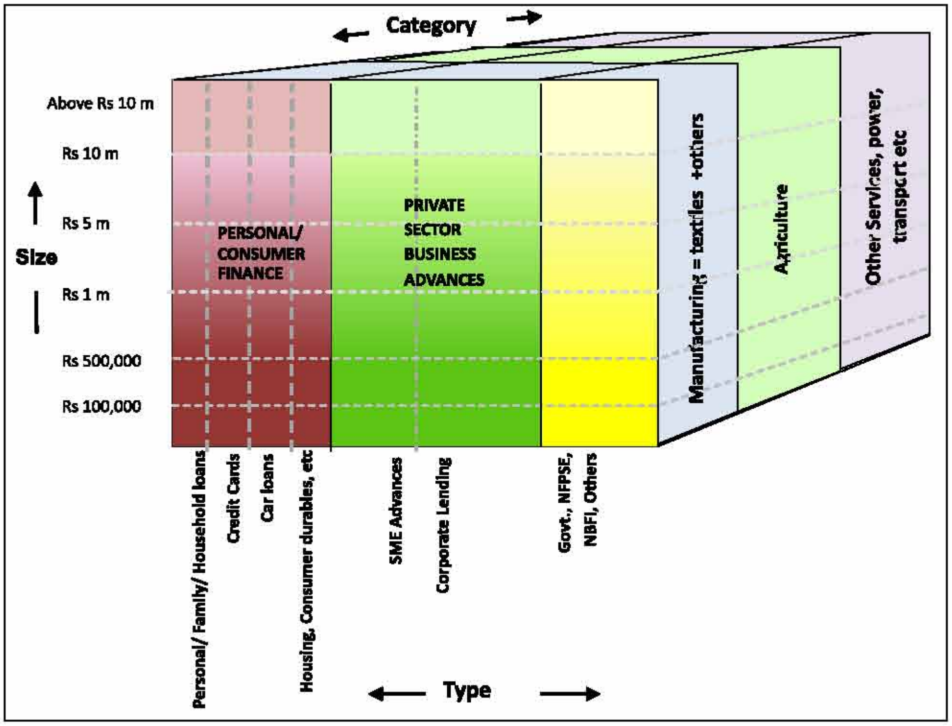
Figure 7.3: Product matrix of loans/ advances



It is clear from these proportions, shown in Table 7.7, that the most sizeable amount of credit is flowing into accounts above Rs 10 million, followed by those accounts that range between Rs 1 million and Rs 10 million. This is the large segment of corporate financing (private sector business accounts) where competition is expected to take place. The only other segment (a much smaller one though) that can be expected to witness competitive activity (and has indeed seen some competition) is that of consumer financing and personal loans, which typically comprises sizes of accounts ranging from Rs 100,000 to Rs 500,000. It also becomes instantly obvious from these data that micro-financing has been neglected by all banks, to the extent that even the meager share of 9.5% in total credit allocation in 2001 has been halved and gone down to 5% in 2008.

Table 7.7: Share of advances according to size per cent

	2001	2002	2003	2004	2005	2006	2007	2008
Up to Rs 100,000	9.5	9.5	9.3	7.9	7.5	7.1	6.2	5.0
Up to Rs 500,000	7.4	7.5	7.9	8.5	10.2	10.7	10.0	8.1
Up to Rs 1,000,000	2.5	2.0	2.8	3.3	3.6	3.0	2.8	2.4
Up to Rs 10,000,000	11.6	10.8	11.6	12.6	18.4	14.5	13.4	12.8
Above Rs 10,000,000	68.9	70.3	68.5	67.7	60.3	64.7	67.5	71.7
Total	100	100	100	100	100	100	100	100

Dominance of domestic commercial banks

Pakistani commercial banks, led by the top 5, have provided the bulk of the advances to the two categories of accounts: business loans and personal loans. The share of the Pakistani commercial banks in these markets is shown in Table 7.8.

Table 7.8: Share of advances by three kinds of banks

Amount in Rs million

	2001	2002	2003	2004	2005	2006	2007	2008
Pakistani commercial banks	663,099.1	688,520.5	861,037.2	1,283,796.8	1,674,193.8	2,092,774.5	2,438,527.5	2,856,164.1
% share	72.9	73.5	78.6	83.6	86.5	91.0	93.3	93.4
Specialized banks	119,664.6	126,083.4	122,994.1	99,211.9	97,791.1	89,732.6	88,506.4	100,975.6
% share	13.1	13.5	11.2	6.5	5.1	3.9	3.4	3.3
Foreign banks	127,272.8	121,590.8	111,716.9	152,883.4	163,164.0	118,025.8	86,171.2	99,353.2
% share	14.0	13.0	10.2	10.0	8.4	5.1	3.3	3.3
Total advances	910,036.5	936,194.7	1,095,748.2	1,535,892.1	1,935,148.9	2,300,532.9	2,613,205.1	3,056,492.9
% Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

These domestic commercial banks cater to about 3 million personal accounts[107] and about 1 million business accounts. Both numbers have risen since 2001 --- that of personal accounts rising most sharply up to 2007, then declining in 2008, marking an end to the expansion of consumer financing. The number of private business accounts rose very gradually after 2003, leveled off after 2005, and then rose in 2008 to cross the 500,000 mark.

It is therefore meaningful to focus only on these two product markets. In the data that follow, other types of accounts have been excluded, since they are not consequential for the present purpose of competition analysis.

Competition in corporate and personal loans/ advances

Table 7.9 is a profile of the corporate loans advanced by Pakistani commercial (domestic), specialized and foreign banks. The progressive dominance of the Pakistani commercial

[107] The exact number was 2,974,779 personal accounts in 2007, and 2,804,843 in 2008

(domestic) banks is instantly apparent. The same trend can be observed in personal loans and advances, from Table 7.10.

Table 7.9: Private sector business loans/advances

		2001	2002	2003	2004	2005	2006	2007	2008
Pakistani banks	Amount (Rs million)	428,622.0	476,618.1	648,974.9	936,672.9	1,205,916.5	1,488,954.0	1,745,654.2	2,073,497.3
	Number	494,910	463,127	509,749	592,756	740,801	809,954	791,043	1,032,708
Specialized banks	Amount (Rs million)	110,048.1	121,751.7	119,025.1	95,822.9	93,233.8	85,505.5	83,246.8	95,920.2
	Number	1,174,371	1,245,226	1,314,509	1,305,136	1,241,973	933,474	829,793	814,573
Foreign banks	Amount (Rs million)	95,806.3	80,952.8	67,684.4	103,301.8	105,044.0	72,155.9	56,022.3	71,350.6
	Number	12,614	3,338	2,912	4,650	4,610	2,341	2,132	2,286

Table 7.10: Personal loans/advances

		2001	2002	2003	2004	2005	2006	2007	2008
Pakistani banks	Amount (Rs million)	52,138.8	47,473.2	91,236.1	169,310.5	254,959.8	335,077.6	392,586.7	369,969.4
	Number	263,610	235,442	644,232	1,402,678	1,979,383	2,703,022	2,974,779	2,804,843
Specialized banks	Amount (Rs million)	8,291.0	4,273.1	3,642.7	2,717.5	3,228.0	3,595.7	4,258.1	4,109.7
	Number	139,073	52,793	39,605	30,693	22,012	24,683	21,622	25,297
Foreign banks	Amount (Rs million)	17,937.3	25,577.7	33,570.1	31,697.3	44,577.0	38,444.5	25,962.1	22,008.9
	Number	197,280	180,837	289,407	364,305	631,578	451,015	280,814	522,110

The number of corporate and personal accounts into which Pakistani banks have lent money is shown graphically in Figure 7.4, while the amount advanced is depicted in Figure 7.5.
The sharpest increase was that of the number of personal accounts, from 263,610 (2001) to 2,804,843 (2008), which was more than ten-fold. The corresponding increase in personal advances was seven-fold, from Rs. 52 billion (2001) to Rs 370 billion (2008). This implied an actual decrease in average loan size, which was about Rs 200,000 (the typical size of a consumer loan) but went down to around Rs 130,000.

Figure 7.4: Pakistani Commercial Banks

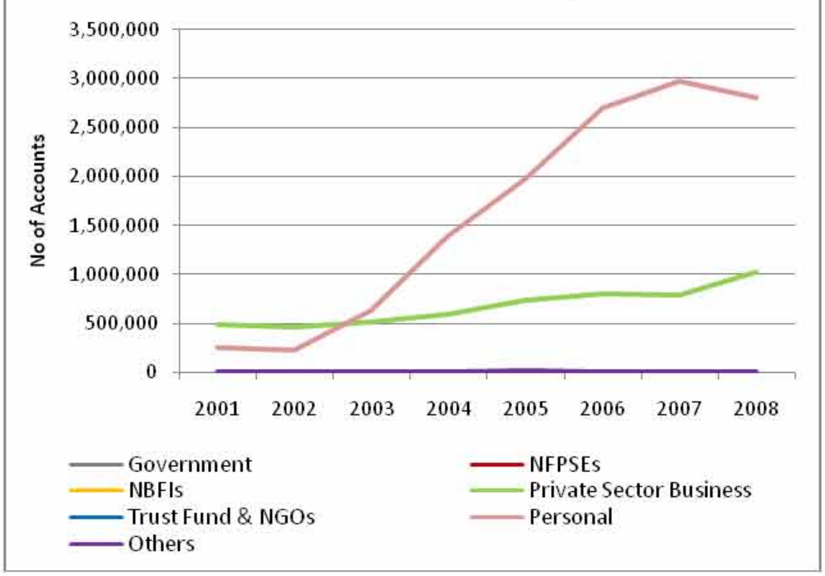
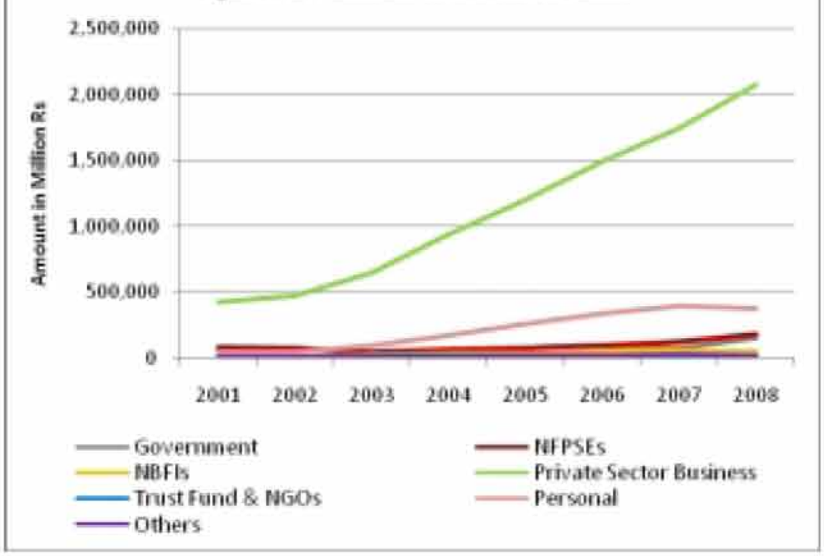


Figure 7.5: Pakistani Commercial Banks



Since the corporate lending portfolio is 5-7 times the size of the personal loan portfolio in bank lending, the greater impact must always be that of advances made to private businesses. This was indeed the case. Figure 7.5 shows the rise in corporate advances from Rs 429 billion in 2001 to Rs 2,073 billion in 2008, a nearly five-fold increase. The corresponding number of accounts doubled. This shows an increase in the average size of business advances by a factor of 2.3. While the average size of a corporate advance in 2001 was Rs 866,000, in 2008 it exceeded Rs 2 million.

