMEs whereby different international and national institutions have varying definitions of MSMEs. The existing definitions rely on the number of employees and the annual turnover to determine the size of an enterprise. While there are varying definitions, for this paper we will be defining MSMEs based on SBPs parameters and thresholds. The SBP defines Microenterprises as institutions with less than ten employees as Table 1 below shows. Moreover for the purpose of this paper, we will only be analyzing Microenterprises and not SMEs.

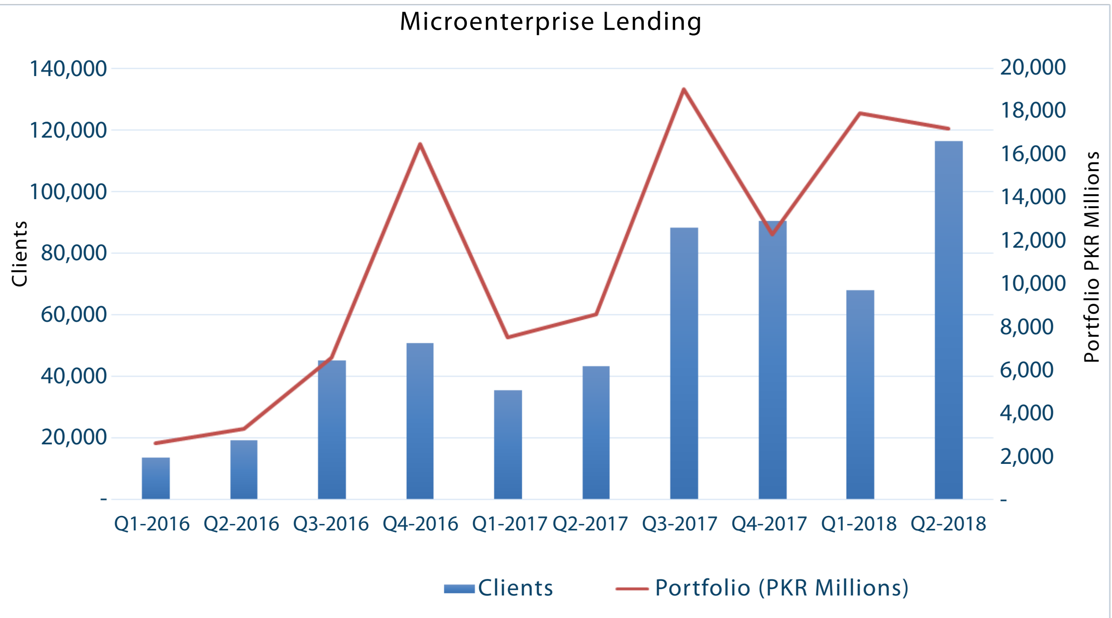
Table 1: MSME definitions in Pakistan by various institutions

