August 2020

Access to Credit in Pakistan

Dissecting the Demand and Supply

Access to credit is important for economic growth, creating employment and smoothening consumption for households. It is also an important factor in increasing the incidence of financial inclusion – a concept that implies inclusivity through easily accessible and affordable financial services for all businesses and households. Aside from credit, these services include remittances, insurance and savings among others. The focus of financial inclusion is entirely on formal provision of these services by financial institutions that are regulated by the state.

The objective of this policy brief is to answer incisive questions around borrowing in Pakistan: What is the incidence of borrowing among adults? Why do they borrow and what are their preferred means to attain loans? To answer these types of questions, the paper relies on demand side surveys conducted by policy makers such as the State Bank of Pakistan and multilateral agencies such as the World Bank. These are rich surveys that help construct the dynamic of borrowing in the country. In addition, these surveys have enough statistical precision to explain geographical variations in borrowing patterns between different provinces and other segments such as urban/rural and informal/formal borrowing.

Aside from the demand side, the volume of credit in consumer financing and microfinance is studied by geographic dispersion. Based on the demand and supply side patterns and behaviour related to borrowing, some recommendations are given towards the end for policy makers and financial institutions.

Incidence of Borrowing Among Pakistani Adults

Three demand side datasets are available to analyse patterns and borrowing behaviour in Pakistan. A brief description of all the datasets is provided below.

The Access to Finance Survey (A2F) was sponsored by the SBP, with the sample size of 10,000 respondents (with ages 18 and above) this survey is representative at national and sub-national level. The latest wave of the survey was completed in 2015.

Financial Inclusion Insights Survey (FII) is sponsored by Bill and Melinda Gates Foundation (BMGF). This is a longitudinal survey covering 6,000 individuals aged 15 and over. The survey has been conducted with a yearly frequency starting from the year 2013 till 2017. Like A2FS, the survey is representative at national and provincial level, however, due to limitations within the sample size, data captured for KP and Balochistan need to be interpreted with caution.

World Bank's Global Findex Survey (Findex) is conducted every 3 years. So far, three survey waves have been completed in Pakistan, i.e. 2011, 2014 and 2017. 1,000 individuals aged 15 and over were interviewed for this survey in each wave and the data captured is representative only at the national level.

The proportion of total borrowers varies significantly and ranges between 7% - 48%, across different waves of the aforementioned demand side surveys. As per recent readings, 35% of the respondents under Findex (2017) reported to have borrowings, while FII (2017) and A2F (2015) report it at 15% and 17%, respectively. The variance is mainly due to different approach used by each survey to define what constitutes borrowing. The definition under A2F and Findex is expansive, compared to the one used by FII (See Box 1 for variations in the definition adopted by

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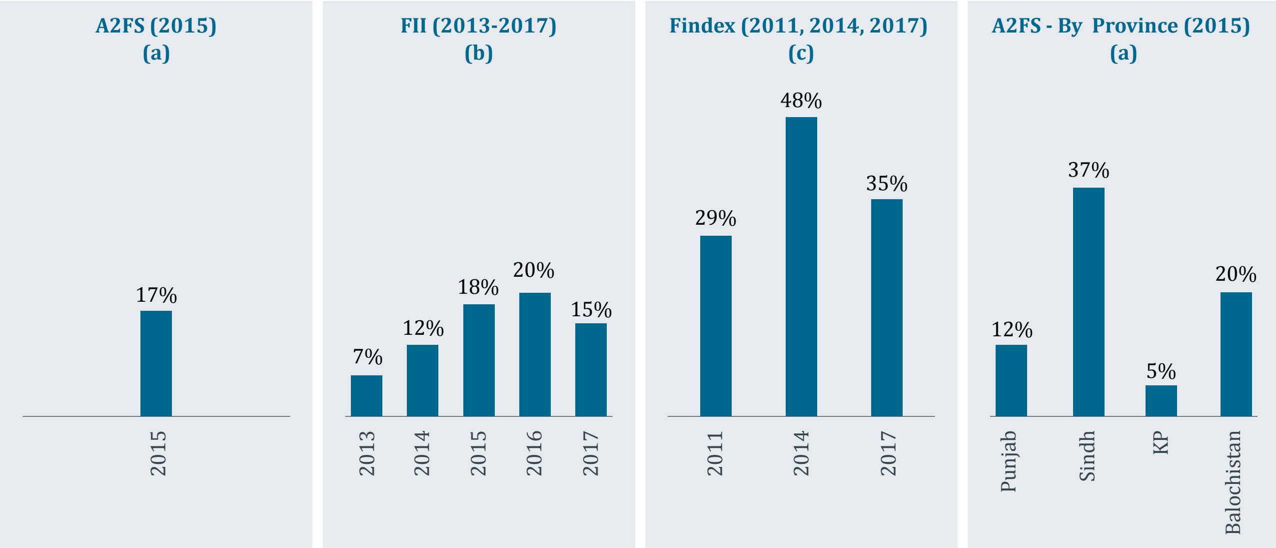
each survey). In terms of provinces, A2F reports the highest number of borrowers in Sindh (37%) followed by Baluchistan (20%). In Punjab, the largest province of Pakistan, this threshold is surprisingly low as only 12% of the respondents said to have borrowed (formally or informally) in the last 12 months. Khyber Pakhtunkhwa (KP), has the lowest level of borrowing incidence (5% of households).