III. SPECIALIZED BANKS

Specialized banks have a very large number of small accounts. In fact the number of these accounts exceeded that of commercial banks. In 2001, for instance, the number of private sector business accounts of specialized banks was 1,174,371, compared with 494,910 of domestic commercial banks. This large number, consists however of small-sized accounts. Typically the account size is below Rs 100,000 as shown in Table 7.11.

The lending of the specialized banks is mostly by way of agricultural credits by ZTBL or PPCB. These constitute 96 % of the loans advanced by them. Only a small proportion (2.5%) comprises advances by SME Bank and IDBP (1.5%). Typically, these specialized bank advances are in the amount of Rs 100,000 to Rs 200,000. Table 7.12 shows the size distribution of these advances.

The market segment in which the specialized banks have operated is thus different, by and large, from that of other commercial banks. Yet, they have been unable to sustain a market niche. This may have been owing to a variety of circumstances and factors other than those relating to increased competitive pressure. There has been not only a continual decrease in the total number of private business accounts but also a corresponding decrease in the amount.

Table 7.11: Number of private business accounts of specialized banks, according to size

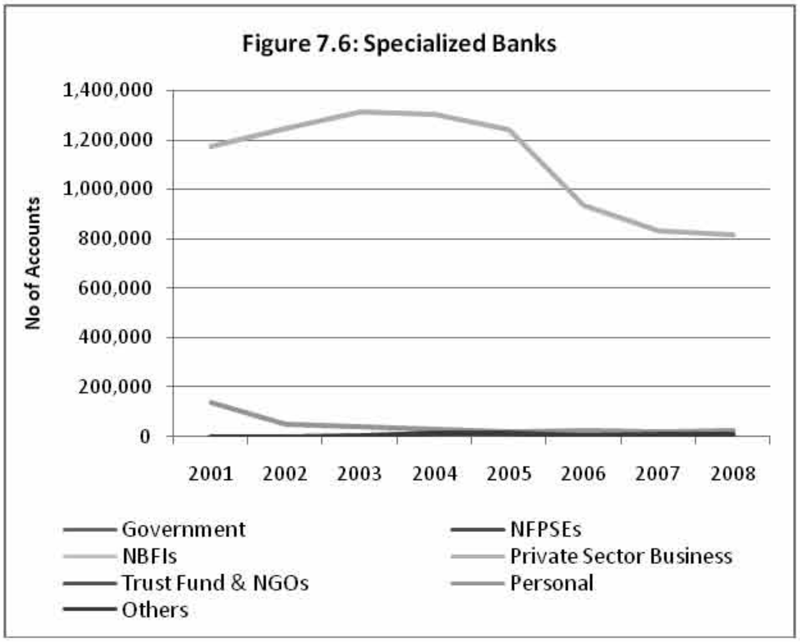
	2001	2002	2003	2004	2005	2006	2007	2008
Up to Rs 100,000	1,050,222	1,119,786	1,159,573	1,093,574	1,032,740	691,018	523,219	416,703
Up to Rs 500,000	115,075	119,677	146,749	210,566	207,461	240,833	304,997	395,985
Up to Rs 1,000,000	6,994	4,058	6,086	268	733	724	636	605
Up to Rs 10,000,000	1,552	1,216	1,594	492	777	687	768	1,079
Above Rs 10,000,000	528	489	507	236	262	212	173	201
Total	**1,174,371**	**1,245,226**	**1,314,509**	**1,305,136**	**1,241,973**	**933,474**	**829,793**	**814,573**

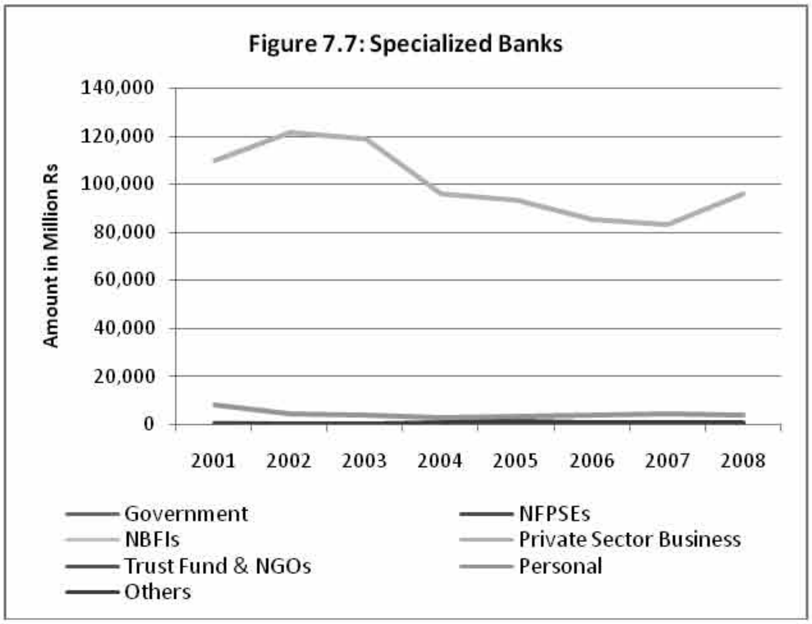
Table 7.12: Amount of private business advances of specialized banks, by size of account

Amount in Rs million

	2001	2002	2003	2004	2005	2006	2007	2008
Up to Rs 100,000	58,229.0	64,531.0	64,335.9	49,631.6	47,607.7	42,459.3	33,744.7	28,990.7
Up to Rs 500,000	19,434.6	20,947.9	25,750.1	31,313.6	32,858.4	33,033.9	41,698.2	57,516.5
Up to Rs 1,000,000	4,858.3	2,731.0	3,653.4	184.1	500.6	492.8	441.8	424.2
Up to Rs 10,000,000	4,183.5	4,046.2	3,820.7	1,937.8	2,951.4	2,335.8	2,259.3	3,106.0
Above Rs 10,000,000	23,342.7	29,495.6	21,465.0	12,755.8	9,315.7	7,183.7	5,102.8	5,882.8
Total	**110,048.1**	**121,751.7**	**119,025.1**	**95,822.9**	**93,233.8**	**85,505.5**	**83,246.8**	**95,920.2**

Figure 7.6 depicts the numerical decrease, while Figure 7.7 shows the trend of the decreasing amount.





Personal loans of specialized banks were never of much significance. In 2008, there were only 25,297 personal loans, that number having come down from 139,073 in 2001. The amount advanced was Rs. 4,109.7 billion (2008), having come down from Rs. 8,291 billion in 2001. Almost all the advances made by the specialized banks were to their own employees, mostly for house building. There was hardly any other borrowers' category for a personal loan.

IV. FOREIGN BANKS

It was seen in the last Chapter that foreign banks had targeted the very rich clients as their prime depositors. This target group was sought to be maintained in their lending strategy, and they also tried to take the lead in consumer financing and credit cards, but without too much success.

Table 7.13: Proportion (number) of personal and business accounts of foreign banks.

(per cent of total)

	2001	2002	2003	2004	2005	2006	2007	2008
Personal	93.88	98.03	98.87	98.65	99.25	99.44	99.23	99.55
Private Business	6.00	1.81	0.99	1.26	0.72	0.52	0.75	0.44

Table 7.14 : Share (amount) of personal and business accounts of foreign banks

(percent of total amount)

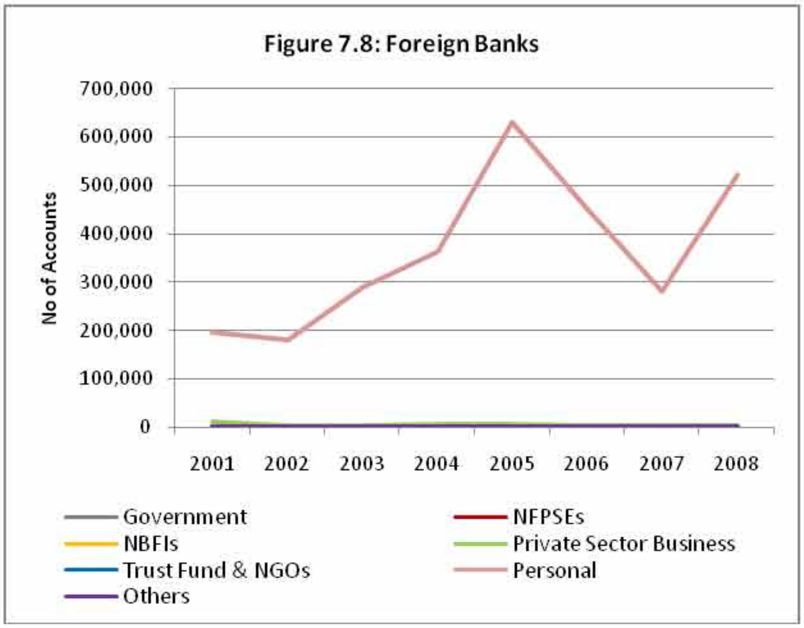
	2001	2002	2003	2004	2005	2006	2007	2008
Personal	14.09	21.04	30.05	20.73	27.32	32.57	30.13	22.15
Private Business	75.28	66.58	60.59	67.57	64.38	61.14	65.01	71.82

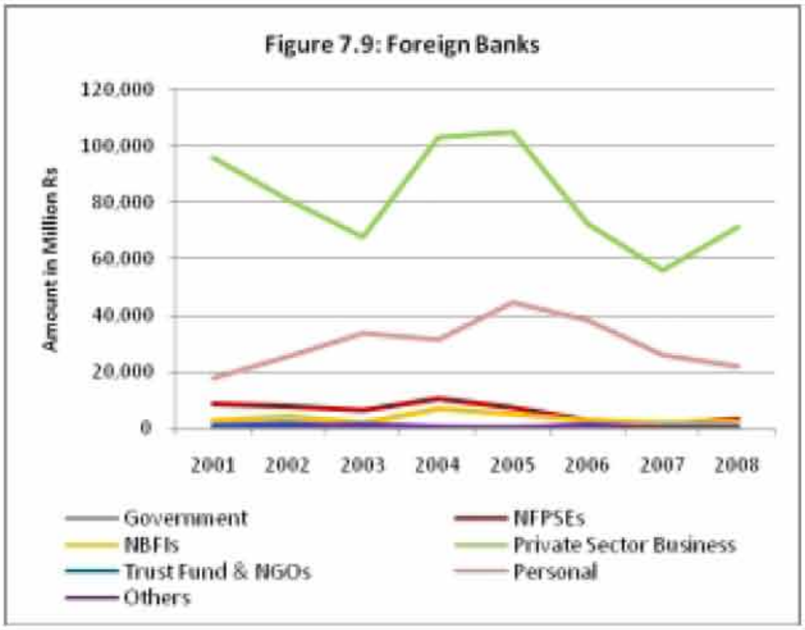
Personal accounts have constituted 93.9% - 99.6% of foreign bank customers. (See Table 7.13) The number of these accounts which was 197,280 in 2001 (and quite substantial compared with that of Pakistani commercial banks , viz: 263,610), actually rose more than three-fold to become 631,578 by 2005, but then started to decline as the early flush of consumer financing began to pale[108]. See Figure 7.8.

