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A Pakistani Microfinance Organization Gears up for Dramatic Growth

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This case study was written by Mahboob Mahmood, Adjunct Professor of Entrepreneurship at INSEAD, with the support of Melanie Hui, Research Assistant. It is intended to be used as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

It is accompanied by a short documentary film entitled "Purse Strings – Women and Microfinance in Pakistan" and will be most effectively studied together with the documentary.

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Kashf Foundation

Growth Plans

From the headquarters of Kashf Foundation in Lahore, Pakistan, Founder and President Roshaneh Zafar and Chief Executive Officer Sadaffe Abid are mapping out a dynamic growth strategy for the organization. Modeled after Grameen Bank, the pioneering Bangladeshi microfinance institution (MFI), Kashf focuses on providing microcredit and social support services to women entrepreneurs at the bottom of the wealth pyramid.

Since its inception in 1996, Kashf has grown to become the third largest microfinance institution in Pakistan. Although established as a non-profit institution, Kashf achieved financial self-sufficiency in 2003, and by the end of 2006 had 69 branches, over 135,000 customers and aggregate outstanding loans of approximately Rs. 5.5 billion ($90 million).[1] By 2010, Kashf plans to expand to 205 branches serving 600,000 customers with a loan portfolio of approximately Rs. 9.7 billion ($160 million).

To achieve such dramatic growth, Roshaneh and Sadaffe are addressing a number of critical questions that reach the heart of the organization's vision and purpose. Who are Kashf's core customers? Should the foundation focus on its more profitable customers with slightly larger businesses or its less profitable new customers who have the most socially compelling funding requirements? How should Kashf balance the opportunity to grow as a financial institution and its role as an agent for social empowerment? Should it remain solely a non-profit institution or should it establish a for-profit bank as well? Should Kashf stay focused on urban areas or expand into rural areas where microfinance is badly needed? What range of products and services should it offer? Should it go-it-alone, work through partnerships, or consider merging with another institution? Coming up with the answers to these questions will be critical to Kashf's success and mission going forward. Right now, social and economic conditions in Pakistan present an opportunity for Kashf to grow, but competition that didn't even exist in 1996 is suddenly emerging.

The Formation of Kashf

In the early 1990s, Roshaneh Zafar was building a career as a development specialist. She had left her native Pakistan to earn a degree in economics from Wharton and in development economics from Yale. Although working as a community participation specialist with the United Nations Development Programme and the World Bank, she longed to make a more meaningful contribution to improving the status of women in Pakistan.

At a conference on women and economic development, she met Muhammad Yunus, the founder of Grameen Bank, who had pioneered microfinance in his native Bangladesh. Talking to him was an inspiration for Roshaneh, who started to think about its application in her home country. To explore possibilities, she decided to visit Bangladesh and learn more about

1 Unless otherwise indicated, Rs. denotes Pakistani Rupees and $ denotes US Dollars. For the purposes of this case study, amounts in Rupees have been converted into Dollars using an exchange rate of Rs. 1 = $ 0.016442, rounding up or downwards where appropriate.

microfinance and the Grameen model. It was a transformative trip. After observing Grameen's operations over an intensive two-month period, Roshaneh was convinced she had to take the model and adapt it to the Pakistani context.

In mid-1996, she launched her new venture under the name "Kashf", which is Urdu for "miracle" or "revelation". Over the next two years, Roshaneh and a small team embarked on an extensive research programme. They devised a series of social action initiatives in order to determine how best to model a sustainable microfinance organization for women in Pakistan. (For an overview of Pakistan and the microfinance sector in Pakistan, see Appendix 1).

The team decided that Kashf would focus mainly on providing credit to women because the loans would create a second income for low-income households to the benefit of the entire family. Kashf would launch a series of social action programmes to educate and support women and give them the confidence to take loans and start micro-enterprises. Using the Grameen model, Kashf would make loans to "solidarity groups" of 25 women who would be jointly responsible for repayment. Unlike Grameen, which had its origins in the villages around the Bangladeshi city of Chittagong, the programme would be initially concentrated on the bustling, high-density inner city of Lahore, with the idea that once proven it would be extended to other cities, smaller towns and rural areas. Kashf has now reached this critical juncture.

Products and Services

Kashf principally serves women who: (a) have a household income of Rs. 3,500 to Rs. 6,000 ($60-$100) per month; (b) own or rent their home and are unlikely to relocate; and (c) have a capacity to work as micro-entrepreneurs. Since most borrowers have no credit history or collateral, the repayment capacity of potential customers is not explicitly taken into account but character references are obtained. Eligible candidates are brought together into "solidarity groups" of 25 women, each with a group leader and four to five sub-group leaders. While no collateral is required for loans, all members of a solidarity group are liable for each others' repayment obligations. Each potential customer and group is assessed and coached by a Kashf loan officer prior to any loan provision.

Kashf's core product is the General Loan, which customers can use to support their own employment or a micro-enterprise, which may employ male family members. It can be used to fund established businesses or start new ones. Typically, the enterprises involve batch work projects such as embroidery or tailoring, small-scale manufacturing such as shoes or product components, and small retail outlets. The minimum amount loaned is Rs. 10,000 ($165) and the maximum is Rs. 50,000 ($500), repayable in 24 instalments over 12 months at an interest rate of 20% per annum. Successive loan cycles entitle customers to increase loan amounts by up to Rs. 4,000 ($65) per cycle.

Kashf customers who have qualified for the General Loan are also eligible for an Emergency Loan facility, which is typically used to cover school fees, utility bills, health related expenses and special events. Emergency Loans start at Rs. 2,000 ($33) and go up to Rs. 4,000 ($66), repayable in 12 instalments over 6 months.

