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IFAD
INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT
Executive Board – Eighty-Sixth Session
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REPORT AND RECOMMENDATION OF THE PRESIDENT

TO THE EXECUTIVE BOARD ON A PROPOSED LOAN TO THE

ISLAMIC REPUBLIC OF PAKISTAN

FOR THE

MICROFINANCE INNOVATION AND OUTREACH PROGRAMME

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CURRENCY EQUIVALENTS

Currency unit	=	Pakistan rupee (PKR)
USD 1.00	=	PKR 60
PKR 1.00	=	USD 0.0167

WEIGHTS AND MEASURES

1 kilogram (kg)	=	2.204 pounds (lb)
1 000 kg	=	1 metric tonne (t)
1 kilometre (km)	=	0.62 miles (mi)
1 metre (m)	=	1.09 yards (yd)
1 square metre (m^2)	=	10.76 square feet ft^2
1 acre (ac)	=	0.405 hectare (ha)
1 ha	=	2.47 ac

ABBREVIATIONS AND ACRONYMS

COSOP	country strategic opportunities paper
I&O	innovation and outreach
LPO	linkage partner organization
MFI	microfinance institution
MI&OP	Microfinance Innovation and Outreach Programme
MIS	management information system
PKR	Pakistan rupee
PO	partner organization
PPAF	Pakistan Poverty Alleviation Fund
PRSP	Poverty Reduction Strategy Paper
RIMS	Results and Impact Management System
YPO	young partner organization

GOVERNMENT OF THE ISLAMIC REPUBLIC OF PAKISTAN
Fiscal Year

1 July – 30 June

MAP OF THE PROGRAMME AREA

IFAD

Pakistan

Microfinance Innovation and Outreach Programme

Source: IFAD, Line of Control from United Nations Map No. 3953 Rev.2, January 2004

The designations employed and the presentation of the material in this map do not imply the expression of any opinion whatsoever on the part of IFAD concerning the delimitation of the frontiers or boundaries, or the authorities thereof

ISLAMIC REPUBLIC OF PAKISTAN

MICROFINANCE INNOVATION AND OUTREACH PROGRAMME

LOAN SUMMARY

INITIATING INSTITUTION:	IFAD
BORROWER:	Islamic Republic of Pakistan
EXECUTING AGENCY:	Pakistan Poverty Alleviation Fund, a government-created apex funding agency operating through NGO partner organizations
TOTAL PROGRAMME COST:	USD 30.5 million
AMOUNT OF IFAD LOAN:	SDR 18.3 million (equivalent to approximately USD 26.5 million)
TERMS OF IFAD LOAN:	40 years, including a grace period of ten years, with a service charge of three fourths of one per cent (0.75%) per annum
COFINANCIERS:	Partner organizations
AMOUNT OF COFINANCING:	USD 3.3 million
CONTRIBUTION OF BORROWER:	USD 772 000 (Pakistan Poverty Alleviation Fund contribution)
APPRAISING INSTITUTION:	IFAD
COOPERATING INSTITUTION:	World Bank

PROGRAMME BRIEF

Who are the programme beneficiaries? While the programme area comprises all rural areas of the country, there is a particular focus on those communities that are currently underserved in terms of microfinance. The overall focus of the programme, and of the Pakistan Poverty Alleviation Fund (PPAF) with which it will work, is on the poor. The mandate of the PPAF is to help the poor, landless and assetless to enable them to gain access to resources for their productive self-employment, to encourage them to undertake activities of income generation and poverty alleviation and in order to enhance their quality of life. The programme's beneficiaries are rural poor households, which can be classified into three groups: (i) small farmers, livestock owners, traders and microentrepreneurs; (ii) women and women-headed households; and (iii) rural poor households living below the poverty line.

Why are they poor? The first group tend to have large families, low levels of literacy, poor access to health care, schooling, clean water and sanitation, limited access to financial services, and are often disadvantaged in marketing surpluses. As coping strategies, they resort to reducing consumption; borrowing from the landlord, moneylender and shopkeeper; seeking wage labour; selling livestock; and liquidating other assets. The second target group, women and women-headed households, are much more vulnerable to poverty than men, due to inter alia: low indicators of socio-economic development, cultural barriers and norms, restricted entry to labour markets, low mobility, limited resource ownership and marginalization. The third group – rural households living below the poverty line (USD 87 per year for an average household) – represents about one third of the rural population and has been increasing. Few of these households own land or have secure access to land and many depend on smallstock for their livelihood.

How will the programme benefit the target group? The programme responds to these livelihood constraints through the provision of a broader range of microfinance services, focused on rural poor households. It will encourage existing microfinance operators, which are – or potentially could be – partner organizations (POs) of PPAF, to explore ways of further extending their outreach to households and communities that to date have been difficult to reach for reasons of remoteness, cultural/religious barriers to traditional credit, gender bias and/or inappropriate delivery systems. To do this, the programme will support the development and testing of microfinance products such as livestock insurance, leasing arrangements, equity partnerships, and Islamic modes of financing (which are based on profit-sharing rather than being interest-based), and other new financing systems that reduce debt burden, minimize risk, promote asset creation and facilitate income-generation. As part of this process, the programme will emphasize the development of approaches and products particularly keyed to women's needs and the constraints they face.

How will they participate in the programme? The main body of programme funding is in the innovation and outreach facility, a flexible funding mechanism to permit the POs to implement pilot projects to test and develop new microfinance products and approaches, and thereafter to finance their scaling up. The innovation and outreach projects will be developed by the POs jointly with their member community organizations and participating rural households. These households will become the recipients of the newly developed microfinance products. For those products that have been successfully piloted and developed, an increased number of households will be able to access the new products/services. As the products/services will be targeted at poorer communities, and particularly the women and women-headed households within them, these communities will experience a marked improvement in their livelihoods. It is estimated that some 180 000 poor households will benefit directly from the programme over its five-year implementation period. With the uptake of successfully piloted products/services through PPAF's mainstream funding (currently about USD 264 million is allocated for credit and enterprise development), the future number of indirect beneficiaries of the IFAD-financed programme could be substantial.

REPORT AND RECOMMENDATION OF THE PRESIDENT OF IFAD TO THE EXECUTIVE BOARD ON A PROPOSED LOAN TO THE ISLAMIC REPUBLIC OF PAKISTAN FOR THE MICROFINANCE INNOVATION AND OUTREACH PROGRAMME

I submit the following report and recommendation on a proposed loan to the Islamic Republic of Pakistan for SDR 18.3 million (equivalent to approximately USD 26.5 million) on highly concessional terms to help finance the Microfinance Innovation and Outreach Programme. The loan will have a term of 40 years, including a grace period of ten years, with a service charge of three fourths of one per cent (0.75%) per annum. It will be administered by the World Bank as IFAD's cooperating institution.

PART I – THE ECONOMY, SECTORAL CONTEXT AND IFAD STRATEGY[1]

A. The Economy and the Microfinance Sector

1. Pakistan has a population of 159 million (July 2004) with the majority of people living in the irrigated Indus River plain in Punjab and Sindh. Sixty-eight per cent of the population are rural. North West Frontier Province and Balochistan, which account for about 20% of the population, are culturally very diverse and among the poorest areas. However, the rural areas of Sindh and southern districts in Punjab are also extremely poor. In spite of a tripling in per capita incomes over the past 50 years, Pakistan's human development lags behind that of countries with similar income levels. About one third of the total population lives below the poverty line but, as the Poverty Reduction Strategy Paper (PRSP) notes, a further 20% are classified as "transitory vulnerable". Nevertheless, the economy has been performing relatively well and has made a strong recovery since the economic crisis of the late 1990s. Sound macroeconomic policies and structural reforms have resulted in a stronger export and current account position, a lower debt burden, access to international capital markets and a revival in growth. The microfinance sector in Pakistan is still small but, with the increasing focus on microfinance as an instrument of poverty reduction in Pakistan, it has been growing rapidly. The availability of donor funding and the promulgation of a legal framework for the microfinance sector have been key factors. The establishment of the Pakistan Poverty Alleviation Fund (PPAF) and the Khushhali Bank, the emergence of an active second tier of microfinance institutions and the availability of a large amount of donor funding have been important elements. However, despite this growth, only a very small portion of the demand for microfinance is currently being met.

B. Lessons Learned from Previous IFAD Experience

2. The lessons learned from IFAD's experience in Pakistan, many of which are also highlighted in the Independent External Evaluation of IFAD, include: (i) the need for more focus on sustainability; (ii) lack of emphasis on innovation; (iii) limited line agency capacity, lack of staff motivation and overly bureaucratic procedures; and (iv) overly complex designs in relation to project implementation capacity. A number of lessons pertinent to the design of the IFAD programme evolved from the implementation of the first project supporting the PPAF, financed by the World Bank: (i) capacity-building and development of pro-poor institutions are critical for poverty reduction;

[1] See Appendix I for additional information.

(ii) programme interventions should be demand-driven; (iii) autonomy and freedom from political pressures are critical for effective functioning; (iv) the organization is only as good as the quality of its staff; (v) decentralization enables organizations to respond rapidly and successfully to community demands; and (vi) simple processes facilitate compliance. The design of the current programme builds on the aforementioned lessons from IFAD's interventions and also reflects the World Bank's findings.