There was a parallel rise and fall in the amount advanced.[109] (See Table 7.14) This implies that the average personal loan size was Rs. 90,923 in 2001, Rs 70,580 in 2005, Rs 92,453 in 2007 and was reduced to Rs 42,154 in 2008. This trend reflected an intrinsic decline in the personal lending portfolio of foreign banks. The magnitude of this decline was however much greater when compared with the ascent of domestic banks.

[108] The number fell to 280,814 in 2007 but went back to 522,110 in 2008.

[109] Advances rose from Rs. 17,937.3 billion in 2001 to Rs 44,577 billion in 2005, falling to Rs 25,962.1 billion in 2007 and to Rs 22,008.9 billion in 2008.





Personal loans (and consumer financing) were, however, a secondary part of the lending portfolio of foreign banks, as is evident from Figure 7.9. The major part of their lending comprised advances to private sector businesses. The number of these clients was always very small. In 2001 there were only 12,614 business accounts of foreign banks. Their maximum was reached in 2004, when there were 4,650 such accounts, but even this number was to fall to 2,132 in 2007 and be 2,286 in 2008. However, while the number of these accounts diminished to such an extent that they were only 18% of what they started off with, the amount of advances made by them did not (not until 2006 at least). This was so because of these banks' usual strategy of focusing on the larger business accounts of the wealthier customers. As a consequence, the average size of an advance, made by foreign banks to a private business account, can be seen to have risen from Rs 7.6 million in 2001, to Rs 22.2 million in 2004, to Rs 22.7 million in 2005, Rs 26.3 million in 2007 and to Rs 31.2 million in 2008.

Yet, the success of this strategy was short-lived. So narrow was this market segment that it could not withstand erosion through retaliation from domestic commercial banks. An analysis of the size of accounts shows that, by 2008, the number of corporate accounts had fallen from 12,614 to 2,286. The small-sized accounts had almost disappeared. See Table 7.15. Accounts under Rs 100,000 numbered 409, with paltry advances of Rs 13.2 million. There were only 154 accounts of up to Rs 500,000 and 124 accounts of up to Rs 1 million. The maximum advances were of the largest variety (above Rs 10 million), but even here the amount of Rs 68 billion was insignificant compared with the 25 times greater amount of Rs 1.7 trillion advanced to the same-sized (above Rs 10 million) accounts in Pakistani commercial banks.

Table 7.15 : Private sector business advances of foreign banks, by sizes of accounts

		2001	2002	2003	2004	2005	2006	2007	2008
Up to Rs 100,000	Amount (Rs million)	397.0	11.2	13.5	17.6	15.4	7.9	7.8	13.2
	Number	7,447	412	447	514	523	303	300	409
Up to Rs 500,000	Amount (Rs million)	463.3	59.5	46.7	121.6	125.2	64.8	39.7	32.6
	Number	1,992	209	174	419	415	200	117	154
Up to Rs 1,000,000	Amount (Rs million)	165.0	115.2	120.7	273.3	320.8	94.3	97.5	99.3
	Number	228	163	160	377	431	135	135	124
Up to Rs 10,000,000	Amount (Rs million)	5,743.2	5,325.9	4,061.7	6,883.3	6,342.1	3,253.9	3,367.0	3,142.5
	Number	1,434	1,294	1,021	1,540	1,652	872	831	726
Above Rs 10,000,000	Amount (Rs million)	89,037.8	75,441.0	63,441.8	96,006.0	98,240.5	68,735.0	52,510.3	68,063.0
	Number	1,513	1,260	1,110	1,800	1,589	831	749	873

Table 7.16 : Personal advances of foreign banks, by sizes of accounts

		2001	2002	2003	2004	2005	2006	2007	2008
Up to Rs 100,000	Amount (Rs million)	4,673.1	5,474.2	7,211.9	8,839.5	14,826.7	13,995.4	9,981.3	15,017.6
	Number	166,979	158,090	261,027	291,991	517,431	327,743	206,044	508,663
Up to Rs 500,000	Amount (Rs million)	4,973.8	4,996.6	5,348.3	12,587.0	20,157.2	18,455.0	12,037.5	2,622.1
	Number	24,849	18,591	24,076	67,951	110,237	120,583	72,900	11,060
Up to Rs 1,000,000	Amount (Rs million)	2,186.1	619.9	485.0	760.2	414.8	268.0	352.6	619.0
	Number	2,981	820	641	1,024	607	400	522	975
Up to Rs 10,000,000	Amount (Rs million)	4,397.8	5,668.4	6,190.8	6,511.6	8,119.8	5,656.3	3,491.3	3,646.6
	Number	2,414	3,075	3,237	3,272	3,280	2,285	1,343	1,405
Above Rs 10,000,000	Amount (Rs million)	1,706.5	8,818.6	14,334.1	2,999.0	1,058.5	69.8	99.4	103.6
	Number	57	261	426	67	23	4	5	7

The steep decline of foreign banks on all fronts does suggest some basic inability to compete in the market place. The empirical facts run quite contrary to the theoretical models which postulate that foreign banks are more efficient compared with domestic banks, especially in under-developed countries. In Pakistan, foreign banking was protected from State expropriation (1974), but with the advent of domestic private banking in the 1990s they became less secure. In the 2000s their number started to decrease. It was seen in the previous chapter (Chapter 6) that they were unable to get deposits. In this chapter we have seen that they were unable to find borrowers, except for the very rich clients, who too turned eventually to domestic banks. Even the large personal accounts (above Rs 10 million) dwindled. See Table 7.16. Consumer lending dried up. Consequently, they faced the same fate which had been in store for them in India, as recounted in Chapter 2. In Pakistan, several foreign banks have been assimilated by domestic banks, with the result that competition from foreign banking, if any, has become irrelevant.

V. PRODUCT DIVERSIFICATION AND CONCENTRATION

Corporate sector loans are more secure than loans to agriculture or SMEs and others. The State Bank has found the infection ratio (NPL to loan ratio) to be highest in the case of agriculture, followed by that of SMEs.[110] The corporate sector lending is less risky[111], having been collateralized. This risk aversion (already commented upon in the earlier Section) is reflected in the pattern of the loan portfolio, shown in Table 7.17.

Table 7.17: Sectoral diversification of loan portfolio
(percent share in loans)

	2004	2005	2006	2007	2008
Corporate Sector	53.9	52.7	53.3	56.3	59.0
SMEs	17.5	17.7	17.0	16.2	13.0
Agriculture	7.4	6.8	5.9	5.6	4.9
Consumer Finance	9.4	12.4	13.6	13.8	12.0
Commodity Financing	7.5	6.9	7.2	5.5	6.8
Staff Loans	2.5	2.1	2.0	1.9	1.8
Others	1.8	1.5	1.1	0.8	2.5

Source: State Bank of Pakistan, Financial Stability Review 2007 – 08, p 44.

Although the concentrated lending to the corporate sector, comprising 59% of the loan portfolio, has been indicated as a sign of risk and uncompetitive behaviour, there is counter evidence of a circumstantial nature, suggesting inter-bank competition within the sectors. This evidence comes from the concentration ratios of the credit suppliers, reported by the State Bank.[112] These are reproduced in Table 7.18

[110] See *Financial Stability Review* 2007-08, p 44. NPLs to Loan ratio for agriculture loans was 20.8% in 2006, 18.7% in 2007 and 16.6% in 2008. The NPLs to Loan ratio of SMEs was 8.8% in 2006, 9.4% in 2007 and 11.2% in 2008.

[111] Corporate sector NPLs to Loan ratio was 6.5% in 2006, 7.2% in 2007 and 7.6% in 2008.

[112] See Annex 1.5 of Financial Stability Review 2007 – 08, p 249 and Annex-F of Banking System Review, December 2006, p 129.

Table 7.18: Concentration in sectoral lending, 2006 – 2007 (per cent of total loans)

	Top 5 banks		Top 10 Banks		Top 20 Banks		Industry
	2006	2007	2006	2007	2006	2007	
Corporate Sector	45.6	47.8	74.6	72.3	92.9	94.6	100
SMEs	52.3	45.5	70.8	74.7	85.4	92.1	100
Agriculture	37.2	35.6	44.0	44.0	94.0	93.8	100
Consumer Finance	56.7	55.2	77.6	76.9	96.9	96.3	100
Commodity Financing	72.8	69.0	96.1	91.2	98.2	98.7	100
Staff Loans	63.1	61.1	81.6	79.8	93.7	93.4	100
Others	47.7	27.6	61.5	68.8	85.7	82.8	100
Total	50.1	48.8	74.1	72.6	92.5	94.1	100

Source: State Bank of Pakistan

In conventional economic analyses, the five-firm concentration ratio has most often been employed to draw inferences about the level of competition prevalent in the market. Unfortunately, statistics on concentration ratios are seldom available separately for different product markets; aggregate industry-level statistics do not serve the purpose. This has been the shortcoming in banking studies word-wide. To overcome this deficiency, Don Cruickshank, in the course of his Review of U.K. banking, conducted a special survey to determine concentration (and other indicators) for individual products (current accounts, credit cards, personal loans, mortgages, SME loans) and found very high levels of concentration (measured by four-firm concentration ratios) for current accounts, credit cards and SME loans.[113] By contrast, the concentration ratios in Pakistan appear to be much lower. The State Bank has reported only one comparable set of statistics --- concentration ratios for the SME product market ----below the aggregate industry level. Insofar as that individual product market (of SME loans) is concerned, the concentration ratio (top 5 banks) is 45.5%.[114] This is much more favourable than the comparable UK statistic (top 4 banks) of 83%, and suggests that inter-bank competition in certain Pakistani product markets might well be greater than that obtaining in the U.K. This would strengthen the State Bank's view that, although there is no competition in the mobilization of deposits in Pakistan, it does exist in advancing credit to corporate and retail customers.

[113] For instance, the concentration ratio (top 4 UK banks) for current accounts was 68%, for credit cards it was 61% and for SME loans it was as high as 83% with a Herfindahl Index of 1,834. According to him, this level of concentration was suggestive of the existence of a "complex monopoly" in the SME market, warranting a reference to the Competition Commission.

[114] It was 52.3% in 2006, but came down to 45.5% in 2007.

CHAPTER 8

THREE BORROWERS' MARKETS

In this Chapter we look at three markets that are of similar size, and in which bank lending is not based primarily on collateral but on individual risk assessment.

The first market, of SMEs, has Rs 383 billion of loan advances, the second has Rs 212 billion of agricultural advances, while the third consists of Rs 396 billion of consumer financing. The customers of the first market are 215,000 predominantly urban businesses, mostly of individual proprietors (not listed companies), engaged in manufacture, trading or services. The second market comprises 1.5 million rural agriculturists who are furnished advances, in their individual capacity, for crops or farm machinery. The third market of 3.4 million salaried persons or individual businessmen are extended credit on their own 'personal' standing of being financial savvy. Despite the different profiles of the three kinds of consumers, their credit needs are of the same order of magnitude. Their credit accounts are typically in the range between Rs 100,000 and Rs 300,000, although there are obviously wide variations, with much smaller (e.g. Rs 20,000) and much larger (e.g. Rs 500,000) advances having been made.