Exhibit 1: Proportion of Respondents Reporting Borrowing in Demand Side Surveys



Box 1: Definition of Borrowing by Survey

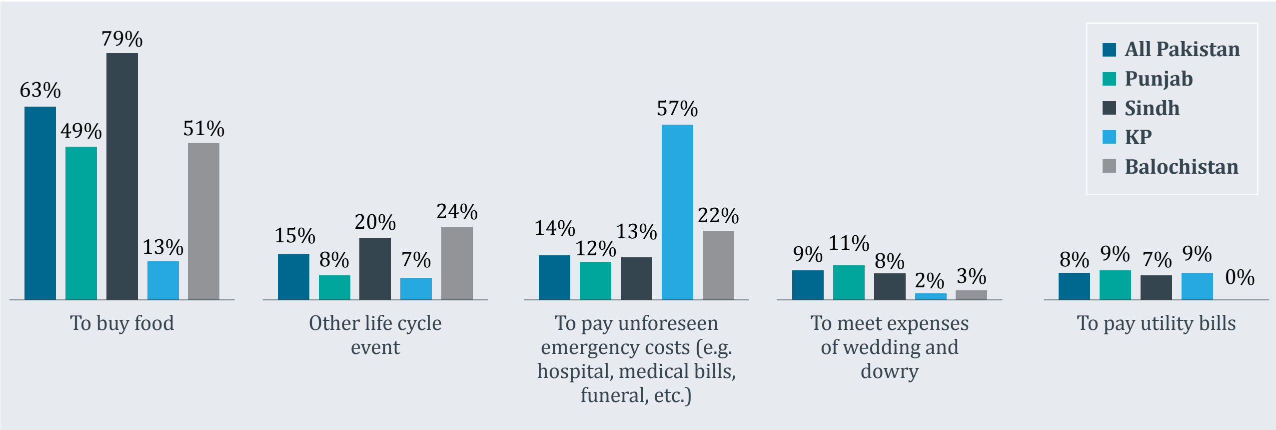
a. Access to Finance (A2F) defines borrowing as the percentage of respondents (age 18+) who have borrowed in the past 12 months with one of the following: i) banks, ii) microfinance banks, iii) leasing companies, iv) non-bank finance company or v) any other informal sources.

b. Financial Inclusion and Insights (FII) defines borrowing as the percentage of respondents (age 15+) who currently have a loan with one of the following: i) bank, or ii) mobile money account, iii) microfinance institution, iv) saving or lending group, or v) any other institution or financial service provider.

c. Global Findex (Findex) defines borrowing as the percentage of respondents (age 15+) who have borrowed from: i). a financial institution, ii) through a credit card, or iii) a saving clubs or iv) a store

Across all provinces majority of the respondents reported to use borrowings to buy food items and ration. Since the definition under A2F also includes borrowing from informal sources, it can be assumed that majority of these respondents rely on store credit to buy grocery and household items, which is a common practice. The other two most quoted reasons were using credit to pay for emergency costs or for other future events (this can include, house building, child education etc.). According to the Household Integrated Economic Survey (HIES), average monthly savings per household is estimated at ~PKR 4,000, depicting a constrained availability of resources to pay for any major emergency expenses or planned future consumption.

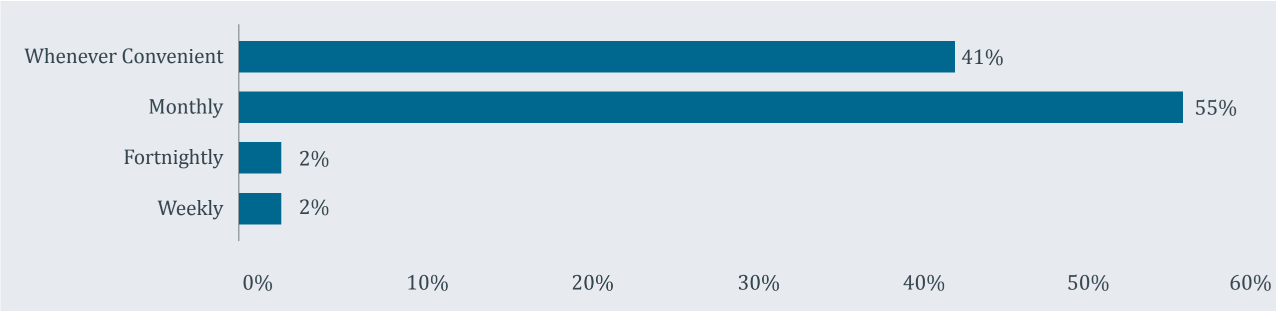
Exhibit 2: Reasons To Borrow (Province Wise Responses)



