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PAKISTAN MICROFINANCE NETWORK

Turning a Mission into a Business:

The Story of SAFCO Support Foundation's Journey in Setting up a For-Profit Subsidiary

A CASE STUDY

Pakistan Microfinance Network

July, 2023

Disclaimer: views expressed in the paper is solely that of the authors and does not necessarily reflect the views of Pakistan Microfinance Network, SECP, SAFCO or other associated parties.

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ABBREVIATIONS

ADB	Asian Development Bank
AKRSP	Agha Khan Rural Support Program
AoA	Articles of Association
BISP	Benazir Income Support Program
CGAP	Consultative Group to Assist the Poor
KBL	Khushhali Bank Ltd
MFBs	Microfinance Banks
MF-CIB	Microfinance Credit Information Bureau
MFIs	Microfinance Institutions
MNOs	Mobile Network Operator
MoA	Memorandum of Association
NBFCs	Non-Banking Finance Companies
NBMFCs	Non-Banking Microfinance Companies
NGO	Non-Government Organization
NOC	No Objection Certificate
PMIC	Pakistan Microfinance Investment Company
PPAF	Pakistan Poverty Alleviation Fund
PMN	Pakistan Microfinance Network
OCT	Orangi Charitable Trust
SAFWCO	Sindh Agriculture and Forestry Worker Cooperative Organization
SBP	State Bank of Pakistan
SECP	Securities and Exchange Commission of Pakistan
SMCL	SAFCO Microfinance Company (Pvt) Ltd
SME	Small and Medium Enterprises
SSF	SAFCO Support Foundation
UN	United Nations
UPAP	Urban Poverty Alleviation Program

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History of Microfinance in Pakistan

Microfinance was pioneered in Pakistan in the 1960s through Comilla Pilot Project in former East Pakistan (present-day Bangladesh).

The microfinance sector saw a significant increase in the late 1990s due to the recognition of its crucial role in the growing economy. This led to the launch of several microfinance initiatives such as the KASHF Foundation (KF), the Urban Poverty Alleviation Program (UPAP) by the National Rural Support Program (NRSP), independent NGOs and MFIs, including Sindh Agricultural Forestry Workers & Coordinating Organization (SAFWCO) and the state-owned microfinance bank (MFB) Khushhali Bank Ltd. (KBL). The establishment of the Pakistan Poverty Alleviation Fund (PPAF) in 1999 as an apex funding body for the sector further boosted microfinance. Additionally, the promulgation of the Microfinance Ordinance 2001, strengthened the microfinance ecosystem by providing a framework for creating privately owned specialized Microfinance Banks (MFBs) under the supervision of the State Bank of Pakistan (SBP).

Since then, Pakistan's microfinance regulatory and business environment has only become stronger and has been consistently ranked globally among the top three for the past four years[1]. Pakistan became one of the first countries to issue guidelines pertaining to regulations for branchless banking in 2008, which proved to be an important catalyst for exponential growth in the digital financial inclusion space. This resulted in CGAP labeling Pakistan as a "laboratory for innovation" in branchless banking in one of its studies[2].

The microfinance sector has been at the forefront of poverty reduction and social advancement. This sector serves over 8 million clients across Pakistan. These 8 million clients would have otherwise been unable to attain services from the traditional banking sector and would be unable to lift themselves from the cycle of poverty. This sector is globally acknowledged as an important tool to reach the marginalized. For example, women make up a huge proportion of the total clientele. This

[1] The Economic Intelligence Unit (EIU) of the Economist magazine has rated Pakistan in the top three consistently now for four years. 'Global Microscope on the Microfinance Business Environment 2013', The Economist Intelligence Unit Limited, 2013. http://www.citigroup.com/citi/citizen/community/data/EIU_Microfinance_2013_Proof_08.pdf

[2] Branchless Banking in Pakistan: A Laboratory for Innovation, Consultative Group to Assist the Poor (CGAP), 2011. http://www.cgap.org/sites/default/ files/CGAP-Brief-Branch-less-Banking-in-Pakistan-A-Laboratory-for-Innovation-Oct-2011.pdf

has allowed them to improve their livelihoods, improve the health and nutrition of their families, and enabled them to a better social standing where otherwise social norms would not allow them such social advancement.