I. SMEs

The problem of SMEs is one of adverse selection. The opportunity cost of entering this market is too high for commercial banks, because they can earn above-normal profits from lending to high-value, low-risk, corporate customers. Only when corporate lending becomes too competitive would banks look towards this market, but even then the marginal cost of serving SMEs would probably exceed marginal revenue. At present, the unit cost of serving small accounts is high. However, this has always been the case, not only in Pakistan but throughout the world, because of SMEs' inadequate and more opaque book-keeping and inability to furnish collateral and sufficiently high margins. In every competition analysis in every jurisdiction SMEs have been identified as a problem area with no ready solution available anywhere.

Cruickshank advocated a 'complex monopoly' investigation by the Competition Commission of the U.K. His finding was based partly on the very high concentration (four-firm ratio of 83%) in the UK SME product market. The South African study likewise pressed for the need for some remedial action. In Pakistan, the concentration level is much lower (45%), ruling out the possibility of the Competition Commission establishing an abuse of dominance. The question of restriction of competition does not arise, because there is, quite simply, no competition to begin with. There never has been. Banks operate willy-nilly in this market not because of attractive profitability but in response to cajoling by the Government and the State Bank in the public interest.

Size of SME market

According to the State Bank's definition, a manufacturing SME is one that employs up to 250 persons and has assets of up to Rs 300 million, while a trading or service SME is one that employs up to 50 persons and has assets of up to Rs 50 million. Usually not a public limited company, an SME qualifies for a loan of up to Rs 3 million without collateral and on a personal guarantee. This is more than what corporate finance customers are allowed.

Despite this liberal attitude on the part of the regulator, there are only 215,302 borrowers, which constitute only 4.7% of the total number of bank borrowers. The amount of SME loans (outstanding on December 2008) was Rs. 383 billion, which is 12% of the bank advances. This is an extremely small proportion of the potential market. According to the Economic Census of Pakistan[115], there are 3.2 million business enterprises in Pakistan, 90 – 99 per cent of which are SMEs[116]. They contribute 78% to employment in industry and 35% to GDP.

Data on the SME market are very limited. Apart from a few surveys, by the World Bank (in 2007 – 2008), KfW (2005) and ShoreBank, and brief periodic reports from the State Bank, regular statistics on this sector were not available. Recently, however, the State Bank set up an SME Department and directed all banks to report all loans under Rs 75 million to SBP every quarter. As a result, the first complete profile of advances to SME has been drawn up by the State Bank for the calendar year 2008, but it has not yet been made public[117]. It is expected that henceforth annualized statistics will come into the public domain the way that data on category-wise corporate lending is routinely published. In the meantime, a base line can be established. This is done in Table 8.1, which presents a composite view of the market derived from the 2008 statistics, which are the most recent and in fact the only ones available. It is obviously not possible to construct a time series for this market segment the way that we have constructed them for other markets in the preceding chapters. Nor is it possible to make accurate estimates. For instance, KfW's urban demand survey estimated a minimum unfulfilled demand of Rs 300 billion, whereas a ShoreBank USA demand survey carried out in Punjab by Business & Finance Consulting arrived at the much higher figure of Rs 1,000 billion.[118]

SME advances are classified according to three categories of borrowers: manufacturing SMEs, trading SMEs and service SMEs. The first category (manufacturing) is the largest, having obtained 48% of advances. Trading SMEs have received 36.4% of advances while service SME obtained 25.6%. The smallest size enterprises (employment under 10 persons) are in fact the recipient of the largest number of trading and service-related advances, although this is not the case for manufacturing SMEs[119].

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[115] May 2005 Report of the Statistics Division of the Government of Pakistan

[116] There is discrepancy in these calculations. The World Bank (2009) gives the figures of 3 million SMEs or 93% of the 3.2 million enterprises. This appears more reliable than the statistics of 99% cited by the State Bank (Financial Stability Review 2007-08, p 170) on the basis of the Economic Census of Pakistan Report (May 2005) putting the number of SMEs at 3.16 million

[117] The author made a request to the SME Development to make these data available, ahead of the official publication. A sketch was indeed provided, which is gratefully acknowledged. The statistical information cited here is based on that information, unless otherwise indicated.

[118] KFW estimates are the basis of the World Bank (2009, p 65) Report, while ShoreBank estimates are used by the State Bank. (see *Financial Stability Review 2007 - 08*, p. 174). On the basis of the Economic Census, the State Bank puts the current outreach of the SME credit at 6%, leaving an unfilled demand of 94% (*Ibid* p. 170)

[119] Manufacturing enterprises employing 31 – 50 persons were the larger recipients.

Table 8.1: Bank loans to SMEs, by size and type of SMEs

		SMEs having employees							
		up to 10	from 11 to 20	from 21 to 30	from 31 to 50	from 51 to 100	from 101 to 150	from 151 to 250	**Total**
Public Sector	Trading	15,848,832	4,404,463	3,201,337	5,655,598	-	-	-	**29,110,230**
	Manufacturing	6,947,824	3,971,011	1,835,287	2,016,769	769,540	194,107	1,667,008	**17,401,546**
	Services SMEs	5,478,258	164,668	170,106	145,924	149,889	112,287	2,091,789	**8,312,921**
	Sub-Total	**28,274,914**	**8,540,142**	**5,206,730**	**7,818,291**	**919,429**	**306,394**	**3,758,797**	**54,824,697**
Specialized	Trading	4,371,341	258,947	92,866	328,498	-	-	-	**5,051,652**
	Manufacturing	585,153	326,302	84,994	250,282	246,975	2,464,520	4,999	**3,963,225**
	Services SMEs	783,998	61,541	26,967	32,228	130,017	-	-	**1,034,751**
	Sub-Total	**5,740,492**	**646,790**	**204,827**	**611,008**	**376,992**	**2,464,520**	**4,999**	**10,049,628**
Domestic Private	Trading	40,273,741	19,475,224	14,218,113	26,814,329	-	-	-	**100,781,407**
	Manufacturing	4,339,018	10,307,020	12,039,898	59,671,024	21,654,801	20,149,182	31,829,944	**159,990,887**
	Services SMEs	14,923,714	10,202,685	4,051,726	7,847,685	3,423,367	2,858,401	5,661,867	**48,969,445**
	Sub-Total	**59,536,473**	**39,984,929**	**30,309,737**	**94,333,038**	**25,078,168**	**23,007,583**	**37,491,811**	**309,741,739**
Islamic Banks	Trading	2,183,903	466,281	510,751	580,867	-	-	-	**3,741,802**
	Manufacturing	165,236	170,573	175,550	407,227	941,306	133,407	141,390	**2,134,689**
	Services SMEs	226,797	129,947	231,697	57,008	214,551	36,166	52,651	**948,817**
	Sub-Total	**2,575,936**	**766,801**	**917,998**	**1,045,102**	**1,155,857**	**169,573**	**194,041**	**6,825,308**
Foreign	Trading	341,450	156,117	123,018	131,060	-	-	-	**751,645**
	Manufacturing	31,876	24,877	48,017	130,984	224,979	238,828	61,535	**761,096**
	Services SMEs	36,510	37,652	72,703	78,611	-	-	25,908	**251,384**
	Sub-Total	**409,836**	**218,646**	**243,738**	**340,655**	**224,979**	**238,828**	**87,443**	**1,764,125**
	Grand Total	**96,537,651**	**50,157,308**	**36,883,030**	**104,148,094**	**27,755,425**	**26,186,898**	**41,537,091**	**383,205,497**

By far the largest type of SME loan (77% of all advances) is for working capital needs. Trade financing accounts for 11.3% while fixed investment lending to SME is 11.7%[120].

In the graphic representations that follow a profile of SME borrowers, and of the advances made to them by different kinds of banks, has been drawn. It is based on the hitherto-unpublished data that the State Bank made available to this author.

[120] The three types of advances stand (as of December 2008) at Rs 288.8 billion for working capital, Rs 42.3 billion for trade and Rs 43.9 billion for fixed investments.

Figures 8.1 & 8.2 show that, in the largest category (manufacturing) Rs 60 billion have been advanced to 12,000 SMEs employing 31 – 50 persons. This implies an average loan size of Rs 5 million.

Figures 8.3 and 8.4 show that, insofar as trading SMEs are concerned, the largest number of advances were to those that employed less than 10 persons. These small trading enterprises (numbering 67,600) received Rs 40 billion from domestic private banks, Rs 16 billion from public sector banks, Rs 4 billion from specialized banks, Rs 2 billion from Islamic banks and Rs 0.6 billion from foreign banks, making total advances to them of Rs 63 billion. The largest number of trading SMEs (30,000) obtained advances from specialized banks, followed by 19,000 getting funding from private commercial banks, 18,000 from government banks. The average loan for trading SMEs size appears to have been Rs 932,248.

Likewise, service SMEs employing less than 10 persons were also the largest recipients: 66,000 SMEs, of which 50,000 were recipients of Rs 5 billion advances from public sector banks. The largest amount obtained (Rs 15 billion) by service SMEs was from private commercial banks. The average loan size of a service SME loan was Rs 322,754. See Figures 8.5 and 8.6.

SME loans are classified either as short term loans or as medium term or long term loans. The largest amount (Rs 272 billion) was of short term advances for up to one year, made to 97,000 borrowers. Medium term |(up to 3 years) advances, given to 16,000 borrowers, amounted to Rs 37 billion. Long term advances to 102,000 borrowers were in the amount of Rs 74 billion. See Figures 8.7 and 8.8.