In the past two years, Kashf has also introduced the Business Sarmaya Loan, which is intended for the "missing middle" of the market. This includes both men and women with ongoing businesses who demonstrate a financial need for working capital and/or an investment in fixed assets. Small entrepreneurs also receive advisory support for their businesses. The facility is available for both new and existing customers whose needs have evolved beyond the General Loan. The Business Sarmaya Loan is made to individuals, with recourse to the individual borrower alone. Loans start at Rs. 30,000 ($500) and go up to Rs. 100,000 ($1,650), repayable in monthly instalments.

Kashf's success has fostered demand for new products. After extensive customer feedback, it is now also developing a Home Improvement Loan and Hire Purchase Financing product.

At present, 90% of Kashf's loan portfolio consists of General Loans (with Emergency Loans representing 9% of the portfolio, and the new Business Sarmaya Loans accounting for 1% of the portfolio). By 2010 it expects that the Business Sarmaya Loan product will represent 20% to 30% of the loan portfolio. The proposed Home Improvement Loans and Hire Purchase Financing will make up a reasonable percentage of the portfolio in coming years. Since these new products involve larger amounts of financing and lower administrative costs, the overall profitability of the portfolio is expected to increase.

Unlike many other microfinance organizations, Kashf doesn't require customers to save with the organization as a pre-condition of a loan, although it does provide a voluntary savings facility. As processing costs for this facility are relatively high, customers do not earn interest on their savings. Although a substantial number of customers use this facility, each account is small and the aggregate amount of deposits has been declining. The facility has not been a major success and, as of 30 June 2006, the aggregate amount of customer savings was under Rs. 7 million ($115,000). Kashf's research shows that there is robust demand for savings facilities among low-income households in Pakistan, but the organization is not licensed to accept deposits and has no automated cash collection or dispensing facilities. Typically, those seeking savings options are in a slightly higher income bracket than its core customer group.

Kashf has also introduced a life insurance policy with a minimum insured amount of Rs. 10,000 ($165) and a ceiling of Rs. 25,000 ($410). The premium is no more than 1.5% of the insured amount. Customers of its General Loan are required to purchase this policy at the time the loan is disbursed to cover the outstanding loan at the time of death plus funeral benefits for the family. Kashf's research indicates that if it were to raise the ceiling for this policy there would be strong uptake among its customers. However, to substantially develop this business and effectively handle the actuarial and investment issues related to insurance products, it would need to create a strong alliance with an insurance company.

Social Action Program

Since its inception, Kashf has devoted substantial resources to building a robust gender empowerment and social advocacy programme. This supports both its social mission to empower women, and its business objective to nurture strong and resourceful customers. Kashf deploys internal resources, including a team dedicated to social action, its loan officer network and links to other non-governmental organizations, community specialists and advocacy groups to reach out to its customers. The social action programme includes individual counselling sessions, spouse and family meetings, solidarity group sessions, meetings with local councillors and government officials, quarterly training sessions, interactive theatre performances and special events. The topics that these interventions cover include explaining microfinance lending, building awareness of issues relating to gender, health and civil rights, and helping female clients to deal with family objections to women working and to address abusive situations and legal problems.

Kashf's training programmes are based on demand-driven subjects such as leadership, gender and reproduction. Its leadership training programme focuses on team building, decision making and conflict resolution. In the gender training programme, both men and women are invited to address issues relating to sex and gender, labour specialization, the role of women in Pakistani society, myths regarding women and violence against women. The reproduction training programme addresses the problem of low levels of awareness of pre- and post-natal care, women's health, hygiene, contraception and family planning.

Management and Operations

Roshaneh has assembled an experienced and well-connected board of directors and a small, seasoned management team. Sadaffe Abid, who took over as Chief Executive Officer in early 2006, manages the organization. A graduate of Mount Holyoke College, she briefly conducted research projects for the World Bank and Asian Development Bank before joining Kashf in 1997. Other key team members include a chief operating officer, chief financial officer and chief technology officer, all of whom have had substantial experience working in leading multinational or national enterprises. Although the current management team is highly competent, it is likely that in order to substantially grow the business the team will need to be reinforced with executives with more experience in retail banking.

Chart1: *Growth in Active Clients, Branches and Staff*

Category / Year	1999	2000	2001	2002	2003	2004	2005	2006
Active Clients	913	3,406	7,221	15,706	45,331	67,552	72,507	135,000
Branches	1	5	10	16	30	30	35	69
Staff	58	88	121	175	263	275	333	690

The Kashf headquarters handles central functions such as planning, finance, accounting and technology, while the branch office is the organization's key operational unit and point of customer contact. There are two types of branch offices – those focused on poverty lending and the General Loan and Emergency Loan products (at the end of 2006 there were 67 such branches), and those focused on enterprise lending and the Business Sarmaya Loan (at the end of 2006 there were 2 such branches).

Kashf's branch network began in Lahore and has spread throughout the province of Punjab. By the end of 2006 it had 22 branches in Lahore, 42 branches in other provincial cities or major towns (with 12 in the textile city of Faisalabad and 7 in the agri-processing city of Sargodha) and 5 branches in Pakistan's largest and Southern-most city, Karachi. So far, Kashf has focused on the urban market and hasn't reached out to address the funding needs of low-income agricultural workers. Provision of microfinancing services for this vast segment would require loan products with longer repayment cycles that match agricultural cash flows and the organizational capacity to deal with a geographically dispersed customer base. In comparison with Bangladesh, the rural sector in Pakistan presents special challenges for any service organization as the country's rural areas are significantly more varied in terms of types of agricultural products, weather and topographical conditions, income levels and linguistic and ethnic composition.