<table>
<tr><th>Enterprise Category</th><th>State Bank of Pakistan (Manufacturing & Services)</th><th>State Bank of Pakistan (Trading)</th><th>SMEDA</th><th>SECP</th><th>IFC</th></tr>
<tr><td colspan="6">Annual Income</td></tr>
<tr><td>Individual</td><td><$ 4760</td><td></td><td>Not Defined</td><td><$ 5700</td><td>Not Defined</td></tr>
<tr><td>Micro</td><td>-</td><td></td><td>-</td><td>-</td><td>-</td></tr>
<tr><td>Small</td><td>-</td><td></td><td>-</td><td>-</td><td>-</td></tr>
<tr><td>Medium</td><td>-</td><td></td><td>-</td><td>-</td><td>-</td></tr>
<tr><td colspan="6">Number of Employees</td></tr>
<tr><td>Individual</td><td></td><td></td><td>Not Defined</td><td>-</td><td>Not Defined</td></tr>
<tr><td>Micro</td><td>1-9</td><td></td><td>Not Defined</td><td>1-10</td><td>1-9</td></tr>
<tr><td>Small</td><td>20 to 50</td><td></td><td rowspan="2">Up to 250</td><td>Up to 250</td><td>10-50</td></tr>
<tr><td>Medium</td><td>51-250</td><td>51-100</td><td>More than 250</td><td>50-300</td></tr>
<tr><td colspan="6">Annual Turnover</td></tr>
<tr><td>Individual</td><td colspan="2">-</td><td>Not Defined</td><td>-</td><td>Not Defined</td></tr>
<tr><td>Micro</td><td colspan="2">-</td><td>Not Defined</td><td>-</td><td>Less than $100k</td></tr>
<tr><td>Small</td><td colspan="2">< $1.4m</td><td rowspan="2">Up to $2.4m</td><td>≤$2.4m</td><td>$100k-$ 3m</td></tr>
<tr><td>Medium</td><td colspan="2">$1.4m –$7.6m</td><td>> $ 2.4m</td><td>$3m-$15m</td></tr>
<tr><td colspan="6">Paid up Capital</td></tr>
<tr><td>Individual</td><td>-</td><td>-</td><td>Not Defined</td><td>-</td><td>Not Defined</td></tr>
<tr><td>Micro</td><td>-</td><td>-</td><td>Not Defined</td><td>-</td><td>Less than $100k</td></tr>
<tr><td>Small</td><td>-</td><td>-</td><td rowspan="2">Up to $240k</td><td>-</td><td>$100k-$ 3m</td></tr>
<tr><td>Medium</td><td>-</td><td>-</td><td>-</td><td>$3m-$15m</td></tr>
<tr><td colspan="6">Credit Limits</td></tr>
<tr><td>Individual</td><td colspan="2"><$ 1400</td><td rowspan="4">Limits Not Defined</td><td><$ 1900</td><td rowspan="4">Limits Not Defined</td></tr>
<tr><td>Micro</td><td colspan="2"><$ 4760</td><td><$ 4760</td></tr>
<tr><td>Small</td><td colspan="2">$ 240k</td><td>Not Defined</td></tr>
<tr><td>Medium</td><td colspan="2">$ 1.9m</td><td>Not Defined</td></tr>
</table>

The Microenterprise Portfolio – Historical Trend

It is important to analyze the historical trend of lending to microenterprise to understand how far the sector has matured before looking at some of the constraints and recommendations to move forward. With 8 Microfinance Banks (MFBs) and a handful of non-banking Microfinance Institutions (NBMFIs) currently catering to this niche segment, the total Microenterprise portfolio represents 2% of total clients and 7.2% of the total Microfinance Portfolio of the industry as of June 2018. By the end of the mentioned quarter, the total clients of this segment stood at a record high with over 116,000 borrowers (June 2017: 43,000 borrowers) and a portfolio of over PKR 17 Billion (June 2017: PKR 8.5 Billion) . These figures indicate a growth of almost 169% in total clients and 100% in the total portfolio within the span of just one year. The growth trends are unparalleled, and the opportunities for further growth are still significant. The figures indicate that there is a need for increased lending to this niche market which would lead to improved growth within the sector and encourage NBMFCs to indulge in the competition as well. Moreover, the fact that there is no standard pattern of entering the enterprise lending market segment, indicates that the market is still underdeveloped.
Figure 1: MSME Portfolio by the numbers below indicates the trend of MSME Lending in Pakistan in the Microfinance Industry since 2016.

Figure 1: MSME Portfolio by the numbers



It can be observed that by the end of 2016, the total Microenterprise portfolio increased by 31 percent as compared to the 2015 . The number of borrowers was approximately 177,000 with an outstanding portfolio of over PKR 400 billion , which accounts for 9 percent of the total credit provided to the microfinance sector. This was seen as a huge year on year increase. One of the major factors apart from the contributions of Microfinance providers and other financial institutions, was SBP's accommodating role towards the financing of these enterprises. The Central Bank over the years issued sets of prudential regulations and 'The Financial Institutions' (Secured Transactions) Act, 2016 which further facilitated access to finance for enterprise borrowers in Agriculture, Trading and other different sectors.

Schemes such as the Credit Guarantee Schemes with the Department of International Development (DFID) UK, Refinance and Credit Guarantee Scheme for Women Entrepreneurs in underserved Areas and the Prime Minister Youth Business Loan Scheme are some examples of subsidized mark-up and risk coverage schemes to encourage enterprise financing in the country. Another push from the regulator for the banking sector came in the form financing targets assigned to financial institutes to extend financing to the segment. In December 2017, the SBP issued the "Policy for Promotion of SME Finance" which sets targets for the Central Bank to increase lending to the segment up to 17 percent of their private sector credit and to increase number of borrowers to 500,000 by 2020. Moreover, loan limit to microenterprise has been revised upwards to PKR 1 million. While these regulatory interventions are a move in the right direction to increase outreach of the segment, there still remain major challenges which need to be addressed.