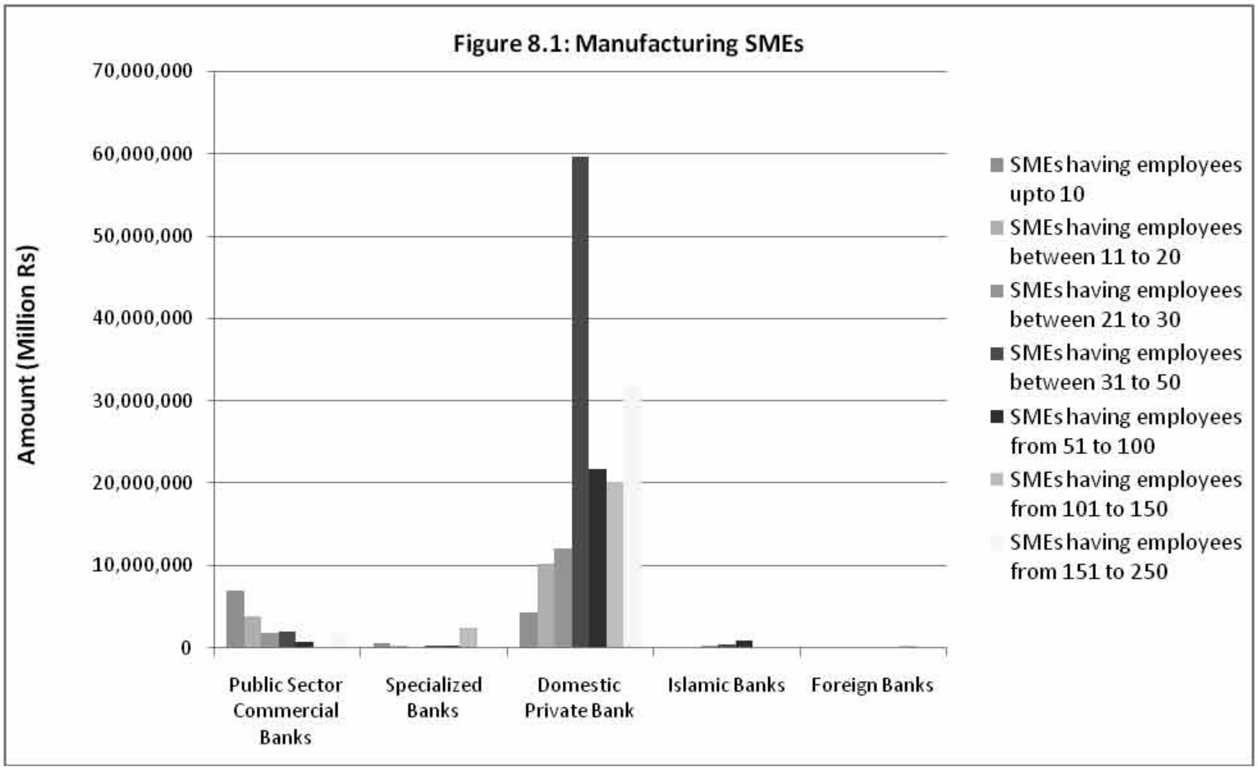


Figure 8.2: Manufacturing SMEs

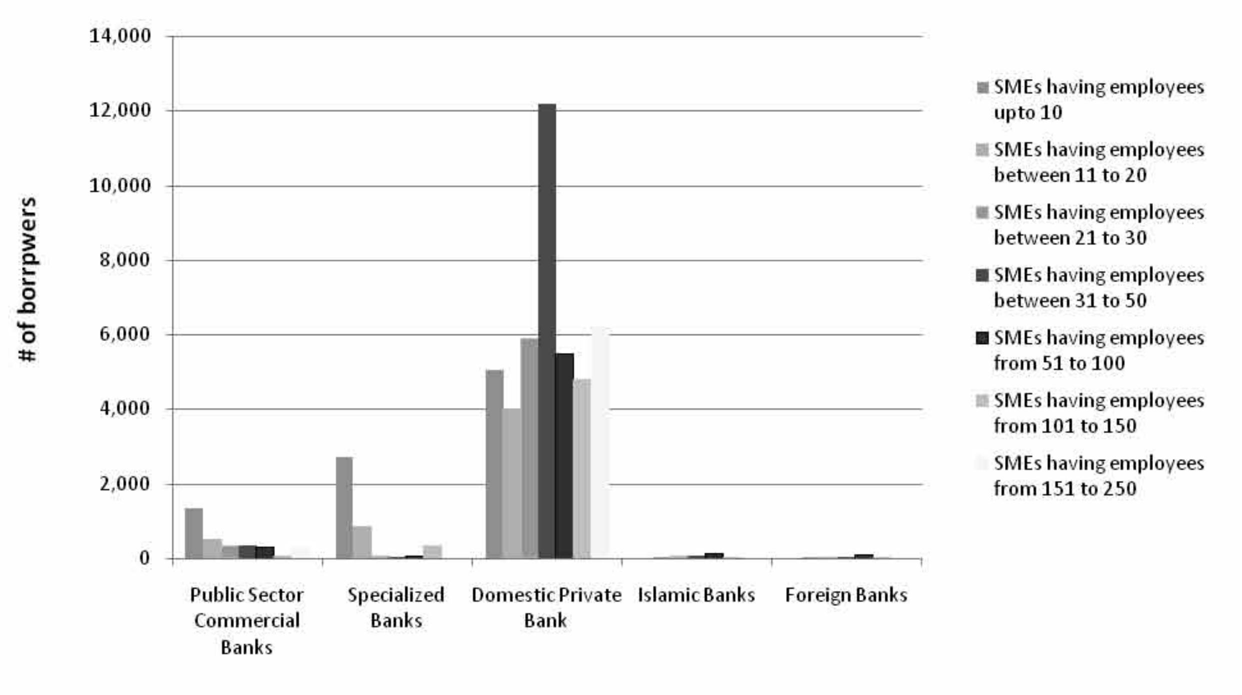
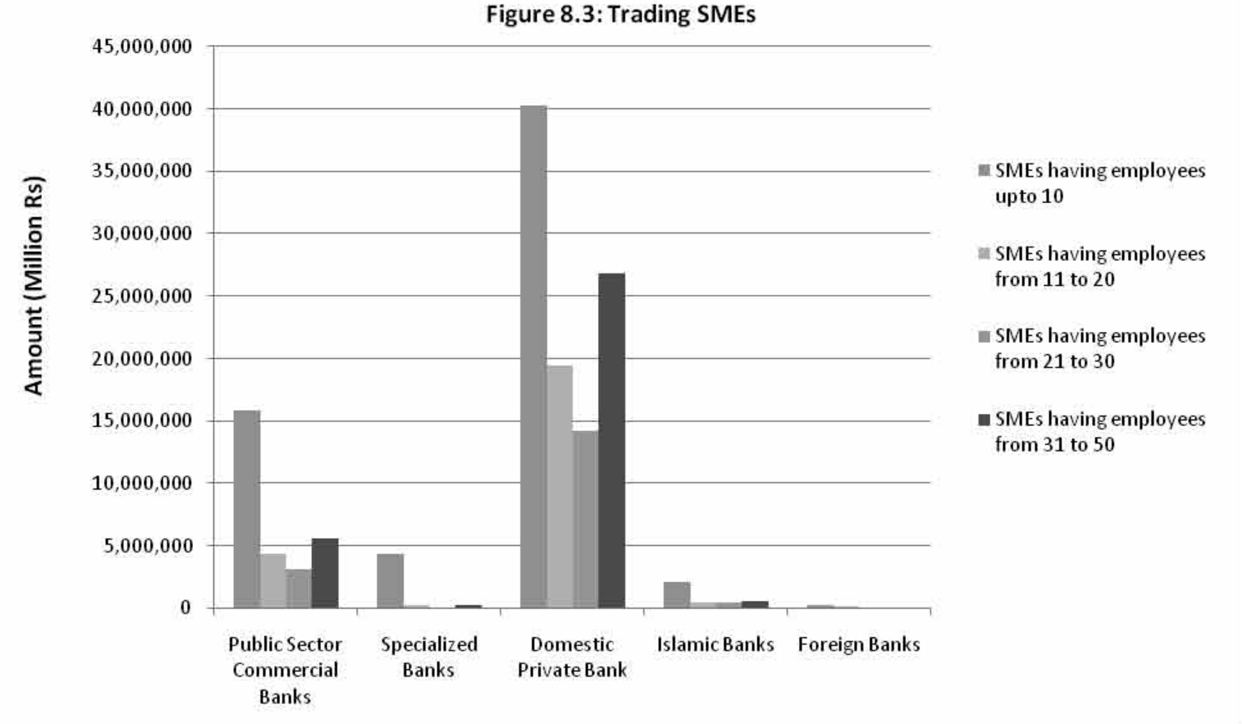


Figure 8.3: Trading SMEs



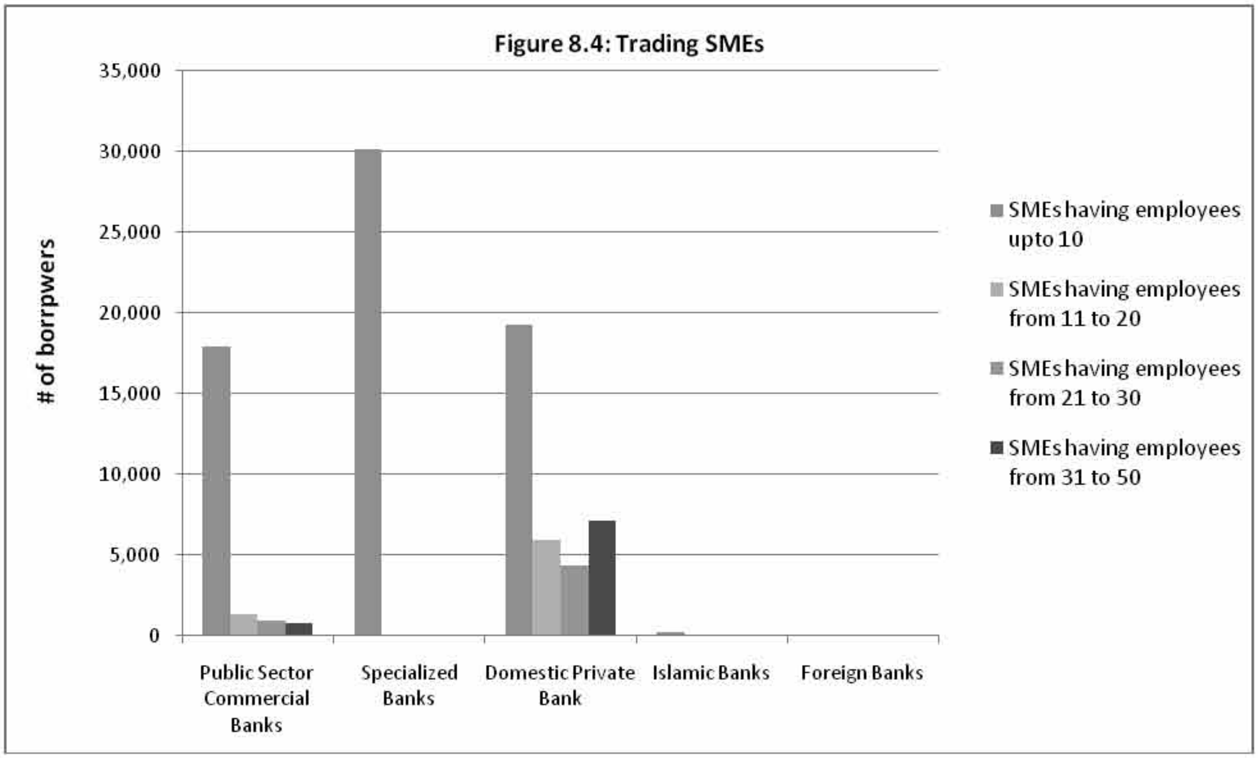


Figure 8.4: Trading SMEs
35,000
30,000
25,000
20,000
15,000
10,000
5,000
0
# of borrpwers
Public Sector Commercial Banks
Specialized Banks
Domestic Private Bank
Islamic Banks
Foreign Banks
SMEs having employees upto 10
SMEs having employees from 11 to 20
SMEs having employees from 21 to 30
SMEs having employees from 31 to 50

