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Managing environmental turbulence in
the microfinance sector - a case study of
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Ashfaq A. Khan
University of Wollongong

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**MANAGING ENVIRONMENTAL TURBULENCE IN THE
MICROFINANCE SECTOR — A CASE STUDY OF THE
AGA KHAN RURAL SUPPORT PROGRAMME IN
PAKISTAN**

A thesis submitted in fulfilment of the requirements for the award of the degree

DOCTOR OF PHILOSOPHY

from

UNIVERSITY OF WOLLONGONG

by

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Bachelor of Business Administration (Gold Medallist) (University of Peshawar, Pakistan), Master of Business Administration (Accounting and Finance) (Second Position in Order of Merit), (University of Peshawar, Pakistan), Diploma in Banking (The Institute of Bankers in Pakistan, Karachi, Pakistan)

**SCHOOL OF ACCOUNTING AND FINANCE
UNIVERSITY OF WOLLONGONG, AUSTRALIA**


2008

AUTHOR'S CERTIFICATION

I, Ashfaq Ahmad Khan, certify that this thesis, in whole or any part thereof, has not been previously submitted for any other degree, and is the outcome of my own research.

I further certify that all sources resorted to or any help received in preparing this thesis have been fully acknowledged in the thesis.

Signed: _____

A handwritten signature in black ink, appearing to be 'Ashfaq Ahmad Khan', written over a horizontal line.

Ashfaq Ahmad Khan

ACKNOWLEDGEMENT

I am grateful to my God for having guided me at every stage in my life. For sure, I wouldn't have made it to this point without His (swt) continuous support and guidance.

Many individuals have had contribution to the successful completion of this thesis.

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Dedication

This thesis is dedicated to my parents whose love I have witnessed throughout my life, and whose sincere supplications to God regarding me have saved me from going astray in my life; and to my wife, Khalida, whose company and deep sincerity gave me the strength to accomplish this task.

Table of Contents.....	i
LIST OF ACRONYMS.....	VI
LIST OF TABLES	VII
LIST OF FIGURES	VIII
LIST OF APPENDICES.....	IX
ABSTRACT	X
CHAPTER 1: INTRODUCTION	1
1.1. MICROFINANCE PREVIEW.	1
1.1.1. THE ‘WELFARIST’ APPROACH.	5
1.1.2. THE ‘INSTITUTIONIST’ APPROACH.....	6
1.2. THE CHANGED ENVIRONMENTAL CONDITIONS.	9
1.2.1. EMPHASIS ON PROFITABILITY AND SELF-SUSTAINABILITY.	12
1.2.2. COMPETITION AMONG MFIS AND NEW GOVERNMENT REGULATIONS.	13
1.3. THE MFIS’ RESPONSE TO THE CHANGED EXTERNAL CONDITIONS.	14
1.4. THE CASE STUDY.	15
1.4.1. THE MICROFINANCE SECTOR IN PAKISTAN.	16
1.4.2. THE RESEARCH SITE.....	18
1.4.3. THE RESEARCH ISSUE.....	19
1.5. THE THEORETICAL FRAMEWORK FOR THE STUDY.	20
1.6. THE RESEARCH METHOD.....	23
1.7. OBJECTIVES OF THE STUDY.....	25
1.8. SIGNIFICANCE AND EXPECTED OUTCOMES.....	26
1.9. ORGANIZATION OF THE THESIS.	27
CHAPTER 2: MICROFINANCE – A LITERATURE REVIEW	31
2.1. MICROFINANCE – A PREVIEW.....	31
2.1.1. WHAT IS MICROFINANCE?.....	33
2.1.2. WHY MICROFINANCE?	36
2.2. THE TERMS ‘POOR’ AND ‘POVERTY’.	38
2.3. MICROFINANCE INSTITUTIONS (MFIS) – THE INTERMEDIARIES.	41
2.3.1. SIGNIFICANCE OF MFIS IN THE FINANCIAL SECTOR.	45
2.4. SIZE OF THE MICROFINANCE INDUSTRY.....	46
2.5. THE EXTENT OF SUCCESS OF MICROFINANCE.....	47
2.5.1. THEORETICAL PERSPECTIVE AS DISCUSSED IN THE LITERATURE.	49
2.5.2. REAL LIFE PERSPECTIVE – MIXED EVIDENCE OF SUCCESS.....	50
2.6. THE NEED FOR EFFICIENT MANAGEMENT OF MICROFINANCE PROGRAMS.	52
2.6.1. REPLICATION OF GOOD PRACTICES.	52
2.6.2. ENSURING LOW DEFAULT RATES.....	54
2.7. THE SUCCESS OF THE MICROFINANCE EFFORT.	55
2.7.1. FROM THE MICROFINANCE INSTITUTIONS’ PERSPECTIVE.	58
2.7.2. FROM BORROWERS’ PERSPECTIVE.	60
2.8. EMPHASIS ON SELF-SUSTAINABILITY.....	62
2.8.1. THE WELFARISTS’ APPROACH.....	63
2.8.2. THE INSTITUTIONISTS’ APPROACH.	64
2.9. THE REASONS FOR THE SHIFT IN THE MICROFINANCE PARADIGM.....	67