Challenges in Financing MSMEs

Even through 90% of the Microenterprises fall in to the category of 'micro' and 'small' enterprises, majority of which operate in an informal economy due to which commercial institutions have historically been reluctant to lend to this segment. While this segment relies on commercial banks for access to finance, commercial banks are seen to lend to relatively larger institutes, lending mainly to Medium enterprises or the higher end of the spectrum of 'Small' enterprises. But little attention has been paid to micro and small enterprises (lower end of the spectrum of 'small' enterprises), which remain off the radar of commercial banks. While this missing middle remains underserved, this presents an opportunity for Microfinance providers (MFPs) to capitalize on this considering the existing similarities of these micro enterprises with their microfinance clientele. The facilitative and enabling environment created by the SBP not only encourages MFPs to cater to a new segment but also provide opportunities for returning clients that have graduated beyond the microenterprise level.

Microenterprises have a separate set of challenges than traditional SMEs given their structure, size, and the customers they cater to. The dynamics of Microenterprises are similar to those of microfinance clients as they face multiple barriers and challenges in access to finance and the majority continue to be financed through informal sources - mainly from family funds and retained earnings. Their economic potential is not only limited by a lack of finance but also other factors: they lack expertise in formal business experience, financial education, marketing and growth strategies and technical expertise. Micro enterprises also face regulatory challenges with formalization. The difficulty in formalization and the detrimental tax burden keeps them small and their business growth restricted. If these challenges faced by microenterprises can be overcome, this could potentially become a profitable and high growth segment that can be well served by MFPs as they are already working with microenterprises, know the market segment well and are comfortable in working with clients and building their capacity. However, this cannot happen without significant investment in the MFP's own capacity as most MFPs lack product development, marketing and capacity building expertise needed to make this a success.

To ensure there is no hindrance in financing Microenterprises, MFPs need to understand the following:

- A unique approach to Microenterprise lending is needed: they are not microfinance clients and not at the SME level yet, so strategies must target this sector in a very different way.
- Since Microenterprise clients do not have the formal capacity to approach banks due to weaknesses in record keeping, financial information, market strategy, product development and assets – the lending models used for their evaluation must be different.
- Microenterprise clients feel more comfortable with MFPs who can lend based on informal business information.
- The market is largely underserved, and the majority grow organically which means that there is great growth potential in the businesses if they can be assisted.
- Microenterprise demand for credit exists but MFPs do not have the products to serve this market currently.
- The learning curves for lending institutions for client acquisition, marketing and sales will be significant and much more different when catering to this segment since MFPs have operated in a supply-based market till now.

There is also a need for MFPs to distinguish between the characteristics of Microfinance clients, Microenterprise clients and SME clients. This distinction is essential to determine the factors and drivers associated with each client type for their growth and success and to address the existing challenges faced in developing appropriate offering for their client base as Table 2 below provides a summary of the different challenges and characteristics discussed above.

Table 2: Distinctive Characteristics based on Client Type

Characteristic	Microfinance Clients	Microenterprise Clients	SME Clients
Purpose of lending	Livelihood activities	Informal Businesses	Formal business at the medium level
Loan Characteristics	Group loans, informal borrowing – no collateral	Limited loans based on personal credit, informal borrowing from family, friends, money lenders and loan sharks – lack formal collateral	Access to SME lending once assets built
Market Outlook	Limited market access	Untapped markets due to lack of financing	Larger markets, dominated by few players
Growth Potential	Limited growth	High growth potential as they are labor intensive and require low capital	High growth potential
Capacity / Resource Outlook	Limited capacity	Need financial education and business capacity building	Use professional expertise and capacity to grow where affordable

In addition to the features highlighted above, another essential feature of these clients is based on the risk profile of each client type. The risk profile of Microenterprises is significantly different from microfinance clients, which highlights the need for a revised risk model. In terms of collateral requirements, MSMEs do not meet this requirement but have strong operational cash flows; which indicates that the current risk assessment process is not able to balance cash flow-based lending with collateral based analysis. Additionally, for Microenterprises to grow and flourish they need a variety of products designed to meet their unique needs and their cash challenges. They need easier ways to make supplier payments, international transfers, improve working capital for operations, equipment financing and leasing and online and mobile payment options for their customers. This highlights the need for institutions to diversify their products once they have successfully identified and developed offerings based on the needs highlighted by this client type.