Each Kashf branch is staffed by a branch manager, a cashier/accountant, four to six loan officers, an office helper and a security guard. The branch serves customers living within a radius of 10 kms in urban areas and 15 kms in semi-rural areas. On average, a "poverty lending branch" will service 2,400 customers, with each loan officer managing 400-600 customers. The most effective loan officers can handle up to 24 solidarity groups (a total of 600 customers) and hold meetings with each group at least once every two weeks. In addition to developing and managing the lending business, loan officers serve as agents for advancing Kashf's social action programme.

Kashf's loan officers may or may not have a basic college degree and are roughly evenly split between genders. New officers are given basic training on operations and products. Many of those who have been with Kashf for several years have built up a strong base of institutional knowledge and close customer relationships. Specially trained officers administer the more sophisticated Business Sarmaya Loan. As Kashf introduces additional products, including the home improvement and hire purchase loans, the need to train loan officers and other more highly-trained staff will become critical. To scale up operations, a sophisticated training programme will have to be developed.

At present, Kashf's information technology systems are quite basic. Transactions with customers are recorded in paper-based bank books and the cashier at each branch inputs the data into a computer. These data are transferred, often on floppy disk, to headquarters, where the information is downloaded into a loan and savings management system. Kashf is currently working on integrated data flows between headquarters and a limited number of branches.

Kashf's cash management system is even more basic. The organization lacks the regulatory approval to accept deposits so it handles cash through licensed banks. Cash transactions with customers take place at the branch, with each branch depositing and withdrawing money from a licensed bank on a daily basis. At present, Kashf is evaluating options for upgrading its cash and account management systems, including the use of biometrics-based automated teller machines (ATMs) now available in Pakistan.

Financial Performance

Kashf's business began to grow in earnest in 2002. Since then, the number of active clients has grown by over 175% annually, and net loans outstanding have increased by nearly 300% annually. In 2006 Kashf had another stellar year. Growth has been achieved without sacrificing profitability. The organization has been profitable since 2003 and has demonstrated robust operational and financial self-sufficiency.

The credit quality of Kashf's portfolio has been excellent. Its portfolio at risk remains well under the 2% provision it maintains as a reserve against bad debt. To maintain that ratio, Kashf has been strict about making sure borrowers meet the customer profiling standards, and maintaining time periods before cyclical increases can be approved. Kashf rotates loan officer portfolios on a six-month basis to make sure applicants are reviewed by multiple officers.

Given its excellent credit control discipline it is unlikely that future profitability will be compromised by poor credit decisions taken so far.

Chart 2: *Loans, Profit (Loss) and Sufficiency Ratios*

Category / Year	1999	2000	2001	2002	2003	2004	2005	2006
Net Loans Outstanding (Rs. Million)	N/A	N/A	18.52	32.64	207.49	467.12	758.36	1200.00
Net Loans Outstanding (USD Million)	N/A	N/A	0.30	0.54	3.41	7.68	12.47	19.73
Net Operating Profit (Loss) (Rs. Million)	N/A	N/A	(5.29)	(4.76)	4.48	74.03	107.01	111.57
Net Operating Profit (Loss) (USD Million)	N/A	N/A	(0.09)	(0.08)	0.07	1.22	1.76	1.83
Operational Self-Sufficiency (%)	N/A	N/A	73.24%	94.74%	121.12%	192.32%	180.20%	N/A
Financial Self-Sufficiency (%)	N/A	N/A	58.42%	57.19%	74.97%	122.40%	117.21%	N/A
NOTE: The financial year is the calendar year. 2006 financial numbers are extrapolated from half-year results.								

The increase in Kashf's loan portfolio is attributable to several factors. First, existing customers are moving into deeper loan cycles and becoming eligible for larger loans. Second, as loan officers become more efficient, they are able to handle larger numbers of customers. Third, the number of branches has increased, leading to a dramatic widening of Kashf's customer base. In the future, as the Business Sarmaya Loan and other larger loan products are deployed more widely, the size of the loan portfolio will grow.

With low loan losses and a robust 20% annual interest rate, the size of the loan portfolio has been the key driver of Kashf's revenue growth and profitability. The size of the market for microfinance provides a great opportunity for Kashf over the next five years. However, as competition increases in the microfinance sector, especially in Lahore, sustaining revenue growth will require a bigger branch network over a larger number of cities and rural areas and, most likely, a declining rate of interest chargeable on loans.

A key driver of its success is its tight control over costs. Kashf has been successful in recruiting personnel from the non-banking sector and building up an excellent team at a relatively low cost. It has also minimized spending on branding and marketing, branch office operations and technology, and has enjoyed below-market rates of interest on most of the financing it has received from donor organizations. However, competitive pressures will raise salary costs and oblige Kashf to spend more on branding and marketing, branch operations and technology. Moreover, as its funding mix changes toward commercial sources, its cost of financing is also likely to increase.

Legal Structure and Considerations

Under Pakistani law, microfinance institutions may be established as (a) non-profit foundations or companies, or (b) for-profit microfinance banks.[2] Kashf was established as a non-profit foundation, but recently converted to a non-profit company to help the organization grow. As a non-profit company it has greater operational flexibility than a for-profit microfinance bank because it can achieve dimensions of its social mission that have no

2 See Appendix 1 for an overview of the different legal avenues available in Pakistan to establish microfinance institutions.

bottom line benefit. Moreover, Kashf is not subject to tax and is free to reinvest all its earnings in its operations.

Unlike a microfinance bank, however, it cannot accept deposits and has to manage cash deposits, loans, payments and withdrawals through a licensed bank. As a non-profit company, it has no access to the capital markets or to profit-oriented private equity sources. It is often more difficult for Kashf to complete transactions with banks and other business enterprises in Pakistan, which are focused on dealing with for-profit enterprises.