2.10. THE IDEAL COURSE OF ACTION FOR MFIS AFTER THE PARADIGM SHIFT.	68
2.11. SUMMING UP.	70
CHAPTER 3: MICROFINANCE’S TASK IN PAKISTAN	72
3.1. BRIEF COUNTRY PROFILE.....	72
3.2. OVERVIEW OF PAKISTAN’S ECONOMY.	73
3.2.1. ECONOMIC STRUCTURE.	73
3.2.2. DEMOGRAPHY.	74
3.2.3. ECONOMIC GROWTH AND PERFORMANCE.	74
3.2.4. POVERTY LEVELS — ACHIEVEMENTS AND FUTURE CHALLENGES.	76
3.3. MICROFINANCE EFFORTS IN PAKISTAN – AN OVERVIEW.....	81
3.3.1. BACKGROUND.	81
3.3.2. DEMAND FOR AND SUPPLY OF MICROFINANCE SERVICES.	83
3.3.3. WHY MICROFINANCE?	84
3.3.4. THE MODERN MICROFINANCE MOVEMENT.....	85
3.4. ASSESSING MICROFINANCE SUCCESS IN PAKISTAN.....	87
3.5. ISLAM’S VIEW ON POVERTY ERADICATION.....	90
3.6. CHARACTERISTICS OF MICROFINANCE PROGRAMS IN PAKISTAN.	92
3.6.1. RELIGIOUS THOUGHT — THE PROHIBITION OF ‘INTEREST’	94
3.6.2. LOW COVERAGE AND TARGETING INEFFICIENCY.	95
3.6.3. INADEQUACY OF THE FINANCIAL SUPPORT.	96
3.6.4. DEPENDENCE ON DONORS.....	96
3.7. FUTURE DIRECTIONS FOR MICROFINANCE PROGRAMS IN PAKISTAN.....	96
3.8. REGULATIONS FOR THE MICROFINANCE SECTOR.....	97
3.9. SUMMING UP.	99
CHAPTER 4: THEORETICAL FRAMEWORK.....	101
4.1. BACKGROUND.	101
4.2. THE ENVIRONMENTAL ‘DISTURBANCE’ OR ‘IMPETUS’ OR ‘JOLT’.....	103
4.3. THE CASE OF THE AGA KHAN RURAL SUPPORT PROGRAMME.	104
4.4. THE ESSENCE OF INSTITUTIONAL THEORY.	105
4.5. INSTITUTIONAL ELEMENTS AND ORGANIZATIONS.....	108
4.5.1. THE COERCIVE INFLUENCE.	108
4.5.2. THE MIMETIC INFLUENCE.	110
4.5.3. THE NORMATIVE INFLUENCE.	111
4.6. ORGANIZATIONAL RESPONSE TO INSTITUTIONAL PRESSURES.....	112
4.7. INSTITUTIONAL ISOMORPHISM.....	113
4.8. VIEWING MICROFINANCE FROM AN INSTITUTIONAL PERSPECTIVE.	115
4.9. MICROFINANCE AND INSTITUTIONAL DEVELOPMENT.....	116
4.9.1. MICROFINANCE PROGRAMS AND LOCAL INSTITUTIONS.	117
4.9.2. COMBINING TWO THEORETICAL FRAMEWORKS TO BETTER EXPLAIN ORGANIZATIONAL CHANGE.	118
4.10. THE TWO THEORETICAL FRAMEWORKS USED IN THIS STUDY.	119
4.10.1. PASSIVE SUBMISSION TO ENVIRONMENTAL PRESSURES — WHY DID THE AKRSP NOT RESIST THE CHANGE?	120
4.10.2. ORGANIZATIONAL TRANSFORMATION AND INSTITUTIONALIZATION.	123
4.11. ORGANIZATIONAL ‘TRANSITION’ OR ‘TRANSFORMATION’.	125

4.11.1. THE EXTERNAL ‘DISTURBANCE’ — PENETRATION INTO THE STRUCTURES.....	127
4.11.2. ORGANIZATIONAL RESPONSE.....	129
4.11.2.i. <i>Inertia</i>	131
4.11.2.ii. <i>Rebuttal</i>	131
4.11.2.iii. <i>Reorientation</i>	132
4.11.2.iv. <i>Colonization</i>	134
4.11.2.v. <i>Evolution or Transformation</i>	136
4.11.3. WHY LAUGHLIN’S MODEL?	138
4.12. SUMMING UP.	139
CHAPTER 5: RESEARCH METHODOLOGY	141
5.1. THE RESEARCH PARADIGMS.....	141
5.1.1. THE POSITIVIST OR QUANTITATIVE PARADIGM.....	142
5.1.2. THE PHENOMENOLOGICAL OR QUALITATIVE PARADIGM.....	145
5.1.3. COMPARING THE TWO PARADIGMS.....	148
5.2. THE ‘CASE STUDY’ RESEARCH STRATEGY.....	151
5.3. WHY THE ‘CASE STUDY’ METHODOLOGY?.....	153
5.4. THE INTERVIEW TECHNIQUE FOR DATA COLLECTION.....	154
5.4.1. REASONS FOR CHOOSING THE INTERVIEW TECHNIQUE.....	155
5.4.2. THE INTERVIEW PROCESS.....	157
5.4.2.i. <i>Sampling and Recruitment</i>	157
5.4.2.ii. <i>Selecting Interview Type</i>	160
5.4.2.iii. <i>Conducting an Interview</i>	162
5.4.2.iv. <i>Recording and Transcribing Interviews</i>	164
5.5. THE RESEARCH DESIGN.....	166
5.5.1. THE TYPE OF CASE STUDY.....	167
5.5.2. CHOOSING A CASE.....	170
5.5.3. THE COLLECTION OF EMPIRICAL DATA.....	171
5.5.4. THE METHOD OF ANALYSIS OF THE DATA.....	173
5.5.4.i. <i>Different Alternatives Available</i>	174
5.5.4.ii. <i>Pattern Matching Model</i>	175
5.5.4.iii. <i>Matching the ‘Observed’ and the ‘Theoretical’ Patterns</i>	177
5.6. SUMMING UP.	178
CHAPTER 6: THE AGA KHAN RURAL SUPPORT PROGRAMME (AKRSP) — THE PRE-TRANSITION ERA (1982-1995).....	179
6.1. THE EMERGENCE OF THE AGA KHAN RURAL SUPPORT PROGRAMME. (AKRSP).	181
6.2. INTRODUCTION TO THE NORTHERN AREAS AND CHITRAL (NAC).....	183
6.3. THE DEVELOPMENT CHALLENGES FOR THE AKRSP IN THE REGION.....	185
6.4. THE AKRSP’S DISTINCTIVE APPROACH.....	191
6.4.1. THE LOW COST OPERATIONS.....	193
6.4.2. THE AGRICULTURAL ACTIVITIES.....	193
6.4.3. THE FORESTRY ACTIVITIES.....	195
6.4.4. THE INTEGRATED PARTICIPATORY APPROACH.....	196
6.4.5. DEVELOPMENT IN THE ENERGY SECTOR.....	199
6.5. THE AKRSP’S ACHIEVEMENTS.....	200
6.5.1. QUALITATIVE ACHIEVEMENTS.....	201
6.5.2. QUANTITATIVE ACHIEVEMENTS.....	202
6.6. THE GOVERNMENT OF PAKISTAN’S APPRECIATION OF THE AKRSP’S APPROACH.	206