Source: State Bank of Pakistan; Access to Finance Survey 2015

Further analysis of A2F dataset reveals that majority of borrowing population prefers to have a monthly frequency for loan payments, reinstating the possibility of reliance on store credit for monthly consumption. Since inclination towards informal borrowing is quite strong (see **Exhibit 4**), most people tend to borrow on unstructured terms. As high as 41% of the borrowing population reported that they follow a fluid payment structure and prefer to pay at a frequency convenient to them.

Exhibit 3: Frequency of Loan Payment



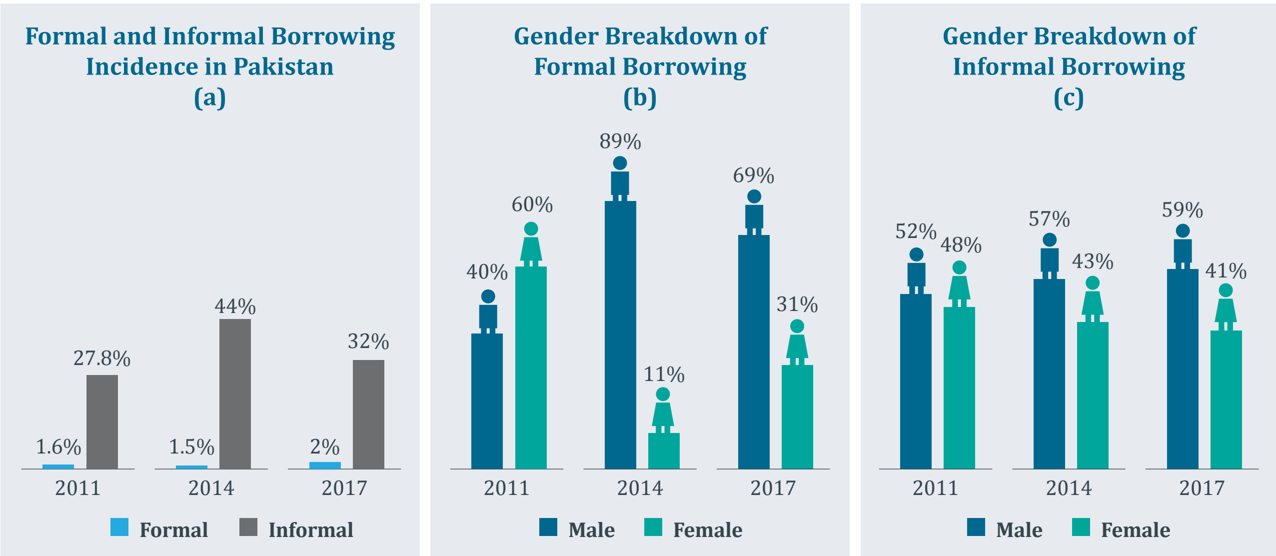
Source: State Bank of Pakistan; Access to Finance Survey 2015

Informal vs. Formal Credit Market

The incidence of borrowing is largely skewed towards the informal market – over 95% of borrowers were borrowing through informal channels. This is both a result and cause of low penetration of formal financial services. The low incidence of borrowing from formal channels and a large unbanked population reinforce each other indicating that it is as much of a demand side problem as it is of the supply side.

On the demand side, top reasons cited for borrowing informally under A2F are buying food (34.2%), life cycle events such as wedding and dowry (14.2%) and unforeseen and emergency situations (12.0%) such as medical bills and funeral. Majority of the borrowing respondents quoted three major reasons for using informal credit: i) convenient location of the informal lender, ii) easier overall access (informal money lenders do not require excessive documentation and heavy collaterals) and iii) an easy process to obtain money (processing times are significantly short compared to the formal market). Please see **Exhibit 5**.