As part of its growth plans, Kashf needs to consider whether it should remain a non-profit company or establish a parallel for-profit microfinance bank. If Kashf were to retain its current structure as a non-profit company, it would find it difficult to build a savings business and attract a deposit base. By establishing a parallel for-profit microfinance bank it would be able to attract equity capital, build a deposit base and attract a cadre of banking professionals. At the same time, it would be competing more directly with other financial institutions that could be important sources of funding for expansion. Moreover, two parallel entities with differing objectives would create unique management challenges for Roshaneh and her team.

Targets for 2010

Kashf plans to consolidate its position as a leading microfinance institution in Pakistan and has set itself the following goals for the coming four-year period:

- Increase market penetration.
- Reinforce its positioning as a premier microfinance institution.
- Build increasingly deep customer relationships.
- Strengthen management and institutional capacity.
- Extend social impact and effectiveness.

To achieve these objectives, Kashf envisions that it will need to spread its reach into other cities in the provinces of Punjab and Sindh and probably into rural areas. Through this expansion it expects to grow its customer base, branch network and loan portfolio.

Chart 3: *Expected Growth in Customers, Branches and Loans*

Category / Year	2006	2007	2008	2009	2010
Active Clients	135,000	220,000	327,000	452,000	551,000
Branches	68	95	135	190	205
Net Loans Outstanding (Rs. Million)	1,200.00	2,450.00	4,700.00	7,300.00	9,709.00
Net Loans Outstanding (USD Million)	19.73	40.28	77.28	120.03	159.64

Funding Sources and Considerations

To date, Kashf has financed its operations through a mix of grants, retained earnings, concessionary financing from the Pakistan Poverty Alleviation Fund (PPAF) and donor agencies and loans from commercial banks. (For a summary of Kashf's financing and equity position as at 31 December 2005, see Appendix 2).

While so far it has managed its funding alternatives very effectively, its finance team now faces challenges of another magnitude altogether. To meet its business targets, Kashf will need to exponentially scale up its funding and capital base – from a total of Rs. 1.31 billion ($21.5 million) at the end of 2005, to over Rs. 10 billion ($164 million) by 2010. To meet this target, it will need to rely less on funding from PPAF, both because more non-governmental organizations and social enterprises are beginning to compete for PPAF funding and because the amount of funding required by Kashf will become progressively larger.

Increasingly, Kashf has been able to fund its operations out of retained earnings. As a non-profit organization it cannot distribute earnings; therefore, as its earnings grow, so does its capital available for expansion. However, retained earnings will only be able to provide a small percentage of the growth capital required. As a non-profit organization, Kashf could continue to attract grants of equity capital, but this is also a small and uncertain avenue of funding.[3]

Given these constraints, Kashf expects that by 2010 over 95% of the financing it obtains will come from the commercial sector. Fortunately, the commercial financing alternatives available to Kashf are multiplying. Given the strong performance of bank stocks over the past few years, the equity and capital markets in Pakistan are receptive to the sector. If Kashf were to establish a parallel for-profit microfinance bank, it would be able to tap both private and public equity capital sources.

Large banking institutions, such as Citibank and Standard Chartered, have also indicated interest in providing attractive financing terms to microfinance institutions such as Kashf in exchange for the opportunity to migrate customers who outgrow microfinance to their own small-and-medium enterprise banking initiatives. In April 2007, Kashf announced a landmark Rs. 1.32 billion ($22 million) term financing deal with Citibank (Pakistan). The transaction represents the first commercial syndication for the microfinance sector in the country. The first *tranche* involves the provision by Citibank of a five-year syndicated term loan to Kashf equal to Rs. 363 million ($6 million), with risk participation by Overseas Private Investment Corporation (OPIC). Kashf expects the next two *tranches* of the deal, each amounting to Rs. 480 million ($8 million), to be implemented in the near future.

In addition to bank loans, Kashf may also be able to tap into emerging sources of financing. In India, ICICI Bank has successfully started securitizing the assets of microfinance loan portfolios and this model could be adopted in Pakistan. Worldwide, Islamic banking has surpassed $500 billion in assets and is expected to grow at over 15% a year for at least the next five years. With their emphasis on social responsibility, Islamic banks could become a major source of funding for microfinance institutions in countries such as Pakistan.

3 However, if, as previously discussed, Kashf were to establish a parallel for-profit microfinance bank, this would open up a source of for-profit equity financing.

Competitive Landscape

Kashf is a leader in the market for a number of reasons. The organization has been able to adopt best practices in microfinance developed over a quarter of a century by institutions such as Grameen. It has an "early-mover" advantage in the microfinance industry in Pakistan and, with very limited competition, has been able to build a strong client base in its core markets. Also, Roshaneh has successfully recruited and retained a cadre of microfinance professionals, and she and her team have attracted substantial funding from PPAF and other donors. However, the competitive landscape is changing rapidly and Kashf's success going forward will depend to a great extent on its ability to develop successful strategies that take into account the emerging competitive dynamics of microfinance in Pakistan. (For a summary of certain key competitors in the microfinance industry, see Appendix 3).

Many different types of market entrants are shaping the emerging microfinance industry in Pakistan. For example, two mainstream commercial banks, the Bank of Khyber and the First Women Bank, provide microfinance services to low-income customers directly through their branches and through relationships with other microfinance institutions and non-governmental organizations (NGOs). Other mainstream commercial banks, including domestic banks with very large branch networks and multinational banks such as Citibank and Standard Chartered, are considering microfinance strategies. These large institutions have the potential to transform the nature of microfinance in Pakistan. In neighboring India, banking giant ICICI is just one example of how large-scale commercial banks can alter the microfinance landscape.