The Microfinance Institutions Ordinance 2001 provides the framework within which MFBs have been established in the country under the regulatory supervision of SBP. The central bank has also been playing a key role in providing strategic direction to the sector and proactively making policy adjustments, in consultation with sector players to provide an enabling environment for MF over the years.

In tandem with the SBP, the SECP recognized the strategic significance of accessible lending in the microfinance sector and acknowledged the requisite shift towards a regulated model in this domain. As a result, SECP established the regulatory framework for Non-Bank Microfinance Companies in 2015 to formalize the unregulated microfinance institutions in Pakistan.

Hence, the microfinance landscape in Pakistan is divided into two categories: Microfinance Banks (MFBs) overseen by the State Bank of Pakistan (SBP) and the Non-Bank Microfinance Companies (NBMFCs) overseen by the Securities and Exchange Commission of Pakistan (SECP). While MFBs are authorized to take deposits and provide financial accounts such as savings and current accounts, NBMFCs are not authorized to do so. Although, most MFIs have also obtained licenses as Non-Bank Microfinance Companies (NBMFCs), but they still operate as not-for-profit entities and are therefore unable to attract equity investors or distribute dividends.

It is pertinent to acknowledge that the microfinance industry has matured and institutional-level business models have evolved, several microfinance providers (MFPs) have moved from traditional group-based lending to individual loans. Secured lending, particularly in the form of gold-backed loans, has also increased among MFBs. Loan sizes are increasing and practitioners are gearing up to lend not only to micro-enterprises but also to the lower end of the small and medium enterprise (SME) market, low-cost private schools, and affordable housing. Focus has shifted from lending in rural areas to urban, semi-urban, and rural areas as practitioners diversify their target market beyond agriculture-based businesses. Moreover, MFPs are not just offering credit products but also focusing on value-added products/services such as saving, micro-insurance, and remittance-related services.

Therefore, it is crucial for the microfinance sector, particularly the NBMFCs, to grow and expand, as there is a vast market for microfinance services, and the socio-economic progress of many marginalized communities relies on it.

Despite this, there remains a lingering question: What is the significance of being apprehensive about NBMFC's capacity to grow its activities and offerings?

While NBMFCs hold promise for growth into critical sectors such as micro-enterprises, affordable housing, sustainable energy, and budget education, their capacity to expand operations and outreach has been limited by their non-profit status, preventing equity investment. In contrast, MFBs have demonstrated consistent progress and expansion due to their financial autonomy and established business models, enabling them to readily adapt to industry shifts.

As highlighted above, MFBs expand primarily due to their convenient access to capital, encompassing both debt and equity, in addition to retail deposits and backing from financially strong sponsors. Conversely, non-profit NBMFCs depend mostly on donor funding, retained earnings, and debt from wholesale lenders or other financial institutions, ultimately raising the cost of financing. As a result, NBMFCs confront challenges with liquidity due to restricted funding sources, which limits their ability to expand their operations.

Over the last decade, the NBMFC’s dependence on donor funding and subsidies has reduced which has induced the need for financial independence, self-sufficiency and sustainability.

Additionally, as highlighted above; NBMFC’s operation often hinges heavily on international grants and donations. This funding model presents a couple of significant challenges, especially in light of Pakistan's ongoing efforts to comply with the Financial Action Task Force (FATF) guidelines. Relying heavily on international grants and donations makes these organizations susceptible to fluctuations in funding availability due to changing donor priorities, global economic conditions, or geopolitical issues. This lack of financial stability disrupts the continuity of services provided by NBMFCs, ultimately impacting the vulnerable populations that depend on them.

Moreover, Pakistan has been under scrutiny by the FATF, which has identified areas where the country needs to strengthen its anti-money laundering (AML) and combating the financing of terrorism (CFT) measures. For NBMFCs, the push for compliance with FATF standards means stricter regulations and higher compliance costs. This poses a challenge as they need to establish robust systems to monitor and report suspicious transactions, which requires additional resources, both in terms of finances and technical expertise.