Why Are MFPs best suited to serve this segment?

Microenterprises have traditionally fallen under the underserved segment which has been labeled as the "missing middle " as it is largely unbanked and lacks access to formal finance. While Microfinance Providers (MFPs) are relatively new phenomenon in the country's financial landscape but similarity of dynamics between microfinance clients and low end of SMEs played a crucial role in convincing policy makers to task the microfinance industry to tap these entities. The argument is further strengthened keeping in view the success achieved by MFPs in a short span of time in providing financial services especially extending clean credit lines to its borrowers. While it was felt that microfinance client graduating from microfinance to microenterprise will be catered by MFPs, the positive synergies created with branchless banking (nearly third of saving accounts with MFBs are m-wallets) and the ability to work with the undocumented segment of the economy contributed to a highly successful combination. Despite this, MFPs were required to upgrade their institutional capacity, invest in product development, risk management and monitoring capacity to effectively meet market demand. These issues are discussed in the coming sections.

Regulatory Regime

This section gives an overview of the prevailing regulatory regime governing lending to microenterprise and its evolution. The State Bank of Pakistan (SBP) through a circular in 2012 revised the amount MFBs can lend to microenterprise to PKR 500,000. Previously, MFBs could only lend up to PKR 150,000 for general purpose loans. Microenterprises have been defined as "project or businesses in trading/manufacturing/services/agriculture sectors that lead to livelihood improvement and income generation. Moreover, these projects/businesses are undertaken by micro-entrepreneurs who are either self-employed or employ few individuals not exceeding 10 (excluding seasonal labor)". In addition, only MFBs that are fully compliant with minimum capital requirement (MCR) and capital adequacy ratio (CAR) shall be able to undertake microenterprise lending. Moreover, the exposure under microenterprise lending shall not be more than 40 percent of the bank's total portfolio so that primary focus of MFBs remains microfinance.

Through this amendment, SBP made an attempt to address the credit needs of the large “missing middle” microenterprise market that has traditionally remained unbanked and also provide MFBs an opportunity to upscale their credit operations and cater to lower end of the small & medium enterprise market (SME), which is viewed as an important market by economic planners in Pakistan due to its potential for income generation and job creation. Following the permission to start enterprise lending by MFBs, SBP also extended the SME credit guarantee facility to MFBs . This was done to facilitate lending to microenterprises on a risk sharing business and provided an excellent opportunity for participating institutes to pioneer operations based this segment.

These regulatory interventions were followed by the Securities and Exchange Commission of Pakistan (SECP) when the regulatory umbrella was extended to non-bank microfinance players. The Loan limit was capped at PKR 500 thousand allowing the newly formed Non-Bank Microfinance Companies (NBMFC) to also lend to microenterprises and upscale their loans.

The Role of MFBs in lending to the MSME was further recognized and supported in the Policy for Promotion of SME Finance launched in December of 2017, MFBs were recognized as a key pillar of the policy and loan limit was revised upwards to PKR 1 million from PKR 500 thousand. Also, SBP committed in the policy to develop a legal and regulatory framework for graduating selected MFBs in Micro & Small Enterprise (MSE) Banks.

Beyond Number: What needs to be done

To effectively meet the funding needs of the Microenterprises, a great deal of work must be done to enable microfinance institutions to effectively capture the Microenterprise market. Lending to this segment required MFPs to invest in their institutional capacity to cater to this market.

Among the first objectives was to understand the potential borrowers and the businesses falling in this category. Research firms were hired in this regard by all leading players to improve their knowhow. It was decided that firms shall have separate staff which was designated to deal with microenterprise lending. Special branches were set up to meet the client needs in this segment or separate staff was posted in existing branches. This was largely due to awareness that existing staff dealing with micro-credits was not suited for lending this segment.