In addition, a number of microfinance banks have been established recently, including Khushali Bank (which is partially government-owned and supported by the Asian Development Bank) and Tameer Bank (which is headed by a sophisticated management team of ex-Citibankers and deploys biometric ATMs and PDAs and sophisticated credit-scoring methodologies). The microfinance market also has been targeted by leasing companies, such as Orix Leasing (a company with a successful history of operations in Pakistan), which are starting to introduce micro-leasing products for low-income customers. At the other end of the competitive spectrum, well-established NGOs are looking at spinning off their financing operations into microfinance institutions. Most notably, the well-established and highly successful Aga Khan Rural Support Program has already transformed its microfinance operations into a new microfinance bank – The First Microfinance Bank.

The emerging competitive landscape is being shaped by players with varying strengths, such as far-flung branch networks, deep financial pockets, extensive commercial banking experience, specialized product offerings and well-established social development capabilities. Many of the new players are looking at Kashf's established customer base and well-trained workforce as easy targets for scaling up their own operations.

Strategic Considerations

While Roshaneh and her team are justifiably proud of their achievements, they recognize that the future holds unique challenges and opportunities. Microfinance is moving from a fringe development activity to a core expansion strategy for banks in emerging markets. Pakistan's equity markets are buoyant, and Pakistani banks are flourishing and flush with cash. Big local and foreign banks are also developing microfinance strategies.

Roshaneh notes: "We are in a very interesting position. On the one hand, microfinance is still in its early days in Pakistan, and there is a vast, underserved market for financial services at the bottom of the pyramid. On the other hand, we are entering a period of intense competition. If we can couple our present momentum with the growing appetite for financing microfinance activities, we can easily achieve, and even exceed, our targets."

Kashf's business is at varying stages of maturity in different locations. Its markets may be classified in three ways: (a) *middle-stage urban*, (b) *early-stage urban,* and (c) *rural*. Pakistan's urban centres are an attractive market for microfinance institutions because population density enables a single branch to service a large number of customers. In addition, the relatively greater commercial intensity of the urban centres promises growth opportunities for micro-entrepreneurs and related financing opportunities for microfinance institutions. Kashf's home city of Lahore is probably the only urban centre that may be classified as a *middle-stage urban* market, in the sense that microfinance services are generally available in the densest inner-city localities. Nevertheless, the city still affords possibilities for expansion. The other cities and large towns in the Punjab and other parts of Pakistan may be classified as *early-stage urban* markets, where the penetration of microfinance institutions is low. In rural areas, which are home to the majority of the country's poor, microfinance has yet to become a meaningful form of financing.

Roshaneh notes: "The smaller cities and larger towns promise the greatest potential to scale our business on a financially rewarding basis with relatively low levels of competition. At the same time, we must defend and strengthen our position in Lahore, our home market. We cannot assume we will enjoy the same market dynamics as before because our competitors are targeting our best customers and employees. We need to make sure we can grow in new geographies while providing increasingly varied value-added services to remain relevant to our most profitable and best-established customers."

In the *early-stage urban* markets, Kashf's greatest competitive strengths are its ability to quickly organize a community for microfinancing activities, its well-developed social action programme and its urban branch and officer network, which can be applied without much modification. By essentially replicating its tested business practices in markets with low levels of competition, it will be able to expand rapidly and establish a strong market position. The challenges will be human resource management and expanding management information systems over a broad geographical area. Sadaffe says: "The Pakistani professional workforce is not very mobile, and this is especially true in the case of women workers. People often live in extended families and we find it difficult to convince our experienced team members to relocate to a new city or town. To address this problem, we have to both hire more men (who are better disposed to relocation) and develop an intensive training and best practices culture."

The rural market represents the earliest-stage opportunity for Kashf and a potentially fertile opportunity with fewer competitors. According to Roshaneh: "The opportunity in the rural sector is huge, but one for which we need to make the greatest number of modifications to our business practices and product offerings. The geographical area that each branch needs to cover is substantially larger, which requires us to rethink branch economics. Additionally, because of the overwhelmingly agricultural nature of the rural economies, we need to design loan products with long repayment periods and we need to deal with agricultural risk." To tackle the sheer scale and unique difficulties of the rural market, Kashf may need to seek alliances with NGOs and other institutions that have a track record of working on rural uplift and poverty alleviation.

The *middle-stage urban* market of Lahore is Kashf's core market. Roshaneh says: "Lahore is important not simply because it is our home market. Even though Lahore is becoming highly competitive, it is also a big and lucrative market. Moreover, if we succeed in new markets but allow the competition to weaken us in Lahore, we will not be able to sustain our successes as our competition follows us into these new markets."

In Lahore, the competition is beginning to test Kashf. Competitors have started poaching some of its best customers by offering larger and more attractive financing packages, as well as assistance in business development by arranging subsidized store rentals and marketing support. As larger institutions step into the ring, they will be able to offer more sophisticated products and banking facilities, including savings and insurance schemes and ATMs.

In Lahore as elsewhere, Kashf has remained committed to its poverty lending agenda of helping poorer micro-entrepreneurs lift themselves out of the poverty trap. However, from a financial perspective, its larger, more mature customers constitute a critical customer segment. They borrow more per customer and require a minimal amount of handholding. Kashf has succeeded in fulfilling its social mission, growing rapidly and remaining profitable by maintaining an acceptable mix of new, less profitable customers with smaller financing needs and well-established, more profitable customers with larger financing needs.

If Kashf remains tightly focused on its poverty lending agenda, it runs the risk of playing the low-profit role of educating new customers who are picked-off by its competitors as the customers mature. Sadaffe said: "The maturation of our lending programme and our competitive situation create issues in boundary management. We are now working to better define and defend the top boundary of our customer base. Our Business Sarmaya Loan, Home Improvement Loan and Hire Purchase Financing products all address the financing needs of this customer segment. By 2010 we expect that 20% to 30% of our portfolio will consist of loans to small enterprises and customers who are above the poverty line. We expect that the remainder of the business will be driven by our poverty lending agenda."

