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ANALYSIS OF CRITICAL FACTORS OF MICROFINANCE INSTITUTIONS OF PAKISTAN

ATHER AZIM KHAN*
Faculty of Commerce, University of Central Punjab

ABSTRACT

This article is about the performance of Microfinance Institutions – MFIs of Pakistan. In this article the types of MFIs operating is Pakistan is discussed with their details i.e. Microfinance Banks, Rural Support Programs and NGOs. Some other organizations are also involved in micro financing but their percentage is very low. It is found that Rural Support Programs RSPs are not totally involved in microfinance but have a large chunk of funds for microfinance. Micro loans are given for various purposes including starting a new business. The real theme of microcredit is to give money to a poor person to start a small or micro business and increase his family income but micro loans are often used for many other purposes such as paying another expensive loan, paying for medical expenses of bread earner of the family, marriages, construction etc. In this research work the researcher has tried to analyze the performance of MFIs of Pakistan and to find out those factors which contribute in their effectiveness. Two approaches of microfinance i.e. Institutionists Approach and Welfarists Approach are discussed. To analyze the performance of MFIs both approaches are considered i.e. Institutionists and Welfarists. Seventeen parameters are selected, many of these are financial ratios and these are divided into four groups i.e. sustainability, transparency, outreach and efficiency. Some ratios/figures of each area of these MFIs are taken in the data and analysis is performed to find out that which ones are contributing more or less. This research can be helpful for the MFIs which want to improve their performance and check their areas of significance for further improvement and development considering their approach of alleviating poverty from the society.

Keywords:

INTRODUCTION OF MICROFINANCE

*Prof. Ather Azim Khan is a professor of Finance and Accounting in Faculty of Commerce University of Central Punjab

Microfinance is a term quite popular among those who have any relationship with poverty or poverty alleviation. Its popular history can be traced back to 1976 when Dr. Muhammad Yunus, who was then the head of Rural Economic Program at the University of Chittagong, launched an action research project to find out the possibilities of developing a banking system for the poor people (Grameen Communications, 1998). Dr. Muhammad Yunus was awarded Nobel Prize for his relentless efforts to promote microfinance (European Microfinance Network, 2009). It became the first drop of rain and afterwards the popularity of microfinance has ever increased. Success-stories of microfinance now spread all over the world starting from South Asia to African Sahara and even Europe. Microfinance was luckily adopted by both sectors of society i.e. governments and the non-government organizations and so the flow of funds started through both i.e. the official governmental sources and also through philanthropy, which made it more effective in any economy of the world.

Despite of some early criticism and opposition, microfinance successfully made its way through and now is regarded as panacea by many experts. Microfinance does not only help poor financially but gives back their pride to them, the pride of being self-dependent and self-sustainable. Microfinance has done wonders and the sole reason that it is getting popular is that it is extremely effective (Ganesha, 2007).

"Participation and development" is the term that describes microfinance but it has many forms and shapes and there are many models of microfinance currently used in the world. This ranges from lending some money to poor i.e. micro credit to providing medical facilities, health insurance, education, water and sanitation, source of increasing nourishment etc. Application of microfinance in various parts of the world having altogether different cultures, climatic conditions, habits, political, economic and social scenario is quite different. This diversity in the lives of people living in different parts of the world creates unique requirements of successfully implementing microfinance at that place.

People who are farmers need microfinance for some different requirements than those who start their small business in urban areas. The important element is that these poor people have the potential to utilize a small amount effectively. Poor people have great potential to be entrepreneurs; they remain deprived and poor just because of unavailability of funds. These are the people who can show impeccable results if provided some financial support. Micro credit can do wonders with these people; their income increases manifold, health and other living conditions including education improve and the most important of all dependency of these people on regular charity eliminates.

In the success of microfinance selection of micro business is certainly an important task, which should be carried out by the providers of microfinance i.e. microfinance institutions – MFIs in order to increase the effectiveness of microfinance. Further, the importance of training and guidance i.e. capacity building is very high to make micro businesses successful for the obvious reasons that most of the poor people are illiterate and lack experience of doing business.

In Pakistan microfinance has gained popularity among both public and private sector. Government, NGOs and other organizations are now providing microfinance facilities to the poor people of the country. In Pakistan to make it more useful and to spread microfinance to those poor people of society who still are unaware of this facility more efforts are needed to be put in and a lot many steps need to be taken. Those models need to be replicated, which have been proven as the most effective models in the last few years, in terms of sustainability and outreach. Considering the prime objective of microfinance i.e. to alleviate poverty, the issue of Micro Finance Institutions – MFIs should not to be extremely profitable and self-sustainable but to benefit the poor people of society and help to alleviate poverty. MFIs should be more profitable and sustainable only for the purpose of providing more and continuous microfinance to help poor, so it is a secondary objective. Only this much of return from micro lending is enough, which can keep an MFI self-sustainable. Although, this is not very widely agreed upon and experts of microfinance argue that lending rates of micro loans should be higher to the extent that the cost of funds and the operating costs both can be covered otherwise the fund-base starts shrinking and MFI vanishes with time in the absence of continuous external financial support. This is one approach, which is discussed in the later part of this article.

