Spotlight on Financial Inclusion Leaders

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Inclusive Finance for Low Cost Private Schools in Pakistan

Serving a new client segment with sector-specific strategies

Pakistan's 70,000 Low Cost Private Schools (LCPSs) are credited with nearly all recent primary school enrollment gains across the country. While they are poised for continued growth, LCPSs need access to external financing to invest in the quality of learning and infrastructure improvements that will ensure significant, sustainable impact on the education sector. Together with other key stakeholders, the Pakistan Microfinance Network is supporting microfinance providers in the development of a sector-based lending methodology and a suite of financial products which will expand and improve access to financial services for LCPSs.

Rationale and background: Why financial products for Low Cost Private Schools in Pakistan?

There are approximately **5.1 MILLION** primary-aged children out of school in Pakistan, more than in any other country in the world except Nigeria. **GIRLS**, **RURAL** children, and children from **POORER** households are most likely to be out of school.[1]

As children get older, the gap between rich and poor widens; **50%** of children between 7 and 16 years of age from the poorest households are considered out-of-school children (OOSC).[2]

Government spending in the education sector was limited to **2.3%** of GNP as of 2011.[3]

There are currently **70,000** Low Cost Private Schools (LCPSs) filling the quality and capacity gaps of public education in Pakistan. The private school sector serves **10.5 MILLION** students across all income brackets, out of a total national enrollment of 35.2 million.[4] Almost all of the gains in school enrollment across the nation during the last decade, particularly at the primary level, can be attributed to private schooling.[5]

Most LCPSs require external funding in order to fully meet enrollment needs, improve teaching quality, and invest in infrastructure. It is estimated that the sector's funding appetite exceeds PKR **77 BILLION** (750 million USD), which exceeds the total combined portfolio of all microfinance providers in Pakistan by PKR 25 billion (150 million USD). [6]

1. "Out of School Children in the Balochistan, Khyber Pakhtunkhwa, Punjab and Sindh Provinces of Pakistan". All Children in School by 2015: Global Initiative on Out-of-School Children. UNICEF. June 2013 http://www.unicef.org/pakistan/OSC_UNICEF_Annual_Report.pdf.
2. The Hidden Crisis: Armed conflict and education. EFA Global Monitoring Report 2011. UNESCO. http://unesdoc.unesco.org/images/0019/001907/190743e.pdf.
3. Barber, Sir Michael. "Education Reform in Pakistan: This Time It's Going to be Different." Pakistan Education Task Force. 4 Nov 2010. http://www.brookings.edu/~/media/events/2010/11/04%20education%20pakistan/barberpakistan_education%20paper.pdf.
4. Pakistan Education Statistics 2011-12. Annual Report of the NATIONAL EDUCATION MANAGEMENT INFORMATION SYSTEM ACADEMY OF EDUCATIONAL PLANNING AND MANAGEMENT MINISTRY OF EDUCATION, TRAININGS & STANDARDS IN HIGHER EDUCATION GOVERNMENT OF PAKISTAN. Islamabad. http://unesco.org.pk/education/documents/2013/pslm/Pakistan_Education_Statistics.pdf.
5. Bari, Dr. Faisal, Emily Richardson, Gul Nasreen. "Access to Finance for Low-cost Private Schools in Pakistan." Ilm Ideas. May 2014. http://www.educationinnovations.org/research-and-evidence/access-finance-low-cost-private-schools-pakistan.
6. Ibid.

The Opportunity: Expanding access to finance in Pakistan

The Pakistan microfinance sector is comprised of diverse types of microfinance providers (MFPs), including Microfinance Banks (MFBs) regulated by the State Bank of Pakistan (SBP), specialized microfinance institutions (MFIs), non-government organizations (NGOs), and rural support programs (RSPs) whose multi-dimensional development programs include microfinance offerings. The sector has evolved from a single product, microcredit-driven industry towards greater product diversification. Today, the sector offers a range of credit, savings, insurance, and remittances products for low-income households. Technology-based innovations in delivery channels (such as branchless banking) along with increased investment in industry infrastructure (including a microfinance credit information bureau) have helped advance the sector along its maturity curve. New guidelines set by the SBP have increased the maximum micro-enterprise loan amount from PKR 150,000 (USD 1,519) to PKR 500,000 (USD 5,066). As a result, enterprises with demand for higher loan amounts—including LCPSs—can benefit from microfinance services.[7]