Exhibit 4: Formal and Informal Borrowing



Source: Wold Bank's Global Findex

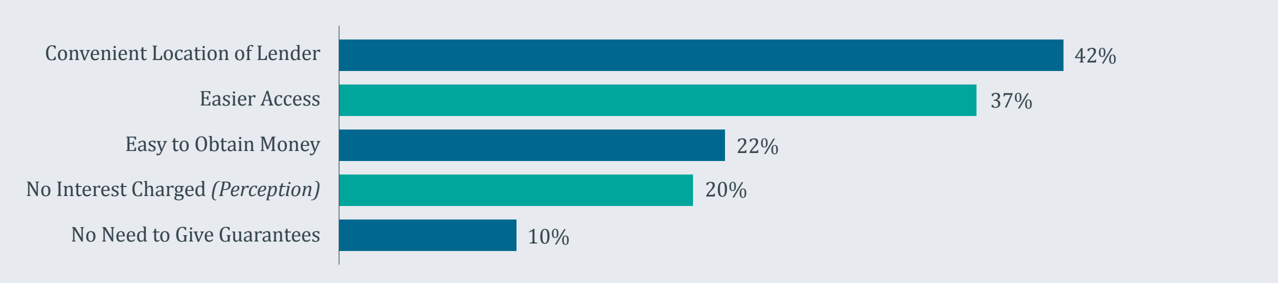
On the point of interest rates, ~20% of the borrowing respondents mentioned low interest rate as one of the reasons to borrow from the informal market. This is a major misconception among informal borrowers as interest rates are generally higher in the informal market, ranging from 62% to 80%[1]. However, in most instances, the interest rate is packaged as processing fee or an additional loan instalment within the principle amount.

[3] IGC. Who is the "*Arthi*": Understanding the Commission Agent's Role in the Agriculture Supply Chain. 2013.

The top reasons for formal borrowing are fairly similar to informal borrowing – life cycle events (14.75%) such as expenses related to a wedding e.g. dowry. The reason that stood out was purchase of durables (11.4%) such as jewellery, watches and furniture, confirming the hypothesis that asset building and expenditure on consumer durables takes place more so through formal borrowing than it does with informal borrowing.

It can also be seen that among borrowers captured within the formal financial system, majority is the male population while in case of informal lending, though the proportion of male borrowers is high, the male/female split does not vary significantly. This potentially points to difficulties women face in accessing formal credit. A number of reasons can be attributed to this, i.e. failure to fulfil documentation requirements or cultural barriers that limit the physical mobility of women and prevent them from moving freely in public places.

Exhibit 5: Reasons for Informal Borrowing



Source: State Bank of Pakistan; Access to Finance Survey 2015

Demand side surveys highlight that use of informal means to access credit is much popular in domestic population. To estimate the size of this grey market, it is important to get an idea of average outstanding loan amount in domestic households. A2F tends to capture this information at household level. **Exhibit 6**, provides a crude estimation for size of informal credit market.

Exhibit 6: Estimation of Informal Borrowing by Households

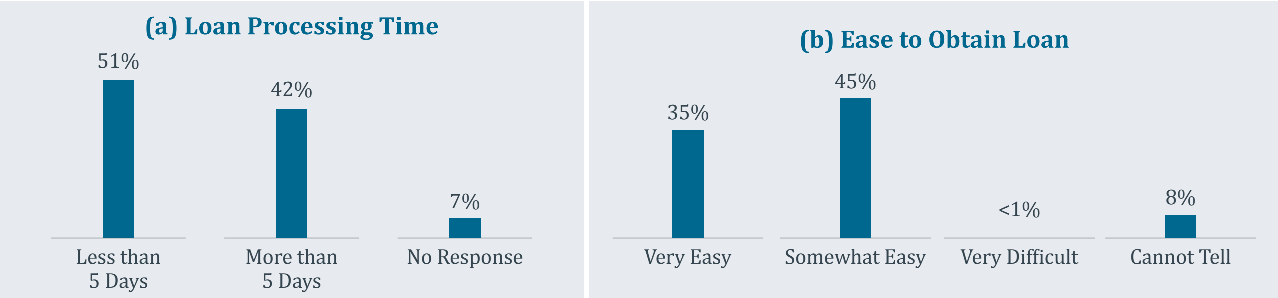
Adult Borrowing Population* (Million)	20
% of Borrowers Reporting Usage of Informal Credit	95%
Adult Population Using Informal Borrowing (Million)	19
Average Loan Size from Informal Sources* (PKR)	42,000
Estimated Size of Informal Household Debt (PKR Billion)	798

Source: State Bank of Pakistan; Access to Finance Survey 2015

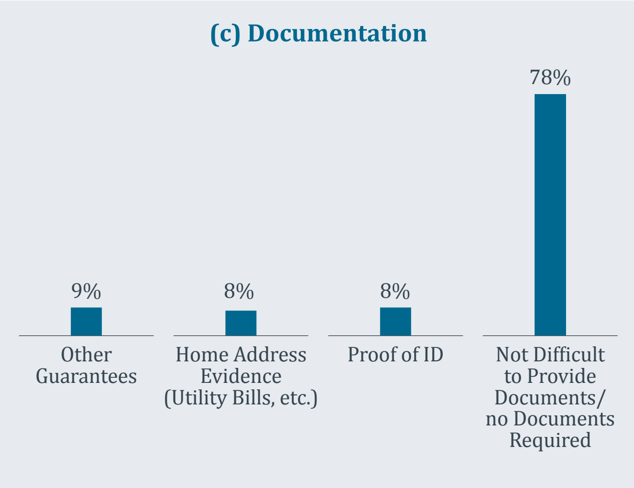
**i) 17% Reading as per A2F 2015, ii) Age wise split under 1998 Population Census applied to population reported under Census 2017 as age wise distribution under Census 2017 is not publically available, iii) Average loan size figures are for individual respondents interviewed in A2F survey's 2015 wave.*