6.7. IS THE AKRSP'S MODEL REPLICABLE?	207
6.8. SUMMING UP.	210
CHAPTER 7: THE AKRSP'S REORIENTATION TO THE CHANGED ENVIRONMENTAL CONDITIONS (1996-2001)	213
7.1. COMMERCIALIZATION OF THE MICROFINANCE SECTOR.	213
7.1.1. BACKGROUND.	213
7.1.2. THE ESSENCE OF MICROFINANCE COMMERCIALIZATION.	214
7.1.3. THE COMMERCIALIZATION PROCESS.	215
7.2. THE NEW CHALLENGE FOR MFIS.	216
7.3. ANALYSIS OF THE EMPIRICAL DATA.	220
7.4. THE AKRSP'S COMPREHENSIVE RESPONSE.	223
7.5. THE PHASE II OF AKRSP'S LIFE (1996-2001) – REORIENTATION TO CHANGED CONDITIONS.	225
7.6. CHANGES TO THE AKRSP'S 'INTERPRETATIVE SCHEMES'.	227
7.6.1. 'THEORETICAL PATTERN- SET AT'	227
7.6.2. 'OBSERVED PATTERNS- SET AO'	228
7.6.2.i. <i>Objectives/Missions.</i>	228
7.6.2.ii. <i>Policies and Rules.</i>	230
7.6.2.iii. <i>Internal Procedures.</i>	235
7.6.2.iv. <i>Organizational Philosophy and Overall Culture.</i>	238
7.7. CHANGES TO THE AKRSP'S 'SUB-SYSTEMS'	239
7.7.1. 'THEORETICAL PATTERN- SET BT'	240
7.7.2. 'OBSERVED PATTERNS- SET BO'	240
7.7.2.i. <i>Changes in Staff.</i>	241
7.7.2.ii. <i>Changes in 'Branches' Buildings'.</i>	242
7.7.2.iii. <i>Changes in 'Premises/Location'.</i>	243
7.8. CHANGES IN THE AKRSP'S 'DESIGN ARCHETYPE'.	243
7.8.1. 'THEORETICAL PATTERN- SET CT'	243
7.8.2. 'OBSERVED PATTERNS- SET CO'	244
7.8.2.i. <i>Changes in 'Overall Organizational Structure'.</i>	244
7.8.2.ii. <i>Changes in 'Internal Communication Systems'.</i>	246
7.8.2.iii. <i>Changes in 'Accounting Use'.</i>	247
7.8.2.iv. <i>Changes in 'Decision Processes'.</i>	249
7.9. AKRSP'S PASSIVE SUBMISSION TO THE ENVIRONMENTAL DISTURBANCES.	250
7.9.1. 'THEORETICAL PATTERNS- SET DT'	251
7.9.1.i. <i>AKRSP's Passive Submission to the External Conditions.</i>	251
7.9.1.ii. <i>Achieving 'Legitimacy'.</i>	251
7.9.2. 'OBSERVED PATTERNS- SET DO'	252
7.9.2.i. <i>AKRSP's Passive Submission to the External Conditions.</i>	252
7.9.2.ii. <i>AKRSP's Struggle for Gaining 'Legitimacy'.</i>	253
7.10. SUMMING UP.	254
CHAPTER 8: THE AKRSP'S TRANSFORMATION – PHASE III	255
8.1. INTRODUCTION.	256
8.1.1. BACKGROUND AND OVERVIEW.	257
8.1.2. GEARING TOWARDS SELF-SUSTAINABILITY – COPING WITH THE NEW ENVIRONMENTAL CONDITIONS.	260
8.1.3. MILESTONES.	261
8.1.4. FUTURE OUTLOOK.	262
8.2. THE AKRSP'S TRANSFORMATION STAGE.	263

