Pakistan Microfinance Network

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MicroNOTE

MAPPING PORTFOLIO QUALITY IN PAKISTAN'S MICROFINANCE SECTOR

By ABAN HAQ, ALEENA NASEEM & MAHEEN SALEEM FAROOQI

INTRODUCTION

Generally, microfinance is characterized by low rates of default and delinquency. Pakistan is no different, with an average portfolio at risk (PAR) comparable to the global averages of PAR >30 days equal to 2.6 percent and PAR > 90 days equal to 1.4 percent[1]. However, maintaining high portfolio quality requires an understanding of the risks faced by an institution and using that knowledge in strategic decision making. This paper presents the different trends in delinquency over the past three years for the microfinance sector in Pakistan, comparing risks across gender, geography, type of institution, lending methodology and purpose of loan. A brief analytic on the relationship between risk and growth, and risk and institution maturity (defined by the age of the organization) are also included.

For the purpose of this paper, delinquency indicators used include a) PAR > 30 days as a percentage of GLP, b) PAR > 90 days as a percentage of GLP, c) Write offs as a percentage of GLP, and d) Delinquency ratio i.e. number of delinquent loans as a percentage of total loans (for definitions of the indicators please see Annexure A)[2]. However, during the course of our analysis it became obvious that there is no consistency in the write-off policies followed by the different MFPs (see End Notes for more). This was causing the write-offs data and delinquency ratios to not only be skewed, but difficult to interpret. We have thus focused our analysis on the PAR indicators, although the write off and delinquent loans data has also been presented.

Presentation of the information is mostly tabular or graphical, accompanied by brief analyses where needed.

Data used has been provided voluntarily by PMN members, and every effort has been made to validate it and seek explanations for any discrepancy (please see Annexure B for the list of reporting institutions). The reporting year for the purpose of this paper is the financial year (i.e. year ending June 30th 2008)[3].

PMN thanks its members for contributing to this study. Our gratitude also extends to our donors for their continued support.

1. The global PAR numbers are for the year 2006, which are the latest available. Source: The MicroBanking Bulletin, Issue 16, Spring 2008, MIX.

2. Please note that throughout the paper, use of the terms PAR >30 days, PAR > 90 days and Write-offs are in terms of a percentage of the GLP whereas delinquency ratio is the number of delinquent loans as a percentage of total loans.

3. Except for Kashf which reported as on Decemer 31st.

DFID Department for International Development

Citi Foundation citi

citi

Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
Confederaziun svizra

2. INDUSTRY TREND

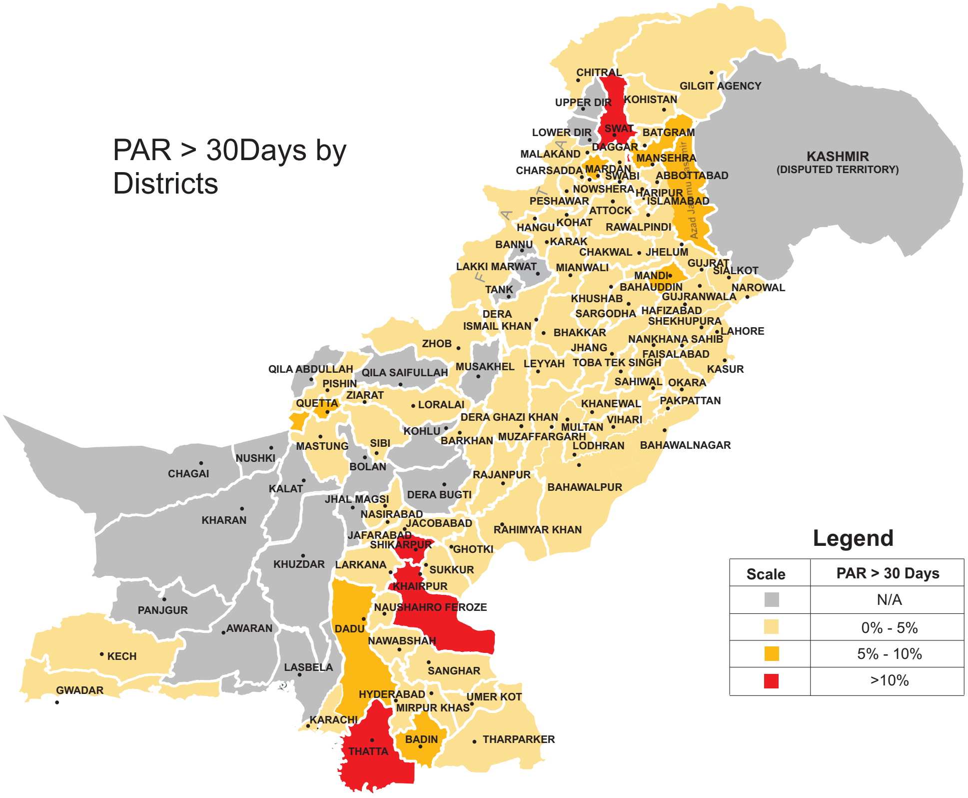
(in percent)