The research is based on the analysis of MFIs working in Pakistan. These MFIs are divided into three broad categories i.e. Microfinance Banks, Non-Government Organizations

– NGOs and Rural Support Programs – RSPs. MIX (2007) publishes ranking of MFIs of the world. MIX develops The MIX Global100, which is a composite presenting 100 leading MFIs out of 607. The ranking is based on four elements i.e. Profitability/sustainability, Outreach – Depositors and Borrowers (Scale is Loan Portfolio), Efficiency – Productivity and Transparency.

Fast growth and greater market share are the two main reasons of moving up in the list of 100 MFIs in the composite. Keeping in view the emphasis of the two approaches i.e. Institutionists' and Welfarists', the areas of analyses are defined i.e. sustainability/profitability and transparency are taken as representative of Institutionists' Approach as these two are likely to indicate the performance of MFIs in terms of the parameters of Institutionists. On the other hands the other two factors i.e. outreach and efficiency/productivity are taken as the areas of analyses as these are main concern of Welfarists.

Forms of Microfinance and Models

The commonly used forms of microfinance are Micro Credit or Microloan, Health and Life Insurance, Infrastructure Development, Education and Vocational, Food Coupons – Improving Nourishment, Asset Lending and Rural Microfinance. There are many models of microfinance used in the world. Some of the commonly used models of microfinance are Individual lending, lending through Intermediaries, Microfinance Associations, Group Lending, Bank Guarantees, Community Banking, Cooperatives, Credit Unions, Grameen Bank Model, Non-government Organizations – NGOs, Akhuwat Model, Village Banking System and Rotating Savings and Credit Associations – ROSCAs (GDRC, 2008).

Outreach of Microfinance

Microfinance, particularly Micro Credit is only for poor people i.e. it is not for very poor or destitute. This requires some guarantee and some skills to generate money, which are not there in case of above mentioned two deprived groups of people. So in that sense microfinance is not for all. Then is the issue of number of people who can be provided microfinance and are not covered due to various reasons. Rhyne & Oterio (2006) state that microfinance related data for 2004 shows a worldwide total of 30 million borrowers served by 675 organizations. Microfinance Summit published data for the year 2004 mentioning 92 million active borrowers against the data published by MIX i.e. 62 million borrowers. It shows that the estimates of active Micro Credit borrowers vary widely. CGAP has done a survey of Alternate Financial Institutions - AFIs, which were serving clientele of a level lower than traditional commercial banks. Many such AFIs do not consider them microfinance providers but reported by CGAP. Three thousand such institutes are providing funds to 152 million borrowers.

MICROFINANCE IN PAKISTAN

Microfinance in Pakistan is gaining popularity gradually as awareness regarding micro credit and other forms of microfinance is increasing. The last decade was certainly significant in the development of microfinance in Pakistan. In the article on evolution of microfinance in Pakistan says, "The microfinance movement in Pakistan followed a unique evolutionary path over the last decades". They described the three phases of development of microfinance with reference to entry of new institutional forms and structures in the Pakistani microfinance sector. Some development can be traced back to the decade of 70s but the real growth was in 80s and 90s (Khan & Platteau, 2006).

In Pakistan mainly three types of microfinance institutes are operating i.e. Microfinance Banks, NGOs and Rural Support Programs. Now the government and international donors both are keen to promote microfinance in Pakistan and hence are providing huge funds for the development of microfinance i.e. just in the year 2008 the amount of disbursement for microfinance was Rs. 7,045 million. Pakistan Poverty Alleviation Fund – PPAF was created for the purpose of alleviating poverty from the country and the main focus of this is also to help poor come out of the vicious circle of poverty through microfinance and other means. It was the biggest initiative of government of Pakistan in 1999. Most of the funds received by Pakistan for poverty alleviation and microfinance are through PPAF. Many MFIs get funds from PPAF particularly RSPs and NGOs. It can provide funds to any legal entity involved in microfinance and poverty alleviation whether in public sector or private sector. Pakistan Poverty Alleviation Fund works on public private partnership basis. Securities and Exchange Commission of Pakistan – SECP is the regulatory body for PPAF. It is sponsored by the Government of Pakistan and is funded by World Bank and other donor agencies. By the end of fiscal year i.e. 2007-08 PPAF had a fund-base of more than one billion dollars. PPAF's mandate is to form partnerships with other organizations involved in poverty alleviation following a given criterion. The main concern of PPAF while developing partnerships with various organizations is the outreach of the organization and the objective i.e. public welfare. PPAF is not just of rural community but urban poor class is also a part of the target population. It also provides funds for the empowerment of women. PPAF helps poor in income generation, improving physical facilities, improving social infrastructure, training poor and developing their skills (Pakistan Poverty Alleviation Fund, 2008).