8.3. PHASE III OF THE AKRSP'S LIFE (2001 ONWARDS) – TRANSFORMATION TO AN INDEPENDENT COMMERCIAL SETUP.	266
8.4. CHANGED POSITION OF THE AKRSP'S 'INTERPRETATIVE SCHEMES'.	268
8.4.1. 'THEORETICAL PATTERN- SET 1T'.	268
8.4.2. 'OBSERVED PATTERNS- SET 1O'.	269
8.4.2.i. <i>Objectives/Missions.</i>	269
8.4.2.ii. <i>Policies and Rules.</i>	270
8.4.2.iii. <i>Internal Procedures.</i>	272
8.4.2.iv. <i>Organizational Philosophy and Overall Culture.</i>	274
8.5. CHANGED POSITION OF THE AKRSP'S 'SUB-SYSTEMS'.	276
8.5.1. 'THEORETICAL PATTERN- SET 2T'.	276
8.5.2. 'OBSERVED PATTERNS- SET 2O'.	276
8.5.2.i. <i>Staff.</i>	277
8.5.2.ii. <i>Branches' Buildings.</i>	277
8.5.2.iii. <i>Location/Premises.</i>	278
8.6. CHANGED POSITION OF THE AKRSP'S 'DESIGN ARCHETYPE'.	279
8.6.1. 'THEORETICAL PATTERN- SET 3T'.	279
8.6.2. 'OBSERVED PATTERNS- SET 3O'.	279
8.6.2.i. <i>Overall Organizational Structure.</i>	279
8.6.2.ii. <i>Internal Communication Systems.</i>	281
8.6.2.iii. <i>Accounting Use.</i>	283
8.6.2.iv. <i>Decision Processes.</i>	283
8.7. ACHIEVING 'LEGITIMACY'.	284
8.7.1. 'THEORETICAL PATTERN — SET 4T'.	284
8.7.2. 'OBSERVED PATTERNS- SET 4O'.	284
8.8. ACHIEVING A STATE OF 'BALANCE'.	286
8.8.1. 'THEORETICAL PATTERN — SET 5T'.	286
8.8.2. 'OBSERVED PATTERN — SET 5O'.	286
8.9. SUMMING UP.	287
CHAPTER 9: DISCUSSION.	288
9.1. COMMENTARY ON THE ANALYSIS OF THE EMPIRICAL DATA.	288
9.1.1. IS COMMERCIALISM OF THE MICROFINANCE SECTOR A STEP IN RIGHT DIRECTION? EVIDENCE FROM THE EMPIRICAL DATA.	289
9.2. ANALYSIS OF THE EMPIRICAL DATA.	291
9.2.1. MATCHING THE PATTERNS.	291
9.2.2. THE BUILDING OF 'EXPLANATION'.	294
9.2.2.1. <i>From the Perspective of Institutional Theory.</i>	295
9.2.2.2. <i>From the Perspective of Laughlin's (1991) Model.</i>	297
9.2.2.2.i. <i>The AKRSP's (Microfinance Division) Initial Adaptation and Reorientation.</i>	297
9.2.2.2.ii. <i>The AKRSP's (Microfinance Division) Transformation or Evolution Phase.</i>	298
9.2.2.2.iii. <i>The Sequence of Change.</i>	300
9.3. CONTRIBUTIONS MADE BY THE STUDY TO EXISTING LITERATURE.	302
9.3.1. ORIGINALITY.	302
9.3.2. COLONIZED REORIENTATION.	303
9.4. CONCLUSION AND RECOMMENDATIONS FOR FUTURE RESEARCH IN THE AREA.	305
9.4.1. SIGNIFICANCE.	305
9.4.2. SUMMING UP.	306
9.4.3. LIMITATIONS.	308
9.4.4. RECOMMENDATIONS FOR FUTURE RESEARCH.	308
BIBLIOGRAPHY	310

List of Acronyms

AKF:	Aga Khan Foundation
AKFED:	Aga Khan Fund for Economic Development
AKDN:	Aga Khan Development Network
AKESP:	Aga Khan Educational Services Pakistan
AKPBSP:	Aga Khan Planning and Building Services Pakistan
AKRSP:	Aga Khan Rural Support Programme
AKUH:	Aga Khan University Hospital
AKFED:	Aga Khan Fund for Economic Development
AJKRSP:	Azad Jammu and Kashmir Rural Support Program
BAAC:	Bank for Agriculture and Agricultural Cooperatives
BRSP:	Balochistan Rural Support Program
BIDS:	Bangladesh Institute of Development Studies
CGAP:	Consultative Group to Assist the Poor
CIDA:	Canadian International Development Agency
DFID:	Department for International Development (UK)
FMFBL:	First Microfinance Bank Limited
GDP:	Gross Domestic Product
GBTI:	Ghazi Barotha Taraqiati Idara
GNP:	Gross National Product
GOP:	Government of Pakistan
GTZ:	German Agency for Technical Cooperation
IFC:	International Finance Corporation
IDAs:	International Development Agencies
IUCN:	International Union for Conservation of Nature and Natural Resources
MFI:	Microfinance Institutions
MACP:	Mountain Areas Conservation Project
NAs:	Northern Areas
NAC:	Northern Areas and Chitral
NRSP:	National Rural Support Program
NRM:	Natural Resource Management
NIE:	New Institutional Economics
NORAD:	Norwegian Agency for Development Cooperation
NWFP:	North West Frontier Province
PPAF:	Pakistan Poverty Alleviation Fund
PMN:	Pakistan Microfinance Network
PRSP:	Poverty Reduction Strategy Paper
PRSP:	Punjab Rural Support Program
RSPN:	Rural Support Programs Network
RSPs:	Rural Support Programs
SRSP:	Sarhad Rural Support Program
SDI:	Subsidy Dependence Index
SDPI:	Sustainable Development Policy Institute
SRDP:	Sind Rural Development Program
TRDP:	Tardeep Rural Development Program
UNDP:	United Nations Development Program
USAID:	United States Agency for International Development
WWF:	The Worldwide Fund for Nature

List of Tables

	<u>Page No.</u>
Table 2.1: Business Coverage by MFIs.....	52
Table 3.1: Percentage Increase in Income Required to Move People Out of Poverty..	80
Table 4.1: Laughlin's typology of organizational change in response to external environmental 'disturbances'	129
Table 5.1: Distinguishing the quantitative from the qualitative research paradigm...	148
Table 6.1: The Northern Areas and Chitral Region's Statistics	184
Table 6.2: Household Profile for the Gilgit District in 1988-89	187
Table 6.3: Trends in Per Capita Incomes (US\$).....	203
Table 6.4: The AKRSP's Accomplishments in Quantifiable Terms.....	204
Table 6.5: Trends in Poverty.....	205
Table 6.6: The NAC Region's Social Performance Indicators.....	206
Table 6.7: List of Rural Support Programs currently operating in Pakistan.....	209
Table 6.8: Evolutions in the operations at the AKRSP over time.....	211
Table 7.1: Savings and Loan Products at the AKRSP, 1982-2001.....	219
Table 7.2: Organizational transformation in the AKRSP — a preliminary sketch of all the three phases of organizational change.....	224
Table 7.3: The AKRSP's Microfinance Operations 1998-2000.....	226
Table 8.1: The FMFBL's Performance Indicators.....	261