For Kashf to scale up its new product offerings, such as the Business Sarmaya Loan and Home Improvement Loan, it will need to make a change in business practices and team competencies. As these products are individual recourse loans, they require credit control and risk assessment disciplines similar to those adopted by conventional banks. Similarly, delivery and monitoring of these products requires officers with conventional banking skills. As new products mature from the pilot stage to full implementation, these disciplines and competences will need to be widely diffused through the organization.

Other avenues for growth in the emerging competitive landscape will also compel Kashf to adopt both conventional and cutting-edge banking practices, skills and technologies. For example, to meet the substantial market demand for savings and cash management, one microfinance competitor has already introduced biometric ATMs and may introduce mobile phone banking. In order to deliver a competing service, Kashf will need to obtain a banking license, raise expansion capital, develop sophisticated cash management systems and implement a new technology network.

Another avenue for growth involves the delivery of non-banking products and services. These include an expanded range of insurance products and financing of home appliances. In Bangladesh, Grameen has had phenomenal success in the mobile phone business, but the Pakistani telecom market is already highly competitive. However, Kashf could tie up with local telecom companies to provide mobile banking services. In all of these value-added areas, success will depend on its ability to articulate an innovative value proposition and create deep alliances with diverse businesses such as insurance companies, appliance distributors and telecom companies.

Roshaneh says: "In order to grow, we will need to develop – either directly or through alliances – various systems and capabilities similar to our commercial bank competitors. While we will be going up a steep learning curve in this respect, we are in an extremely strong position with respect to the social dimension of our business. Our core competency is in social action and mobilization and our competition cannot match us on this front. Commercial banks need to replicate or tap into our strengths, just as we need to develop further our commercial banking capabilities. There are possibilities both for competition and cooperation."

In just one decade, Kashf has firmly established itself as a leading microfinance institution in Pakistan. As competition heats up, what growth strategy should it adopt between now and 2010 to expand and keep focused on its mission?

Appendix 1

Overview of Pakistan and Microfinance in Pakistan

Pakistan – an Overview

Pakistan was founded in 1947 upon the violent division of British India into a Muslim majority state, Pakistan, and a Hindu majority state, India. Pakistan straddled India's western and eastern boundaries until 1971, when the eastern half seceded to form Bangladesh. Pakistan is divided into four major provinces and ethnic groups, each with its own language and cultural identity. The challenges of governing an ethnically divided population have been exacerbated by geo-political tensions between Pakistan and its neighbors, India, Afghanistan and Iran. Since the late 1970s, the country has had to deal with escalating levels of Islamic fundamentalism and sectarian strife. These problems have persisted across a succession of military regimes and unstable democratically elected governments.

Pakistan is the ninth most populous country in the world, with 155 million people and an annual population growth rate of 2.4%. At current growth rates, Pakistan's population will equal that of the United States by about 2050. Pakistan is a low-income country with *per capita* income of $720 and over 32% of its population living in poverty on $2 per day or less. Poverty is a particularly intractable problem in rural areas, where 65% of the population resides. Pakistan has not succeeded in developing a successful export or industrial growth strategy. The principal drivers of the economy include remittances from overseas workers and low value-added textiles and agri-products. Despite these conditions, the country has a vibrant class of small- and medium-size business entrepreneurs and an untaxed, underground economy that is estimated to be at least as big as the formal economy. In the past five years, Pakistan has experienced strong growth, principally fueled by the so-called "9/11 dividend" in the form of generous aid flows and debt forgiveness from the West and repatriation of funds by overseas Pakistanis and investments by Middle Eastern countries.

While there has been some success in poverty alleviation over the past ten years, the challenges facing women in particular remain extremely difficult. Only 22% of girls above the age of ten have completed primary schooling (compared with 42% of boys). Women typically marry at an early age, and the average number of children is between 5 and 6, tying women to the home. Women have a heavy burden of work in their homes and in the fields and face discrimination in the formal business sector. Women constitute only 30% of the total formal workforce. Social discrimination against women has been reinforced by the Hudood laws passed in the 1980s, which have had the effect of reducing the legal rights of women in specific cases such as rape and adultery.[4] Hemmed in by illiteracy and early marriage, a large number of children, domestic work pressures, social prejudice and legal discrimination, the majority of women in Pakistan are faced with extreme difficulty to realize their economic and career potential.

Microfinance in Pakistan

Microfinance was pioneered by organizations such as ACCION in 1973 and Grameen Bank in 1976 on the premise that credit could be provided on a profitable and sustainable basis to entrepreneurs at the bottom of the wealth pyramid. The microfinance movement is now well established globally, with over 20,000 institutions worldwide. The movement recently gained international recognition with the award of the 2006 Nobel Peace Prize to Grameen Bank and its founder, Muhammad Yunus.

Microfinance is a relatively new development in Pakistan. At present, approximately only 8% of the estimated 10-15 million households that require microfinance services have access to it. As a general rule, the formal banking sector avoids lending to the bottom 30% of the population and to a substantial portion of the lower-middle class as well, due to the lack of collateral and perceived difficulties in loan

4 Recently, the Pakistan Parliament passed the Protection of Women (Criminal Laws Amendment) Act, which will carve back some of the draconian effects of the Hudood laws.

collection. Generally, the only sources of credit available to low-income families are financing from family and community members, shopkeepers and other suppliers and extortionate moneylenders.