The first initiative regarding microfinance in Pakistan was in 1982 when Orangi Pilot Project – OPP in Karachi was initiated by a local NGO. Dr. Hameed Akhtar Khan was the key person who initiated this project and successfully completed it. Agha Khan Rural Support Program – AKRSP followed it in the same year i.e. 1982. After the program of Agha Khan Foundation - AKF, government of Pakistan also started its first rural support program in North Western Frontier Province i.e. Sarhad by the name of Sarhad Rural Support Program – SRSP. This program was very much a replica of Agha Khan Rural Support Program - AKRSP. It was started soon after the successful implementation of AKRSP in 1989. The objectives of these rural support programs were to provide agricultural facilities and to help poor improve their living standards. Small loans were provided to farmers for various items related to agriculture such as seeds, urea, mechanical facilities etc.

THEORETICAL PERSPECTIVE OF MICROFINANCE

There is a lot of literature on microfinance and microfinance institutions published by the institutions themselves or by rating agencies and analysts. Elahi and Danopoulos (2004) write, “Although the idea has become quite popular among donor agencies, development practitioners and academicians, theoretical premises on which this idea is founded seem entirely unexamined”. Considering the importance of the question and taking the issue further it was added they the theory is not examined as required. Elahi and Danopoulos (2004) further state:

> "The literature describes eloquently why the poor need small loans (Micro Credit), the factors that constrain them from getting these loans, and the benefits they receive from these small loans. But the literature is almost silent about the motives, means, and abilities of those who are supposed to run these small loan programs. More specifically, the literature does not examine the theoretical foundation of the Micro Credit and microfinance industries. As a result, the theoretical soundness and policy implications of the proposed microfinance revolution are questionable."

Microfinance idea is based on two theories i.e. Economic Theory and Psychological Theory. Both the theories have their own premises and arguments. Both theories treat microfinance in an entirely different manner hence looking at the objectives or goals is different ways. The two theories develop the theoretical basis of microfinance.

Economic Theory of Microfinance

Economic theory of microfinance treats microfinance institutions as infant industry. Remenyi (2000) says that the gist of the economic argument is that success in any business venture, including MFIs, is determined by the entrepreneurs' ability to deliver appropriate services and profitably. However, studies conducted in different parts of the third world show that there are no successful MFIs by this definition. At best, some MFIs cover their operating costs while some of the better known among them are able to cover in part the subsidized cost of capital employed. This situation suggests that the MFIs will not become financially viable in the long run.

The infant industry argument in economics is based on the concept of protectionism i.e. policies or doctrines which "protect" businesses and workers within a country by restricting or regulating trade with foreign nations. The infant industry argument as first given by Alexander Hamilton in 1790, is that nascent industries because of smaller size do not enjoy economies of scale and so have high costs as compared to their competitors and so they need to be given protection in the initial phase of their business until they achieve the economies of scale and become competitive. This justifies measures of protectionists in the scaffold of free trade theory in its classical sense. This infant industry argument is applied to microfinance industry to help it in the initial stages until it reaches to the level where it can survive at its own and sustain itself. This means MFIs should be provided low or cost free funds, subsidies in operating costs, long term funds and other benefits to help them survive in the market. Elahi & Danopoulos (2004) suggest that critical evaluation is needed to judge the academic virtue of microfinance theory.

The Economic view is supported by the main theorist of capitalism; Adam Smith that basis of system is prosperity depends upon the progressive creation of private wealth. Smith says that the main source of creation of private wealth is the self-interest. Smith (1776) states, "It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their self-interest; we address ourselves not to their humanity but to their self-love and never talk to them of our own necessitates but of their advantages".

Thomas Hobbes who is a diehard materialist gives his view of every economic activity as nothing but making profit and self-interest. He calls human beings as living machines and says that these machines move only by natural passions i.e. appetites and aversions. He further defines appetites as innate and social; the biggest social appetite he considers the desire for power. He considers the human beings are propelled only by self-interest, which may be the fear of extinction that leads to law and justice.

Coming back to the Infant Industry argument sprouting from the protectionist's argument in mercantilism, this was developed to accommodate mercantilist feelings inside the Adam Smith's structure of liberal economic theory and this argument is invoked to develop microfinance in the third world.

Psychological Theory of Microfinance

Psychological theory of microfinance, as advocated by Dr. Muhammad Yunus, makes a distinction among the professional money lending and microfinance and present microfinance providers as, "social consciousness driven people". The psychological component of the micro credit theory - known as social consciousness-driven capitalism - has been advanced by the most ardent promoter of micro finance. His theory argues that a species of profit-making private venture that cares about the welfare of its customers can be conceived. In other words, it is possible to develop capitalist enterprises that maximize private profits subject to the fair interests of their customers.