List of Figures

	<u>Page No.</u>
Figure 1.1: Diagrammatic representation of the MFIs' sustainability arrangements <i>before</i> the changed environmental conditions.....	10
Figure 1.2: Diagrammatic representation of the MFIs' sustainability arrangement <i>after</i> the changed environmental conditions.....	12
Figure 1.3: Laughlin's Model of Organizational Change (1991).....	23
Figure 2.1: Poverty Pyramid.....	39
Figure 3.1: Pakistan.....	72
Figure 4.1: Institutional elements and organizational response.....	113
Figure 4.2: Laughlin's Model (1991) for interpreting organisational change in response to external environmental disturbances.....	126
Figure 4.3: 'Design Archetype', 'Interpretative Schemes', and 'Sub-systems' and the nature of the elements in Laughlin's Model (1991).....	127
Figure 4.4: 'Rebuttal' changes in an organization.....	132
Figure 4.5: 'Reorientation' changes in an organization.....	133
Figure 4.6: 'Colonization' changes in an organization.....	135
Figure 4.7: 'Evolution' or 'Transformation' changes in an organization.....	137
Figure 5.1: Pattern Matching Model for a Case Study Data Analysis.....	175
Figure 6.1: An organization's 'balanced' functioning before change.....	180
Figure 6.2: The map of Northern Areas in Pakistan.....	183
Figure 7.1: The continuum of microfinance commercialization.....	215
Figure 7.2: Extent of change at an organization's reorientation stage.....	220
Figure 7.3: Laughlin's Model of Organization Change (1991).....	221
Figure 7.4: AKRSP's Own and VOs'/WOs' Internal Lending.....	250
Figure 8.1: Severity of change at an Organization's transformation stage.....	255
Figure 8.2: Laughlin's Model of Organizational Change (1991).....	266
Figure 8.3: Laughlin's Model of Organizational Transformation (1991).....	267
Figure 9.1: Patterns Matching Model for a Case Study Data Analysis.....	292
Figure 9.2: The Transformation/Evolution Part of the Laughlin's Model of Organizational change (1991).....	298
Figure 9.3: The sequence of change at the AKRSP depicted by the empirical data..	300

List of Appendices

Appendix A	Ethics approval from Human Research Ethics Committee
Appendix B	Initial letter to the AKRSP and its response
Appendix C	Participant Information Sheet
Appendix D	Sample Consent Form individually signed by all the participants
Appendix E	Sample questions for semi-structured interviews
Appendix F	List of Interviewees
Appendix G	Minutes of the AKRSP's different Board of Directors meetings
Appendix H	SBP internal documents regarding the FMFBL
Appendix I	The AKRSP internal office memo regarding transition issues
Appendix J	Certificate of Incorporation of the AKRSP
Appendix K	Certificate of Incorporation of the FMFBL
Appendix L	The Microfinance Ordinance, 2001
Appendix M	The SBP Prudential Regulations, 2002
Appendix N	Some correspondence with the AKRSP and FMRBL staff

Abstract

Microfinance is a powerful development tool with which to alleviate the problem of poverty through providing financial services to the poor. The real essence of all microfinance efforts around the world is to enable the poor to break the cycle of poverty by establishing and nourishing small businesses. The international donor community¹ and governments have had substantial financial and non-financial investments in developing and providing subsidized financial services for the poor on the premise that they have limited access to the formal mainstream financial institutions.

There was a drastic shift in the microfinance paradigm during the early 1990s when the donor community changed its thinking and approach as to the sustainability of microfinance institutions around the world. Instead of providing subsidized financial services to microfinance institutions (MFIs) for their life time, the donors started emphasizing self-sustainability on the part of MFIs through cost control, efficient operations, and adopting commercialism. The shift in the donors' approach, in turn, resulted in competition among MFIs as they had to struggle for more and more clients to ensure their sustainability. These new issues came as external disturbances for the MFIs which were previously heavily dependent on the donors' subsidized funding, and they had to adapt and reorient to the changed external conditions.

This study is a case study based on the Aga Khan Rural Support Programme (AKRSP) — one of the prominent microfinance institutions in Pakistan. It explores the internal

¹ The term 'international donor community', referred to as 'donors', 'donor community', or 'donor agencies' in the thesis, connotes international sources of subsidized funding for the poor. This includes bi-lateral and multi-lateral financial organizations such as the Consultative Group to Assist the Poor (CGAP), The World Bank, and the Asian Development Bank (ADB), among others.

adaptation and reorientation of the Programme's microfinance division in response to these changed external circumstances. The study has two different aspects; *first*, the internal adaptation and reorientation of the microfinance division of the AKRSP to the changed external circumstances and, *second*, its passive submission to the changed environmental conditions. Therefore, the study resorted to two theoretical frameworks — Laughlin's (1991) Model of Organizational Change and Institutional Theory (DiMaggio and Powel, 1983) to placate the two aspects of the research issue. The study provides insights into the successful adaptation of the AKRSP in which it had to tailor all of its tangible and intangible organizational elements in response to the changed external conditions to ensure its survival and sustainability.

The study examines the process of transformation of the subject as it changed from a donor based institution to a sustainable, commercial institution. The study draws parallels between the theories of Laughlin, and DiMaggio and Powell, and the events that took place during this transformation.