Formal microfinance services were first introduced in Pakistan in the 1960s and 1970s through federally and internationally subsidized programmes for the rural poor. Mired in inefficiency and corruption, these unsustainable programmes generally failed to reach the intended beneficiaries. In the 1980s, the Aga Khan Rural Support Programme achieved success in Northern Pakistan through programmes that provided financial grants and technical support for village communities to develop small infrastructure projects and commercial ventures. This community-based rural support model was replicated, with a limited degree of success, in other parts of Pakistan through the 1980s and early 1990s. The rural support organizations that promoted this model also established the first connections with the banking sector by opening lines of credit with commercial banks and on-lending the proceeds as small loans to farmers. Similarly, the Orangi Pilot Project developed an individual lending methodology adapted to urban slums by targeting entrepreneurs in Karachi, the country's largest city.

In the mid-1990s, new non-profit institutions such as Kashf began to emerge, which replicated well-established microfinance models imported from other countries such as Bangladesh, India and Bolivia. Unlike the rural support programmes, which implemented a holistic development paradigm, these institutions adapted the "specialized" microfinance approach to conditions prevailing in Pakistan. In the early 2000s, the fledging microfinance sector was given a boost through the formal support of the Government of Pakistan and the World Bank. Then came governmental initiatives through the Pakistan Poverty Alleviation Fund and the Microfinance Ordinance of 2001.

The Pakistan Poverty Alleviation Fund (PPAF) was established in 2000 by the government and funded by the World Bank and other donors, including USAID and the United Nations International Fund for Agriculture Development. PPAF serves as an apex institution which partners with and supports non-governmental organizations involved in poverty alleviation, gender empowerment and physical and social infrastructure development. To further these objectives, PPAF channels governmental, multilateral and bilateral funds and provides training and best practices support to eligible social enterprises and NGOs. PPAF has a resource base of approximately Rs. 38 billion ($625 million) and has made cumulative disbursements of over Rs. 13.37 billion ($220 million) to over 50 organizations. Up to the end of 2005, microfinance lending accounted for over Rs. 9.5 billion ($156 million) of its funding transactions.

There are three legal avenues in Pakistan for creating and operating microfinance institutions: (a) establish a non-profit foundation under the Societies Registration Act of 1860, a legacy law from the days of British colonial rule which governs philanthropic associations, (b) establish a non-profit company under the Companies Ordinance of 1984, which governs the formation of companies, or (c) establish a microfinance bank under the Microfinance Institutions Ordinance, which was enacted in 2001 to regulate for-profit microfinance banks.

A non-profit foundation or company may be established under the Societies Registration Act or Companies Ordinance for all types of philanthropic purposes, including the provision of microcredit. Such entities require minimal start-up capital. Foundations are very lightly regulated, but the Securities and Exchange Commission of Pakistan, which sets standards for corporate governance and audited accounting, regulates companies more closely. Both types of non-profits are prohibited from distributing any profits to shareholders or members, are not allowed to accept deposits from the public and may not be designated as "microfinance institutions." However, such entities are not subject to income tax, even if they are managed on a profitable or self-sustaining basis.

Microfinance banks, on the other hand, are licensed and regulated by the State Bank of Pakistan, the country's central bank. The minimum paid up capital for a microfinance bank with a national charter is Rs. 500 million ($8.2 million). In contrast with non-profit foundations and companies, microfinance banks are authorized to accept deposits from the public, but, consistent with the regulation of other types of financial institutions, are required to take into account the economic and commercial merits of any transactions they undertake. At present, the State Bank prohibits such institutions from making loans to single borrowers in excess of Rs. 100,000 ($1,650). Like other for-profit organizations, microfinance banks are subject to income tax.

Appendix 2

Financing and Equity Position as at 31 December 2005

Funding Source	Rs	USD	Comment
Loan Facilities as of December 31, 2005			
Pakistan Poverty Alleviation Fund (PPAF)	374,681,709	6,160,517	PPAF has extended a Rs. 750 million ($12,331,500) revolving credit facility to Kashf at a 6% annual rate of interest. The facility is secured by Kashf's loan portfolio.
Grameen Foundation U.S.A. (GFU)	21,198,548	356,338	GFU is the US-based foundation established by Grameen. GFU has provided an unsecured loan of US$356,338 to Kashf. The loan bears a 6% annual rate of interest and is repayable in equal quarterly instalments from July 2007 through December 2012.
Acumen Fund (Acumen)	8,923,500	150,000	Acumen is a US-based organization which provides funding and support to social enterprises. Acumen has provided an unsecured loan of US$150,000 to Kashf. The loan bears a 6% annual rate of interest and is repayable in equal quarterly instalments from July 2006 through December 2010.
Muslim Commercial Bank (MCB)	172,322,892	2,833,333	MCB is a commercial bank in Pakistan. MCB has extended a Rs. 300 million ($4,932,600) line of credit to Kashf. The line of credit bears a floating rate of interest equal to 1% over the Karachi Inter-Bank Offered Rate (the 1-year offered rate as of the end of October 2006 being 10.91%). Kashf uses this facility mainly for bridging and cash management purposes.
Total	**577,126,649**	**9,500,188**	
Equity as of December 31, 2005			
Department for International Development (DFID)	254,226,980	4,180,000	DFID is the part of the UK Government that manages Britain's aid to poor countries and works to get rid of extreme poverty. DFID supported Kashf from April 1999-Dec 2003 for operational costs of HO and branches and funds for revolving credit.
Aga Khan Foundation - Aga Khan Agency for Microfinance (AKF)	39,532,905	650,000	The Aga Khan Foundation is a non-denominational, international development agency established in 1967 by His Highness the Aga Khan. Its mission is to develop and promote creative solutions to problems that impede social development. Since its establishment in 2005, The Aga Khan Agency for Microfinance (AKAM) has taken over 25 years of microfinance activities, programmes and banks that were administered by sister agencies within the Aga Khan Foundation. AKF supported Kashf from April 1999 to March 2003 for HO operational costs and research and development activities.
CGAP	36,491,911	600,000	CGAP is a consortium of 33 public and private development agencies working together to expand access to financial services for the poor in developing countries. CGAP provided Kashf a flexible grant to meet funding needs.
Others	45,614,889	750,000	
Total Grants	**375,866,685**	**6,180,000**	
Retained Earnings	**357,620,000**	**5,879,988**	
Total	**733,486,685**	**12,059,988**	