C. IFAD's Strategy for Collaboration with Pakistan

3. **Pakistan's policy for poverty eradication.** The Government's policies recognize that the incidence of poverty and the vulnerability of the poor will not be reduced without sustained, broad-based economic growth. The Government also recognizes that growth can only be generated and sustained by the private sector. The response is a supportive investment climate and a policy framework that provides ample room for private firms, small and large, to invest and create jobs in agriculture, industry and services. The PRSP, entitled "Accelerating Economic Growth and Reducing Poverty: The Road Ahead", is a key instrument in spelling out this policy. It is built around four pillars: (i) accelerated and broad-based economic growth while maintaining macroeconomic stability; (ii) improving governance and consolidating devolution; (iii) investing in human capital; and (iv) targeting the poor and the vulnerable with emphasis on social inclusion. Within this framework, there is increasing focus on microfinance as an instrument of poverty reduction in Pakistan, as reflected in the new Microfinance Ordinance that emphasizes targeting the poor and encourages the entry of new players. Furthermore, the effort made in creating a sound legal and regulatory framework for the finance and banking sector has resulted in a conducive environment for development of the sector and particularly for growth in microfinance.

4. **The microfinance activities of the major donors.** Two of the largest poverty reduction programmes with a microfinance focus are: (i) the World Bank-financed Second Pakistan Poverty Alleviation Fund (PPAF-II); and (ii) the Microfinance Sector Development Programme (MSDP) financed by the Asian Development Bank. The PPAF-II provides the main body of finance for the PPAF and was instrumental in its establishment. Funding totals USD 238 million, of which USD 158 is for microcredit. The MSDP has as its key objective poverty reduction by developing the microfinance sector to efficiently provide financial and social services to the poor. It has two components: a policy loan to support a reform programme for the microfinance sector; and a project loan of USD 80 million to provide microfinance services to the poor through the Khushhali Bank. Other important donor initiatives include: the **European Union's** programme for Financial Services Sector Reform to help develop new local microfinance institutions (MFIs) through a partnership with the Orangi Charitable Trust and, recently, a new programme to develop young microfinance NGOs. The Kashf Foundation (a PPAF partner organization) and the Pakistan Microfinance Network have been supported by the Department for International Development of the United Kingdom of Great Britain and Northern Ireland. The United States Agency for International Development and the United States Department of Agriculture are supporting the PPAF through its assistance for drought mitigation schemes in Balochistan and funding of the PPAF's Enterprise Development facility. The Swiss Agency for Development and Cooperation has responded to the needs of the finance sector by providing support through its Financial Sector Strengthening Project to promote innovative initiatives in microfinance and assistance to the State Bank of Pakistan to develop microfinance legislation.

5. **IFAD's strategy in Pakistan.** IFAD's strategy for the development of its lending portfolio in Pakistan is evolving. The current country strategic opportunities paper (COSOP), which was presented to the Executive Board in December 2003, provides the framework for the most recent programme in the country and for the proposed programme. The six projects/programmes currently under implementation in Pakistan, including the most recent Community Development Programme emerging from the current COSOP, are all area development projects/programmes, targeted at poor districts of the country. The proposed Microfinance Innovation and Outreach Programme (MI&OP) is fully in line with the COSOP. It responds directly to the COSOP's three strategic objectives: (i) strengthening the capacity of the rural poor and their organizations; (ii) improving equitable access

to productive natural resources and technology; and (iii) increasing access to financial services and markets. It also responds to the "real challenge in Pakistan", as identified in the COSOP, "to secure necessary local support for implementation of poverty-reduction strategies and programmes, particularly those incorporating gender-mainstreaming elements". The programme deals explicitly with three of the COSOP's thrusts: (i) agricultural and rural development; (ii) women's empowerment; and (iii) access to resources. Within the COSOP, the importance of credit in addressing poverty and in improving the livelihoods of the rural poor is highlighted.

6. **Programme rationale.** The rationale for programme design is based on a number of factors. First, while the PPAF's microfinance operations have grown rapidly, as have the resources at its disposal, there is substantial unmet demand, particularly among the rural poor, both for increased availability of credit and for more diversified microfinance services that respond to the particular needs of the rural poor. Second, although the PPAF has been highly successful in building up the capacity of its partner organizations (POs) and developing a sustainable microfinance system, the expansion of microfinance lending is placing stress on the PPAF's current network of POs. There is thus a need to identify and promote new POs capable of working effectively in the microfinance arena, particularly in rural areas. Finally, the programme's emphasis on enterprise development for the benefit of poor households, focusing particularly on livestock, will complement present PPAF operations and provide the PPAF with a powerful tool to reduce poverty and empower women, especially in poorer rural districts where livestock is the main source of household livelihood.

7. The rationale for the programme is also very closely linked to the rationale of working with the PPAF as an organization. PPAF is one of Pakistan's most successful and effective agencies for promoting poverty eradication and through its current network of some 56 POs, ranging from small local NGOs to large regional and national NGOs and microfinance institutions, it provides a suitably sound and dynamic system for managing the proposed microfinance programme. The PPAF handles its investment resources with prudence and discipline and produces results through rigorous monitoring and management. As such, it is an ideal institution for IFAD to work with and through which to pursue IFAD's poverty eradication mandate.

PART II – THE PROGRAMME

A. Programme Area and Target Group

8. The programme will be national in scope and geographically will concentrate exclusively on rural areas and poor communities. Criteria for defining rural areas will be specified in the operation manual. In terms of outreach, the programme will assist the PPAF's POs in focusing on those communities that either do not currently come within their operational area or do not have adequate access to microfinance services from the POs.

9. The target group for the programme can be divided into three: (i) small farmers, livestock owners, traders and microentrepreneurs; (ii) women and women-headed households; and (iii) rural poor households living below the poverty line. Poverty in Pakistan is largely rural and intrinsically linked to the performance of the agriculture sector, with asset ownership being one of the principal variables. In most rural areas, the majority of the first group – small farmers, livestock owners, small traders and microentrepreneurs – would be classified as poor. They represent perhaps the largest segment of the target group and the one that is most poorly served by microfinance institutions – especially those who live in the less accessible districts and subdistricts. Participatory processes during programme design indicated that even when households and enterprises do have access to rural finance, the nature, terms and conditions and size of the loans available often do not match their needs or ability to repay. The situation is similar with the second target group – women and women-headed households. Very often the terms of the credit, the repayment structure, the need for them to travel outside their communities and even the tendency for credit officers to be male, constrain them from

accessing rural finance – and this is especially true in traditional rural communities. The programme will focus particularly on this target group and develop special products and processes for women. To help facilitate this, a new staff member of the PPAF will be financed by the programme: a gender manager, to stimulate gender debate, develop gender strategies and promote a gender agenda. The third target group – poor rural households below the poverty line – have been shown to be viable recipients of microfinance when it is matched to their potential constraints. The focus on innovation and development of new products is geared to their capabilities and potential. The special emphasis on livestock – one of the main sources of livelihood for households in the target group – will also respond to the opportunities that could be available to improve their livelihoods and increase their household assets.

B. Objectives and Scope

10. The **development goal** is to **reduce poverty and improve livelihoods of rural households.** Central to achieving this goal and as the **overall objective**, the programme will **enable the active rural poor increasingly to access a wider range of sustainable financial services and products that respond to their needs.** The programme will be an integral part of the PPAF's most important operation – its credit and enterprise development programme – and will through the development of new microfinance products and services leverage the sizeable funding already available to POs through the PPAF's regular lending programme (2.5 million beneficiaries to date). The 180 000 households that are projected to benefit directly from programme funding represent only a portion of the households that should ultimately benefit from the programme once successful products and services are mainstreamed.

C. Components

11. **Component 1**: **innovation and outreach facility.** The **objective** of the component is to **enable POs to develop new approaches/credit packages and other financial products keyed to market demand** in order to, as the PPAF states, "move from microcredit to microfinance". This requires a greater range of financial products and a more dynamic approach to provision of credit, ensuring greater responsiveness to the needs of the client and the funding modalities of the enterprises/activities being financed.

12. The **component investment** involves the creation of a fund totalling USD 20.8 million, composed of credit and grant resources, with a 50/50 split between credit and grants. The facility represents a flexible source of funding that could be drawn on by the PPAF's POs to facilitate piloting, action research, assessment and initial scaling up of new microfinance products and approaches in rural areas of the country.

13. The facility will be a fully demand-driven mechanism. The allocation of grant versus credit resources will be made on a project-by-project basis, guided by simple and transparent criteria, specified in an operations manual. Credit will be used to fund the lending/financing element of projects, while the grant portion will cover the costs of setting up the project, training/systems development and a portion of the operating and capital costs. Any PO registered with the PPAF will be eligible to submit a project proposal for financing. Projects must meet eligibility criteria specified in the operational policies manual. Projects must demonstrate that they will target exclusively poor households (as defined in the programme's operations manual), contribute to poverty reduction, be implemented in rural areas or have a strong scaling up potential for rural areas and reach financial self-sufficiency within the project period.

14. The facility will comprise two financing windows: (i) the **regular window** with pilot project subloans (and other financial products) up to PKR 100 000 (currently about USD 1 700) per client; and (ii) a **private sector linkage window** with subloans up to PKR 300 000 (USD 5 000) per client. The first window is geared to individual loans and other financial services. The second window,

which is allocated about 10% of the facility's loan funds, is aimed primarily at small enterprises and trading/marketing operations that are able to facilitate production increases by a number of linked poor households, thereby improving their economy and that of their communities.

15. The range of potential projects that could be financed from the facility is considerable. A partner design workshop held at the beginning of programme formulation provided ideas potentially of interest to the POs. A number of these were analysed, elaborated, and models produced indicating their financial attractiveness, including: Islamic mode of financing, private animal health services, rural savings and credit groups/internal lending, micro-insurance, microleasing, social microlending/emergency credit and equity-based financing.