Analysis of this theory reveals that it is based on the understanding of capitalistic approach, an approach where profit is the ultimate objective and as said it has somewhat selfish nature. Investors also have the profit motive and funds are available when required rate is offered to them. This does not consider that element, which provides funds for reasons other than making profit or getting high returns. In the present age where social responsibility is also associated to corporations so an additional objective of social returns is also added to profit making. Considering this we can differentiate entrepreneurs into three categories. Elahi & Danopoulos (2004) state that the first group consists of traditional capitalists who mainly maximize financial returns or profit, the second group is of philanthropic organizations e.g. traditional Micro Credit NGOs and public credit agencies that mainly maximize social returns and the third group consists of entrepreneurs who combine both rates in making their investment decision under the additional constraint that financial return cannot be negative. The third group consists of entrepreneurs who are to be treated as socially concerned people, and microfinance, which is to be treated as a social consciousness-driven capitalistic enterprise.

Elahi and Danopoulos (2004) with reference to Dr. Muhammad Yunus write that these socially motivated people can bring a change in the society as they can do many activities of public welfare while making profit. He includes health care, education, training, financial services, energy ventures, old age homes, recycling enterprises or marketing of products made by poor. Elahi and Danopoulos (2004) further, discussing Dr. Muhammad Yunus's idea suggests that this system can replace the current ruthless capitalistic system where some are winners and more are losers. He suggests that this system does not demand for charity from individuals, companies or public sector but it demands doing business with poor for profit. In the words of Steven Covey this leads to a Win-Win situation where the entrepreneur does not have to sustain a financial loss to help poor but to bring him on board and make him self-sustainable. They further explain the weakness of theory of capitalism as appears from the inconsistent views of Adam Smith, which are very much contradictory to each other in explain human nature.

Adam Smith who on one hand gave the main theory of capitalism also talks about the psychological aspect in his book “The Theory of Moral Sentiments”. The interesting point is that this book was published many years before the Wealth of Nations so it may contain a view point which may be altered by Adam Smith himself. Smith (1759) writes that the real source of moral judgement lies in the conception of sympathy, as written by him:

> “How selfish so ever, man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it. Of this kind is pity or compassion, the emotion, which we feel for the misery of others, when we either see it, or are made to conceive it in a very lively manner. That we often derive sorrow from the sorrow of others is a matter of fact too obvious to require any instances to prove it; for this sentiment, like all other original passions of human nature, is by no means confined to be virtuous and humane, though they perhaps may feel it with the most exquisite sensibility. The greatest ruffian, the most hardened violators of the laws of society, is not all together without it.”

Smith in his views about the psychological approach negated Thomas Hobbes who conceived human beings as living machines. According to Adam Smith there is a fundamental virtue in human nature. He used the word sympathy in describing the moral judgment of human beings. Smith says that the word sympathy includes two kinds of moral judgment i.e. one is the propriety of an action that determines right or wrong and the second is action’s merits or demerits that determines praise or blame. The conflicting views of Adam Smith in his two books “The Wealth of Nations” and “The Theory of Moral Sentiments” are stated in the literature as “Das Adam Smith Problem”, this is an allegation that the two cannot be compatible.

Approaches to Microfinance

There are two basic approaches to microfinance i.e. Welfarists'' Approach and the Institutionists' Approach. These two approaches are entirely different in their philosophies.

Welfarists'' approach – old paradigm. The Welfarists'' Approach sees microfinance as one of the most effective tool to help poor come out of poverty and have a sustainable life. The concept is very much directed towards a self-sustainable family and society. The goal is poverty alleviation and also women empowerment, as microfinance mostly emphasizes lending to women and involving them in economic activity, hence empowering them. This does not only lead to financially stronger family but also generates economic activity in the country. The important point in this approach is the economic activity due to microfinance is a by-product and not the main product, so the decision in micro financing should not be taken to generate or increase the economic activity but to help poor and alleviate poverty. This may or may not generate economic activity and may or may not be financially a viable proposition in all cases and so it should not be stopped because of the fact that it is not a financially viable proposition for a certain period of time. The approach stresses the fact that if it is not considered an act of welfare then microfinance will be discontinued in many cases. If we look at it from the Welfarists'' angle it becomes extremely important that those who do it i.e. either state or non-state players must have a good intention i.e. to help poor. This means morality becomes an integral part of this microfinance. When microfinance is offered by a bank or financial institution formed for the purpose of making profits then it will only be done when the bank earns profits or foresee profits in the future. In case there are no chances of profits this activity will be stopped by such banks and financial institutions. The approach calls for subsidizing this finance and ask some outsiders to bear the cost of funds and operations giving the poor money at minimum rate. In this approach mobilizing savings of poor is not the main objective. Robinson (2001) writes that savings mobilization is not a common feature of this poverty approach. So the advocates of this approach certainly do not emphasize on making profit and are not very much concerned about the issue of sustainability. The point that with reduction in fund-base over longer period lesser and lesser people will be benefitted is not an issue in this approach. Robinson (2001) further writes, "Most institutions that provide subsidized credit fail and even successful institutions following the poverty lending approach, in aggregate; can meet only a small portion of the demand for microfinance”. Morduch (2000) calls it microfinance schism and gives a split of two approaches. In case of Welfarists’ the emphasis is actually placed on the number of beneficiaries rather than the profits made by the MFI. Welfarists’ are more concerned about the well-being of the people than financial stability or financial sustainability and are of the view to give perpetual subsidies to maximize the impact of microfinance in poverty reduction. This approach is a humanistic approach where institutions become less important and human beings become more important. The responsibility of the society towards the poor at present is more important than the probable poor of future, hence maximum benefits should be passed to the poor at present and better strategies and policies should be formulated to make subsidies more consistent. Woller, Dundord, & Woodworth (1999) write, “Like Institutionists, Welfarists’ have assumed more impact than they actually have been able to document”, which is a statement of that needs empirical evidences from various parts of the world. Grameen Bank, FINCA etc. in the world and MFIs in Pakistan have certainly good performance supporting Welfarists’’ approach. Welfarists’ believe that the Institutionists’ Approach is a threat to the shared objective of poverty reduction. Another valid argument of Welfarists’ is that if microfinance is basically to help poor than with Institutionists’ Approach it would never be a tool to help the poorest of poor i.e. destitute. If this element of subsidy and donation is added to microfinance then it can reach to that level of poverty, which is deprived in true sense. Robinson (2001) states the viewpoint of Institutionists that financial sustainability and access to financial services are more important than poverty alleviation is a concept of Institutionists, which is very strongly opposed by Welfarists’. Robinson (2000) has also written that some of the best microfinance providers are Bank of Rakyat Indonesia (BRI), BancoSol in Bolivia and Association of Social Advancement (ASA) in Bangladesh.