However, significant challenges remain vis-à-vis expanding access to finance at both the household and firm levels. To date, microfinance in Pakistan has only served about 10.2 percent of its potential market, estimated to be close to 27 million clients. This indicates there is room for microfinance providers to enhance outreach to underserved populations through targeted strategies. [8]

Enterprise lending has become an increasingly important segment for microfinance providers, though there is a need for greater market segmentation, product diversification, and sector-specific strategy development. Following the revision of the loan ceiling by the SBP, several MFPs—especially the microfinance banks—have already begun taking steps that will enable them to reach out to micro, small, and medium enterprises (MSMEs) by creating enterprise loan products and employing the individual lending methodology for higher loan amounts. Within this context, there is great potential for facilitating access to financial services for owners of low cost private schools, a specific sub-set of the MSME sector in Pakistan.

Low Cost Private Schools: A robust potential client base for microfinance

- The LCPS model has been replicated across Pakistan and has grown quickly, accounting for 30% of total school enrollment as of 2012.
- Even the LCPSs with the lowest fees generate a healthy net profit margin. While profitable enterprises, they are in need of access to additional capital for growth.
- LCPS owners are interested in and willing to explore external finance opportunities for quality improvements and sustainable expansion.
- The business strategy of LCPSs aligns with parental preferences for proximity, an attractive environment for the education of girls, and a flexible pricing structure. LCPSs are perceived as local and customized solutions that offer better learning opportunities to the middle, lower-middle, and low income segments of the Pakistani population.

7. Haq, Aban and Khadija Ali. "Financing Low Cost Private Schools (LCPS) Through Microfinance." PMN MicroNote. March 2014. http://www.microfinanceconnect.info/assets/articles/5b1cc9ff056a1ff794fd647aeb3b2280.pdf.

8. Ibid. #4.

Activities implemented to date by key stakeholders

1 Market Assessment and Feasibility Study

With leadership and funding support from the UK Department for International Development (DFID), a group of key stakeholders including the Pakistan Microfinance Network, Khushhali Bank, Kashf Foundation, First Microfinance Bank, Sindh Education Foundation and Punjab Education Foundation contributed to a research study examining the overall market for LCPSs and their financing needs. The research, implemented by Ilm Ideas[9] and SEBCON[10] also enabled the development of client assessments and product development tools for MFPs.

The study[11] surveyed over 300 schools in Khyber Pakhtunkhwa, Punjab, and Sindh and revealed that the volume and sources of initial investment for existing schools are typical of the MSME sector. A substantial number of LCPSs have initial investments of less than PKR 300,000 (USD 3,000), usually sourced from personal savings and loans from family and friends. The research also indicated that one of the major barriers to growth in the LCPS sector is the lack of access to finance beyond this initial investment.

The study's results clearly demonstrate the existence of a demand for financial services and products for LCPSs. As illustrated in the estimated need of PKR 77 billion (750 billion USD) in funding, there is an opportunity to reach significant scale.

2 Development of sector-based lending methodology and tools specific to financing Low Cost Private Schools

Within Pakistan, there is growing recognition that enterprise-focused lending represents a shift for microfinance providers from a predominant reliance on the character of the individual to the enterprise's capacity to generate cash-flow. The research study revealed that LCPS enterprises are characterized by a lack of formal registration, the absence of tangible collateral, and the unavailability of documented financial information.

The DFID-funded project developed a sector-based lending methodology for financial providers interested in offering products to LCPSs. The methodology includes a financial modeling tool and LCPS-sector-specific product suite. This is designed to supplement prevalent borrower due diligence by the lending institution. This methodology responds to the lack of enterprise and LCPS sector knowledge among branch officers, thereby enabling them to undertake a reasonably accurate cash flow analysis of the enterprise.

Following the identification of a potential client/LCPS owner, the financial institution conducts an assessment of the school/enterprise (to include ownership of premises, enrollment numbers, classrooms, teachers etc.) and their financial needs (for infrastructure improvement, capacity development of teachers, scaling up from primary to middle/secondary classes etc.). Using the modeling tool, the financial institution can determine the appropriate loan amount and repayment schedule.