16. **Component 2: young partner programme.** The **objective** of the component is to **strengthen emerging capacities in the microfinance sector in rural areas.** This will be achieved by helping the PPAF develop new POs and providing young graduates with practical exposure and experience to enhance the availability of professionals for existing and emerging POs at the middle management level, thereby increasing the institutions' capacity for professional management and growth. This will involve three initiatives: (i) young partner development initiative; (ii) internationally-linked partner initiative; and (iii) young professionals scheme.

17. As with the innovation and outreach (I&O) facility, **component investment**, totalling USD 6.3 million, will involve a combination of grant and credit resources. The first two initiatives combine **grants** for institutional development packages that organizations will access for training and management support with an incremental line of **credit** to allow potential POs to test their skills and capacity in handling loans and other financial service products. The third will finance training and technical support.

18. The **young partner development initiative** will enable the PPAF to work with new rurally focused organizations that have the potential to be serious microfinance providers. There is a range of organizations that could qualify for participation in the programme, from small, essentially community-based organizations to larger, relatively well-established, local NGOs or even nascent MFIs that currently are not formally registered as POs with the PPAF. Each participating organization will work with the initiative for a period of three years, at which time the successful ones will graduate and be accredited as PPAF POs. Over the programme period, plans call for 15 young partner organizations (YPOs) to be supported under the initiative, with a target of 12 YPOs accredited as new PPAF POs. This should result in an expansion in the number of PPAF POs by 21% over the current level of about 56.

19. The **international linkage partner initiative** provides an opportunity for PPAF to partner with international MFIs operating successful rural credit programmes in the region, with the aim of assisting promising Pakistani professionals to set up microfinance operations. The international linkage MFIs will bring a proven system and sound credit management experience to the partnership. The PPAF will contribute knowledge of the local microfinance market, access to a line of credit, and its ability to attract dynamic, young Pakistani people with the ability to set up new microfinance institutions. The initiative will comprise: an intense nine-month exposure and training programme, followed by establishment of new MFIs as PPAF linkage partner organizations (LPOs), and provision of the line of credit. It would comprise two phases: the first in year 1 and a second one after the mid-term review in year 3. Each phase will be managed by the PPAF and an international MFI and provide for the induction of ten international programme professionals, with a target of two new MFIs being established at the end of each nine-month training period – four new partner MFIs in total.

20. The **young professionals scheme** will support the PPAF's current internship programme for young professionals wishing to work in POs. It focuses on motivated young people coming from poor rural families with a solid educational background. It will be a relatively small and low-cost intervention but one that will work towards the programme's main objectives: to build up capacity to

provide sound financial services to rural clients. The scheme will comprise training over a period of four months, followed for successful graduates by an additional eight-month attachment to a PO. Over the programme, the PPAF will train about 96 young professionals.

21. **Component 3: support for partner organizations.** The **objective** is to **strengthen POs' ability to sustainably extend their outreach and expand the scope of current microfinance operations in rural areas.** The component investment, totalling USD 1.3 million, will involve the financing of technical assistance, studies, training and workshops in support of cross-cutting themes and key areas of focus.

22. Support under the component is focused on six subjects that are key to the successful implementation of the programme and the I&O facility, and to development of viable microfinance institutions. This will be a demand-driven facility available to POs, with acceptance of proposals based on an agreed and published set of criteria, as specified in the I&O Operations Manual. The six special subjects, or special areas of focus, include the following: (i) cross-cutting themes of **poverty reduction** and **gender balancing**; (ii) assistance to facilitate **livestock enterprise financing**, the **financial sustainability** of POs' microfinance operations and adoption of **risk management** strategies; and (iii) **assistance for POs' development/preparation of I&O projects**. To help the **POs** work with the programme's cross-cutting themes and special areas of focus, PPAF will make available funding for training sessions, studies and technical support in order to: (i) help POs better understand and "activate" the themes within their organizational/management structure and design or adjust I&O projects so that they are responsive to the themes; and (ii) facilitate POs' development of proposals and their participation in the I&O facility prior to submission of projects to the PPAF.

23. **Component 4: management support.** The **objective** of the component is to **increase PPAF's capacity to develop innovative microfinance products and approaches and to expand their microfinance operations in rural areas**. The **component investment**, totalling USD 1.7 million, comprises funding for vehicles and equipment, studies and technical support, training and exchange visits, and workshops plus funding the salaries and allowances for six new staff positions in the PPAF.

24. As such, the programme will provide the incremental management resources necessary to enable the PPAF to take on the added management load and responsibilities resulting from the activities funded under the programme. Rather than creating a programme management unit and programme coordinator position, the programme will be managed within the PPAF's present management structure with the Chief Operating Officer having the day-to-day responsibility. To enable the key units in PPAF to handle the increased workload resulting from the programme, the equivalent of six new management executive positions will be funded. While most of these officers' time will be spent on programme activities, they will perform other PPAF activities as and when required. In addition, the programme will create a new position of 'gender manager', thus establishing a gender focal point in PPAF.

25. In addition to funding these positions, the component will provide supplementary resources for the PPAF to enable the institution to fund supporting operations for the programme, including inter alia: (i) promoting and facilitating start-up for the I&O facility and for the young partner programme; (ii) carrying out thematic research, baseline surveys, impact assessment, Results and Impact Management System (RIMS) anchor indicator surveys and mid-term and completion reviews; (iii) organizing I&O/PO coordination/lessons learned workshops; (iv) developing regional linkages and exchange programmes with other MFIs; (v) developing a gender strategy and operational means to promote women in microfinance activities and in the PPAF and POs; and (vi) facilitating policy response work to draw out constraints and opportunities regarding microfinance legislation and policy.

D. Costs and Financing

26. Programme **costs** are estimated at USD 30.5 million, with a base cost of USD 30.2 million. Physical and price contingencies and foreign exchange content are small, each less than 1% of the base costs. By far the largest portion of the programme costs is allocated to financing the I&O facility – about 70% of total resources. The second major element of programme costs is the young partner programme, representing about 21% of base costs. The management cost of the programme would be low, at 6% of base costs.

27. In terms of programme financing, **IFAD** will make available a loan of about USD 26.5 million, on highly concessional terms, which would cover 87% of the estimated programme costs. The **POs** will contribute about 10.8% of programme costs. The **PPAF's** contribution (2.5% of total costs) will cover a portion of the costs of staff remuneration, allowances and operating expenses, plus taxes and duties on the goods and services procured directly by PPAF.

TABLE 1: SUMMARY OF PROGRAMME COSTS[a]
(USD '000)

Component	Local	Foreign	Total	% of Foreign Exchange	% Base Costs
A. Innovation and outreach facility	20 833	-	20 833	-	69
B. Young partner programme					
1. Young partner development initiative	3 436	4	3 440	-	11
2. International linkage partner initiative	2 643	17	2 661	1	9
3. Young professionals scheme	227	12	240	5	1
Subtotal	**6 307**	**34**	**6 341**	**1**	**21**
C. Support for partner organizations	1 302	24	1 326	2	4
D. Management support	1 669	51	1 720	3	6
Total base costs	**30 112**	**108**	**30 220**	**-**	**100**
Physical contingencies	81	4	85	5	1
Price contingencies	229	4	233	2	-
Total programme costs	**30 421**	**116**	**30 537**	**-**	**101**

[a] Discrepancies in totals are due to rounding.

TABLE 2: FINANCING PLAN[a]
(USD '000)

Component	IFAD		PPAF		Partner Organizations		Total		Foreign Exchange	Local (Excl. Taxes)	Duties and Taxes
	Amt.	%	Amt.	%	Amt.	%	Amt.	%			
A. Innovation and outreach facility	18 700	89.8	-	-	2 133	10.2	20 833	68.2	-	19 767	1 067
B. Young partner programme											
1. Young partner development initiative	2 706	77.0	67	1.9	740	21.1	3 513	11.5	5	3 313	195
2. International linkage partner initiative	2 257	83.1	24	0.9	436	16.0	2 717	8.9	19	2 594	104
3. Young professionals scheme	161	64.2	90	35.8	-	-	251	0.8	13	230	9
Subtotal	**5 124**	**79.1**	**181**	**2.8**	**1 175**	**18.1**	**6 480**	**21.2**	**36**	**6 137**	**308**
C. Support for partner organizations	1 262	90.9	126	9.1	-	-	1 388	4.5	26	1 237	126
D. Management support	1 370	74.7	465	25.3	-	-	1 835	6.0	54	1 644	136
Total disbursement	**26 456**	**86.6**	**772**	**2.5**	**3 309**	**10.8**	**30 537**	**100.0**	**116**	**28 785**	**1 637**

[a] Discrepancies in totals are due to rounding.

E. Procurement, Disbursement, Accounts and Audit

28. **Procurement**. Procurement of goods, equipment and services will be in accordance with IFAD's procurement guidelines. The programme involves no procurement requiring international competitive bidding. Goods and services estimated at USD 60 000 (or equivalent) or more will be awarded through local competitive bidding. Goods and services costing less than USD 60 000 will be procured on the basis of local or international shopping. Direct contracting will apply to goods costing USD 600 or less and consultant services costing USD 5 000 or less. All contracts costing more than USD 60 000 will require prior no-objection by the cooperating institution.