It's also important to emphasize the actions taken by the SECP in response to the Covid-19 pandemic. SECP offered various relaxations and exemptions to NBMFCs to help mitigate potential liquidity problems and facilitation of the borrowers. In this regard, NBMFCs were permitted to defer principal repayments and reschedule loans, a step that protects the credit status of borrowers. Similarly, the Pakistan Microfinance Investment Company (PMIC), the principal wholesale lender to the NBMFCs, was authorized to facilitate NBMFCs on similar terms by deferring principal repayments and rescheduling NBMFCs loans.

An amendment was made in the NBFC Regulations, 2008 for allowing NBMFCs to access credit lines from their wholesale lender to strengthen their equity base. This amendment has enabled PMIC to extend unsecured finance to NBMFCs, up to 10% of its own equity and hence, NBMFCs can now avail unsecured subordinated loans from PMIC. An additional provision now allows the wholesale lender to increase its exposure to a single NBMFC by an extra 10%, thereby significantly boosting its capacity to support NBMFCs. Further, in order to provide ease of doing business, NBMFCs have also been permitted to take on exposure against unsecured debt security or an instrument issued by NBMFCs according to its internal policy, with no need for credit rating requirements for such securities.

The aforementioned challenges and drawbacks encountered by NBMFCs, along with the progress and financial security of MFBs, the aftermaths of Covid-19 and stringent FATF requirements highlighted the necessity of transforming non-profit NBMFCs into for-profit entities. To this end, the SECP collaborated with PMN to organize multiple awareness-raising sessions for the industry, outlining the fundamental steps for non-profit NBMFCs to establish for-profit subsidiaries.

SAFCO Support Foundation (SSF) is a renowned non-profit NBMFC operating in Sindh Province that has capitalized on the opportunity to establish itself as the first NBMFC to create a for-profit subsidiary. This highlights the significance of recognizing and resolving challenges within the industry, as demonstrated by the formation of Safco Microfinance Company (Private) Limited (SMCL).

History of SAFCO

SAFWCO was founded in the late 1980s as an NGO registered in Societies Act by Mr. Suleman G. Abro and his few friends in response to the underdevelopment and low living standards in Sanghar, Sindh. Its primary objective was social mobilization through micro-loans to help people self-develop and improve their living conditions.

In 2009, SAFWCO spun off its microfinance operations into the SAFCO Support Foundation (SSF), a not-for-profit organization. SSF was registered with the SECP as a public limited company under Section 42 of the Companies Ordinance 1984 and lately the Companies Act 2017[3]. SAFWCO was the pioneer and first NGO MFI who take a lead to separate microfinance operations from development operations and registered a specialized microfinance public limited company. Since its inauguration until 2022, , SSF had served over 850,000 customers through its branch network in Sindh.

SAFCO Support Foundation (SSF) has been pioneers in promoting community development, particularly in District Sanghar, within the province of Sindh. The institution's goal is to provide financial inclusion to the underprivileged, and it has impacted thousands of households through its range of products and services. As a socially responsible organization, SSF has implemented a "targeting Ultra-Poor" strategy, and it has created products aimed at addressing the nutritional needs of undernourished children who may lack proper schooling and social opportunities. Recognizing the need for a formalized and systematic approach to support economic development at the grassroots level, SSF has acquired the status of an NBMFC, thereby becoming a specialized microfinance institution.

SSf's efforts also focus on integrating women into the formal economy. The company has provided lending products to over 800,000 borrowers aimed at supporting livelihoods, with

[3] SAFCO Support Foundation A Non-Banking Finance Company (NBFC): Company Profile and Investment Proposal

women making up 61% of their borrowers. These products range from agricultural loans to education loans, which women can access without the need for collateral. SSF collaborates with the Benazir Income Support Program (BISP) to identify populations in need of financial assistance, and it partners with the Pakistan Poverty Alleviation Fund (PPAF) to provide unconditional cash transfers to deserving beneficiaries. Additionally, SSF is one of the partner organizations for the Prime Minister's Interest-Free Loan scheme, which places an emphasis on women's empowerment, with a majority of female clients benefiting from the program.