3 Pilot Testing

Four members of the Pakistan Microfinance Network are currently piloting the methodology proposed in the DFID study. They each committed to pilot loans to 2-10 schools, to be disbursed over 6 months. Kashf Foundation & Tameer Microfinance Bank are working with schools in and around Lahore; First Microfinance Bank (FMFB) is working with schools in Karachi and Bhawalpur; and Khushhali Bank is vetting several different locations in which to introduce the product.

The pilot is still in early stages. Participating MFPs have disbursed loans to about 20 schools to date. Product features include:

- Loan tenures of 12 to 24 months, with a grace period of three months to allow schools to acquire relevant equipment/skills/staff and other inputs for expansion/improvement.
- An effective interest rate (IR) of 27 percent.
- Pilot loan products both with and without collateral.

As of this writing, it's difficult to fully measure the cost effectiveness of these methodologies, as adequate scale has yet to be achieved. Early indications suggest that the schools that will fully benefit from the product are ones that have a vision and strategy for sustainable growth.

9. Ilm Ideas is a three-year DfID-funded, DAI-managed programme which awards grants nationwide for the purpose of improving education for children aged 5-16 across Pakistan. http://ilm-ideas.com/.
10. Socio-Economic & Business Consultants Pvt Ltd (SEBCON) http://www.sebcon.org.pk/.
11. Ibid. #1.

Challenges identified to date in the pilot project

Regulation

The current loan ceiling of PKR 500,000 (USD 5,066) may limit lending to schools that are larger and require more expensive infrastructure improvements.

Additionally, the formal classification of micro and small enterprises is based on their number of employees, limited to 20. This could limit qualification and access for schools, given the labor-intensive realities of the sector.

LCPS Model

In most cases, these schools do not have financial statements and are unable to provide formal documentation of cash flows.

School revenues depend on monthly cash flows derived from the school fees charged to students. This entails a certain level of financial risk for school owners and financial service providers, due to variability in collecting fees in full each month from parents. This is especially relevant for schools that target low income populations.

Microfinance Providers

Enterprise-focused lending is a new tactic for microfinance providers, in contrast to the individual lending that has been historically dominant in the industry. Limited enterprise and sector-level knowledge among loan officers may limit sustainability and the ability to achieve scale.

PMN's role in expanding access to finance for Low Cost Private Schools

PMN, as a trusted and credible representative of the microfinance sector in Pakistan, has played a key role in this initiative. One of the network's key goals is to introduce innovation in the financial inclusion sector and to support its members to expand their product offerings.

Research: PMN was a key member of the steering committee set up to guide the market feasibility study. In this role, the network provided key insights to the study. Upon its completion, PMN and Ilm Ideas co-hosted the launch event for the financial inclusion community to disseminate the results and begin the recruitment process for the follow-up pilot study.

Pilot Study: The four microfinance providers currently engaged in the pilot are all members of PMN. The network was actively involved in the selection and recruitment process, as well as in monitoring and documenting their progress and challenges during the pilot phase.

Market Facilitation: In its role as a market builder and facilitator, PMN authored and published a briefing paper analyzing the opportunity for microfinance providers to serve LCPSs, and mapping the regulatory challenges and opportunities for the wider microfinance sector.

Once the pilot project is completed, PMN plans to engage in further market building activities to support other members in developing and offering financial products for LCPSs. This support could include:

- Leveraging PMN's status in the market and its available platforms to widely disseminate the results of the pilot, which will build confidence in the methodology and work to engage other financial service providers in serving the LCPS segment;
- Facilitating a member-working group on this topic;
- Facilitating exchange visits between members;
- Further documenting and disseminating lessons learned; and
- Engaging with regulators to amend the current regulation to promote such products.

Lessons for microfinance associations

Create linkages

- ✓ Associations like PMN can play a key role in creating linkages - particularly in sector-specific approaches to funding where microfinance practitioners do not have sufficient experience to engage with other sectors. For example, while MFPs can conduct financial assessments of the schools they want to fund/ continue to fund, they may not be the best stakeholders to conduct assessments/monitoring of outcomes related to education quality. MFPs need to be able to effectively engage other stakeholders already working or possessing expertise in this area. In this case, PMN has effectively served to link MFPs and other stakeholders in the LCPS sector, such as donors and research institutions, in order to optimize the use of skills and resources across the sector.