Key words: microfinance, sustainability, commercialism, organizational change.

CHAPTER 1: INTRODUCTION

1.1. Microfinance Preview.

The scope and significance of microfinance can be well ascertained from Rao's (2003) assertion in which he emphasized the fact that developing a sound financial system for the world's poor which could cater to their specific financial requirements is not only in the interest of the poor, which most of us know about, but also the non-poor. According to Rao, not paying due attention to this aspect of poverty would be tantamount to a colossal blunder on the part of the world's developed nations and, in the long run, may prove highly deleterious to the current relatively halcyon situation in the world. Rao stated that:

...with about a third of the population of the world living in poverty, and more than one billion people surviving on less than US\$1 per day², the role of development finance deserves greater attention in the interests of the poor as well as the non-poor (Rao, 2003, p. 2).

The poor, around the world, are often faced with the problem of access to financial services from formal sources due to a variety of reasons including lack of collateral to secure the lending institutions' position in case of a default, lack of training and expertise in successfully undertaking a business venture, and economic viability of, and apparent difficulties, in reaching them for lending institutions. This lack of access to suitable financial services tailored specifically to the unique needs of the poor is the main reason blocking the poor's way out of poverty (Hermes and Lensink, 2007; Fernando, 2006).

² In 2002, about 1.3 billion people were living in extreme poverty with their individual income less than US\$1 a day (Hermes and Lensink, 2007). About 800 million people in Asia only (ILLUME quarterly, 2005).

The poor in under-developed and developing countries often operate with meagre financial and non-financial resources. They can break the poverty cycle through engaging in different income-generating activities but to do that they must be provided with access to a variety of financial services. The microfinance strategy — making arrangements for providing financial services in the form of small loans to help the poor engage in small business activities and, thus, get out of the poverty web — has become a popular tool for developed nations to fight world poverty (Ledgerwood, 1999). The strategy has developed over time from a simple form involving provision of small loans to poor households in rural areas to include provision of suitable training to the poor to ensure prudent utilization of the loan proceeds. Moreover, it has become renowned for its efficacy and effectiveness in terms of its success in fighting world poverty (Adams and Von Pischke, 1992; Raheim, 1996).

The traditional mainstream financial institutions were neither willing to serve this segment of the society nor did they command the necessary resources to meet the special financial requirements of the poor. Thus, the poor had to resort to informal sources for fulfilling their financial needs. These informal sources of finance, such as informal money lenders, used to exploit the needy poor and charge them exorbitantly high interest rates. Developed nations, therefore, felt the need for a specialized financial sector which could cater to the specific needs of the poor. Thus, microfinance was developed to provide financial services to poor households to help them start a small business and change their economic situation (Gallardo *et al*, 2003; Hubka and Zaidi, 2005).

Ledgerwood (1999, p.1) defines microfinance as the provision of financial services to poor households including street vendors, small traders, small farmers, service providers

(rickshaw drivers, hairdressers), artisans, and small-scale producers. Microfinance Institutions³ (MFIs) serve as intermediaries between the international donor community which provides subsidized financial resources to the sector and the poor recipients of the financial services. Ledgerwood (1999, p.34) names microfinance institutions development organizations because their primary objectives are to reduce poverty through creating employment opportunities for the local poor, help existing small businesses grow, and empower women through the provision of financial services.

These microfinance institutions are very much part of the local culture because their operations are limited to a particular locality. Over years of operating in a closed-knit community, they become an integral part of it and share its cultural values. Thus, they have both social and economic dimensions (Meyer and Rowan, 1977; Chaves and Gonzalez-Vega, 1996; Oliver, 1997). The Grameen Bank — one of the pioneers in the field, is a classic representation of these institutions, began its operation in 1976. The Grameen Bank has been a major success story in Bangladesh and its model has been replicated by numerous microfinance institutions across the globe. More details about microfinance and microfinance institutions will be discussed in Chapter 2.

Keeping in view the amount of subsidized financial resources being poured into the sector and the limited success achieved in terms of poverty eradication around the world, a major portion of the literature on microfinance has been devoted to the performance related aspects of microfinance institutions particularly since the mid-1990s (e.g., Remenyi and Quinones, 2000; Conning, 1999; Remenyi, 1991; Hashemi *et al*, 1996; Khandker, 1996; Hulme and Mosley, 1996a; Hulme and Mosley, 1996b). The

³ The abbreviation 'MFI' and the words 'microfinance institution' are used interchangeably within the thesis.

achievement of a good performance in terms of both return on investment and the number of poor households served on a sustainable basis reflect on the success of a microfinance institution. Different studies, since the 1990s, assessed the performance of microfinance institutions operating in a variety of social and cultural contexts using different analytical tools and the performance criteria discussed above (e.g., Yaron, 1994; Chaves and Gonzalez-Vega, 1996). Dreze and Sen (1991) studied poverty issues in some developing countries and urged policy makers not to treat all the poor alike. They suggested in their book that the poor are all different in their behaviour and, as such need different financial services to overcome their poverty. They need a variety of financial services, not just credit, to fight poverty (Dreze and Sen, 1991).

Looking at the performance and success of microfinance institutions from the view point of Institutional Theory, DiMaggio and Powell (1983) and Meyer and Rowan (1977) argue that an organization can ensure its success and long-term survival if it practically proves that all its policies and procedures conform to the prevalent local social values and the outcome of its overall operations in terms of benefits to the local community meet the society's expectations. By ensuring all this the organization achieves a sustainable and legitimate status in the eyes of general public and is deemed to be eligible for the society's scarce available resources.