29. **Disbursement, accounts and audit.** A special account in United States dollars in a commercial bank acceptable to IFAD and operated by the PPAF, as authorized by the Ministry of Finance, will be set up to facilitate the regular flow of funds. The initial deposit is expected to be USD 2.6 million. The special account will be used for transfers to the general PPAF account and to the POs, YPOs and LPOs under financing agreements with the PPAF. Replenishment of the special account by IFAD will be made against withdrawal applications, supported by appropriate documentation or statements of expenditure. The PPAF and POs will maintain appropriate financial records and accounts in accordance with PPAF's systems. For goods and services procured directly by PPAF, the general PPAF account will be used. This account is held by the PPAF with the ABN AMRO Bank and used for all PPAF's direct expenditures. PPAF operates separate ledger accounts for its various projects and would open three additional ledger accounts for MI&OP: (i) for general expenditure; (ii) for the regular window of the I&O facility revolving loan fund; and (iii) for the facility's private-sector linkage window revolving loan fund. Programme accounts would be subjected to independent annual audit contracted by the PPAF. The auditors will certify the accounts, including a separate opinion on the special account. Each implementing agency will be responsible for financial reporting and onward provision of financial statements to the PPAF, who will produce and submit to IFAD and the cooperating institution, the consolidated financial statements on an annual basis. Annual consolidated financial statements will be prepared and audited in accordance with International Standards on Auditing subjected to annual audit by independent external auditors contracted by the PPAF acceptable to IFAD and will also include a separate opinion on the operation of the special account and a management letter addressing the adequacy of the accounting and internal control systems

F. Organization and Management

30. The PPAF will be responsible for programme implementation, undertaken through its network of **POs**, which will retail the credit and other microfinance products and services to the ultimate beneficiaries. The Economic Affairs Division of the Ministry of Economic Affairs and Statistics, and the Ministry of Finance, will provide government oversight, as they currently do for the PPAF through their representation on the PPAF Board of Directors. The systems and bodies currently in place to provide oversight and coordination for the World Bank-financed PPAF-II, and for the PPAF itself, operate effectively and will be used by the programme: the PPAF's main body, which provides policy guidance and reviews financial statements and annual budgets; and the PPAF Board of Directors, consisting of representatives from the private sector, NGOs and the Government, which is responsible for setting operational policies and procedures, and reviewing and approving annual workplans and budgets. To facilitate programme implementation, The PPAF will employ additional staff to assist in managing the programme and in particular the I&O facility. The staff will be fully integrated as part of the PPAF's regular management structure (see chart in Appendix VI) and while the main part of their workload will be to implement programme activities, they will also be responsible for carrying out other PPAF work. The prime document for guiding programme implementation will be the I&O Operations Manual that forms an integral part of the PPAF's general operations manual. The manual, taken together with the appraisal report, loan agreement and subsidiary financing agreement, will be the main documents guiding programme implementation.

G. Economic Justification

31. **Programme benefits.** Some 180 000 households will benefit directly from the programme. The **I&O facility** will, by matching new financial products and services to the needs of rural households and microenterprises, result in increases in household incomes and reduction in household debt levels. The second component, **young partner programme**, by bringing young and dynamic institutions into the PPAF's network of POs, will help to develop new ideas, adopt an increasingly rigorous approach to microfinance, and expand the presence of dedicated microfinance providers in rural areas. The **support for partner organizations** will promote greater focus on a number of key subjects for the PPAF's POs and help to ensure that essential cross-cutting themes will be adequately integrated into the implementation of the I&O projects and the strengthening of partner institutions. The **management support** component will promote the PPAF's operational efficiency, facilitate effective monitoring and evaluation, and ensure sound implementation of the programme.

32. **Gender benefits.** The substantial attention to gender in the design of the programme is expected to produce a clear and positive impact during implementation. The impact is expected in three ways: (i) greater gender focus of participating institutions, through promoting gender audits, developing gender strategies, providing gender training and ensuring equal or preferential treatment for women in the selection of participants in the international linkage initiative and the young professionals scheme; (ii) gender focus in I&O projects, by requiring that participating POs include a project gender strategy in the design of their projects; and (iii) gender focus in programme operations, through programme planning that consciously incorporates gender aspects, paying rigorous attention to gender in monitoring and evaluation, and establishing a gender focal point in the PPAF.

33. **Livestock-related benefits.** The programme's initiative to broaden the range of livestock enterprises is likely to provide benefits to both rural poor livestock producers and the POs. At present, producers are obtaining credit mostly for the purchase of animals – profit margins are generally narrower and risks tend to be higher than they are further up the market chain. Making finance available for the poor to engage in enterprises that add value to their livestock rearing will produce higher returns for the borrowers. For the **POs**, expanding the range of financial products aimed at the livestock sector will create new opportunities and help reduce the risk of lending by spreading the risk across a wider range of activities with different risk profiles.

34. **Financial and economic analysis.** No economic analysis of the programme was carried out, in light of its emphasis on institutional support for the microfinance subsector; the flexible nature of the funds to be established under the programme; the diversity of institutions involved; and applicable tax regimes. However, direct benefits will be reflected in the incremental number of rural institutions providing more efficient and client-responsive financial services. These benefits to the rural economy would be particularly evident in the increased outreach to underserved areas, as measured in terms of the numbers of active clients and the size of the portfolios supported by the programme. The financial impact of the programme was examined at three levels: (i) the programme's rural clients; (ii) the PPAF; and (iii) the Government. The **clients** of the participating POs – i.e. the programme beneficiaries – will improve their incomes and also their savings rates. Regarding the **PPAF**, a cash flow analysis of the institution, "with programme", shows a small but positive impact on the PPAF's financial position, with an incremental income over the five years of USD 1.2 million, equivalent to a contribution of 3% to annual income. The programme's financial return to the **Government** will also be positive. Government cash flow "with programme" would result in a net positive effect on government finances of about USD 3.8 million at current prices.

H. Risks

35. With an innovative programme of this nature, there are always some risks but none of them is substantial. While there are risks associated with individual components, these are considered acceptable and manageable. With the I&O facility for example, there is a risk of limited uptake by the

POs for developing new and innovative financially viable products and approaches for poor clients in rural areas – a risk for a facility that is demand-driven. It is however mitigated by the positive experiences that a number of POs already have had with new products and approaches and the strong interest expressed during programme design by a broad range of POs in testing and developing new products. Another possible risk for the facility is that PO Boards of Directors could prevent POs from charging cost-covering rates for financial services thus jeopardizing the financial sustainability of the microfinance operations supported under the facility. While many PO Boards of Directors are reluctant to increase interest rates to market levels, the programme includes a special initiative under the third component to promote professional management of financially sustainable microfinance operations among the POs; it also includes as a prerequisite that pilot projects funded under the facility must demonstrate that they would be financially sustainable. There is also a broader risk: whether there is potential to develop new financially viable products for poor rural clients. Rural areas are unquestionably more difficult and more costly for MFIs, but POs already have experience of running a range of viable rural microfinance operations. Experience from neighbouring countries also indicates the potential for developing financially viable and sustainable rural finance operations.

I. Environmental Impact

36. An environmental screening and scoping note was prepared during formulation in line with IFAD procedures. The note classified the programme as a low Category B and confirmed that the potential for significant negative impact is minimal and that no formal environmental impact assessment would be required.

J. Innovative Features

37. The approach of using a private-sector-managed public company to reduce poverty – the PPAF is one of Pakistan's most important poverty eradication initiatives – is not unique. Neither is the PPAF's approach of working with a broad range of community-focused NGOs that deliver microfinance to poor households and small enterprises. However, to do so successfully, to do it profitably and to achieve the growth rates that the PPAF has achieved over the past four years is quite remarkable. The programme will contribute to the PPAF's continued success by providing a source of funding that will allow the PPAF and particularly its POs to test, pilot, experiment, assess and develop new ideas and approaches to the delivery of microfinance services and share them among the POs in the PPAF's partner network – i.e. to give them the latitude to innovate. Innovation should help them improve penetration in rural areas, and reach poor households, women and socially conservative groups more effectively. Innovation is particularly important in Pakistan as standard loan packages, while successful, cannot fully respond to the constraints experienced by these groups or take full advantage of available opportunities.

PART III – LEGAL INSTRUMENTS AND AUTHORITY

38. A loan agreement between the Islamic Republic of Pakistan and IFAD will constitute the legal instrument for extending the proposed loan to the borrower. A summary of the important supplementary assurances included in the negotiated loan agreement is attached as an annex.

39. The Islamic Republic of Pakistan is empowered under its laws to borrow from IFAD.

40. I am satisfied that the proposed loan will comply with the Agreement Establishing IFAD.

PART IV – RECOMMENDATION

41. I recommend that the Executive Board approve the proposed loan in terms of the following resolution:

> RESOLVED: that the Fund shall make a loan to the Islamic Republic of Pakistan in various currencies in an amount equivalent to eighteen million three hundred thousand special drawing rights (SDR 18 300 000) to mature on or prior to 1 December 2045 and to bear a service charge of three fourths of one per cent (0.75%) per annum, and to be upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented to the Executive Board in this Report and Recommendation of the President.

Lennart Båge
President

ANNEX

SUMMARY OF IMPORTANT SUPPLEMENTARY ASSURANCES INCLUDED IN THE NEGOTIATED LOAN AGREEMENT

(Negotiations concluded on 29 November 2005)

1. **PPAF programme account**. The PPAF will open and thereafter maintain in a bank accepted by IFAD an account denominated in local currency for programme operations (the "PPAF programme account"). The PPAF will be fully authorized to operate the PPAF programme account.