Welfarists’ very strongly react to the Institutionists’ approach of making self-sufficiency the goal of MFPs and they stick to their very basic objective of helping poor and alleviating poverty. Because of their approach Welfarists’ are not ready to make any compromise on their goal and they are not ready to take steps to attain financial self-sufficiency.

The question is that whether organizations should be allowed to undertake microfinance as an economically viable activity and let them make profits out of it i.e. making profits by helping poor. As and when a micro bank or financial institution for microfinance will become economically unviable it will stop its operations and the either the poverty reduction rate will stop or start reducing in the community.

Genesis of Institutionists' approach and threat to Welfarists'. Institutionists' approach developed during the two decades of sixties and seventies. Woller, Dundord, & Woodworth (1999) states that this approach is the outcome of experience of Rural Development Institutions – RDIs in 1960s and 1970s the results were derived by the researchers at Ohio State University Rural Finance. Third world countries put large sums of money in these projects. During this period low cost, highly subsidized credit was given to farmers. These subsidies caused many problems such as grant mentality among clients, high overheads and transactions costs, and heavy corruption. The production response from farmers who received these subsidized credits was limited. This resulted into squeezing donors' money and ultimately the programs failed. Among many other lessons learnt the most important was the lack of institutional viability of those RDIs. The experience of Rural Development Institutions in various countries became the basis of development of Institutionists' Approach of microfinance. The above mentioned problems and the lessons learnt forced donors and financing agencies to develop financially sustainable projects of microfinance.

Summarizing the two paradigms the researcher finds a common point i.e. both actually are for the benefit of poor, one looks at it from the current angle and the other suggests the longer view and added advantages of microfinance to the society as a whole. Institutionists have practical edge over Welfarists' as they have developed and defined "best practices", which are accepted even by Welfarists'. The view of Institutionists is dominant and is becoming even more in the free market world. Woller, Dundord, & Woodworth (1999) wrote that the practical implications of two camps can be three fold; first is the *differences in the population segments served* (the not-so-poor true entrepreneurs vs. those who struggle on the margins of survival), second *differences in the designs* (lending to individuals vs. small solidarity groups vs. large village banking) and third *differences in the institutional structures* *and financing to support these services* (social service NGOs vs. community –based credit unions and community banks vs. commercial banks and fiancé companies). Along with the fact that Institutionists' Approach is now very much dominant and prevalent it is also a fact that most of the microfinance institutions are financially not sustainable. Wrenn (2008)stated that although the Institutionists' Approach is promoted, CGAP found that 5% of worldwide MFIs are financially sustainable, while IMP claimed that there is only 1%. There needs to be a balance between social and commercial objectives. Morduch (2000) claims that it can be achieved if the microfinance provider MFP is administered well and the market and clients' needs are understood. Wrenn (2008) writes that Simanowitz and Walter argue regarding microfinance providers and states, "It is now time to innovate and design services that maintain high stands of financial performance, but which set new standards in poverty impact."

The threat to Welfarists' from Institutionists has several dimensions. These threats are to be seriously considered by Welfarists' in order to maintain their view point and make it a success in the world of microfinance. Woller, Dundord, and Woodworth (1999) state that the threats are:

1. The belief that social mission motive will shift and profit motive will become dominant because of the fact that commercialization and the outside investors' need to be satisfied.
2. The fear that commercialization of microfinance may divert the industry from its spiritual foundation. The result will be a profitable but soulless endeavor.

Donors withdraw support from unsuccessful programs, which will result into what may be called "broad-brush resource allocation on the basis of good institutional performance alone".