	Microfinance Industry		
	2006	2007	2008
PAR > 30 days	2.87	2.49	1.35
PAR > 90 days	1.95	1.90	0.96
Write offs	3.29	0.27	1.20
Delinquency ratio	10.76	8.58	6.78

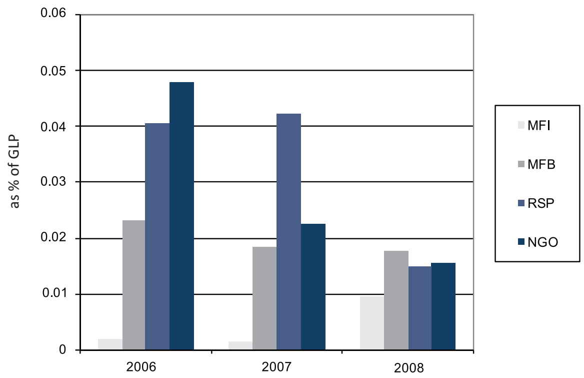
Overall portfolio at risk has not been high in Pakistan's microfinance sector and in fact, there seems to be an improvement over the past three years. Except for a few districts, portfolio at risk above 30 days remained below 5 percent (see map on next page). Some areas which showed high levels of non-performing loans (NPLs) lie in the NWFP where the security situation has been tense and MFPs have been finding it hard, if not impossible to operate. For our analysis we thus chose to look at districts from the other three provinces that show higher that 5 percent PAR > 30 days.

Interestingly in each of these six districts, one MFP tends to have a relatively high infected portfolio whereas the other service providers in the same area do not. Additionally these tend to be institutions with relatively more experience. For example, in the Sindh districts that show up as risky its either NRSP (in Badin and Thatta) or TRDP (in Dadu and Khairpur) that account for most of the infected portfolio whereas in Quetta and Mandi Bahauddin it is Khushhali Bank. It is only in the case of Mandi Bahauddin that we see the other MFP working in the area also showing above their institutional average delinquency whereas in the other districts the problem seems to be limited to the respective MFP mentioned above (see Section VIII below for more on delinquency by districts).

Also, PAR >90 days tends to be significantly less than PAR >30 days. This implies that a large proportion of loans that become choked at the 30 day are resolved before 90 days and perhaps PAR > 90 days is thus a more stable indicator of portfolio risk and quality.

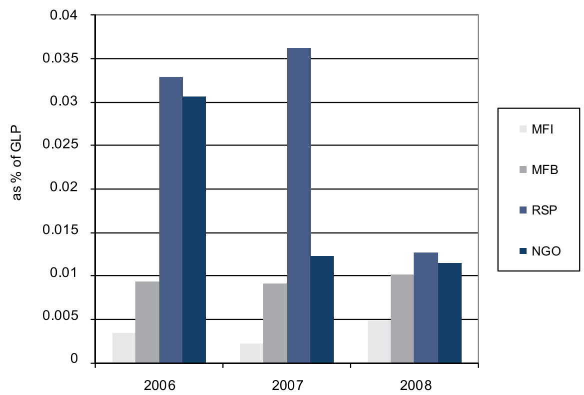


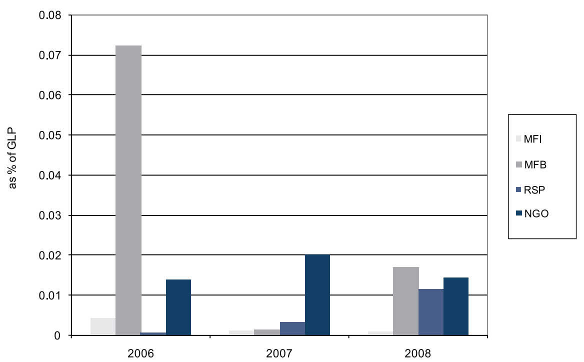
3. PORTFOLIO QUALITY BY PEER GROUPS[4]