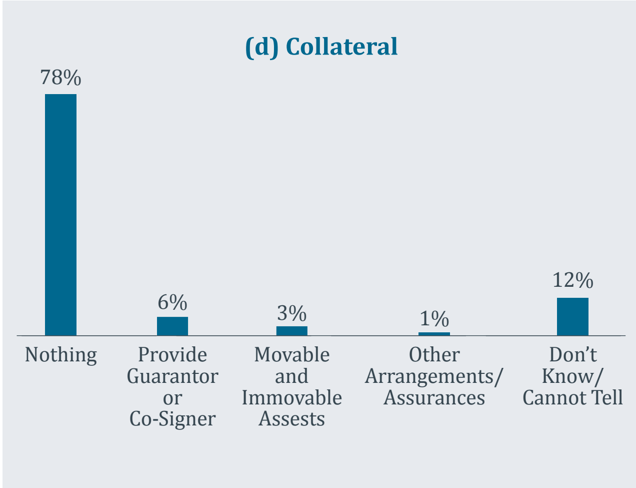
A2F dataset provides further insight on the overall lending process of the informal market. More than half of the informal borrowers reported getting the loan in less than 5 days. 35% declared that they face no difficulties at all, 45% said the process is "somewhat easy" and less than 1% stated that it was very difficult. 78% of the informal borrowers mentioned that either no documents were needed or the requisite documentation was not difficult to provide. Surprising, only 9% mentioned to have been asked about the proof of formal ID. With respect to provision of collateral, 78% of respondents stated that no security was requested against the loan.

Exhibit 7: Features of Informal Credit Provision



Source: State Bank of Pakistan; Access to Finance Survey 2015





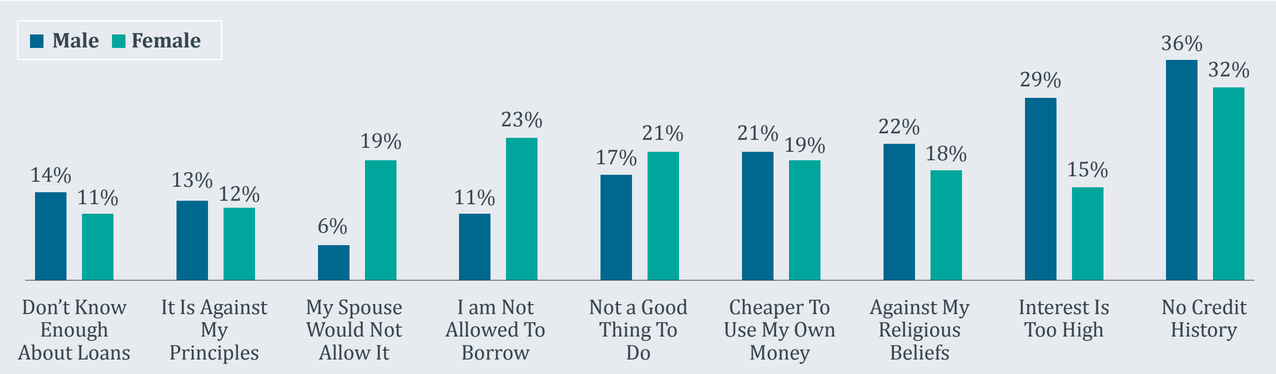
Source: Wold Bank's Global Findex 2017

The Excluded Population: What Inhibits Them from Borrowing?

While it is important to understand why people borrow, it is equally useful to explore the reasons that inhibit potential borrowers from borrowing. This part of the behavioural attribute completes the demand side credit dynamic.

A2F data set reveals some interesting information in this regard. One key reason for not borrowing (irrespective of the gender) is lack of a credible credit history. This issue is widely acknowledged in the formal market and it is expected that locally domiciled credit bureaus with their expanding data bases will help address this market failure. Inclusion of records regarding utility bill payments would provide some key insights on transaction history of a consumer new to the financial system. The other two major reasons quoted by male respondents for not accessing loans (from the formal market or informal market) are high interest rates and religious beliefs that prohibit taking interest bearing loans. In case of females, 23% stated that they are not even allowed to borrow. This highlights the prevalence of a societal encumbrance, as females are not allowed to participate in the economic decisions within a household. This also negatively impacts their inclusivity within the formal financial system.