Institutionists' approach. Onthe other hand the other side of the picture is the Institutionists' Approach. This approach is very much tilted towards building institutions rather than depending on individuals or temporary funds. Institutions are long lasting and sustainable and in the long run can support the cause of poverty. Institutes are not run at the will or desires of individuals but with given norms, principles and rules and are governed by regulatory authorities making it is difficult to misuse the funds available in these institutes. So it is important to build institutes rather than stressing on the need of philanthropy. For an institution to be sustainable it is very important that the institution generates enough revenues that it makes up its costs i.e. borrowing cost, operational cost and capital expenditure. Institutionists also highlight the point that Welfarists' put more emphasis on micro credit and ignore savings and insurance, which are equally important.

Comparative analysis of the two theories of microfinance and contradictions. The combination of the two theories i.e. Institutionists' Approach and Welfarists'' Approach creates disbelief about the theory of microfinance. Capitalism is mainly driven by selfishness and so social consciousness or sympathy cannot be the motivating factor to do business in capitalistic economies. As microfinance is also motivated by same factors so in capitalistic economies it is not possible to successfully do micro financing without profit incentive.

Specific Objectives

- To analyze the forms of Microfinance Institutions – MFIs in Pakistan
- To assess the effectiveness of microfinance institutions and their potential
- To individually evaluate the performance of MFIs in Pakistan using the two approaches of microfinance i.e. Welfarists' Approach and Institutionists' Approach.

LITERATURE REVIEW

Reviewing the literature on the significant factors of MFIs it is observed that we need to analyze MFIs from two angles i.e. from the view point of profitability and financial sustainability the prime objective of those who follow Institutionists' Approach and from the view point of outreach and efficiency i.e. effective poverty alleviation at a given time and helping poor maximum, which is the prime objective of those who follow Welfarists' Approach. Efficiency and Transparency are two factors that are common in two approaches and need to be applied with the same emphasis in all institutions whether following Institutionists' Approach or Welfarists' Approach. In this way the significant factors will be those which make an MFI sustainable and also those which make an MFI more beneficial for the poor of a community and these are Profitability, Financial Sustainability, Outreach, Efficiency and Transparency.

In a The authors referred to a document of Consultative Group to Assist the Poorest mentioned, "A set of performance indicators has arisen, and many of them have become standardized, but there is by no means general agreement on how to define and calculate them. A consensus group composed of microfinance rating agencies, donors, multilateral banks and private voluntary organizations agreed in 2003 some guidelines on definitions of financial terms, ratios and adjustments for microfinance (Nieto, Cinca, & Molinero, 2004)".

The areas identified were sustainability/profitability, asset/liability management, portfolio quality and efficiency/productivity. Microrate, an organization that provides rating facility of MFIs, uses twenty one ratios to assess the level of performance in each of the above mentioned four areas. It also gives three types of ratings i.e. performance rating, credit rating and social rating. The ratios are related to Portfolio Quality, Efficiency and Productivity, Financial Management, Profitability and Productivity.

Ranking methodology of MFIs used by Microfinance Information Exchange-MIX (most reliable MFIs ranking institute in the world) in developing 100 Composite Ranking of MFIs of the world include three principles i.e. there are quantitative factors, these factors are simple and are goal oriented. Microfinance Information Exchange (2005) provides that the factors of measurement should be quantifiable i.e. the results can be measured in numbers to see whether that it is good or bad and no qualitative judgment is used. The factors are simple to reproduce i.e. variables are not explicitly weighted in the composite score and an MFI currently not listed should be able to find out its standing or ranking.

1. Profitability/Sustainability
2. Outreach – Depositors and Borrowers (Scale is Loan Portfolio)
3. Efficiency - Productivity
4. Transparency – Quality of Portfolio

In the report of Americans for Community Cooperation in Other Nations-ACCION has written that to promote transparency in the microfinance institutes two-way approach should be adopted i.e. use CAMEL (Capital, Asset Quality, Management, Earnings and

Liquidity) instruments and ensure high standards of transparency in the financial statements. In the report it is highlighted that it is important that the quality of data is ensured and then appropriate uses of data are guaranteed (Rhyne, 2002).

There are various users of information so it should be reliable and appropriate for all of them. Disclosure is one requirement along with it analysis which should also be done to make it meaningful for the users. In this regard it is appropriate that International Accounting Standards – IAS and International Financial Reporting Standards – IFRS (or whatever standards are followed in the country of MFI) and the legal requirements are strictly followed. In case of MFBs the banking laws and regulations of central banks should be strictly adhered as this solves the problem of transparency to a great extent.

METHODOLOGY

The research is done using secondary data. Information related to financial and operating performance is available and is authentic because of the fact that data is provided to governing authorities and is audited and approved.