2. **Counterpart funds**. The Government of Pakistan (the "Government") will ensure that the PPAF makes available to the programme funds from its own resources in an aggregate amount of approximately USD 772 000 or its equivalent in accordance with the subsidiary loan and grant agreement.

3. **Channelling of programme resources.** The PPAF will transfer available funds and other resources called for in the annual workplans and budgets to each PO, YPO and LPO, in accordance with the relevant PO, YPO and LPO agreement to carry out the relevant component in accordance with such PO and YPO agreements.

4. **Monitoring.** The PPAF will expand, as soon as practicable but in no event later than 180 days after the effective date, and thereafter maintain its existing information management and progress monitoring system to enable it to continuously monitor the programme. The programme monitoring and evaluation will be integrated in the overall MIS operated by the PPAF. The PPAF will ensure that as a condition for PO**,** YPO and LPO participation in the programme, each PO, YPO and LPO's MIS includes training and technical support activities in a manner satisfactory to IFAD. The MIS of the PPAF and each PO, YPO and LPO will also perform results and impact monitoring, acceptable to IFAD, to gather information on programme impact. A set of indicators will be developed to enable regular monitoring using parameters that are consistent with those of the Government's Microfinance Network and the Microfinance Information Exchange, thus facilitating the participating institutions' access to local and international information platforms. The PPAF will collect its implementation progress and impact data consistent with IFAD's Results and Impact Management System (RIMS) anchor indicators.

5. **Insurance**. The PPAF will insure all programme staff and equipment during programme implementation in accordance with its policy for its regular staff.

6. **Gender focus**. The Government will ensure that due consideration is given to gender issues in programme implementation and management in respect of, inter alia, programme beneficiaries, the recruitment of programme staff by the PPAF, POs, YPOs and LPOs, and young professionals.

7. **Legal framework.** The Government will continue to support the development and coming into force of an enabling legal environment for microfinance institutions in the programme area.

8. **Suspension.** In addition to the events set forth in Article 12.01 of the General Conditions:

(a) IFAD may suspend, in whole or in part, the right of the Government to request withdrawals from the loan account upon the occurrence of any of the events set forth therein or any of the following events:

(i) the subsidiary loan and grant agreement, or any provision thereof, has been waived, suspended, terminated, amended or otherwise modified without the prior consent of IFAD, and IFAD has determined that such waiver, suspension, termination, amendment or modification has had, or is likely to have, a material adverse effect on the programme.

(ii) any competent authority has taken any action for the dissolution of the PPAF or the suspension of its operations, or any action or proceeding has been commenced for the distribution of any assets of the PPAF among its creditors.

(b) IFAD will suspend, in whole or in part, the right of the Government to request withdrawals from the loan account if the audit report required by the loan agreement has not been satisfactorily completed within 12 months after the financial reporting period set forth therein.

9. **Conditions precedent to withdrawal**. The conditions precedent to withdrawal are as follows:

(a) no withdrawals will be made in respect of expenditures from the loan until the programme operations manual has been adopted by the PPAF in the form approved by IFAD; and

(b) no withdrawals will be made in respect of expenditures from the loan until the special account and the PPAF programme account have been duly opened.

10. **Conditions of effectiveness**. The following are specified as conditions precedent to the effectiveness of the loan agreement:

(a) the loan agreement has been duly signed, and the signature and performance thereof by the Government have been duly authorized and ratified by all necessary administrative and governmental action;

(b) the subsidiary loan and grant agreement, in form and substance acceptable to IFAD, has been duly signed by the Government and the PPAF; the signature and performance thereof by the Government and PPAF have been duly authorized or ratified by all necessary corporate, administrative and governmental action; and a copy of the signed subsidiary loan and grant agreement, certified as a true and complete copy thereof by a competent officer of the Government, has been delivered to IFAD; and

(c) a favourable legal opinion, issued by an authorized officer of the Ministry of Law, Justice and Parliamentary Affairs of the Government, approved by IFAD, in form and substance acceptable to IFAD, has been delivered by the Government to IFAD.

COUNTRY DATA

PAKISTAN

Land area (km^2 thousand) 2003 1/	771
Total population (million) 2003 1/	148.44
Population density (people per km^2) 2003 1/	193
Local currency	Pakistani Rupee (PKR)
Social Indicators	
Population (average annual population growth rate) 1997-2003 1/	2.4
Crude birth rate (per thousand people) 2003 1/	32
Crude death rate (per thousand people) 2003 1/	8
Infant mortality rate (per thousand live births) 2003 1/	74
Life expectancy at birth (years) 2003 1/	64
Number of rural poor (million) (approximate) 1/	n/a
Poor as % of total rural population 1/	n/a
Total labour force (million) 2003 1/	55.72
Female labour force as % of total 2003 1/	30
Education	
School enrolment, primary (% gross) 2003 1/	69 a/
Adult illiteracy rate (% age 15 and above) 2003 1/	n/a
Nutrition	
Daily calorie supply per capita	n/a
Malnutrition prevalence, height for age (% of children under 5) 2003 2/	37 a/
Malnutrition prevalence, weight for age (% of children under 5) 2003 2/	38 a/
Health	
Health expenditure, total (as % of GDP) 2003 1/	3 a/
Physicians (per thousand people)	1 a/
Population using improved water sources (%) 2002 2/	90
Population with access to essential drugs (%) 2/	n/a
Population using adequate sanitation facilities (%) 2002 2/	54
Agriculture and Food	
Food imports (% of merchandise imports) 2003 1/	10
Fertilizer consumption (hundreds of grams per ha of arable land) 2003 1/	1 381 a/
Food production index (1999-01=100) 2003 1/	106
Cereal yield (kg per ha) 2003 1/	2 312
Land Use	
Arable land as % of land area 2003 1/	28 a/
Forest area as % of total land area 2003 1/	3 a/
Irrigated land as % of cropland 2003 1/	81 a/

GNI per capita (USD) 2003 1/	520
GDP per capita growth (annual %) 2003 1/	2.6
Inflation, consumer prices (annual %) 2003 1/	3
Exchange rate: USD 1 =	PKR 60
Economic Indicators	
GDP (USD million) 2003 1/	82 324
Average annual rate of growth of GDP 1/	
1983 1993	5.8
1993-2003	3.3
Sectoral distribution of GDP 2003 1/	
% agriculture	23
% industry	24
% manufacturing	16
% services	53
Consumption 2003 1/	
General government final consumption expenditure (as % of GDP)	12
Household final consumption expenditure, etc. (as % of GDP)	73
Gross domestic savings (as % of GDP)	15
Balance of Payments (USD million)	
Merchandise exports 2003 1/	11 930
Merchandise imports 2003 1/	13 038
Balance of merchandise trade	-1 108
Current account balances (USD million)	
before official transfers 2003 1/	-2 728
after official transfers 2003 1/	3 573
Foreign direct investment, net 2003 1/	534
Government Finance	
Cash surplus/deficit (as % of GDP) 2003 1/	-3
Total expenditure (% of GDP) 2003 1/	n/a
Total external debt (USD million) 2003 1/	36 346
Present value of debt (as % of GNI) 2003 1/	41
Total debt service (% of exports of goods and services) 2003 1/	16
Lending interest rate (%) 2003 1/	n/a
Deposit interest rate (%) 2003 1/	n/a

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a/ Data are for years or periods other than those specified.

1/ World Bank, *World Development Indicators* database CD ROM 2005
2/ UNDP, *Human Development Report*, 2005

PREVIOUS IFAD FINANCING IN PAKISTAN

Project/Programme Name	Initiating Institution	Cooperating Institution	Lending Terms	Board Approval	Loan Effectiveness	Current Closing Date	Loan/Grant Acronym	Currency	Approved Loan/Grant Amount	Disbursement (as % of approved amount)
Small Farmers Credit Project	World Bank: IDA	World Bank: IDA	HC	27 Jun 79	04 Jun 80	31 Dec 85	L - I - 18 - PA	SDR	23 750 000	100
South Rohri Fresh Groundwater Irrigation Project	AsDB	AsDB	HC	19 Dec 79	28 Mar 80	31 Dec 90	L - I - 33 - PA	SDR	12 400 000	37
Barani Area Development Project	IFAD	AsDB	HC	03 Dec 80	27 Aug 81	31 Dec 90	L - I - 48 - PA	SDR	9 800 00	48
On-Farm Water Management Project	World Bank: IDA	World Bank: IDA	HC	17 Dec 81	28 Jul 82	31 Dec 85	L - I - 83 - PA	SDR	10 500 000	85
Small Farmers' Credit Project II	World Bank: IDA	World Bank: IDA	HC	13 Dec 83	09 Jul 84	31 Dec 87	L - I - 138 - PA	SDR	23 200 000	100
Gujranwala Agricultural Development Project	IFAD	AsDB	HC	12 Dec 84	21 Jun 85	31 Dec 93	L - I - 162 - PA	SDR	8 650 00	100
Chitral Area Development Project	IFAD	AsDB	I	10 Sep 87	25 Nov 88	31 Dec 97	L - I - 209 - PA	SDR	8 700 00	78
Punjab Smallholder Dairy Development Project	IFAD	AsDB	I	30 Nov 88	18 Feb 91	30 Jun 98	L - I - 234 - PA	SDR	12 050 000	47
Second Barani Area Development Project	IFAD	AsDB	I	19 Apr 90	18 Feb 91	30 Jun 98	L - I - 257 - PA	SDR	15 200 000	71
Smallholder and Women's Rural Credit Project	IFAD	World Bank: IDA	I	02 Oct 90	19 Jun 92	30 Jun 96	L - I - 265 - PA	SDR	19 000 000	8
Neelum and Jhelum Valleys Community Development Project	IFAD	UNOPS	I	04 Sep 91	05 Jun 92	30 Jun 04	L - I - 288 - PA	SDR	11 900 000	94
Mansehra Village Support Project	IFAD	UNOPS	I	03 Dec 92	26 Mar 93	31 Dec 00	L - I - 319 - PA	SDR	10 350 000	64
Pat Feeder Command Area Development Project	AsDB	AsDB	I	19 Apr 94	02 Feb 95	31 Dec 03	L - I - 353 - PK	SDR	20 250 000	60
Dir Area Support Project	IFAD	UNOPS	HC	11 Sep 96	15 Apr 97	31 Dec 06	L - I - 425 - PK	SDR	11 350 000	51
Northern Areas Development Project	IFAD	UNOPS	HC	11 Sep 97	11 Sep 98	31 Dec 07	L - I - 453 - PK	SDR	10 750 000	47
Barani Village Development Project	IFAD	UNOPS	HC	03 Dec 98	01 Sep 99	31 Dec 07	L - I - 492 - PK	SDR	11 150 000	66
Southern Federally Administered Tribal Areas Development Project	IFAD	UNOPS	HC	07 Dec 00	24 Jul 02	31 Mar 09	L - I - 554 - PK	SDR	13 400 000	21
North-West Frontier Province Barani Area Development Project	AsDB	AsDB	HC	26 Apr 01	09 May 03	31 Dec 09	L - I - 558 - PK	SDR	11 150 000	13
Community Development Programme	IFAD	UNOPS	HC	18 Dec 03	02 Sep 04	31 Mar 12	L - I - 625 - PK	SDR	15 250 000	10