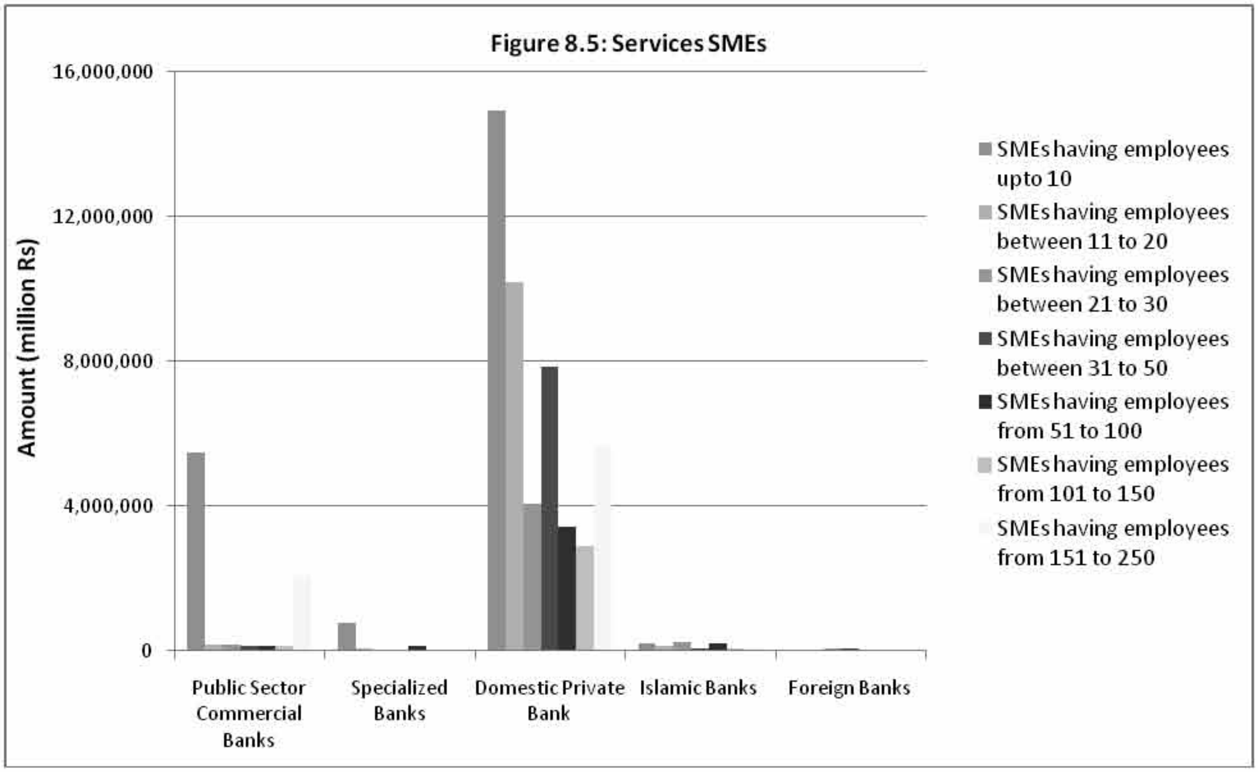


Figure 8.5: Services SMEs
16,000,000
12,000,000
8,000,000
4,000,000
0
Amount (million Rs)
Public Sector Commercial Banks
Specialized Banks
Domestic Private Bank
Islamic Banks
Foreign Banks
SMEs having employees upto 10
SMEs having employees between 11 to 20
SMEs having employees between 21 to 30
SMEs having employees between 31 to 50
SMEs having employees from 51 to 100
SMEs having employees from 101 to 150
SMEs having employees from 151 to 250

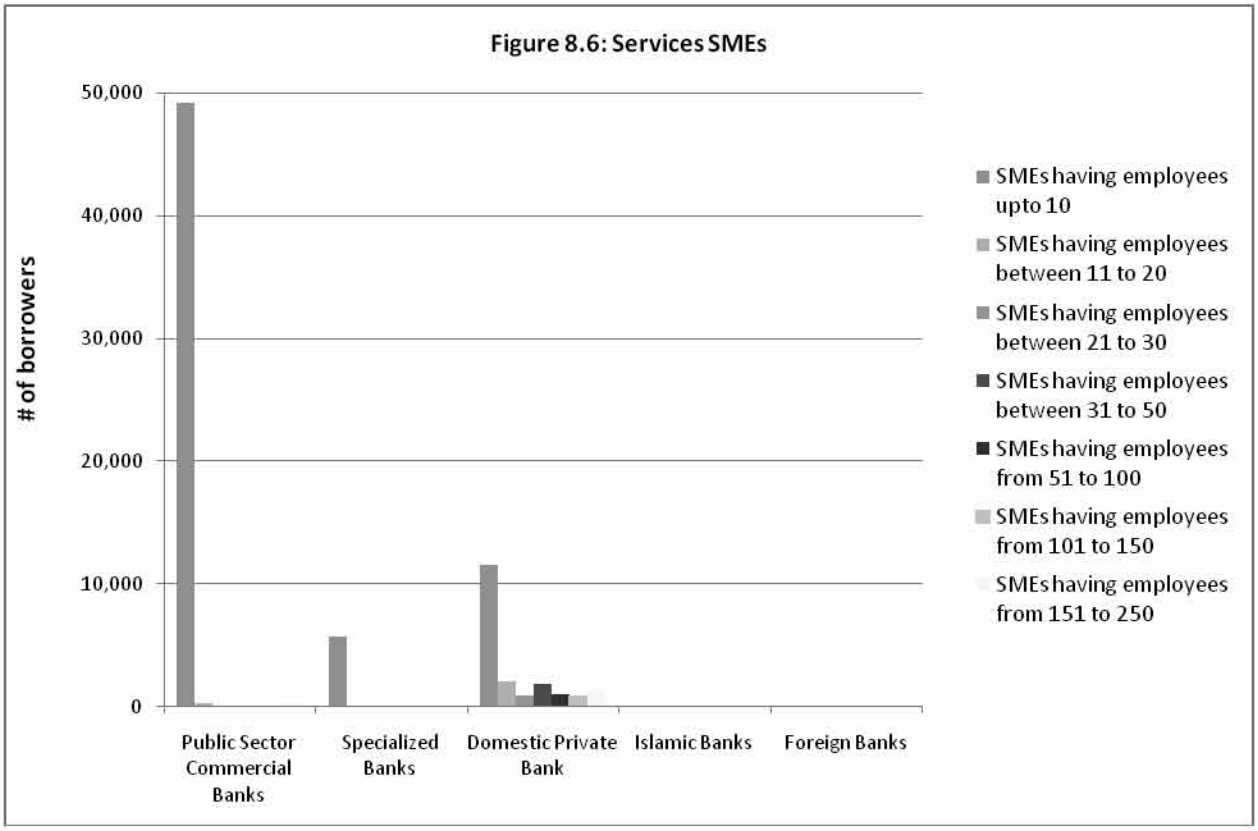


Figure 8.6: Services SMEs
# of borrowers
50,000
40,000
30,000
20,000
10,000
0
Public Sector Commercial Banks
Specialized Banks
Domestic Private Bank
Islamic Banks
Foreign Banks
SMEs having employees upto 10
SMEs having employees between 11 to 20
SMEs having employees between 21 to 30
SMEs having employees between 31 to 50
SMEs having employees from 51 to 100
SMEs having employees from 101 to 150
SMEs having employees from 151 to 250

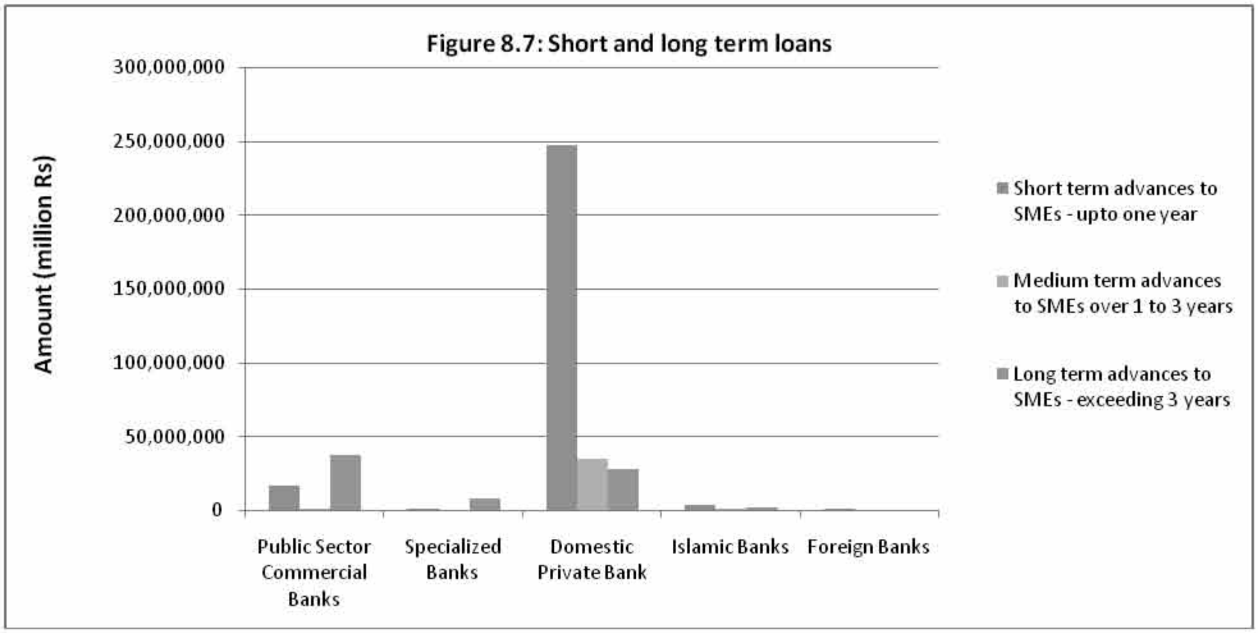
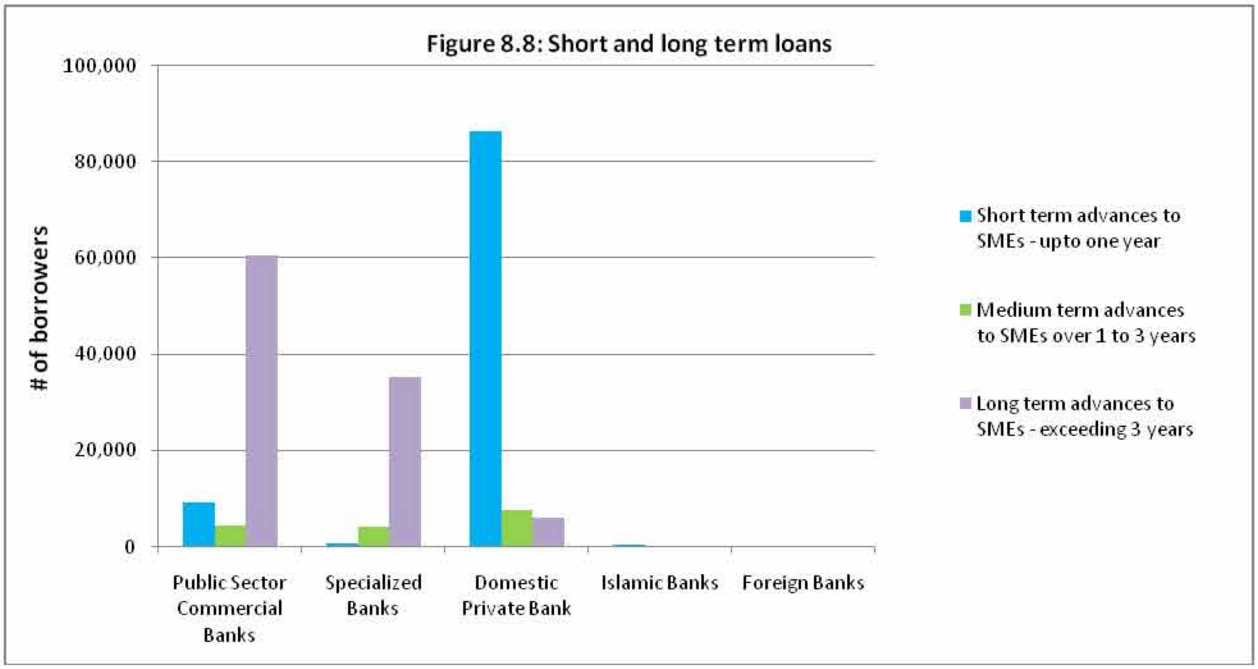


Figure 8.7: Short and long term loans
Amount (million Rs)
300,000,000
250,000,000
200,000,000
150,000,000
100,000,000
50,000,000
0
Public Sector Commercial Banks
Specialized Banks
Domestic Private Bank
Islamic Banks
Foreign Banks
Short term advances to SMEs - upto one year
Medium term advances to SMEs over 1 to 3 years
Long term advances to SMEs - exceeding 3 years



Complacence in SME market

According to the World Bank (2009) Report, the top 5 banks now have a market share of 43.3%, which is 2% lower than what was reported 2 years earlier by the State Bank (as mentioned above). This share consists of that of 15.55% of Habib Bank (the largest), followed by 7.86% of National Bank, 7.46% of Allied Bank, 6.72% of MCB and 5.81% of UBL. The other domestic private banks (excluding these 5) have a composite share of 44.36. Bank of Punjab, Bank of Khyber and First Women (the three remaining public sector banks) hold 4.82% share, while Islamic banks (excluding Al Baraka) also hold 4.82%. Specialized banks have 2.19% while foreign banks are 0.42%. The State Bank's statistics are slightly different, perhaps because they are the latest, while the World Bank relied on earlier figures provided to it. According to the latest figures, the 4 public sector banks hold 14.4% of the portfolio, private domestic banks 80%, specialized banks 2.6%, Islamic banks 1.8% and foreign banks 0.5%.