Breaking Boundaries: How SSF Overcomes Funding Constraints through For-Profit Subsidiary

Because of SSF's extensive product portfolio and outreach, it has become a prominent player in aid and development initiatives, garnering interest from the UN and other multilateral organizations, as well as being a potential partner for the Pakistan Microfinance Investment Company (PMIC). However, despite the high demand for its services, SSF has faced funding constraints due to its inability to accept deposits and lack of shareholder equity.

Additionally, in Pakistan, NBMFCs can only receive funding from the Pakistan Microfinance Investment Company (PMIC), a wholesale lender. Local commercial banks offer very limited financing options to NBMFCs due to their non-profit status and voluntary governance structure. As a result, NBMFCs are facing difficulties in securing funding, which was a significant motivating factor for SAFCO to consider transforming into a for-profit NBMFC.

Consequently, in order to abridge the liquidity constraint issue, SSF considered to set up a for-profit subsidiary named as SAFCO Microfinance Company (Private) Limited (SMCL) incorporated under Companies Act, 2017 and licensed by the Securities & Exchange Commission of Pakistan (SECP) under the NBFC Regulatory Framework. SMCL operates with the aim of seeking multiple investment opportunities from reputed investors globally to raise equity investments on retained earnings basis and to raise more investment opportunities from private investors on competitive rates.

The incorporation of SMCL has provided an avenue for additional funding to expand its range of products and services and target new potential market segments of society. By 2023, SMCL has expanded its outreach to over 120,000 borrowers with a Gross Loan Portfolio of over PKR 3.9 Billion. It has branches in over 13 districts of Sindh.

At present, SMCL has a range of funding partners from both national and international sources, and is currently in talks with several local and international equity investment firms. The management of SMCL is optimistic that by 2024, they will be able to secure external equity shares in accordance with their projected expectations.

From Non-Profit to For-Profit: A Step-by-Step Process to Establishing a For-Profit Subsidiary NBMFC

There are around 8 million microfinance borrowers with a Gross Loan Portfolio of over PKR 300 billion. The sector has over 3,700 branches but still lacks outreach to the marginalized and to the vast segments of the population which still are under-banked. Pakistan Microfinance Network (PMN) notes that only 20% of the market for microfinance services is tapped. This is noted by the practitioners as well[4], that the potential of business in this market is untapped.

Over the decade, microfinance banks and microfinance institutions have seen a comparable increase in their customer base. However, microfinance banks hold 75% of the asset base, while Non-Banking Financial Companies only account for 25%. Microfinance Banks rely on commercial debt and equity, whereas Non-Banking Microfinance Companies primarily rely on retained earnings to meet their equity requirements as they struggle to attract commercial investors due to their non-profit status and hence are unable to scale up their interest and get commercial investors on board to provide growth capital .

It was, thus, tantamount for SSF to benefit from the latest SECP regulation allowing establishing a for-profit entity i.e. SMCL as a subsidiary of SSF to allow them to reach out to investors and expand their funding sources.

[4] 6th Annual Microfinance Conference (AMC6) – Pakistan Microfinance Network - YouTube

[5] Transformation of NBMFCs to For-Profit-28-01-21 (005), Securities and Exchange Commission of Pakistan

The following were the transformation steps taken by SAFCO in the journey to for-profit conversion:

Step 01: Planning and Preparation

- Board Approval for Transformation of SSF to a Private Limited Company under the legal provisions
- Transformation proposal Development under regulatory provisions and Intimation of transformation to SAFCO existing Investors and donors
- Submission of the proposal to the regulator (SECP) and discussion under the regulatory obligations of transformation
- Selection of the directors and Nomination of Shareholders, board structure, management structure for the new company under the regulatory obligations i.e. fit & Proper Criteria