PAR> 30 days by Peer Group

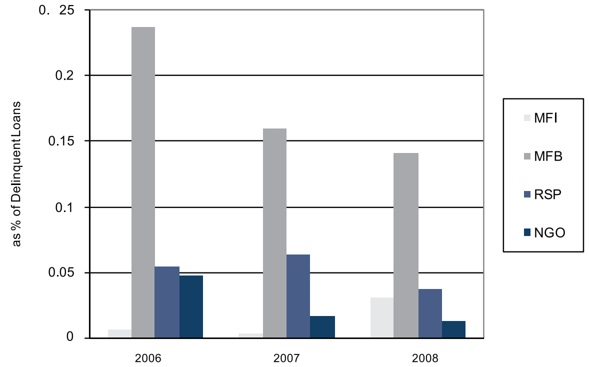
PAR> 90 days by Peer Group





Write-offs by Peer Group

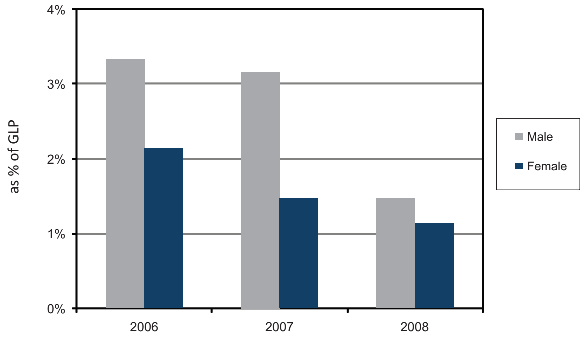
Delinquency Ratio by Peer Group



4. For definitions of peer groups, please see Annexure A.

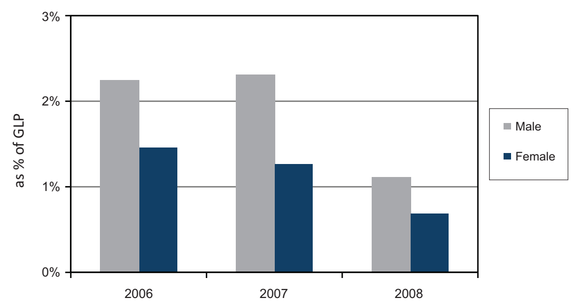
4. PORTFOLIO QUALITY BY GENDER[5]

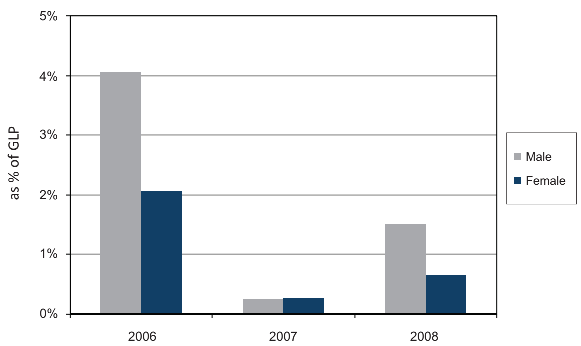
Looking at the sector's portfolio quality through the gender lens shows that female clients have a better repayment rate compared to male clients. However, it is also important to note that MFPs which have focused on women are also relatively stronger (in terms of financial performance as measured by OSS and efficiency as measured by cost per borrower) institutions and this may be the reason delinquency amongst women borrowers shows up as less.