AsDB: Asian Development Bank
HC: Highly concessional
I: Intermediate
IDA: International Development Association (World Bank Group)
UNOPS: United Nations Office for Project Services

LOGICAL FRAMEWORK

(IFAD Results and Impact Management System indicators are underlined and in bold)

A. RESULTS	TARGET INDICATORS	MONITORING AND EVALUATION MECHANISMS AND SOURCES	ASSUMPTIONS
<u>*Development Goal*</u> Reduce poverty and improve livelihoods of rural households	1. Increased income of rural households 2. <u>**Increased asset ownership of rural households**</u> 3. Improved social indicators, <u>**including reduction in child malnutrition**</u> and increased enrolment in primary education (male and female) 4. Participation of poor households in design, planning, decision-making and implementation of programme-supported activities	(1 and 2): Results of household income and expenditure surveys (1-4): Baseline and impact surveys (including PPAF and PO gallup surveys) (3): National nutritional surveys (1): Poverty assessments undertaken periodically by the Government and donors (1 and 3): Relevant government statistics at the provincial and national levels	
<u>*Programme Objective*</u> Active rural poor increasingly accessing a wider range of sustainable financial services and products that respond to their needs	1. Increase in the number of active microfinance clients in poor rural areas obtaining PPAF funds (through POs) by 180 000 (50% women) 2. Increase of 5% in the portion of rural clients among Pakistan's microfinance clients 3. Increase in the PPAF microfinance portfolio outstanding in poor rural areas by PKR 1.5 billion	(1-3): Management Information Systems (MIS) of POs, from which the data would be reported in I&O project reports (2): Performance indicator reports by Pakistan microfinance network (2): Progress reports of other microfinance projects	▪ The political and economic stability in the country and a conducive policy and legislative environment for microfinance prevails

B. OUTCOMES	INDICATORS AND TARGETS	MONITORING AND EVALUATION MECHANISMS AND SOURCES	ASSUMPTIONS
Innovation and Outreach Facility			
POs are increasingly delivering a wider range of financially sustainable microfinance products and approaches	1. 160 000 rural clients accessing new financial services (50% women) 2. Of these 160 000 clients, 120 000 are active borrowers (50% women) 3. 20 successfully piloted products/approaches adopted by POs 4. Increasing level of **operational self-sufficiency** among participating **POs** 5. Increase in POs' portfolio outstanding of PKR 1.3 billion resulting from pilot activities 6. High quality of participating POs' total portfolio outstanding (**portfolio-at-risk** [30 days] < 5%) 7. **Total savers and borrowers (gender); total savings; gross loan portfolio**.	(1-7): MIS of POs, from which the data would be reported in I&O project reports	▪ POs are willing to move their microfinance operations towards operational sustainability
Young Partner Programme			
An increasing credit demand from PPAF's young partner organizations (YPOs and LPOs) that are operating in rural areas	1. YPOs' rural portfolio outstanding of PKR 90 million 2. LPOs' rural portfolio outstanding of PKR 90 million 3. 50% **operating self-sufficiency** of participating YPOs 4. 75% **operating self-sufficiency** of participating LPOs 5. High quality of YPOs and LPOs total portfolio outstanding (**portfolio-at-risk** [30 days] < 5%) 6. **Total borrowers (gender); gross loan portfolio**	(1-6): MIS of YPOs and LPOs, from which the data would be reported in YPO and LPO reports	▪ The accredited YPOs and LPOs are prepared to try new financial products and approaches

Support for Partner Organizations			
Participating POs' capacity to manage their microfinance operations and to identify and plan new financial products and approaches increased	1. 50 I&O proposals received by PPAF 2. 40 I&O proposals accepted by PPAF 3. 20 participating POs with an operational MIS 4. 40 innovation and outreach projects completed	(1 and 2): PPAF registry of proposals (3): MIS of POs, from which data reported in PO project reports (4): Innovation project completion reports submitted by POs	▪ POs committed to increasing outreach of financial service products to poor rural communities
Management Support			
PPAF's capacity to provide microfinance services in rural areas expanded	1. Turnaround time for I&O proposals (target: average less than six weeks) 2. 100% of programme reports of PPAF are timely/complete	(1): PPAF registry of I&O proposals (2): The cooperating institution's registry of PPAF reports	▪ PPAF continues as sound financial institution ▪ PPAF maintains commitment to poverty reduction in rural areas

C. OUTPUTS	TARGET INDICATORS	MONITORING AND EVALUATION MECHANISMS AND SOURCES	ASSUMPTIONS
Innovation and Outreach Facility			
Increased number of financially sustainable microfinance products and approaches piloted and scaled up	1. 40 financial products and approaches on offer by POs 2. 16 products and approaches successfully scaled up 3. Number of rural subdistricts covered by the new approaches and products of the POs	(1-3): PO reports (1-3): PPAF reports on visits to POs to verify the POs’ assessments	▪ There is potential to develop new and innovative financially viable products for poor rural clients ▪ POs are willing and able to scale up financial products tested under the I&O facility ▪ POs’ Boards of Directors allow the POs to charge cost-covering rates for financial services
Young Partner Programme			
More and stronger PPAF partner organizations serving rural areas	1. 15 supported YPOs 2. 15 YPOs with 100% rural borrowers 3. 12 YPOs graduate to POs 4. 4 supported LPOs 5. 4 LPOs with 100% rural borrowers 6. 4 LPOs graduate to POs	(2): MIS of YPOs, from which the data would be reported in YPO reports (5) MIS of LPOs, from which the date would be reported in LPO reports (1,3,4 and 6): MIS of PPAF	▪ YPOs/LPOs have dedicated and well-trained management staff ▪ YPOs and LPOs maintain commitment to develop/expand rural financial services
Support for Partner Organizations			
Opportunities identified, PO staff trained, systems developed to enable POs to improve their operations and effectively implement I&O projects	1. 30 POs have participated in systems development and capacity-building activities 2. **Number of PO staff trained** (male/female) (to be defined in annual workplans and budgets)	(1): PPAF Human and Institutional Development unit and training records, from which the data would be reported in PPAF progress reports	▪ No significant assumptions
Management Support			
PPAF effectively managing the Microfinance Innovation and Outreach Programme	1. **<u>Programme disbursement as scheduled</u>** 2. Zero per cent portfolio-at-risk for programme-specific PPAF wholesale loans (overdue by more than 30 days) 3. 4 follow-up visits carried out by PPAF per participating PO, YPO and LPO per year 4 100% of agreed follow-up visit recommendations implemented on time	(1 and 2) PPAF financial records (3 and 4): PPAF follow-up visit database	▪ No significant assumptions

COST AND FINANCING

Expenditure Accounts by Components
Totals Including Contingencies
(USD '000)