Step 02: Incorporation of SAFCO Microfinance Company

- Agreement with a Legal Advisor for the company Incorporation
- Written Approval from SECP for formation of new subsidiary Company
- Appointment of CEO and approval from SECP
- Selection and Reservation of New Company name with SECP
- Selection of Directors and Independent Directors
- Submission of New Company Incorporation Application to SECP along with Fee
- Acquire NOC from the Investors
- Development ad submission of Memorandum of Association (MoA) and Articles of Association (AoA)
- Third party audit to determine fair value of assets and liabilities
- Apply for NBFC License after completion of the incorporation completion

Step 03: Business Transformation and Business Commencement from SSF to SMCL

- Transfer of all the Net Assets and Liabilities to SMCL
- Opening of CDC account
- Renewal of Partnership Agreements with all the stakeholders under the new legal structure of SMC
- Signing of Novation Agreement with all existing lenders provided NOCs
- Opening of the Bank Accounts
- Surrendering of SAFCO Support Fou

SSF's Timeline for the Transformation

The entire process took less than six months, with a major portion of the time being dedicated to obtaining No Objection Certificates (NOC) from lenders who had extended credit lines to SSF. Such NOCs are required since the conversion of the company from non-profit to for-profit brings about a change in its balance sheets, including assets and liabilities, as well as legal implications for existing contracts.

The transformation was in four phases: planning and preparation, seeking permission of SECP for incorporation of the Microfinance Company, grant of license to newly incorporate for-profit subsidiary and then the transformation of assets and liabilities from SSF to SMCL.

The first phase included a Board Resolution, which was also SECP's initial requirement. All creditors, investors, and stakeholders were informed for seeking their NOCs. This development was submitted as a proposal with details of NOCs and plans to transform the company under the regulatory frameworks. The permission from SECP was granted for fulfilling the requirements in 6 months before applying for the lending license as per NBFC Rules 2003, along with providing Auditors certifications and appointing a CEO and Board of Directors (including independent directors).

The second phase included incorporating the company. After consultation with legal advisors and SECP approval, the new company was incorporated, the MoA and AoA were presented to the selected directors and the registration fee was paid. A new bank account was opened to fulfill minimum equity requirements and was certified by an auditor. After completing this stage, the final stage was applying for NBFC License for the incorporated company.

The final phase was the transformation of SSF to SMCL. Within 4 months, the license was acquired. All net assets and liabilities (on the basis of NOC from credits and stakeholders) were transferred to the SMCL. An account was opened with the Credit Depository Company (CDC) for depositing the company's promoters or majority shareholders and directors' shares in an account marked as blocked. The new company also had to file tax returns, which previously as non-profit were exempted. Upon filing the returns, convening the first Annual General Meeting and abiding by regulatory requirements, the SAFCO Support Foundation NBFC license acquired in 2016 was surrendered and SMC started operations on the 1st of August 2022.

Overcoming the Odds: Navigating the Challenges Faced by SSF

SSF faced challenges in this transformation on three fronts: with the regulator (SECP), with creditors and the internal changes. Of these, the most time-consuming, as noted during conversations with SSF and SECP, was seeking the creditor's NOCs and signing the novation agreements.

The Companies Act of 2017 does not contain a provision for non-profit organizations to directly convert to for-profit entities. However, the SECP has been addressing this issue by identifying legal gaps and providing legal support to allow non-profit entities to surrender their existing business license and become parent entities of a for-profit NBFC, which is the path that SSF has taken. SSF's management acknowledges to supportive role of the Securities and Exchange Commission of Pakistan (SECP) in this move, particularly because SSF was the first organization in the industry to take this step.

Since non-profits have tax relaxations and are legally structured in a very different way, the assets and liabilities of SSF could not directly be transferred to a for-profit company. Each creditor, including the SBP, had to be contacted at their internal departmental level (i.e. legal and risk management departments) to fulfill their legal requirements in converting their contractual obligations to the new for-profit company. As mentioned earlier, these NOCs and legal procedures were the most time consuming.