The point of it is that this is not at all a very concentrated market. The Herfindahl-Hirshman Index is 800, compared with 700 for the overall loan portfolio. [121] This suggests that this too is a very competitive market. Yet it is not. The concentration indices can in fact be misleading, as we have seen on a number of occasions.

Only 6% of the short term loans have been made by public sector banks. 91% of them have been made by private domestic banks. Similarly, 95% of medium sized loans have also been made by private domestic banks (2% by public sector banks). It appears that the public sector banks have chosen to stay away from short term and medium term lending, but not from long term lending –

[121] *Financial Stability Review 2007-08*, p.91

because 50% of the long term advances have been made by public sector banks, versus 37% by private domestic banks, 11% by specialized banks, 2% by Islamic and 1% by foreign.

The dominance of the public sector in the long term SME lending market and abstention from short term lending is quite obviously a matter of strategic choice. The long term loan segment is smaller than the short term one (Rs 74 billion vs. Rs 272 billion). The average loan size of Rs 725,500 is also much smaller than the average loan size of Rs 2.8 million of short term advances, although the number of borrowers is only slightly more (102,000 vs. 97,000).

It appears that lending to the SMEs is largely a matter of convenience for the commercial banks, especially the big ones. It is reported that commercial banks make very little effort to provide loans to SMEs, which are treated no differently than large corporate clients. Products are not tailored to suit their needs. The most recent study (World Bank 2009) illustrates this by recounting the trying efforts of the international team of ShoreBank that provided technical assistance, under a USAID project, to the National bank of Pakistan:

> "Initially the task of convincing loan officers and managers to focus on small enterprise loan proved to be difficult. The branches lacked a performance – based culture, and there were many management layers. Most credit decisions were based on the basis of immovable collateral." (World Bank 2009, pp. 61-62)

Yet, according to *Financial Sector Assessment 2005* of the State Bank, the attention paid (by the Government and the State Bank) to the SME market after 2001, had borne results. Between 2001 and 2005, both the volume and the share of SME financing rose from less than Rs 150 billion (13%) in 2003 to Rs 350 billion (17%) in 2006.[122] This growth appears, however, to have come to a halt, or perhaps gone into reverse gear, because in the very next year, another publication of the State Bank, *Financial Stability Review 2006* , observed that:

> " the flow of credit to the SME sector has declined gradually in the last three years. In specific terms, the credit flow during FY07 (at Rs 26.5 billion) is less than half of FY05 (at Rs 59.9 billion). Disaggregated data shows that credit flow and growth in the manufacturing sector was maintained at almost the same level during the last three years, whereas the credit flow to the commerce and trade sector has declined considerably. This led to a decline in the overall credit flow to the SME sector during FY06-07"[123]

The same conclusion has been reached by the World Bank study (2009) – that "Government efforts to increase SME financing have had modest results, with loans to SMEs declining as a percentage of total lending".[124]

Besides offering non-friendly SME products, the commercial banks have made no effort to assess risk. There are 27 steps involved in securing a loan that take 30 -45 days. Transaction costs are thus very high. Stated quite simply, the problem with bank lending to SMEs is that there has never been any incentive for banks to compete in the SME market. Otherwise, they

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[122] *Financial Sector Assessment 2005*, p. 155

[123] "Issues in Sectoral Allocation of Credit", in *Financial Stability Review 2006*, pp. 66-67

[124] World Bank (2009) *Bringing Finance to Pakistan's Poor,* p. 62

would have treated this market very differently – for instance, the way they have looked at consumer financing.

SME financing is a prime example of an institutional failure. Nor is this a recent phenomenon. In fact it has become chronic. It goes back to the 1950s when the Government set up a Credit Enquiry Commission. The Report of this Commission (in 1959) recommended the reorganization of PICIC into a small industrial bank for providing loans of up to Rs 1 million to SMEs. The Commission found that large borrowers had no difficulty in accessing bank credits but SMEs found it impossible to do so. It recommended that there should be a fund to guarantee and cover losses on loans of up to Rs 25,000 and that a Peoples Finance Corporation should be established.

Highlighting the problems of small borrowers, the Commission's Report (1959) suggested the simplification of procedures for small loans, apportionment of SME credit targets and the setting up of SME departments in each bank, guarantee brokerage and discount houses. None of the recommendations were followed. Although there was an increase in small loans between 1959 and 1962 (they rose from 5.6% of bank lending to 8.4%), the basic problems remained unaddressed. On 10 May 1962, another Credit Committee was appointed, comprising some of the most eminent economists. This Committee endorsed the views of the earlier Commission, and, although it did not recommend the formation of any new specialized bank or fund for SMEs, it suggested consistency in government policies and the stipulation of lending targets for banks, so that an aggregate level of 15% -20% SME loans could be reached. The Committee's recommendations also appear to have remained a dead letter. Fifty years after the Enquiry Commission, only 12% of the bank advances are to SMEs. The World Bank Report (2009) has not discovered anything significantly different. If anything, the credit distribution has become even more skewed and access to credit by SMEs perhaps more problematic.

II. AGRICULTURAL CREDIT

Agriculture contributes 20% to GDP and provides 43.4% of national employment. Yet it is another neglected sector insofar as bank credit is concerned. After nationalization, commercial banks were required to adhere to credit targets laid down by the Government or face a penalty. The banks happily paid the penalty rather than meet the targets. Even today the State Bank sets targets, some of which are met, others are not. This can hardly be called a competitive or buoyant situation. Even so, in its *Financial Sector Assessment 2005*, the State Bank reported that

> " the trend changed drastically from FY01 onwards. Specifically, commercial banks have considerably increased agriculture lending in the preceding five years and have actually been lending more than their set targets mainly because of the excess liquidity at their disposal…
>
> "As a result, there appeared a visible shift in the agriculture disbursements with commercial banks taking over the largest share…
>
> "The impact of credit available to agriculture sector is visible in the sharp increase in the import of agriculture inputs including machinery and insecticides during the preceding five years."[125]

The buoyancy was contradicted the next year in the *Banking Sector Review 2006:*

[125] *Financial Sector Assessment, 2005,* p. 154

> "Due to limited access to formal financing modes, a major portion of credit needs of this vital sector of the economy are filled through informal financial arrangements which are not only very expensive but also very exploitative. Despite SBP and Government's extensive efforts, the financing to agriculture has been very low…
>
> "The share of agricultural credit compared to overall credit portfolio of banks is around 6 per cent, which is very low. The share further declines to 3 per cent if we exclude the share of specialized banks. Of the total loans extended by the specialized banks, around 96 per cent have been extended to the agriculture sector…. Since the overall loan portfolio grew with much greater pace, the share of agricultural loans to total loans has declined to around 5.9 per cent from 6.8 per cent in CY05 and 7.4 per cent in CY04."[126]

Agricultural credits did witness a growth in line with the targets set up by the State Bank. They rose from a meager Rs 45 billion (5% of total bank advances) in 2001 to Rs 137.5 billion in 2006 (6% of the total advances). This was the proudly proclaimed "visible shift" resulting from the post 9/11 excess liquidity (quoted above). Next year (2007), the advance went up to Rs 168.8 billion (6.5%) and to Rs 212 billion (6.9%) in 2008. In nominal terms, this represented a steady increase. Yet, as a share of total advances, there was a contraction in supply during this period (up to 2006). From 7.4% in 2004, the share of agricultural advances went down to 6.8% in 2005, and then to 5.9% in 2006. This implied that the credit coverage of the agricultural sector remained most inadequate. Only 45% of the loan requirements were met. Only 1.5 million of the estimated number of 6.6 million rural households could be catered to[127] through institutional credit. According to the Agricultural Census of 2000, 65% of credit to rural households came through family, other social networks and informal arrangements.

Antecedents

Rural credit insufficiency is a chronic ailment. It touches the roots of peasant society in South Asia and manifests itself in multiple social malaises, political scars and economic asphyxiation. It is exacerbated by the feudal structure of society and has led to the deprivation of landless peasants, whose plight is worsened by the fact that they do not have title to the land that they till or to other agricultural assets that they use but do not possess. Many a peasant revolt has arisen out of this proprietary condition; almost all have failed to cast away the yoke. The proverbial stranglehold of the rural money-lender, charging an exorbitant rate of interest, has become part of the country's folk lore, epitomized in the popular saying that a peasant is born into debt, lives in debt and dies in debt.

Objective -- as well as subjective and emotive --- analyses of this human condition have been plentiful. There have also been several institutional responses to alleviate rural indebtedness. The most long-standing one has been through cooperative societies.

The cooperatives movement in undivided India was institutionalized in 1904 with the passage of the Cooperative Societies Act. It became a 'provincial' subject in 1919 with the coming of the Montague-Chelmsford Reforms. Accordingly, the Bombay Act (1925) regulated cooperative credit societies in Sind. The Punjab and NWFP were covered by the earlier (1912) Cooperative

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[126] *Banking System Review, December 2006,* p .20 State Bank of Pakistan.

[127] See *Development Finance Review 2007* of the State Bank, and farm households survey of 2005

Societies Act. At the time of partition there were 36,000 credit societies in Pakistan, 27,000 being in East Pakistan but on the verge of extinction. In West Pakistan, three provincial cooperative banks provided agricultural credit. The largest, the Punjab Provincial Cooperative Bank, was established in 1925, and continues to this day, albeit with difficulty, as one of Pakistan's 4 specialized banks. The second was the Sind Provincial Cooperative Bank, set up in 1919 as an affiliate of the Provincial Cooperative Bank in Bombay. The third was the Frontier Cooperative Bank that came into existence in 1948 as a result of a merger between cooperative banks at Dera Ismail Khan, Bannu and Hangu.