The research comprises of secondary data collected either from the documents published by the institution or other authentic information providing organizations such as MIX. Secondary data, comprising of financial results and other published information by MFIs and research already done on MFIs is taken. In addition to this material published by other organizations on MFIs is also included in the analysis i.e. both government and nongovernment organizations. The population in this research comprises of all the microfinance institutions operating in Pakistan. As there is not a very large number of MFIs in Pakistan so most of the institutions are included in the sample i.e. out of seven banks six banks are included in the sample, all six NGOs providing microfinance are included, all four rural support programs and in addition to this three other MFIs are included. As almost all MFIs are included in the analysis so it is not based on sampling of any kind and hence no sampling technique is used. The following is the list of MFIs included in the list for this research. Unit of sample is Microfinance Institution – MFI.Sample consists of 18 MFIs of Pakistan. Five microfinance banks, six microfinance NGOs, four rural support programs and three other MFIs are taken in the sample.

For the purpose of research in each of the above mentioned four areas under the heading of Institutionists and Welfarists some ratios are selected which represent the performance of MFIs in these four areas. The ratios or other parameters which are likely to represent each approach in Institutionists' Approach are Sustainability/Profitability and Transparency. In the Welfarists' Approach these are Outreach and Efficiency/Productivity.

The *"Analysis of the key factors of microfinance institutions in Pakistan – MFIs with reference to their sustainable growth and effective poverty alleviation from the country"*

Hypothesis

H1: Significant factors of microfinance operations in Pakistan have major impact on the growth of MFIs

The number of MFIs is very small in Pakistan, so almost all MFIs are included in the sample whose data was available. The problem that arose was different nature of MFIs i.e. some of the MFIs are banks, governed statues and some are NGOs having almost no governance. The data is taken from the audited financial statements of MFIs and is reliable and authentic.

The following indicators and ratios are used in the analysis under the two approaches as given under:

Institutionists' approach.

1. Sustainability/Profitability
    a. Debt/Equity Ratio % (Debt / Shareholders' Equity)
    b. Return on Assets % (PAT / Total Assets)
    c. Return on Equity % (PAT / Shareholders' Equity)
    d. Profit Margin % (PAT / Revenue)
    e. Operational Self-sufficiency % [Operating Revenue / (Financial Expense + Loan Loss Provision Expense + Operating Expenses)]
    f. Total Expense Ratio % [(Financial Expense + Loan Loss Provision Expense + Operating Expenses) / Average Total Assets

g. Financial Expense Ratio % (Financial Expense / Average Total Assets)
h. Operating Expense Ratio % (Operating Expense / Average Total Assets)
i. Write Off Ratio % (Write Offs for the 12-month period / Period Average Gross Loan Portfolio)

2. Transparency
    a. Extent to which information is available to general public (Disclosure Information)
        1. Audited Financial Statements (Average number of times)
        2. Name of Audit Firm (Average number of times)
        3. Compliance with CGAP Disclosure Guidelines (Average number of times)

Welfarists' approach.

2. Outreach
    a. Number of Active Borrowers (Number)
    b. Women Borrowers % (Number of Female Borrowers / Number of Active Borrowers)
3. Efficiency/Productivity
    a. Operating Expense/Loan Portfolio % (Operating Expense / Period Average Gross Loan Portfolio)
    b. Cost Per Borrower – in USD (Operating Expense / Period Average Number of Active Borrowers)
    c. Borrowers per Staff Member – in number (Number of Active Borrowers / Number of Personnel)

DATA ANALYSIS

Data is collected from secondary sources is analyzed in terms of several ratios pertinent to the analysis of MFIs. The ratios are established ratios for the analysis of performance of MFIs in the respective areas.