The internal changes in an entity are significant as that plays a vital role in how well the first two challenges play out. The policies and procedures from the board level to the managerial level inside SSF changed. New systems were to be developed. The Audit Committee was at the forefront of ensuring compliance throughout since dual audits had to be conducted, across SSF and SMCL. Moreover, the Integrated Information Management System had to be developed further which would integrate digitalized channels for customer appraisal, risk assessment and onboarding. A new Human Resource system was also implemented and the company invested heavily in Information Technology and Data Security.

In addition, SMCL has reviewed its internal policies and procedures in accordance with the Companies Act 2017, and the revised policies and procedures have been approved by the SMCL board. Staff training and orientation on the updated policies and procedures have also been conducted..

Cozying up to Change: Navigating Internal Transitions with Ease

As noted by SMC's senior staff, the biggest internal change was the company culture. Corporate culture plays a vital role in how a company works and looks at itself. The employees of SSF were required to change their mindset and their own vision, as they were now part of a company that seeks to maximize profit rather than the objective of social development. This includes non-tangible and uncountable changes in behaviors and the way the employees approach their everyday tasks.

The business development side of the company also saw significant changes in its marketing and branding. Even though non-profits have brands too, they do not have the resources and the will to invest further in marketing strategies. SMCL has revamped its image by investing in every office and branch and ensuring a match of color schemes, logos, and uniformity in how they want its customers to now know them.

There are some changes to the products and services offered as well. Non-profit are bound by a single object and limited by the service they wish to provide, as well as by their ability to expand their operations into business ventures. SMCL has diversified their products and services and now offers two ranges of services. Firstly, microcredit loans covering the sectors of agriculture, livestock, enterprises (small and medium), education, solar and renewable energy, housing and personal loans. Secondly, microfinance "Plus" services which include insurance, business counseling, training and literacy, value and supply chain integration. They have also established emergency funds and now invest more in research and development.

Bridging the Gap: Overcoming the Limitations of Non-Profit Organizations

Non-Profit Companies are registered Under Section 42 and are not allowed to give dividends. The main criteria of the License by SECP are:

"A not-for-profit association applies its profits and income in promoting its objects only and prohibits the payment of any profits, dividends or income proceeds to its members"[6]

The Object is the main activity or social cause an entity is registered to pursue. SSF's main objective pre-2022 was poverty alleviation and community development. However, there are three challenges to improving their business and expanding to serve more clients while staying a non-profit.

With 62 branches and over 850,000 customers served, SSF was growing and needed additional capital to scale up its operations. The object of SSF, and many non-profits, is social advancement through poverty alleviation. Non-profits working in the microfinance sector face significant hindrances in expanding their business due to a lack of capital and financing. Since non-profits do not pay dividends or proceeds from their income, there is a lack of interest from investors, shareholders, and even creditors such as commercial banks which might deem non-profits are riskier borrowers.

Succession planning and equity injection into an NGO is limited. Because there are no dividends that investors can seek, NGOs have limited equity and capital injection. As an NGO, SSF was less attractive as an investment than the for-profit SMCL. As far as succession planning is concerned, for-profit company shares can be transferred to the next-of-kin.

From Good to Great: Unleashing the Advantages of For-Profit Entity Status

While SSF acts as SMCL's holding company and fulfills its social advancement objectives through small quantum of interest-free micro-credit, social development projects and Corporate Social Responsibility (CSR) Initiatives; SMCL, on the other hand, offers micro-loans and conducts everyday business in order to make a profit.

[6] Section 42 of the Companies Ordinance 1984 | SECP

SMCL, being a for-profit entity, is able to market itself in the financial markets. Relying on debt as the only source of funding does not meet sustainable capital needs. SMCL is able to raise and generate equity in order to enlarge its balance sheets.

There is also enough evidence to suggest that for-profit entities are able to expand their financial services far greater than non-profit organizations. This evidence stems from the fact that non-profit entities have only enough resources to fulfill their objectives in a relatively smaller geographical area. For-profit entities establish business networks and attract resources to be able to expand, such as microfinance banks compared to microfinance institutions.