The products developed by leading MFBs cover agriculture, business, renewable energy and education loans. Customers are mostly fresh borrowers and there are fewer instances of microfinance clients graduating to microenterprise. The loan products are structured as bullets or amortized and are secured against gold, cash or hypothecation. Third party and personal guarantees are also obtained from the borrowers and the Tenor of the loans as compared to the microfinance loans is longer – with loans ranging from 3 years to 5 years.

While the current deposit base of MFBs is adequate to meet the liquidity needs of the Microenterprises, the future growth in the segment can force these entities to borrow. Moreover, Microenterprises having a longer tenor which is spread over couple of years as compared to normal microfinance loans having a tenor of few months, there is a need for matching liabilities.

MFBs will have to issue longer tenured liabilities to adequately meet the funding needs arising due to lending to microenterprises.

The situation is relatively more challenging for NBMFC since they are non-deposit taking their liquidity needs are amplified due to higher loan sizes of microenterprise loan . This would require extending dedicated funding lines and retail guarantees to promote lending to microenterprises by this segment.

Box 1: Case Study

Chase Bank – International Case Study

Chase Bank Limited is a financial institution in Kenya with the vision of being the premier pan African relationship bank offering one stop financial solution to its customers. The bank aims to fulfill its vision by continuously evolving its strategy to remain in the cutting edge of financial services provision. Based on this philosophy, in recent years the organization has begun to focus on tailor-made solutions for the MSME segment in Kenya. Chase Bank has been one of the most successful banks in Pan Africa in terms of growth in profits and assets due to their ability to serve a rapidly growing market. The network of branches of the bank has expanded notably from 1 branch in 1996 to 30 branches by 2013 spread-out in Kenya strategically. Chase Bank is also recognized as a market leader in offering solutions to the MSME market segment in Kenya by its peers and industry analysts. The organization was also dubbed as the best SME bank in the year 2012.

Asset Financing

Perhaps one of the most appealing credit products for the MSME segment provided by the bank is the Asset Finance which has been the core offering of the business development at the organization. A combination of competitive rates, the products straightforward nature and an effective marketing strategy makes it the ideal choice in the market for MSMEs. This product allows micro-enterprises to lease assets which in turn frees up a hefty sum of expenditure for the enterprises. Instead the organization only incurs a series of smaller expenditures over a certain period, which thereby improves liquidity for the micro-enterprise. This means that a significant amount of financial resources is freed up which then could be utilized in inventory, working capital, short-term assets or other productive purposes. Another advantage for financing or leasing assets is that it reduces the risk of obsolescence of an asset that is subject to becoming obsolete due to changes in the technology.

Hire Purchase

Another successful product offering by Chase Bank for smaller entities is a Hire-Purchase. This is an alternative to asset financing which is like leasing but is mostly short-term. Since smaller entities lack the ability to qualify for asset financing due to reasons such as low turnovers to support facility or startups lacking in experience etc., Hiring proves to be an alternative. Hire-Purchase involves paying for an asset in regular installments while having the use of it for the period it is required. Though the costs of hiring are borne by the client, it normally translates into net savings when the client finally qualifies for asset financing. Hiring can therefore be an intermediate process to asset financing.

Lesson Learnt from Chase Bank

Apart from designing appropriate product offerings for the MSME market segments, what distinguishes Chase Bank from other enterprise lenders in the region is the development of appropriate strategies that enhance growth. The use of networks, strategic alliances, the legal and regulatory framework, innovation, diversification, market research and development are what aid the organization in successfully capturing the MSME segment and achieving high growth levels while also promoting inclusiveness and development.

Recommendations

For the microfinance sector to tap into the microenterprise segment effectively capacity building of staff and clients' needs to be done; customized products need to be developed and interventions on the policy and regulatory front can play a pivotal role as a catalyst for growth in the segment. Some of the strategies and skills that financial institutions could adopt to address these issues are discussed in detail below.