	Innovation and Outreach Facility	Young Partner Programme: Young Partner Development Initiative	Young Partner Programme: International Linkage Partner Initiative	Young Partner Programme: Young Professionals Scheme	Support to Partner Organizations	Management Support	Total	Physical Contingencies: %	Physical Contingencies: Amount
I. Investment costs									
A. Vehicles	-	-	20	-	-	223	243	5.0	12
B. Equipment and materials	-	2	8	8	-	26	45	5.0	2
C. Training and workshops	-	23	174	12	236	335	780	5.0	39
D. Technical assistance and studies	-	75	10	-	1 090	495	1 670	-	-
E. Grant-supported activities									
1. I&O Grant-supported activities	10 667	-	-	-	-	-	10 667	-	-
2. YPP Grant-supported activities	-	1 758	868	52	-	-	2 678	-	-
Subtotal Grant-supported activities	10 667	1 758	868	52	-	-	13 345	-	-
F. Onlending funds									
1. Onlending funds for regular loans	9 083	1 475	1 567	-	-	-	12 125	-	-
2. Onlending funds for PSLW[a] loans	1 083	-	-	-	-	-	1 083	-	-
Subtotal onlending funds	10 167	1 475	1 567	-	-	-	13 208	-	-
Total investment costs	**20 833**	**3 333**	**2 646**	**73**	**1 326**	**1 080**	**29 292**	**0.2**	**53**
II. Recurrent costs									
A. Allowances	-	20	-	109	-	172	301	-	-
B. Staff remuneration	-	50	-	-	-	325	375	5.0	19
C. Operating and maintenance	-	37	15	57	-	143	252	5.0	13
Total recurrent costs	**-**	**107**	**15**	**167**	**-**	**640**	**928**	**3.4**	**31**
	20 833	3 440	2 661	240	1 326	1 720	30 220	0.3	85
Physical contingencies	-	6	11	4	12	53	85	-	-
Price contingencies									
Inflation									
Local	-	283	187	29	210	255	964	-	-
Foreign	-	0	0	0	1	2	4	-	-
Subtotal inflation	**-**	**283**	**187**	**30**	**211**	**257**	**968**	**-**	**-**
Devaluation	-	-216	-143	-22	-160	-195	-736	-	-
Subtotal price contingencies	-	67	45	7	51	62	233	1.2	3
Total programme costs	**20 833**	**3 513**	**2 717**	**251**	**1 388**	**1 835**	**30 537**	**0.3**	**88**
Taxes	1 067	195	104	9	126	136	1 637	0.4	6
Foreign exchange	-	5	19	13	26	54	116	3.5	4

[a] Private sector linkage window.

Disbursement Accounts by Financiers
(USD '000)

	IFAD		PPAF		POs		Total		For. Exchange	Local (Excl. Taxes)	Duties and Taxes
	Amount	**%**	**Amount**	**%**	**Amount**	**%**	**Amount**	**%**			
I. Equipment, materials and vehicles	252	81.0	59	19.0	-	-	311	1.0	-	252	59
II. Training, workshops, TA and studies	2 362	91.6	216	8.4	-	-	2 578	8.4	84	2 278	216
III. Grant-supported activities											
a. I&O grant-supported activities	8 533	80.0	-	-	2 133	20.0	10 667	34.9	-	9 600	1 067
b. YPP grant-supported activities	1 604	57.7	-	-	1 175	42.3	2 779	9.1	-	2 511	268
Subtotal grant-supported activities	10 137	75.4	-	-	3 309	24.6	13 446	44.0	-	12 111	1 335
IV. Onlending funds											
a. Onlending funds for regular loans	12 125	100.0	-	-	-	-	12 125	39.7	-	12 125	-
b. Onlending funds for PSLW[a] loans	1 083	100.0	-	-	-	-	1 083	3.5	-	1 083	-
Subtotal onlending funds	13 208	100.0	-	-	-	-	13 208	43.3	-	13 208	-
V. Salaries, allowances, operating and maintenance	497	50.0	497	50.0	-	-	995	3.3	31	936	27
Total programme costs	**26 456**	**86.6**	**772**	**2.5**	**3 309**	**10.8**	**30 537**	**100.0**	**116**	**28 785**	**1 637**

[a] Private sector linkage window.

IMPLEMENTATION ARRANGEMENTS AND RESPONSIBILITIES

Organizational Structure and Relationships

1. The management of the Innovation and Outreach Facility would be with the PPAF Chief Executive Officer and come under the direct responsibility of the Chief Operating Officer (COO). PPAF would employ seven additional staff, provided for under programme financing, to assist in managing the programme and in particular the Innovation and Outreach Facility. Six of these staff would become what PPAF refers to as Management Executives (MEs) and the other would be a level higher – manager-gender. The staff would be fully integrated as part of the PPAF's regular management structure and while the main part of their work load would be connected with supporting implementation of MI&OP activities, they would also be responsible for carrying out other PPAF work.

Decision Making and Management Arrangements

2. While overall decision making responsibility rests with PPAF's Chief Executive Officer, day-to-day responsibility for MI&OP implementation would be with the Chief Operating Officer and the heads of the participating operating units: Credit and Enterprise Development (CED), Human and Institutional Development (HID), Finance and Accounts (F&A) and Evaluation, Research and Development (ERD). To facilitate these units management of the programme, the following positions would be financed under the programme:

- *COO support position*, the allocation of this ME (*Management Executive MI&OP – COO*) would be decided within the first year of programme implementation, once the demands on PPAF management are better know.
- *HID support positions*, two MEs (*Management Executive I&O – HID and Management Executive Young Partner Programme – HID*) would be allocated to the HID unit, one to assist in the institutional support/training aspects of the I&O facility and the other to work with the Young Partners Programme. The responsibility of the former would be to help the POs to develop their proposals for the I&O facility, assessing proposals submitted and guiding the POs in the implementation and monitoring of the projects, and developing crosscutting themes.
- *CED support position*, this ME (*Management Executive I&O – CED*) would focus particularly on the credit and other financial products/services that would be developed within POs in projects funded from the I&O facility. Similar to his/her counterpart in HID (they would form a team), s/he would be work with the POs in developing proposals, assessing proposals submitted and guiding the POs in the implementation of the projects, and in their monitoring.
- *F&A support position*, the main responsibility of this ME (*Management Executive (MI&OP) – F&A*) would be to assume part of the work load, under the direction of the head of the unit, connected with the programme's financial management, procurement/tendering procedures,[1] disbursement arrangements, accounting, auditing and financial monitoring and reporting.
- *ERD support position*, the main focus of the work of this ME (Manag*ement Executive MI&OP – ERD*) would be the assessment of the results of the projects financed under the I&O facility. S/he would also assist the unit in developing their new operations and in providing general backup for the unit relating to the coordination of MI&OP M&E requirements.

[1] PPAF's Human Resources, Administration and Procurement unit would be responsible for procurement/tendering.

Implementation Arrangements by Component

3. **I&O Operations Manual.** The I&O Operations Manual would provide guidance, criteria and supporting information for implementation of each of the programme's four investment components. The Appraisal Report provides a working draft of the manual that has been reviewed, discussed in detail and agreed with PPAF. The implementation arrangements described under each of the components form a key part of the information contained in this draft manual.

4. **Innovation and Outreach Facility.** While the facility would be managed by PPAF, it would be the POs that determine its implementation and the type of projects that would be financed. The financing for each project would include the full costs for operating the project over its lifespan, say one to two or even three years. All costs would be included within the project budget: credit line or other form of financing, operating costs, capital costs (vehicles, equipment, furniture, etc.) and training costs. However, those costs linked to development of project ideas and exploration of crosscutting themes would not be included but rather provided for under 'Support for Partner Organizations'. Some of the key criteria, taken from the draft I&O Operations Manual, include:

As eligibility criteria, participating partner organizations shall:

- be registered POs of PPAF
- have active microfinance portfolios
- have a portfolio quality of no more than 5% portfolio-at-risk of loans with amount overdue more than 30 days
- be committed to integrating the successfully tested or up-scaled services in their regular product range
- have sufficient capacity to implement the proposed projects effectively
- have or be willing to develop a gender strategy.

Innovation projects to be supported shall:

- target exclusively households considered poor by PPAF and contribute directly or indirectly to the reduction of poverty and be gender focused
- are considered innovative by PPAF in the nature of the financial products, the way in which they are offered, their operational environment or their target group
- either be implemented in rural areas or have a strong up-scaling potential for rural areas
- be expected to reach financial self-sufficiency of supported services within the project period.

Initial up-scaling projects to be supported shall:

- significantly expand the access of the rural poor to financial services that have been successfully piloted previously
- have demonstrated solid potential for client demand, poverty reduction and sustainability
- be integrated in the applicant PO's regular operations
- reach financial self-sufficiency of the supported services within the project period

5. **Young Partner Programme.** The Young Partners Programme would be managed by the HID unit as an expansion of its current programme to promote the development of new POs and its support for the development of experts. The three schemes supported by the programme each have their own set of criteria that would enable PPAF to determine which organizations and which individuals would qualify to participate the schemes.

6. **Support for Partner Organizations.** Like the financing from the Innovation and Outreach facility, the funding available within this component would be used in response to demands from the POs. PPAF would orchestrate the demand and ensure that the POs that receive funding from it, either individually or jointly, meet the criteria as spelled out in the I&O operations manual.

Financial Management Responsibility

7. The Finance and Accounts (F&A) Unit of PPAF would be responsible for day-to-day financial management of the programme, including: funds disbursement, preparation of withdrawal applications, management of the Special Account and local currency accounts, financial reporting and arrangement for audits.

Pricing of Funds

8. The terms for pricing of funds are consistent with those provided for in the World Bank-financed PPAF II, as follows:

Government to PPAF

- *Credit funds for I&O facility, Young Partner Development Initiative and International Linkage Partner Initiative* – Government would on-lend IFAD funds to PPAF on the same terms as those provided to PPAF by government under PPAF II: at three quarters of one percent interest; with repayment over 23 years including a grace period of eight years. In line with IFAD's lending conditions, no commitment charge would be levied.
- *All other funds* – Government would provide IFAD funds for all other programme costs in the form of a grant to PPAF.