Exhibit 8: Reasons Cited for Not Borrowing

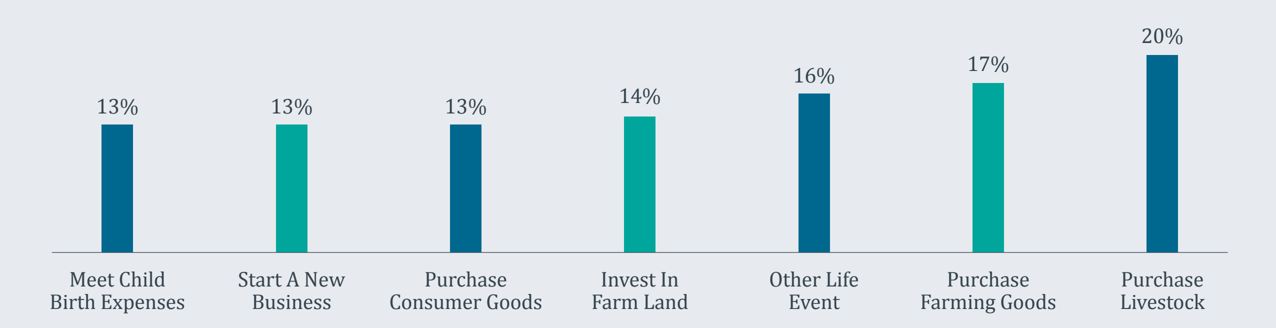


Source: State Bank of Pakistan; Access to Finance Survey 2015

Potential Borrowing Needs – Agriculture Leading the Way

To enhance their respective outreach, it is important for formal financial institutions to understand the borrowing needs of potential borrowers. This will help in identifying segments and the requisite products needed to meet the needs of potential customers. According to A2F, when potential borrowers were asked about the key reason behind borrowing, a majority identified an agricultural sector related requirement. 20% needed it to buy livestock, 17% for farming goods while another 14% needed a loan to purchase farm land. Local financial institutions should consider enhancing their foot print in the under/un-served rural areas of the country with an effective penetration strategy designed to tap the potential credit demand. Other key reasons cited in the survey were future life events (16% of potential borrowers), starting new business (13%), meeting child expenses (13%) and purchase of other consumer durables (13%).

Exhibit 9: Needs of Potential Borrowers



Source: State Bank of Pakistan; Access to Finance Survey 2015

Understanding the Supply Side

Two key means for formal household credit are Micro Finance and Consumer Financing. Statistics related to each of these are presented below to understand the supply dynamic and patterns. The provision of formal credit is concentrated in Punjab and Sindh while KP and Balochistan are underserved.

Microcredit

Within microcredit space, Punjab has the highest share in terms of outstanding loan amount (PKR 234 billion) and also has the most number of active borrowers (73% of total). KP and Balochistan have the lowest number of active borrowers, constituting a meagre 2% and 0.2% of the total respectively. Even when compared to the estimated market potential, penetration rate in both of these provinces hover at around 3.5%. The average loan size, however, in both these provinces is higher than the country's average.

Exhibit 10: Province Wise Microcredit Statistics

Indicator	Pakistan	Punjab	Sindh	KP (including FATA)	Balochistan
Gross Loan Portfolio (GLP) (PKR Billion)	309	234	56	9	1
Provincial Share in GLP (%)	N/A	76%	18%	3%	0.40%
Active Borrowers (Million)	7.3	5.4	1.6	0.2	0.02
Provincial Share in Active Borrowers (%)	N/A	73%	22%	2%	0.24%
Estimated Potential Borrowers* (Million)	21	13	2	5	0.5
Penetration Rate* (%)	36%	43%	66%	4%	4%
Average Loan Size (PKR '000)	42	44	36	52	71

Source: Pakistan Microfinance Network; MicroWatch (Figures as of March 2020).

**As per Pakistan Microfinance Network (PMN)*

Consumer Financing

Another key product for household credit is consumer financing, extended by domestic commercial banks. Within personal/consumer financing, vehicle financing is the most popular product, making up 35% of the total portfolio, followed by house financing and personal loans (each constituting 28% of the total). Financing under credit cards makes 9% of the total.

Exhibit 11: Category Wise Outstanding Portfolio Under Personal Advances

Financing Type	Outstanding Portfolio (PKR Billion)	Share (%)
House Financing	199	28%
Transport i.e. Purchase of Car, etc.	245	35%
Credit Cards	49	7%
Consumer Durables	7	1%
Personal Loans	198	28%
Other	1	0%
Total Personal Advances*	**700**	**N/A**

Source: State Bank of Pakistan; Credit/Loans Classified by Borrowers (Figures as of December 2019).