PAR > 30 days by Gender

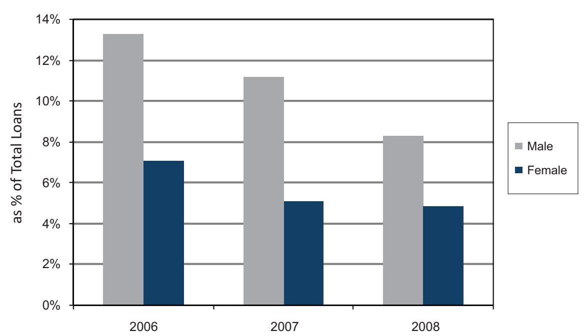
PAR > 90 days by Gender





Write-offs by Gender

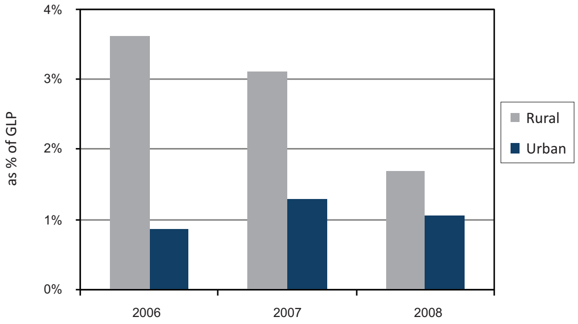
Delinquency Ratio by Gender



5. Data for this section was not available for First MFB.

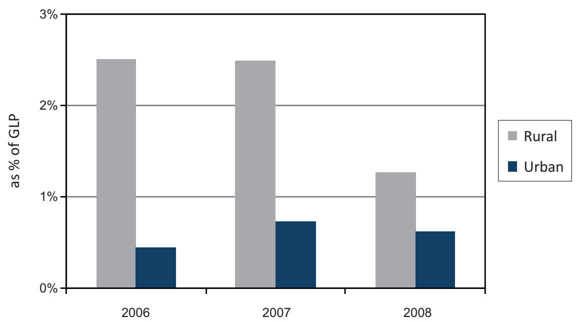
5. PORTFOLIO QUALITY BY RURAL/URBAN

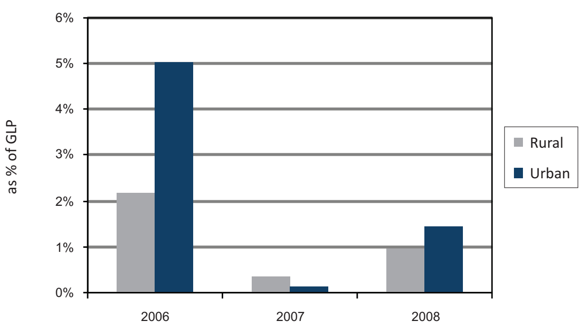
There is a significant difference between the level of PAR between rural and urban portfolios. Nearly all institutions that operate in rural and urban areas show higher percentage of risk in their rural credit portfolios than the urban portfolio. Although the overall level of rural PAR has been declining over the past three years, it still remains significantly higher than urban PAR. The spike in urban write-offs in 2006 is due to write-offs by Khushhali Bank.



PAR > 30 days by Rural/Urban

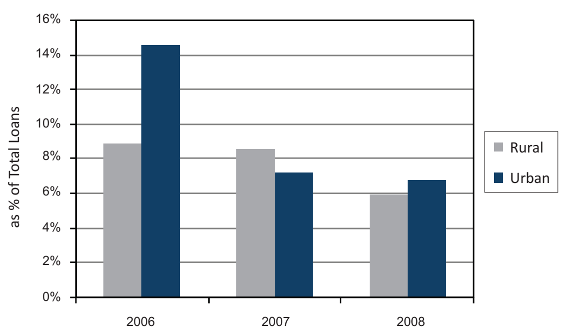
PAR > 90 days by Rural/Urban





Rural/Urban Write-offs

Rural/Urban Delinquency Ratio



6. PORTFOLIO QUALITY BY PURPOSE OF LOAN[6]

Since rural lending appeared more risky (see Section V above), it could be expected that agriculture and livestock/poultry would be the riskier credit markets. Although livestock/poultry does show PAR above the overall average, manufacturing/production, services and housing seem to be riskier than agriculture. However one reason for the apparently better quality of the agriculture portfolio could be that most of these loans tend to be 'bullet' loans, which can depress delinquency. Additionally, these numbers should be read carefully as field experiences have shown that often MFP staff at the field level is not very particular about the classification of loans as far as their purpose is concerned.