Name	DER	ROA	ROE	PM	OSS	TER	FER	OER	WOR	NAB	NWB	OELP	CPB	BPSM	AFS	NAF	CCGA	FGR	BGR
KB		-3.62	-12.76	-31.35	76.27	13.4	2.17	10.1	*5.01*	249351	23.27	30.78	44.87	142.67	0.67	0.67	0	14.13	19.75
NMFB	59.87	-6.43	-10.6	-74.3	59.77	16.6	0.78	14.79	*1.21*	2322	18.13	42.23	138.73	42.67	0.67	0.67	0	39.2	8.6
POMFB	3.27	-2.57	-2.7	-37.9	42.6	6.1	0.02	5.59	*1.17*	8271	8.53	30.9	36.4	54.33	1	0.33	0	1	38.2
TMFB	151.83	-6.37	-19.3	-68.47	33.03	11.8	2.27	7.2	*3.4*	17016	2.43	19.43	58.23	31.33	1	0.67	0	-2.4	64.6
FMFB	187.73	-0.63	-1.9	-2.83	98.3	13	2.7	9.77	*0.48*	56877	41.8	30.8	86.6	97.33	1	1	0	34.13	126.7
AKHUWAT	1.73	-1.72	-1.75	-16.73	53.76	8.76	0.05	8.34	*0.04*	5945	59.63	10.78	5.53	66.33	0.67	0.67	0	70.3	46.85
ASASAH	0	-13.4	169.6	-56.84	60.93	37.83	12.47	24.5		16238	100	38.11	46.33	74.67	1	1	0	134.9	84.63
KASHF	134.51	9.25	20.57	38.95	164.3	14.57	3.34	9.9	*0.29*	168202	97.97	14.21	24.07	179.33	1	1	0	68.93	70.2
OPP	42.25	3.93	5.49	22	132.5	11.95	1.91	8.72	*2.19*	13325	17.83	13.58	19.77	368.67	1	1	0	31.1	75.37
SAFWCO	274.01	-10.5	-36.88	-54.58	66.17	25.51	3.29	21.44	*0.57*	10021	34.6	47.94	35.03	136.33	0.67	0.67	0	113.43	55.57
CSC	424.28			-74.63	39.89					7020	33.33			77.33	0.5	0.33	0	6.7	162.6
DEMEN	774.54	-2.6	-16.45	-10.32	92.04	28.38	6.59	18.62	*2.57*	24556	100	26.17	27.37	144.33	1	1	0	98.07	71.57
NRSP	590.88	-1.54	-8.07	-10.07	91.36	18.96	5.18	12.66	*0.99*	203112	43.63	15.84	27.1	119.33	1	1	0	40.47	49.23
PRSP	88.42	-3.66	-6.79	-42.13	70.54	12.4	2.46	8.38	*7.82*	52333	33.2	33.33	34.43	118	0	0	0	22.1	11.93
SRSP	133.05	-10.4	4.64	-202.4	58.16	19.1	5.76	10.7	*9.31*	3844	29.9	13.67	5.03	60.33	0.67	0.67	0	69.3	13.87
TRDP	336.49	-21.5	257.68	-143.7	44.15	35.42	7.17	17.73	*2.51*	37581	29.3	18.78	26.6	395.33	0	0	0	5.84	101.7
ORIX	3236.7	1.97	23.49	10.29	111.8	16.55	7.91	7.96		5514	76.43	7.83	24.1	244	0	0	0	39.1	70.4
SDF	73.34	-9.52	-10.15	-344.6	22.9	12.5	0.14	12.36		870	30.07	70.7	91.6	93	0.67	0.67	0	9.85	4.77
TF	1495.4	-13.4	315.5	-131.0	50.39	24.51	4.32	14.65		18538	53.2	20.6	32.5	141.33	0.67	0.67	0	33.93	22.5

Source: Annual Reports of MFIs containing audited financial statements

CONCLUSIONS

The research has concluded that due to two factors i.e. nature of MFIs and their approach we can divide them into two categories. These are:

a. Strictly governed by government authorities
b. Flexible governance

In case of regularized and un-regularized MFIs the distinction is very clear and evident as banks and government's rural support programs are under strict watch of authorities and have to follow set procedures. NGOs are not governed and have flexible structures of operations.

The other classification of MFIs is on the basis of their approach the two categories are:

a. Institutionists MFIs
b. Welfarists' MFIs

Although it is not very easy to distinguish MFIs on the basis of their approach of microfinance as it is not given in black and white and all MFIs work for poverty alleviation but it can be seen from the cost of lending and what micro borrowers are charged. In this regard we find that some NGOs like Akhuwat are working on the second approach as it does not charge any interest.

Analyzing the performance of MFIs in Pakistan in terms of their effectiveness it is seen that:

1. MFIs determine their effectiveness in terms of the level of sustainability achieved or poverty alleviated;
2. In the light of research performed it is seen that in Pakistan there is small number of MFIs operating and these MFIs are different in nature. Some of the MFIs are operating for a few years and others also do not have a very long history. Some MFIs are not solely involved in microfinance or micro credit but spent their funds for poverty alleviation in other ways also;
3. MFIs in Pakistan have not clearly adopted any approach in terms of providing microfinance i.e. Institutionists' approach or Welfarists' approach;
4. Poverty alleviation is measured in terms of increase in outreach;

5. Considering the fact that there is a large number of poor people in the country i.e. almost 40% of the total population living below the poverty line microfinance has not yet contributed significantly in poverty alleviation but looking at the performance with reference to funds employed for this purpose and the number of MFIs operating in the country we can say that impact is significant;
6. Keeping in mind that microfinance is not for the poorest of the poor this further supports our conclusion;
7. With these high rates of inflation it is very difficult for the poor borrowers to make enough profits to pay back high interests and even high rates of profits in micro businesses cannot benefit the poor. Various organizations are charging different rates of interest to the poor and it very much depends upon;
    a. Cost of borrowing
    b. Approach of microfinance
    c. Willingness of the borrowers
8. Most of the MFIs in Pakistan are not very old and have started their operations only a few years ago and at this point of time it is difficult to assess their performance in terms of poverty alleviation. Their performance will be better judged after about a decade from now; and
9. In terms of fund growth rate some MFIs are outstanding such as ASASAH with 134.9% growth rate and other high growth rate achievers are SAFWCO, DAMEN, KASHF and NRSP with growth rates 113.4%, 98.1%, 68.9% and 40.5% respectively. In terms of growth rate of borrowers CSC is at the top with 162.6% growth rate and FMFB, TRDP, ASASAH, OPP and DAMEN follow with borrowers' growth rates of 126.7%, 101.7%, 84.6%, 75.4% and 71.6% respectively.

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