** This includes personal financing to bank employees and other consumers.*

Supply side statistics on consumer financing reveal a similar situation to the micro credit landscape. Punjab and Sindh remain the prime focus of domestic commercial banks for extension of credit. In terms of total advances, Punjab constitutes 52% followed by Sindh with 47%, while the share of KP and Balochistan is miniscule (1% and 0.3%, respectively). In terms of personal advances, the numbers are slightly different for the top two provinces, uptake of personal advances is much higher in Sindh with 60%. Again, KP and Baluchistan are underserved, capturing only 2% and 1% of the pie respectively, depicting a significant disparity among provinces.

A granular look at data further reveals that while commercial banks do rely on personal deposits as a source of liquidity (making 49% of the total deposits as of Dec. 2019), their credit extension under personal advances category is too low; a meagre 10% of total personal deposits raised by commercial banks. The highest ratio is for Sindh where personal advances are 22% of the personal deposits raised from the province, while for Punjab the ratio is less than 10% (~6%). For Balochistan and KP this ratio is even lower (4% and 1%, respectively).

Exhibit 12: Province Wise Total and Personal Advances

Indicator	Pakistan	Punjab	Sindh	KP (including FATA)	Balochistan
Total Advances (PKR Billion)	7,991	4,120	3,741	88	27
Provincial Share in Total Advances (%)	N/A	52%	47%	1%	0%
Personal Advances* (PKR Billion)	700	254	417	16	6
Provincial Share in Personal Advances (%)	N/A	36%	60%	2%	1%
Personal Deposits* (PKR Billion)	7,208	4,087	1,957	683	166
Personal Advances to Personal Deposits (%)	10%	6%	21%	2%	4%

Source: State Bank of Pakistan; Statistics on Scheduled Banks in Pakistan (Figures as of December 2019).

***Notes:** i) Country level Total and Personal Deposits include figures for Azad Jammu and Kashmir and Gilgit Baltistan. (ii) Total Advances include deposits held by non-residents, Government, Non-Financial Public Sector Enterprises, Non-bank Financial Institutions (NBFIs) and Finance Auxiliaries, Private Sector, Trust Funds, Personal deposits and others. iii) Personal Advances includes personal financing to bank employees and other consumers. iv) Personal Deposits include deposits raised from Salaried Persons, Self-employed and Other Persons (House-wives, students etc.).*

In terms of rural vs. urban, bulk of these advances are concentrated in urban centres of the country; rural areas receive only 4% of the share. This pattern seems to be somewhat similar when compared to geographic concentration of personal deposits. Balochistan, surprisingly has the most balanced split between urban and rural advances (whether total or personal) but the base is too low and this conclusion might be tenuous. It can be further seen that quantum and incidence of personal advances vis-à-vis personal deposits at the national level is too low for rural consumers (personal advances equivalent to ~5% of total personal deposits raised from rural areas of the country). As already mentioned, Advances to Deposits (ADR) for Personal Loan category is much better for Sindh, similarly, urban and rural areas of the province have a relatively better ADR compared to other provinces. Rural Balochistan, is another region where ADR is relatively better compared to the country's average, however, in absolute terms the portfolio is too small.

Exhibit 13: Urban/Rural Split of Total and Personal Advances

Indicator	Pakistan		Punjab		Sindh		KP (including FATA)		Balochistan	
	Urban	Rural	Urban	Rural	Urban	Rural	Urban	Rural	Urban	Rural
Total Advances (PKR Billion)	7,691	300	3,931	189	3,657	84	80	7	11	15
Urban/Rural Share in Total Advances	96%	4%	95%	5%	98%	2%	92%	8%	42%	58%
Personal Advances* (PKR Billion)	645	55	233	21	390	27	14	2	3	3
Urban/ Rural Share in Personal Advances	92%	8%	92%	8%	94%	6%	88%	12%	51%	49%
Personal Deposits* (PKR Billion)	6,046	1,162	3,426	660	1,854	103	464	219	130	36
Urban/ Rural Share in Personal Deposits	84%	16%	84%	16%	95%	5%	68%	32%	78%	22%
Personal Advances to Personal Deposits	11%	5%	7%	3%	21%	26%	3%	1%	2%	8%

Source: State Bank of Pakistan; Statistics on Scheduled Banks in Pakistan (Figures as of December 2019).

***Notes:** Country level Total and Personal Deposits include figures for Azad Jammu and Kashmir and Gilgit Baltistan. (ii) Total Advances include deposits held by non-residents, Government, Non-Financial Public Sector Enterprises, Non-bank Financial Institutions (NBFIs) and Finance Auxiliaries, Private Sector, Trust Funds, Personal deposits and others. iii) Personal Advances includes personal financing to bank employees and other consumers. iv) Personal Deposits include deposits raised from Salaried Persons, Self-employed and Other Persons (House-wives, students etc.).*

The penetration in KP and Balochistan is also restricted by inadequate access points, as evidenced by the restricted outreach of formal financial institutions (see **Exhibit 11**). Both these provinces have the lowest penetration of bank branches (KP: 4 per 100,000 inhabitants; Baluchistan: 3 per 100,000 inhabitants, respectively) and branchless banking (BB) agents (KP: 1 agent per 1,000 inhabitants and Baluchistan 0.5 agent per 1,000 inhabitants).