The literature on microfinance suggests that microfinance institutions (MFIs) will only be regarded as successful if they meet the needs of the target poor they are designed and formulated to help or, in other words, if they achieve their primary objective of eradicating poverty (Snow, 1999). Thus, to ensure its survival in the long-run, a microfinance institution not only has to comply with the local rules and regulations applicable to its operations and meet society's expectations but also ensure the

accomplishment of its primary objectives in terms of reaching highest possible number of poor households and eradicating poverty in its area of operations. By doing so, it demonstrates its legitimate existence to the society and also proves itself to be a legitimate recipient of financial and non-financial resources allocated to the sector (Snow, 1999).

1.1.1. The ‘Welfarist’ Approach.

The main objective under this approach is to help reduce poverty through subsidized credit. The idea is to ensure the inflow of subsidized financial resources to the sector on a continuing basis. In addition, the intermediary organizations — the microfinance institutions — must also ensure imparting appropriate training to the poor recipients of loans with regard to the prudent utilization of scarce financial resources and develop their skills in undertaking different business ventures. A general awareness about health and education related issues is also created among poor borrowers under this approach. Advocates of the welfarist approach argue that in order to alleviate poverty the provision of all these financial and non-financial services should be ensured through the availability of subsidized resources (Ledgerwood, 1999). Thus, unlike the mainstream business sector, financial resources under the approach have to be provided to the sector at an interest rate substantially below the prevailing rate in the open market. Subsidized financial resources being not unlimited, the number of poor households served remains limited. In addition, the survival and sustainability of microfinance institutions remain dependent and conditional on the provision of these resources on a continuing basis (Robinson, 2001).

It has been suggested that many of the poor households who participate in microfinance programs are not capable of bearing the burden of commercial loans which carry market interest rate. Thus, it is not possible to simultaneously accomplish two contradicting objectives: *first*, ensuring profitability on the part of microfinance institutions through charging an interest rate which could cover all operational costs and provide for profits and, *second*, ensuring the eradication of poverty. Thus, profit motive will overtake the service motive if profitability is emphasized more than outreach and poverty eradication on the part of microfinance institutions (Woller *et al*, 1999).

Woller *et al* (1999) argue that advocates of the ‘welfarist’ approach are not interested in banking *per se*. They merely want donors to keep providing subsidized financial resources to the sector. They argue that if international development agencies have assumed responsibility for fighting world poverty, the provision of subsidized financial and non-financial resources to the economically active poor is the only way to accomplish the aim. Microfinance institutions should not see the poor as a source of profit for their long term survival and sustainability. Some researchers argue that more emphasis on ‘cost recovery’ and ‘profitability’ on the part of microfinance institutions in order to survive and achieve sustainability in the long run would result in a deviation from the very purpose for which the program was initially developed i.e. poverty eradication, which is primarily a social objective (Morduch 1998 and 1999).

1.1.2. The ‘Institutionist’ Approach.

In volume II of her book, Robinson (2002) argues that the success of microfinance institutions both in terms of making a real dent on poverty through reaching a maximum

number of poor households and ensuring their own long term survival and sustainability depend on their ability to adopt principles of commercialization in all their operations. The approach finds its roots in the Ohio School of thought on microcredit (Hulme and Mosley, 1996a). The performance of microfinance institutions using the institutionist approach has proven it to be a viable alternative to make financial services available to the poor on a large scale, and that too with profitability and self-sustainability on the part of the MFIs (Robinson 2001, p. 23).

Many of the subsidized microfinance programs have failed to improve the lives of poor households and the donor community could not realize the real benefits of allocating their scarce resources to the sector (Fernando, 2006; Rhyne and Otero, 1994). The donor community's resources being limited and scarce compared to the potential demand for them, donors now want to make sure that the benefits of the available resources reach the maximum possible number of poor households. In addition, in order to encourage more inflow of financial resources, the sector has to attract private capital for which it needs to show a reasonably high return on investment, at least more than the opportunity cost of private capital. This is possible only if microfinance institutions switch to commercialism and ensure a scrupulous check on their operational and administrative costs and charge a market rate of interest on their loans.

However, microfinance institutions' commercialism should not be limited to charging higher interest rates on loans only. It should rather reflect in their overall operations and the variety of services they offer to the poor as well (Rhyne and Otero, 1994; Christen and McDonald, 1998). Advocates of 'institutionist approach' or 'financial system' approach argue that by showing profits to society the microfinance organization can present itself as a legitimate recipient of the society's limited financial resources. If the

organization is able to pay back what it has borrowed from society, then it will be considered worthwhile by society from social service point of view, and would be deemed to be benefiting the poor community at no cost to the society.

Supporters of the ‘institutionist approach’ maintain that to achieve sustainability in the long-run, MFIs have to adopt a ‘financial system’ approach to microfinance under which the main objective is to achieve financial self-sufficiency for the microfinance institution (Hermes and Lensink, 2007; Robinson, 2001). The main focus is on the microfinance institution and institutional success under the approach is gauged by the extent to which the institution is financially self-sufficient and subsidy-free (Woller *et al*, 1999). The idea, under the institutionist approach, is to pursue microfinance efforts through a large number of commercial institutions with all their operations geared towards achieving profitability and long term self-sustainability. Institutionists insist that all microfinance programs should ensure their survival and sustainability through generating enough funds from their operations instead of expecting subsidized funds from the donor community ((Woller *et al*, 1999; Schreiner, 2002).

In terms of impact, most microfinance programs, under the ‘welfarist’ approach, had wasted donors’ subsidized funds and the primary purpose for which these funds had been allocated — to help the poor break the poverty cycle they are entangled in, had remained unaccomplished (Gonzalez-Vega, 1994). This had left microfinance institutions’ (MFIs) long-term survival and sustainability dependent on the continuous inflow of subsidized financial resources from the donor community. Robinson (2001), an active advocate of the institutionist approach, argued that to diminish the wide gap between the available financial and non-financial resources and the potential demand

microfinance institutions would have to switch from a social service-oriented to a business-oriented approach.