PPAF to Partner Organizations (including YPOs and LPOs)

- The CEO, together with participating unit heads, would be responsible for recommending the price of programme *credit funds* going to POs, YPOs and LPOs based on market conditions and the vision, mission and objectives of the PPAF, and when required recommending changes thereof to the PPAF Board.
- PPAF's Board would be responsible for authorizing revision in the price of *credit funds* provided to POs, YPOs and LPOs.
- All *other funds* would go to the POs, YPOs and LPOs on a grant basis, governed by terms and conditions as laid down in legal agreements between them and PPAF.

POs, YPOs and LPOs to Ultimate Beneficiaries

- Microfinance loans and other financial products, such as equity, micro-leasing, etc., would be on-lent to the ultimate beneficiaries at rates that, in the long run, fully cover their costs of intermediation, including all transaction costs, bad debts and cost of capital.
- In line with PPAF's current policy, PPAF would require that POs, YPOs and LPOs adopt lending rates that are, at a minimum, not below commercial banks' prevailing lending rates to avoid market distortions and abuse.

Monitoring, Evaluation and Reporting

9. **M&E Objectives and Approach.** The primary objective for programme M&E is ongoing real-time assessment of the outputs, outcomes of programme activities and how they contribute to programme objectives. The secondary objective is an ongoing assessment of the participating PO's performance as sustainable microfinance providers in order to ensure the security of on-funds. Integration of the programme's data collection and M&E management into PPAF's overall systems

would be an overriding criterion for the programme's M&E system, which would use the programme logframe as its structural anchor.

10. **Programme Monitoring.** The major part of the programme monitoring effort would be directed towards the POs, YPOs and LPOs, which together represent the main thrust of the programme and are the recipients of 90% of programme funding. PPAF's monitoring of the programme and the use of programme funds represents the other part. The design of the monitoring system is structured accordingly.

11. The key to PO monitoring and reporting would be the monitoring of their implementation of I&O projects. In addition to the project-by-project monitoring, POs, YPOs and LPOs would be required to report quarterly. A set of indicators has been developed to enable regular monitoring using parameters that are consistent with those of the Pakistan Microfinance Network and the Microfinance Information Exchange, thus facilitating the participating institutions' access to local and international information platforms.

12. PPAF's date generation and MIS relates mainly to data on management aspects of the I&O facility and the financing aspects for both grants and wholesale loans. The responsibilities for collecting the monitoring data and for data entry into the MIS would rest with the respective operations units within PPAF, particularly with the Credit and Enterprise Development unit. Programme monitoring would be fully integrated into PPAF's overall MIS, in that PPAF databases would contain both programme and non-programme information in an identifiable way. The design and evolution of the MIS would be the responsibility of the newly formed ERD unit and the programme-financed I&O Monitoring and Evaluation Adviser.

13. A limited array of appropriate monitoring indicators has been selected for the programme, wherever relevant, gender-specific data would be collected. In addition, PPAF would collect its implementation progress and impact data consistent with IFAD's RIMS anchor indicators. The indicators included in the Logical Framework have been selected bearing these requirements in mind.

14. **Programme Evaluation.** Baseline studies would be conducted: by the *POs*, in the form of a project-specific client survey at the beginning of the implementation of each I&O project, and by *PPAF*, which would mount a RIMS anchor indicator survey shortly after project start-up to assess the target group's situation regarding agreed household assets and child nutrition. The survey would cover 900 households and use the standard RIMS questionnaire form and IFAD-provided software.

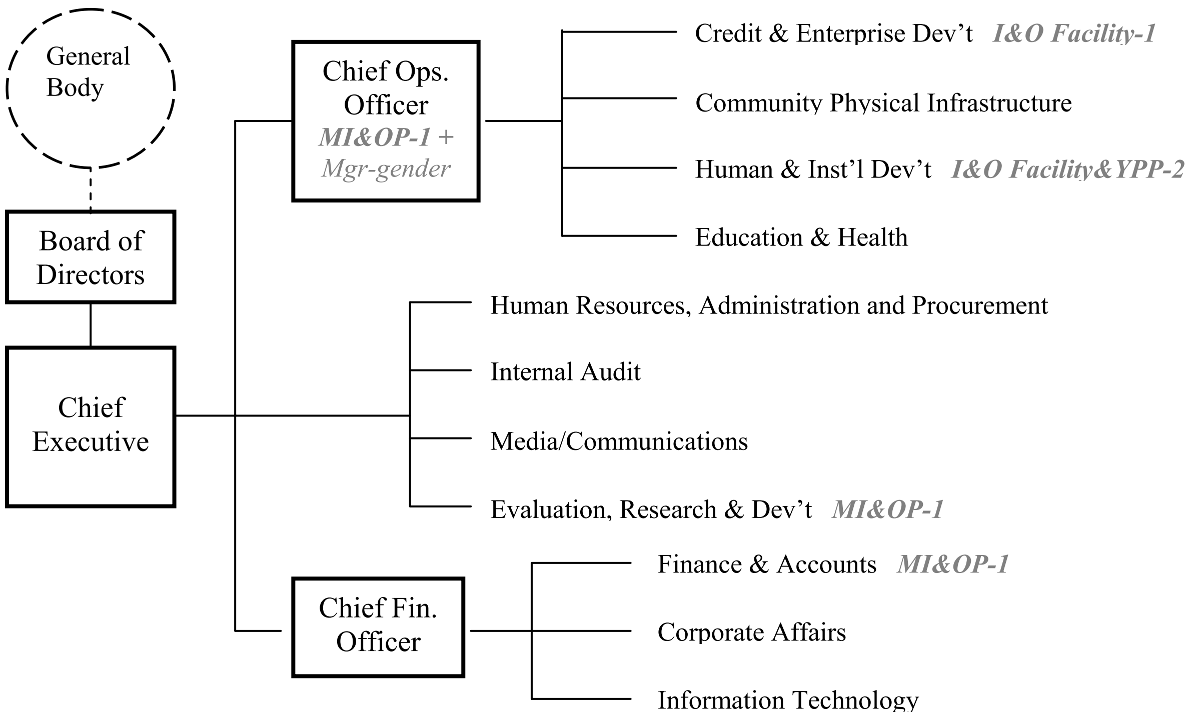
15. Impact assessment studies would be carried out by the *POs* in the form of client surveys at the end of the implementation of each I&O project, and through a second and third RIMS anchor indicator survey towards mid-term and at the end of the programme. In addition, *PPAF* would arrange thematic impact studies on particular aspects, including the five crosscutting themes/areas of focus.

Programme Supervision

16. The World Bank will be the Cooperating Institution for the programme. As it is already supervising its own programme for PPAF – PPAF II – there would be considerable synergies and cost efficiencies in having the World Bank supervise the new IFAD-financed programme.

ORGANIZATIONAL CHART

Management Structure of PPAF and Project Staffing



Note: Programme-funded unit staff in italics – number of positions

FINANCIAL AND ECONOMIC ANALYSIS

1. **Financial Analysis**. In financial terms, programme impact would be felt at three levels: first and foremost by the PO, YPO and LPO clients as the programme's prime target group, secondly by the participating institutions including PPAF, and thirdly by government. At all three levels, analysis shows that programme interventions would be financially viable. Firstly, the activities undertaken and enterprises operated by clients accessing the POs' financial services are represented by a typical family activity for which credit would be taken: a small-scale livestock enterprise. Secondly, PPAF's cash flow for the implementation period of the programme is analysed for the 'with programme' and the 'without programme' scenarios. Thirdly, the programme's financial impact on government is examined.

2. The clients of the PO, YPO and LPO – i.e. the programme beneficiaries – would improve their incomes as well as their savings rates as a result of their interaction with the financial institutions. Field visits combined with analysis of a number of enterprise models indicates a broad financial attractiveness of the types of activities that could be foreseen under the programme. This holds true for both short-term investment such as trading or veterinary care or for medium-term investments in, for example, livestock or small-scale processing or local transport. The typical and popular investment in buffaloes was analysed and found viable with a financial internal rate of return of about 58%. The regular income from this enterprise would thus allow the repayment of an investment loan with an effective interest rate of 30% and leave net revenue from the enterprise of about PKR 5 000 for a period of 12 months, equivalent to a return to labour of about PKR 100 per person-day.

3. For the POs, YPOs and LPOs, the financial attractiveness of the programme is based on their ability to develop new and financially viable financial products and approaches that would allow them to expand their portfolio on a sound financial basis. While it is not possible to determine what activities the POs would develop under the I&O facility, the models in Working Paper 3 indicate opportunities for financially viable operations, which in turn would help ensure good repayment levels and thus a positive return to the participating POs. In addition, one of the eligibility criteria for I&O projects is that the new piloted products demonstrate financial sustainability within the programme period. This requirement would also contribute to the POs' own financial sustainability and thus financial soundness. Regarding PPAF, a cash flow analysis of the institution demonstrates that the programme would result in a positive impact on PPAF's financial position, with a contribution of 3% to annual income. While this is small, it is still positive and is in fact a clear indication of PPAF's sound financial basis.

4. The financial return to government for the programme would also be positive. Government cash flow with the programme would result in a net positive effect on government finances of about USD 3.8 million at current prices.

5. **Economic Analysis**. Given the programme's emphasis on institutional support for the microfinance sub-sector, the flexible nature of the funds to be established under the programme and the diversity of types of institutions and thus applicable tax regimes, no economic analysis was carried out. However, the direct benefits would be reflected in the incremental number of rural institutions providing more efficient and client-responsive financial services. These benefits to the rural economy would be particularly evident in the increased outreach to under-banked areas, as measured in terms of the numbers of active clients and the size of the portfolios supported by the programme.