SAFCO's vision of improving efficiency, cost reduction, and improvement in employee performance was hindered due to being a non-profit and having a more relaxed organizational culture. As per their President & CEO Mr. Suleman G. Abro, the move from non-profit to for-profit changed the company's culture while improving performance and efficiencies which are instilled from the grassroots to the upper management. Non-profits also tend to be slower in processes, due to a lack of resources to hire new staff or buy new technologies.

Moreover, the transformed for-profit company will become a shareholding institution in which owners have vested interests and liabilities and responsibilities more clearly defined. As per SSF management, "they understand that with the improved and diversified owned governance, the company will lead to more improved robust procedures in setting strategic plans, positioning the SMCL in the market, responding to emerging crises, and leading the management executives efficiently and effectively". SSF has expanded its board and management to cater to increasing business, which is further expected to streamline and improve its productivity and internal procedures. It gives confidence to banks and other lenders specifically regarding governance and risk management practices.

Possible Drawbacks for Transforming to For-Profit

Non-Profit companies operate for the fulfillment of defined social objectives. Poverty alleviation, for example, is one of those objects achieved through micro-loans and enterprise support. SSF has had a tremendous impact in creating better livelihoods and improving the quality of life across numerous districts in Sindh. It is possible that going for-profit, SMCL's management will have interests along the lines of better governance and improving stakeholder satisfaction rather than as focused on the objective of SSF.

On similar lines, non-profit companies are able to secure grant-funded projects and welfare projects. SSF themselves have worked with numerous donor interventions in the form of the installation of water supply systems across numerous districts. For-profit companies may find it difficult to secure such grants and welfare projects.

The other possible long-run misalignment with SSF's core object is the influence profit-making and stakeholder value will have on the services offered by SMCL. SSF started as zero-interest loans, as mentioned above, with the objective of helping the poorest improve their livelihoods and quality of life. SSF has also been at the forefront of improving communities around areas of water supply and sanitation. However, there is no example in Pakistan of a for-profit microfinance institution that offers interest-free loans.

The possibility of a mission drift is vital to understanding how regulators must approach the conversion of NGOs to for-profit entities in the future. This was one of the points of discussion with SECP as well, as mentioned above. A drawback of profit-seeking is that MFIs serve either wealthier clients or reduce their risks by reducing loan amounts in collateral-free contracts. Increasing loan sizes is one measure of mission drift. The impact, however, will be measurable after a few years.

Corporate income taxes for corporations are, as of 2023, 29%. Since SMCL is a for-profit entity, it is liable to pay corporate taxes on profit. Furthermore, there is no provision for tax-relaxations for companies which have recently transformed from being a non-profit. This can lead to a tax burden as the newly formed entity is focused on its internal developments and may already be incurring numerous challenges: in their time/energy/efforts and costs.

Maximizing the Benefits of Entity Transformation: Key Suggestions

Newly transformed for-profit entities should be granted a tax waiver for the first five years to help ease their tax burden of

29% (basic), which is often accompanied by Income-Level tax slabs. This tax holiday, similar to the one provided to microfinance banks (MFBs) a decade ago, would facilitate the transformation of entities like SAFCO. For this, SMCL has approached to SECP and submitted tax proposal to further submit with FBR for consideration.

Another recommendation to enhance lending outcomes for clients is to revise lending limits based on the company's for-profit status. Specifically, lending limits may be reorganized up to PKR 3 million, or based on the company's Capital Base, with companies having a higher Capital Base being allowed higher lending limits.

Steps by the Policy-Maker

The SECP is taking actions to tackle the challenges identified in the case study by implementing measures to fill the gaps in the existing regulatory framework. As part of these efforts, the SECP is currently working on introducing provisions that would enable non-profit companies to convert to for-profit companies. This includes creating a mechanism for Non-Bank Microfinance Companies to convert from non-profit section 42 companies to for-profit companies, which would allow them to attract equity investors, access capital markets and commercial funding sources, and expand their operations without being subject to provincial Charities Acts or other legacy issues.

Furthermore, with regards to the proposals of tax holiday and reevaluation of lending limits for NBMFCs, the SECP is carefully examining these proposals and considering their implementation in the best interest of the industry.

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Achieving Together

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