PAR > 30 days (%)			
	2006	**2007**	**2008**
Agriculture	2.24	1.62	1.12
Manufacturing/Production	7.58	5.20	3.52
Livestock/Poultry	4.72	4.47	2.43
Trade	3.65	4.04	1.28
Housing	2.30	6.95	0.41
Services	2.30	8.60	4.74
Other	3.40	1.36	0.56
Total	**3.36**	**3.12**	**1.44**

PAR > 90 days (%)			
	2006	**2007**	**2008**
Agriculture	0.97	0.96	0.70
Manufacturing/Production	7.07	4.69	2.63
Livestock/Poultry	3.92	3.77	2.02
Trade	2.55	3.18	1.11
Housing	1.60	6.08	0.21
Services	1.60	7.10	2.40
Other	2.60	1.31	0.35
Total	**2.28**	**2.40**	**1.12**

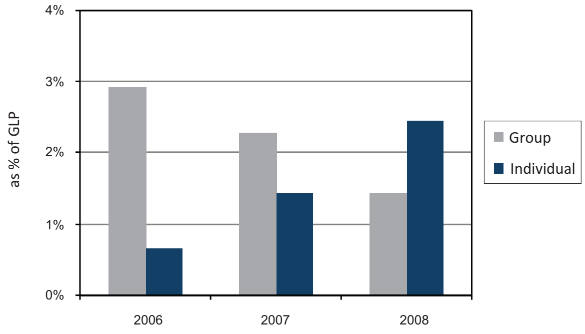
6. Data for this section was not available for two reporting MFPs: Kashf and First MFB.

Write offs (%)			
	2006	**2007**	**2008**
Agriculture	1.75	0.03	0.31
Manufacturing/Production	0.44	0.58	1.15
Livestock/Poultry	7.05	0.17	1.60
Trade	4.19	0.18	2.47
Housing	0.00	1.28	0.00
Services	0.00	1.58	0.00
Other	0.81	1.31	0.31
Total	**3.80**	**0.31**	**1.47**

Delinquency Ratio (%)			
	2006	**2007**	**2008**
Agriculture	6.29	5.49	5.09
Manufacturing/Production	7.13	3.63	4.01
Livestock/Poultry	15.51	13.54	10.17
Trade	17.08	14.89	9.30
Housing	1.14	1.18	0.90
Services	1.14	1.24	9.35
Other	2.85	1.20	0.65
Total	**12.06**	**10.39**	**7.63**

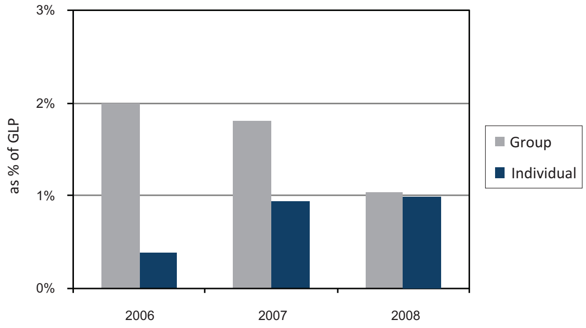
7. PORTFOLIO QUALITY BY LENDING METHODOLOGY

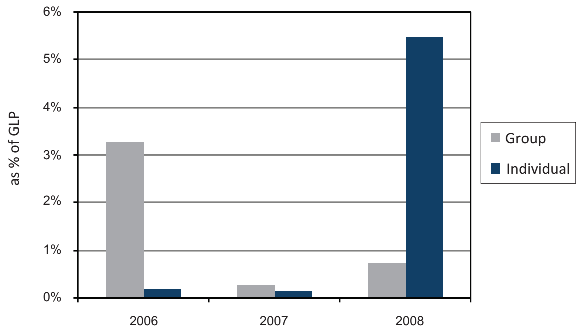
Splitting the delinquency numbers by lending methodology appears to confirm that individual lending is more risky compared to group lending. However, excluding one of the newer MFPs, the picture is reversed. The data also suggests that more established institutions that may not have experience in individual lending but considerable experience with group lending tend to have lower delinquency even when lending to individuals. Additionally, whereas group lending portfolio has been improving over time, that of individual lending has been deteriorating.



PAR > 30 days by Lending Methodology

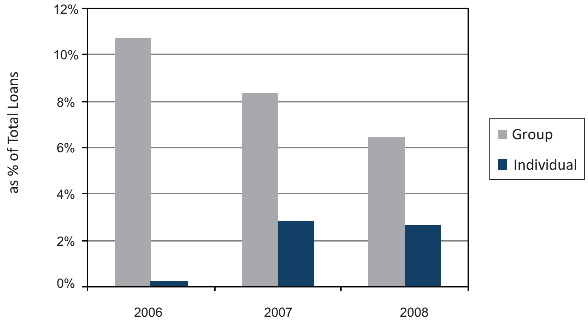
PAR > 90 days by Lending Methodology





Write-off by Lending Methodology

Delinquency Ratio by Lending Methodology



8. PORTFOLIO QUALITY AT THE DISTRICT LEVEL USING PAR > 30 DAYS (JUNE 2008)[7]

(in percent)