Exhibit 14: Financial Service Access Points by Province

Indicator	Pakistan	Punjab	Sindh	KP (including FATA)	Balochistan
Bank Branches	14,603	8,267	3,523	1,609	575
Share in Total Bank Branches (%)	N/A	57%	24%	11%	4%
Bank Branches Per 100,000 Inhabitants	7	7	7	4	3
Branchless Banking (BB) Agents	437,182	275,381	90,801	51,485	9,890
Share in BB Agents (%)	N/A	63%	21%	12%	2%
BB Agents per 1,000 Inhabitants	2	2	2	1	0.5

Source: State Bank of Pakistan; Statistics on Scheduled Banks in Pakistan and Branchless Banking Statistics (Figures as of December 2019).

***Note:** Country level Bank Branches and Branchless Banking Agents include figures for Azad Jammu & Kashmir and Gilgit Baltistan.*

Recommendations

- Borrowing in Pakistan is largely skewed towards informal borrowing (95% of all borrowing) because of various reasons that include convenience, faster processing times, no collateral, perceived lack of interest charged amongst others. Branchless Banking is setup to compete with informal borrowing on all the aforementioned factors but it is largely limited to remittances and P2P transfers. This is a low hanging unutilized fruit that can be used to increase the incidence of formal borrowing especially through Level 0 accounts that are easy to activate and have no associated account opening costs.

- If Branchless Banking is to be successful in converting informal borrowing to formal borrowing, there is a need to build credit histories using large data for population at the bottom of the pyramid. Data from large G2P programs alongside P2P and P2G can be used for this purpose. Aside from a strong business case for credit bureaus, there is also an enabling regulatory environment by SBP that has paved the way for the establishment of private credit bureaus which will help achieve this objective.

- Regulators are already taking initiatives to integrate telecom and utility companies' data into credit bureaus to expand their data bases. Inclusion of these records regarding utility payments would provide some key insights on transaction history of consumers, especially those who are new to the financial system, however, this needs to be fast tracked to close the existing gap and address prevalent information asymmetries that inhibit financial institutions to take exposure on these un/underserved clients.

- Conventional financing through microfinance and personal banking loans are largely skewed towards urban centres and the largest province of Punjab. Although it can be argued that this is justified given the large concentration of population and economic activity, if the gap, captured by informal financing is to be bridged, other provinces and rural areas need more attention from FIs.

- The incidence of female borrowing in Pakistan is very low when compared to males for formal as well as informal borrowing. However, the gap in informal borrowing (~18 percentage points) is much lower than formal borrowing (~40 percentage points), (See **Exhibit 4**). Women are not allowed to fully participate in the economic decisions of the households and have limited mobility in public spaces, especially in the rural areas. FIs can leverage G2P programs such as BISP to increase penetration towards the female segment. Cash transfer in BISP takes place through an account where only withdrawals are allowed. FIs can take advantage of these accounts if they are converted from Limited Mandate Accounts to full service accounts as per announced policy.

- Interest on loans is a major pain point and inhibitor of formal borrowing due to cultural and religious reasons. This is paradoxical because there is ample evidence that shows that interest rates are actually higher in informal borrowing as compared to formal borrowing. This requires FIs to develop Islamic financial products which meet the religious requirements. On the other hand, consumers need to be educated on the hidden interest rate packaged as an instalment.

- State Bank's A2F Survey is the most in-depth survey compared to FII and Findex. It has the biggest sample size and highest number of demand side indicators that can be parsed and segmented in various ways. While FII and A2F can go down to the provincial level, they should go down further and have indicators at the district level.

About Karandaaz

KARANDAAZ PAKISTAN is a Section 42 company established in August 2014 and focuses on fostering economic growth and creating jobs through financial inclusion of unbanked individuals and unserved enterprises, with a special focus on women and youth. The company has four verticals:

Karandaaz Digital

Focuses on expanding the poor's access to digital financial services in Pakistan by working across the ecosystem with all stakeholders.

Karandaaz Capital

Provides wholesale structured credit and equity-linked direct capital investments to micro, small and mid-size enterprises (MSMEs) that demonstrate compelling prospects for sustainable business growth and employment generation in Pakistan.

Karandaaz Innovation

Manages the Innovation Challenge Fund and Women Entrepreneurship Challenge, providing risk capital and grants to partners with the aim to generate innovative solutions in areas of financial inclusion and entrepreneurship.

Knowledge Management and Communications

Supports the company's core financial inclusion goal by developing and disseminating evidence based insights and solutions.

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