Appendix 3

Competitor Profiles

Name of Organization	Background	Financial Products	Loan Sizes (Rs.)	Mobilization Strategy
Asasah	• Non-Governmental Organization established in 2001, registered 2003 in Lahore • Serves the Punjab province • Over 12,500 urban/semi-urban active borrowers and Rs. 207 million cumulatively disbursed • Collaborates with financial institutions First Elite Capital Modaraba, ORIX Leasing Company, Cres Leasing Company and Pak-Oman Investment Company.	1. Loans: a. Protective / Productive loans (PL) b. Emergency loan c. Business loan (BL) 2. Micro-insurance 3. Savings 4. Micro-leasing	PL: 3,000-8,000/10,00-30,000 BL: 26,000-50,000	Group lending; 25 women per group Smaller BL groups; 5-10 people
Bank of Khyber	• Commercial bank with a microfinance department since 1999 • Serves NWFP (Northwest Frontier Province) • Over 7,800 active urban/rural borrowers and Rs. 1.2 billion cumulatively disbursed • Microfinance represents fewer than 10% of the bank's operations and women account for under 8% of borrowers	1. Loans: a. Productive loan (PL) b. Business loan (BL) c. Industry specific financing (e.g., tea planting, rickshaw 2. Credit Lines to qualifying Rural Support Programs and NGOs for on lending in rural areas.	PL: 30,000 BL: up to 100,000	Group lending for productive loans
Center For Women's Cooperative Development (CWCD)	• Non-Governmental Organization established in 1992, but recently registered • CWCD works principally in the areas of microfinance, but is also active in provision of health and education in urban and rural areas of the Lahore district for established micro-enterprises and experienced micro-entrepreneurs	Information not available Based on market information, CWCD provides enterprise loans and equity financing	Information not available	Information not available
First Microfinance Bank	• Private commercial microfinance bank established in 2002 • Serves urban and rural communities nationwide • 16, 931 active borrowers • Transformed from the microfinance department of the Aga Khan Rural Support Program (AKRSP), one of the country's first microfinance success stories, with additional financing from Aga Khan Fund for Economic Development (AKFED) and the World Bank's International Finance Corporation (IFC)	1. Loans: a. Productive loan b. Business loan c. Home improvement loan (limited scope) d. Loans for salaried employees 2. Credit life insurance 3. Savings 4. Fund transfer services	5,00- 25,000	Group lending; 3-15 men/women
First Women Bank	• Private commercial bank for women, established in 2002 with a microfinance department • Serves urban and rural areas in Karachi and Punjab regions • Over Rs. 824 million disbursed cumulatively to 32,000 borrowers	Loans	5,000-100,000	Information not available

Kashf Foundation	• Non-Governmental Organization established in 1996 in Lahore • Serves urban, semi-urban and rural communities in Punjab. • Over 135,000 active borrowers.	1. Loans: a. Productive loan (PL) b. Business loan (BL) c. Emergency loan (EL) 2. Insurance 3. Savings	PL: 6,000-35,000 BL: 30,000-100,000 EL: 2,000-4,000	Group lending; 25 women Individual lending
Khushali Bank	• Non-bank financial institution; established in 2000 as the first microfinance retail bank in Pakistan (owned by a group of private and public commercial banks) • 227,000 active borrowers in NWFP, Punjab, Sindh, Baluchistan and Azad Jammu and Kashmir. • Created by the government with lending support from the Asian Development Bank	1. Productive loan for working capital and asset purchase 2. Training and consulting	3,00-30,000	Group lending consisting of 3-20 men or women
National Rural Support Program (NRSP)	• Non-Governmental Organization established in 1991 • National coverage with 126,034 active rural borrowers and over Rs. 6.8 billion disbursed cumulatively • Microfinance is just a supporting component of a larger, integrated programme	1. Productive Loan 2. Compulsory blocked savings 3. Micro-insurance	10,000-30,000	Group lending; 15-30 men and women
Urban Poverty Alleviation Program (UPAP)	• Program of the NGO NRSP (see above) launched in 1996 • Over 36,000 active clients in the 5 cities of Islamabad, Faisalabad, Karachi, Multan and Lahore • An adaptation of Grameen Bank's lending programme	Enterprise loan	8,000-25,000	Small urban groups of 3 cross-guarantee
Orix Leasing	• Leasing company that services micro-enterprises that operates in the major cities of Karachi, Lahore, Faisalabad, Sialkot, Islamabad, Peshawar, Multan and Hyderabad • The company has a microfinance component (less than 10% of operations) and 4,709 female borrowers	1. Loans 2. Leasing	10,000 (average)	Group lending
Tameer Microfinance Bank	• Private commercial microfinance bank established in 2005 • Serves urban areas in the Karachi region • 14,500 active borrowers and Rs. 550 million cumulatively disbursed • One of the first nationwide, private sector, non-NGO transformed microfinance institutions	1. Loans: a. Productive loan b. Home improvement loan 2. Savings and Term deposit	10,000-100,000	Individual loans from a consumer finance platform i.e., salesforce, collection force and strong MIS

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