Help translate ideas into practical opportunities for members

- ✓ In this case, PMN saw a clear opportunity to encourage its members to take a sector-specific approach to product development. This represents an innovative shift from the general practice of first developing generic product features and later applying them to various sectors. The network enthusiastically engaged with DFID in the research project, disseminated the research results to members, conducted additional analyses, and helped select pilot participants.

About the Pakistan Microfinance Network

The Pakistan Microfinance Network (PMN) is a network of organizations engaged in microfinance and dedicated to improving the outreach and sustainability of microfinance services in Pakistan. Its 55 members represent 99% of the microfinance market in Pakistan.

PMN's mission is to support the sector—and especially retail MFPs—to enhance scale, quality, diversity and sustainability in order to achieve inclusive financial services.

This is achieved through the following strategic objectives:

» Promotion of an enabling environment

» Building capacity of stakeholders, in particular retail microfinance providers

» Serving as an information hub by:

- Collecting and disseminating industry data
- Publishing and disseminating relevant industry materials
- Supporting increased transparency among microfinance institutions
- Promoting benchmarks and international best practices

Pakistan Microfinance Network

"At PMN, remaining at the cutting edge of market development is our job. We can never sit back and think that everything that needed to be done has been done."

-Syed Mohsin Ahmed,
CEO, PMN

Microfinance in Pakistan

Pakistan is considered to have one of the most enabling environments for microfinance, ranked third in the world by the Economist Intelligence Unit. The sector is comprised of diverse types of microfinance providers (MFPs), including Microfinance Banks (MFBs), specialized microfinance institutions (MFIs), non-government organizations (NGOs), and rural support programs (RSPs). Specialized MFBs and commercial banks (the two types of regulated microfinance service providers in Pakistan) are allowed to provide a range of services to poor and low-income clients, including mobilizing deposits. The State Bank of Pakistan (SBP) provides a regulatory framework under which MFBs can be established or commercial banks can downscale. The SBP does not impose interest-rate caps, but it does limit the size of loans.

The government-supported Pakistan Poverty Alleviation Fund (PPAF) is the main apex of the microfinance sector. Additionally, a credit bureau for microfinance was recently established after a period of pilot testing and trainings. In total, the Pakistani microfinance sector serves 3.1 million borrowers with an outstanding loan portfolio of PKR 61 billion. The sector's 7.3 million savers maintain PKR 37 billion in deposits, and its 3.3 million policyholders have the total sum of PKR 45 billion insured.[12]

About this Series

This article is one in a series developed by SEEP with support from Citi Microfinance titled **Spotlight on Financial Inclusion Leaders**. The series profiles selected microfinance associations, showcasing the ways in which they are supporting their members and meeting the challenges of value-added growth in financial inclusion. These associations are leaders in implementing innovative and locally-responsive approaches to financial inclusion. Their work is having a clear and measured impact on the lives of their clients, and their experiences bring valuable new knowledge to the industry at large.

12. "A Quarterly Update on Microfinance Outreach in Pakistan." MicroWatch June 2014. http://www.microfinanceconnect.info/assets/articles/4f454c2503afb84d931cec0afc2b93ca.pdf.

About SEEP

SEEP is a global learning network. We explore strategies that create new and better opportunities for vulnerable populations, especially women and the rural poor, to participate in markets and improve the quality of their lives.

Founded in 1985, SEEP was a pioneer in the microcredit movement and helped build the foundation of the financial inclusion efforts of today. In the last three decades our members have continued to serve as a testing ground for innovative strategies that promote inclusion, develop competitive markets, and enhance the livelihood potential of the world's poor.

SEEP members work together and with other stakeholders to mobilize knowledge and foster innovation, creating opportunities for meaningful collaboration and—above all—for scaling impact.

About Citi Microfinance

Working across Citi's businesses, product groups and geographies, Citi Microfinance serves more than 150 microfinance institutions (MFIs), networks and investors as clients and partners in nearly 50 countries, with products and services spanning the financial spectrum - from financing, access to capital markets, transaction services and hedging foreign exchange risk, to credit, savings, remittances and insurance products - to expand access to financial services for the underserved. For more, please visit http://www.citi.com/citi/microfinance/

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