Districts with the Highest Delinquency

BALOCHISTAN[8]		NWFP		PUNJAB		SINDH	
Quetta	5.01	Swat[9]	58.48	M. Bahauddin	6.82	Khairpur	16.09
Gwadar	3.69	Mansehra	5.42	Kasur	1.50	Thatta	11.84
Loralai	3.33	Haripur	3.27	Rawalpindi	1.28	Badin	7.04
Mastung	2.46	Kohat	3.12	Sargodha	1.17	Dadu	5.45
Sibi	1.71	Mingora	2.85	Lahore	1.02	Umer Kot	4.56

Districts with the Lowest Delinquency

BALOCHISTAN		NWFP		PUNJAB		SINDH	
Nasirabad	0.00	Malakand	0.01	Layyah	0.00	Ghotki	0.00
Pishin	0.06	Swabi	0.17	Gujrat	0.00	Larkana	0.02
Barkhan	0.24	Mardan	0.20	Lodhran	0.00	Matyari	0.07
Jafarabad	0.65	Peshawar	0.66	Khanewal	0.01	Shikarpur	0.17
Zhob	1.49	Charsadda	0.77	Khushab	0.07	Jacobabad	0.26

Delinquency in the Largest 5 Districts (by number of loans)

	2007		2008	
District	PAR >30 days	PAR >90 days	PAR >30 days	PAR >90 days
Lahore	0.65	0.36	1.02	0.45
Bahawalpur	0.28	0.19	0.22	0.18
Faisalabad	0.17	0.01	0.45	0.04
Karachi	5.33	2.77	4.01	2.40
Bahawalnagar	0.35	0.14	0.19	0.06

Amongst the larger markets, Karachi seems to stand out with much higher delinquency. For nearly all institutions operating in Karachi, their PAR >30 days for this district is above their overall institutional average PAR, irrespective of institution type, lending model or extent of experience in the microfinance sector.

7. Data for this section was not available for PRSP.

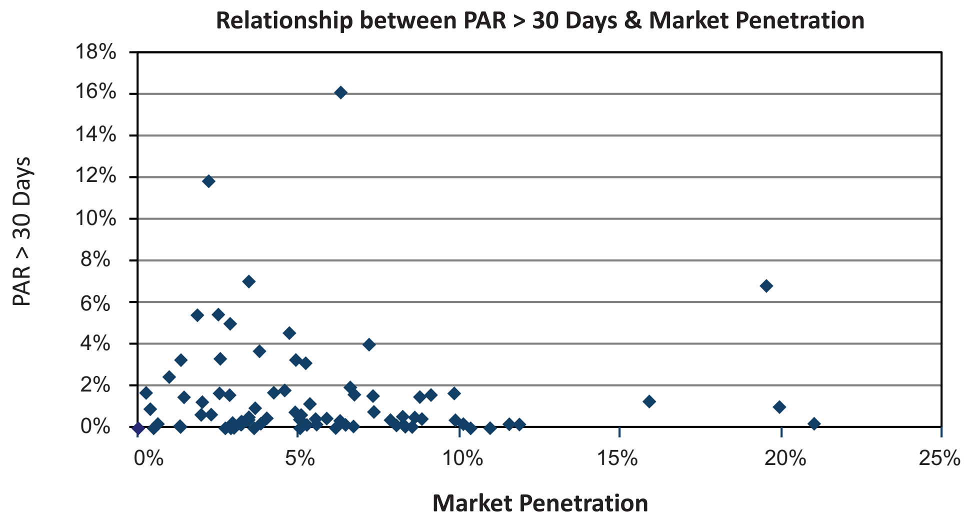
8. The total number of loans equaled or exceeded 1000 in only eight districts in Balochistan. We have thus used 400 total loans as the selection criterion for ranking districts of Balochistan.

9. The extraordinarily high delinquency in Swat can be attributed to the recent unrest and volatile security situation in the district.