Capacity Building

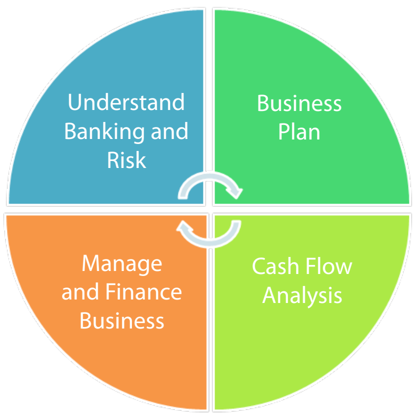
Capacity Building of MFP Staff

The primary difficulty in the credit analysis process is the lack of business analysis and cash flow analysis skills in the staff of MFPs. To completely understand the business plan and identify clients' cash requirements, staff of financial institutions needs to be able to conduct cash flow based analysis and identify the market and operational risks that these fast-growing businesses face. In order to address this challenge and other key barriers to access, MFPs need to emphasize on staff capacity building; this implies that improved financial education, business management, assessment skills and financing risk assessment ability for the staff could reduce the access gap between service providers and Microenterprise clients.

Capacity Building of Microenterprise Clients

The incapacity and lack of formal education and knowledge of microenterprise clients also presents a challenge for MFPs to serve this segment. Therefore, there is a need for MFPs to educate their clients /potential clients to help formalize some of their operational procedures while reducing potential risks in the future that may affect their business. The figure below highlights the theoretical framework which may be used when addressing client capacity building needs.

Figure 2: Client Capacity Building



The figure indicates potential areas of capacity building for Microenterprise clients. There are four key areas where the clients may be benefit from capacity building:

1. Understanding Banking and Risk: clients need to understand banking and risk in the sense that it is their characteristics which distinguishes them in the market and it that they have specialized needs which hinders their access to funds as opposed to other businesses.

2. Business Plan: To evaluate their businesses and have a clear future strategy along with the associated risks involved, microenterprises must understand how to determine their existing and future potential in terms of sales, forecasts and marketing of their products.

3. Management Skills: Most microenterprises lack the appropriate management skills and the understanding of how to properly finance their businesses and working capital – such as supplier payments and customer debts. The need of appropriate management information systems and data management solutions can also be addressed in this section.

4. Cash Flow Analysis: To ensure the sustainability of their business and better plan their finances, there is a need to help microenterprises develop their cash flow statements to help better understand the health of their business and determine financing needs.

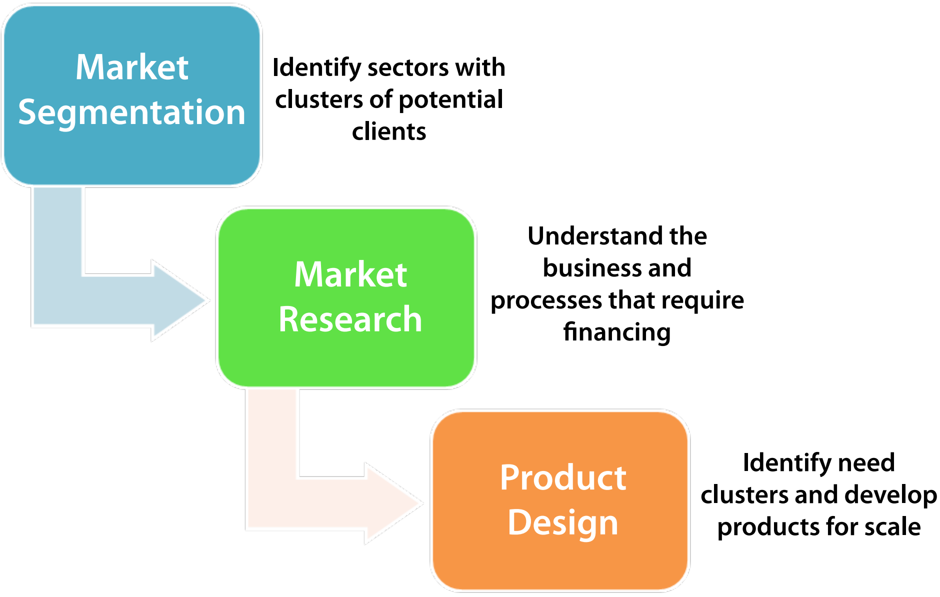
In addition to capacity building related to lack of awareness regarding non-financial services has been a great challenge for the financial inclusion of those seeking access to finance. The lack of record keeping, inefficient systems, redundant business process etc. are some of the key issues portrayed by this market segment. To address this challenge, it is vital to raise awareness during initial contact with the potential clients. The relationship officers of institutions need to provide broader services and ensure they support clients to improve their own business management. After determining their needs and areas for development, the sector must decide how best to provide non-financial services to be able to serve this market segment.