After partition, these cooperative banks were forced by circumstances to start trading in agricultural commodities and to also ensure the distribution of staple crops. They also started managing cotton ginning, rice husking and flour mills. All these functions were outside their normal jurisdiction, which was to provide credit to its member cooperative societies. Quite naturally, these extra-jurisdictional activities led to serious malpractices. The State Bank wanted to take over the regulatory functions of these cooperative banks, but was denied it, since cooperative lending was a provincial subject[128]. However, in 1952 an Agriculture Development Finance Corporation was set up to provide regulated developmental rural credit. The Corporation was unable to perform its functions. It came up against legal problems arising out of uncertainties of title, alienation rights and money lenders' hold over rural property. In its eight years of operation (1952 – 1960) the Corporation advanced Rs 35.75 million and incurred losses of Rs 1.36 million[129]. The corporation was merged in 1961 with the Agriculture Bank of Pakistan to form the Agriculture Development Bank of Pakistan (ADBP), which has now been re-named Zari Taraqiati Bank Ltd (ZTBL).

The Banks Nationalization Act (1974) did not touch the special status of the ADBP or the Punjab Cooperative Bank. A new institution, the Federal Bank for Cooperatives (FBC), was also set up in 1976 in order to support and strengthen the cooperative societies in their rural credit operations. The State Bank also stipulated compulsory lending targets for production loans to be given by all commercial banks to small farmers[130] and development loans to all agriculturists. To overcome the problem of collateral, Pass Books were introduced. These were issued by the Revenue Departments of the provincial governments.

The government's own lending instrument was the "taccavi" loan, a disaster relief credit extended by the Revenue Departments of the provincial governments under the Land Improvement Act of 1883 and the Agriculturists' Loan Act of 1884[131]. The volume of government lending, through this instrument, was always smaller than that through cooperative

[128] This account of the cooperative banks is based on the *History of the State Bank of Pakistan*, 1948-1960, Vol I, pp. 193 -204

[129] State Bank of Pakistan, *Agricultural Credit in Pakistan*, 1962. pp. 87- 90

[130] The ceiling of these small loans (introduced in 1972) was Rs 5,000, but was raised in 1977 to Rs 10,000. Even these modest targets were avoided, and the banks paid the penalty of making interest-free deposits with the State Bank, equivalent to their shortfall in meeting lending targets.

[131] These twin pieces of nineteenth century legislation, with their derivatives in the form of the provincial laws, provided the main incentives in the system of the revenue administration of British India (and later of Pakistan too), while the Tenancy Acts regulated ownership and effective control

societies. Both forms of advances became secondary to the ADBP after 1961. After 1972, commercial banks were obliged to join in, and within 2 years overtook the volume of ADBP lending. See Table 8.2.

Table 8.2: Agricultural Credit, 1970 -77 (in million Rs)

	ADBP	Taccavi	Cooperatives	Commercial Banks	Total
1970-71	92.7	10.20	55.48	-	158.58
1971-72	80.00	8.92	39.08	-	128.00
1972-73	168.80	10.23	42.02	85.70	306.75
1973-74	415.18	67.50	144.22	286.40	913.30
1974-75	395.50	12.13	81.54	520.90	1,010.07
1975-76	532.19	25.67	91.83	808.10	1,457.79
1976-77	637.93	13.14	95.43	970.00	1,716.50

Source: *History of the State Bank*, 1961 – 1977 Vol. II, p. 209

Current Situation

Commercial banks now provide more than 60% of agricultural credit. In 2006, their advances were Rs 84 billion out of the total of Rs 137.5 billion (61%); and in 2007 they were Rs 104.4 billion out of Rs 168.8 billion (61.8%). The share of ZTBL was 35% (Rs 47.6 billion) in 2006 and 33% (Rs 56.5 billion) in 2007, while that of PPCB was a meager 4% (Rs 5.9 billion) in 2006 and 5% (Rs 8 billion) in 2008.

The top 5 banks provided 49% (Rs 68 billion) of the agricultural loans in 2006 and 48% (Rs 80.4 billion) in 2007. The other private domestic banks contributed 12% (Rs 16 billion) in 2006 and 14% (Rs 24 billion) in 2007.[132]

The decline of the two specialized agricultural banks, ZTBL and PPCB, which has been depicted already in Chapter 7, attests to the continual neglect of agricultural financing. Although the commercial banks have made up the shortfall in meeting the modest lending targets set by the State Bank, they are nowhere near bridging the gap between demand and supply. In a market economy, this can only mean a supply constraint, ineffective demand or lack of any incentive to compete – in other words, the market is not profitable enough or has a high opportunity cost attached to it. The market is indeed not a very profitable one, because of the lack of purchasing power of farmers, which leads to a vicious circle ---farmers do not have the power to purchase expensive inputs (the prices of which are continually rising) and are therefore not productive enough to generate the output that is required to enable them to invest in the purchase of inputs. This circle of rural poverty is altogether well known and cannot be broken without a credit subsidy. In the absence of this subsidy (which can be granted only in the public interest), banks will not compete in agricultural markets – unless the opportunities of high profitability elsewhere are foreclosed. The situation is similar to that in the SME market – only it is much worse.

[132] These figures are based on the State Bank's review (p. 65) of agriculture sector lending in "Issues in Sectoral Allocation of Credit", Chapter 5 of *Financial Stability Review 2006*. There appears to be some discrepancy between these figures and those reported by the State Bank in Annex-F (p. 129) of *Banking System Review* December 2006, which provides the figure of 37.2% (not 49%) for the share of the top 5 banks, and Annex 1.5 (p. 249) of the *Financial Stability Review 2007-08*, giving the comparable figure of 35.6%. See also Table 7.18 in Chapter 7.

The causes are well-known. Agricultural markets are risky. Crop failures and vagaries of weather increase systematic risk, especially in the absence of institutionalized crop insurance. Lack of collateral, accompanied and accentuated by lack of title over rural property, is the biggest stumbling block in the way of actual tillers of the soil obtaining credit to purchase inputs and capital equipment. Usually the Pass Book is the only surety that the farmers can provide and this too is often insufficient evidence of repayment capacity. For the banks, the transaction costs are high, partly because the geographic markets are too small and too widely dispersed. The borrowers too are numerous and widely dispersed. Bank branch networks are inadequate; the cost of augmenting them cannot be justified. More fundamentally, commercial banks are neither disposed towards evaluating credit risk nor equipped to do so. The inability to assess individual risk actually increases the market risk. That is why the infection rate in agricultural lending is the highest among all sectors. Helped by politically-motivated profligacy, the NPLs in agricultural advances are by far the highest of any sector. In 2006, the NPLs to loan ratio was 20.8%. The next highest was that of SMEs (8.8%), against the corporate NPL-lending ratio of 6.5%. By 2008, this ratio had come down from 20.8%to 16.6%, but it was still way above the corporate ratio of 7.6% and the SME ratio of 11.2. By contrast, the ratio for consumer finance -- which, like SMEs and agricultural loans, is not based on collateral --- never exceeded 5.5% and was 2.2% to begin with.

The overall (NPLs to loan) ratio of 20.8% in agricultural lending actually conceals wide variations across banks. The commercial banks have succeeded in keeping their infection ratio within limits, either through caution or refusal to make advances. Their ratio is 8%, almost at par with that for corporate clients. What drives the aggregate up is the infection rate of the specialized banks. It is 33% for the two institutions.[133] In what can only be construed as an indictment of the two institutions, the following observation is apt:

> "During the course of our tours, evidence was forthcoming critical to the range and scope of activity of the two institutions. It was stated that they had so far failed to create any impact on the rural credit situation, that their procedures and requirements were such as to either deter or exclude a vast majority of credit-worthy borrowers, and in any case, to seriously delay the sanction and disbursement of funds. It was felt that credit has been confined to the propertied elements by their statutory requirements that loans be secured by mortgage of land or the guarantee of the landed. It was also stated that the cost of borrowing is quite high when account is taken of the expenses of travel of distant offices, the loss of income during the period, the exaction of petty government officials whose services must be called for several times in order to comply with the procedural requirements, etc."[134]

The reader can be forgiven for mistaking this testimony as having been given to the present author in 2009. Actually, it was recorded fifty years earlier by the Credit Enquiry Commission of 1959.

III. CONSUMER FINANCE

In the present context, "consumer finance" means unsecured credit advanced to a person. The State Bank categorizes such 'personal' advances under 7 headings (sub-categories) that are listed

[133] *Banking System Review*, December 2006, pp 20 - 21

[134] Government of Pakistan, *Credit Enquiry Commission Report*, 1959, para 138, p 61

in Table 8.3. They have constituted 12% - 16% of total bank advances. Table 8.4 shows the number of these accounts to which consumer products (including personal loans) have been provided.

Strictly speaking, four of these categories of advances (advances on credit cards, for consumer durables, lending to bank's own employees and personal loans) can be called unsecured advances, since residential houses and automobile transport (for which banks provide credit) are mortgaged to the bank, while the status of "other personal" is indeterminate.

Market segments

Of these 7 categories, the largest is that of personal loans, followed by transport (car loans). Both rose sharply in the four-year period 2003-2007, personal loans by a factor of 3.6, auto loans by a factor of 6. Credit card advances went up more than 5 times, as did those for consumer durables (but only in 2007-2008). Advances to bank employees doubled, while housing loans increased ten-fold. On the whole, the 'personal' category of bank advances tripled, showing the same trend as that of the aggregate increase in the total advances made by commercial banks.

Table 8.3: 'Personal' category of advances (2003-2008)

Amount in Rs. million

Year	Bank Employees	House Building	Transport	Credit Cards	Consumer Durable	Personal Loans	Other Personal	Total Personal	Total Advances	%[135]
2003	32,774	5,902	18,646	8,766	1,038	39,481	21,843	128,450	1,095,748	12
2004	42,522	18,304	49,261	13,156	3,191	61,784	15,508	203,725	1,535,892	13
2005	45,736	32,997	83,599	27,253	1,698	110,322	1,160	302,764	1,935,149	16
2006	49,470	48,188	106,169	39,154	1,633	129,557	2,948	377,118	2,300,533	16
2007	53,370	63,619	113,036	47,238	1,111	142,115	2,318	422,807	2,613,205	16
2008	65,286	64,191	93,877	41,093	5,538	122,368	3,734	396,088	3,056,493	13

Table 8.4: Number of borrowers in 'Personal' category of advances (2003-2008)

Year	Bank Employees	House Building	Transport	Credit Cards	Consumer Durable	Personal Loans	Other Personal	Total Personal	Total Advances	%[136]
2003	171,833	7,292	52,932	429,096	25,246	225,342	61,503	973,244	2,822,911	34
2004	194,001	19,501	109,764	640,463	60,597	684,492	88,858	1,797,676	3,722,858	48
2005	142,395	17,482	194,395	1,130,948	34,088	1,102,676	10,989	2,632,973	4,661,967	56
2006	166,108	33,388	264,828	1,386,195	37,307	1,272,935	17,959	3,178,720	4,938,817	64
2007	137,252	45,244	316,777	1,374,535	23,212	1,348,466	31,729	3,277,215	4,919,834	67
2008	168,204	33,415	388,266	1,489,136	32,365	1,216,113	24,751	3,352,250	5,219,886	64

[135] Share of 'personal' category of advances in the total advances between years 2003 - 2008

[136] Share of 'personal' category (number of accounts) in the total number borrowers between years 2003 - 2008