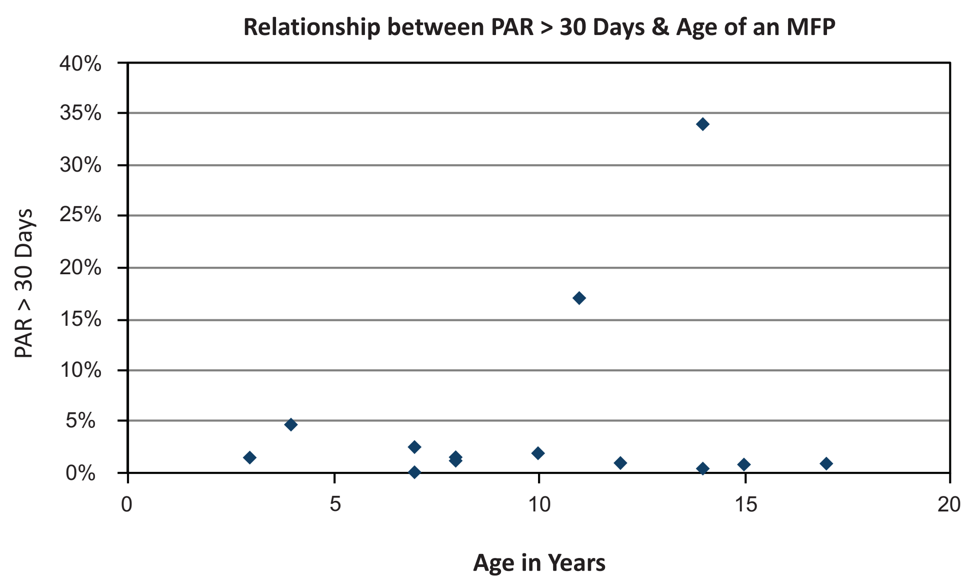
9. RELATING RISK TO DIFFERENT VARIABLES

It may be argued that high growth leads to greater competition that leads to deterioration in portfolio quality. In order to analyze whether such relationships exist in Pakistan's microfinance sector, correlation of risk (PAR >30 days) and a) market penetration – a proxy for competition, b) age – to analyze Greenfield versus experienced institutions, and c) growth is presented below. Not surprisingly none of these variables have a systematic relationship with risk. This reinforces the idea that delinquency is determined by an institution's capacity and capability to assess and deal with risk rather than its age or rate of expansion.

Relationship between Risk and Market Penetration
(Each point in the graph below represents a district)

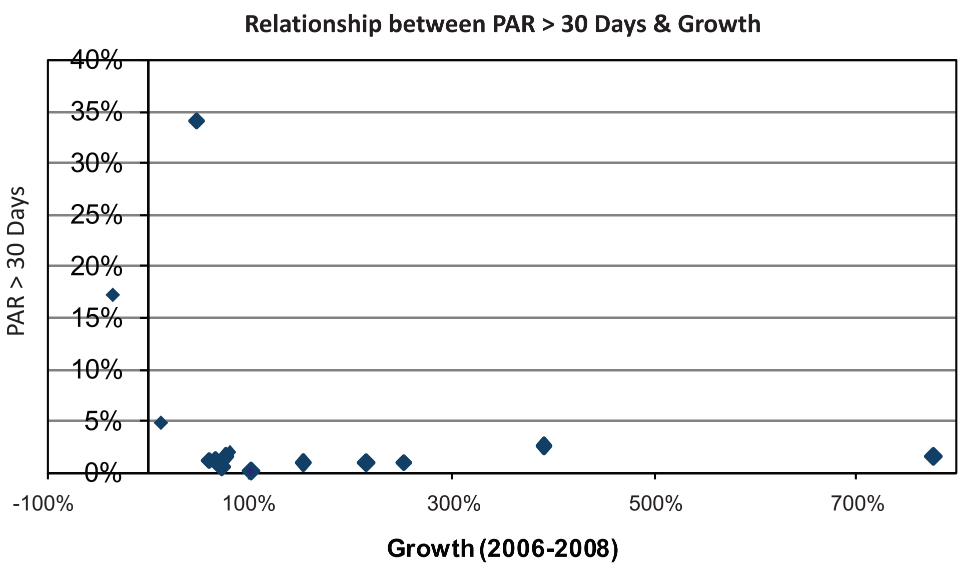


Relationship between Risk & the Age of an MFP
(Each point in the graph below represents an MFP)



Relationship between Risk & the Grouth of an MFP

(Each point in the graph below represents an MFP)



10. END NOTES

During the course of our analysis for this paper it became obvious that there is no consistent policy for write-offs followed by all MFPs in the sector. It also seems that many institutions are not writing off loans and carrying these bad assets on their books for imprudent periods. Under the existing regulatory framework for the sector, only the MFBs have a clear policy for classification of loans which is defined by the State Bank of Pakistan (SBP). As a best practice we thus propose that all other institutions should also adopt the same guidelines. Sections 12a and 14 of SBP's Prudential Regulations for Microfinance Banks, which outline the loan classification and write-off policies for MFBs, are reproduced below.