While the microenterprise market has potential to grow, it represents a whole new market for MFPs. The needs of clients and their financial structures are new to MFPs which have so far been operating in a market segment (individual microcredit) where the lending process is relatively unsophisticated, and client acquisition has not been a major hindrance to their growth. Microenterprises are more sophisticated and will require sales and marketing capacity of both MFPs and their clients.

Product Development

In addition to the capacity building of MFP and their clients, there is a need to develop more customized products; MFPs can no longer design 'vanilla' or single products covering all clients. Transportation, garment industry, private schools, agriculture, manufacturing, retail trade, all these sectors require various products and the first step is product development expertise starting with market segmentation, need analysis, and then determine the potential for product innovation and design. The approach of one size fits all need to be discouraged and products for various sectors need to be developed as highlighted in the figure below.

Figure 3: Steps to design appropriate Products for Microenterprises



One of the key strategies to help develop suitable products is to identify sectors so that product development can be targeted to specific clusters and deliver profitability and scale. The first step is to Segment the potential microfinance market based on clusters and client types. Once the Microenterprise cluster is identified, it's essential to understand the needs of each microenterprise based on its business type and the appropriate level of funding it requires. After this Market Research is conducted, providers can move on to the Product Design stage and develop appropriate offerings based on the needs of these microenterprises and the information gathered during the market research stage. Most MFPs do not have this expertise in house and will require market research and product development capacity.

Regulatory and Policy Interventions

MSE Banks

From the policy and regulatory perspective, keeping in view the success of the creation of a separate tier of deposit taking institute in the form of MFBs by SBP, a special tier of banks may be created for microenterprise lending. One of the options worth exploring is the possibility of existing MFBs to scale up their operations and transform into MSE Banks. Another possibility is for greenfield institutes to be established that provide funding lines for this segment or smaller commercial banks, with reduced capital, may be allowed to scale down the spectrum of the clients they serve to cover this segment. With the focus on commercial banks on corporates and consumer lending, dedicated financial institutions for microenterpriseswould promote lending and other financial services to this segment.

Funding Lines

Separate funding lines may be created for Microenterprise lending. Such lines are crucial for NBMFCs as they have not been able to extend higher loan sizes despite regulatory permission. Lines extended by commercial banks for the said purpose or by Pakistan Microfinance Investment Company (PMIC) can play a crucial role in this regard.

Guarantee Funds

Retail Guarantee Funds like the SME Guarantee under the Financial Inclusion Program (FIP) housed at SBP and a similar guarantee formerly extended by US AID, may be extended to the sector to promote lending to Microenterprises as well reduce the risk of lending institutes.

Conclusion

Microenterprises are a distinct sector, different from microfinance clients and SME segment. They face multiple barriers and challenges in access to finance and the majority continue to be financed through informal sources, family funds and growth. Their economic potential is limited by a lack of finance but also other factors: lack of formal business experience, financial education, marketing and growth strategies and technical expertise while facing regulatory challenges and difficulty in formalization.

Regardless of all these challenges, it is understood that the microenterprise segment is a profitable and high growth segment that can be well served by MFPs who play a catalyst role with beneficiaries on a regular basis and are comfortable in building client capacity. This cannot happen without significant investment in their own capacity as most microfinance institutions lack product development, marketing and capacity building expertise needed to make this a success.

In a time when country is witnessing an increase in workforce entering the market, Microenterprises provide an excellent opportunity for employment and wealth creation. It is estimated that there are 1.7 million enterprises including both agriculture and non-agriculture in the country . In order to meet their funding needs, MFPs need to enhance their capacity, extend non-financial services to the clients and focus on product development. Regulators and policy makers can also play a crucial role in promoting this segment by creating an enabling regulatory environment for this particular segment. Moreover, provision of retail guarantees and dedicated funding lines can play a catalytically role in the enhancement of funding to this segment.

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