12. Classification of Assets and Provisioning Requirements

(a) Loans & Advances: The outstanding principal of the loans and advances, payments against which are overdue for 30 days or more shall be classified as Non- Performing Loans (NPLs). The unrealized interest / profit / mark-up / service charges on NPLs shall be suspended and credited to interest suspense account. Further the NPLs shall be divided into following categories:

i. Substandard: loans in arrears (payments/installments overdue) for 30 days or more but less than 90 days

ii. Doubtful: loans in arrears (payments/installments overdue) for 90 days or more but less than 180 days

iii. Loss: loans in arrears (payments/installments overdue) for 180 days or more. MFBs shall maintain a Watch List of all accounts delinquent by 5 – 29 days. However, such accounts may not be treated as NPL for the purpose of Classification / Provisioning.

Provisioning Requirements:

i. General Provision: The MFB shall maintain a General Provision equivalent to 1.5% of the net outstanding advances (advances net of specific provisions).

ii. Specific Provisions: In addition to the general provision, the MFB shall make specific provisions against NPLs at the following rates:

a. Substandard: 25% of outstanding principal net of cash collaterals

b. Doubtful: 50% of outstanding principal net of cash collaterals

c. Loss: 100% of outstanding principal net of cash collaterals.

Note: MFBs shall undertake “Classification and Provisioning” exercise at the end of every month. The MFBs at their discretion may also apply more stringent classification and provisioning criteria for NPLs.

14. Writing-off Non-Performing Loans (NPLs)

All Non-Performing Loans (NPLs) shall be written off; one month after the loan is classified as “Loss”. This shall, however, not extinguish the MFBs' right of recovery of such written-off loans.

For a look at the complete prudential regulations for MFBs, please visit SBP's website: http://www.sbp.org.pk/publications/prudential/micro_prs.pdf

ANNEXURE A: DEFINITIONS

1. INDICATORS

GLP (Adjusted): All outstanding principal amount for all outstanding client loans, including current, delinquent and restructured loans.

Portfolio at Risk > 30 days: The Rupee amount of outstanding balance of overdue (client) loans greater than 30 days, divided by the Adjusted GLP.

Portfolio at Risk > 90 days: The Rupee amount of outstanding balance of overdue (client) loans greater than 90 days, divided by the Adjusted GLP.

Write-offs: The value of client loans written-off during the year for loans outstanding equal to or greater than 180 days.

Number of Delinquent Loans: The number of client loans outstanding equal to or greater than 180 days. These are essentially the loans to be written off.

Delinquency ratio: Number of Delinquent Loans/Total Loans

2. PEER GROUPS

Microfinance Bank (MFB): Microfinance Bank licensed and prudentially regulated by the State Bank of Pakistan to exclusively service microfinance market.

Microfinance Institution: Microfinance institution providing specialized microfinance services.

Rural Support Programme (RSP): Rural support programme running microfinance operation as part of multi-dimensional rural development programme.

Non-Government Organization (NGO): Non-government organization running microfinance operations as part of multi-dimensional developed programme.

ANNEXURE B: REPORTING INSTITUTIONS

PMN thanks all reporting institutions for their support and patience.

Akhuwat
Community Support Concern (CSC)
Development Action for Mobilization and Emancipation (DAMEN)
Kashf Foundation
Khushhali Bank (KB)
National Rural Support Programme (NRSP)
Network MicroFinance Bank Ltd. (NMFB)
Punjab Rural Support Programme (PRSP)
Sarhad Rural Support Programme (SRSP)
Sindh Agricultural and Forestry Workers Cooperative Organization (SAFWCO)
Sungi Development Foundation (SDF))
Tameer Microfinance Bank Ltd. (TMFB)
Thardeep Rural Development Programme (TRDP)
The First MicroFinanceBank Ltd. (FMFB)

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