1.2. The Changed Environmental Conditions.

Traditionally, the long-term survival and sustainability of microfinance institutions have been largely dependent on the provision of subsidized financial resources by the international donor community. Their Subsidy Dependence Index⁴ depicted the state of their extremely high level of dependence on the continuous inflow of subsidized funds (Yaron, 1994). Thus, microfinance institutions' long-term survival and sustainability was primarily dependent on two factors — the provision of subsidized financial and non-financial resources and the general public's support (i.e., society's endorsement).

The various types of subsidies enjoyed by the microfinance institutions included low-interest bearing loans from the government or donors, government's absorption of foreign exchange losses on loans denominated in foreign currencies, reimbursement of operating costs by donors, exemption from reserve requirements or forced investment in government securities, and obligatory deposits by other financial institutions at below-market interest rate (Yaron, 1994). Figure 1.1 demonstrates the prerequisites of a microfinance institution's long-term survival and sustainability in a diagrammatic form.

⁴ SDI shows the extent of a microfinance institution's dependence on the availability of subsidized funding (Yaron, 1994, p. 56).

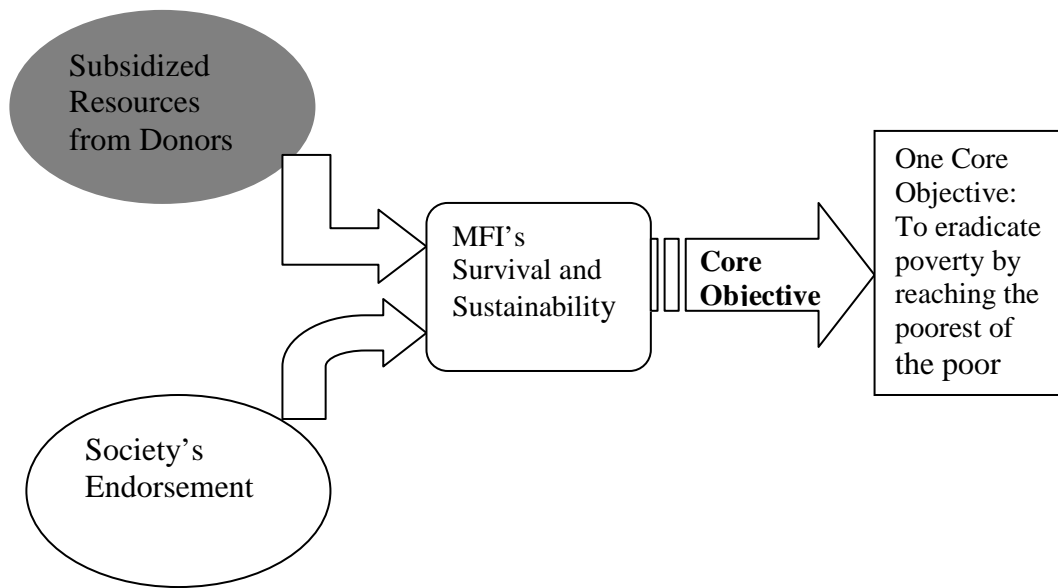


Figure 1.1: Diagrammatic representation of the MFIs' sustainability arrangements *before* the changed environmental conditions.

The microfinance market was big and the financial resources that must be committed to the sector were far beyond the ability of the donors to provide. There was still a significant unmet demand for the microfinance services. The most recent estimates put the market demand for microfinance services at US\$ 300 billion, while the supply was just a meagre US\$ 4 billion (Meehan, 2005). It was, therefore, beyond the means of the donors to keep on extending subsidized credit to the sector without any provision for a payback. The donors therefore considered it essential for the MFIs not only to cover their operational costs but also to earn profits to sustain their operations. The idea was that MFIs' profitability will attract private investment to the sector, which was essential for enhancing the outreach of the microfinance efforts. Donors now want to ensure that microfinance institutions show operational and financial efficiency and demonstrate efficient utilization of the existing funds at their disposal before allowing them further financial assistance (Yaron *et al*, 1998; Rhyne and Otero, 1994).

As discussed above, microfinance was originally used as a poverty reduction tool by non-government organizations (NGOs), and was heavily dependent on the donors' support in the form of subsidized financial resources (Yaron, 1994). The performance of microfinance institutions in terms of achieving their primary objective of eradicating poverty had been discouraging. Morduch (1998) argued that despite the remarkable attention being paid to microfinance as a tool to eradicate world poverty, the real achievements of microfinance in terms of results were questionable. Cernea (1993, p.12) in his study revealed that 13 out of 25 World Bank projects in Asia, Africa, and Latin America had no long term developmental impact on their respective areas of operations and had failed to benefit their respective communities they were operating in.

During the period from the beginning to the mid-1990s the donor community started changing their thinking and approach as to the sustainability of microfinance institutions from providing subsidized financial resources to the sector to emphasise profitability and self-sustainability on the part of MFIs (Robinson 2001 and 2002; Hermes and Lensink, 2007). The idea behind the approach was that subsidies would be provided to the sector to cover the start-up and expansion costs of the microfinance institutions, and that their long-term sustainability would be achieved through revenues from the MFIs' operations (Schreiner, 2002).

The shift in the donor community's thinking from a welfarist-based to an institutionist or financial systems-based approach can be traced back to the period from the early to the mid-1990s (Robinson, 2001 and 2002; Fernando, 2006; Yaron, 1994; Baydas *et al*, 1997; CGAP, 1996; Chaves and Gonzalez-Vega, 1996; Gonzalez-Vega and Schreiner, 1997; Dichter, 1996; Rogaly, 1996). As a result of the changed thinking and approach on the part of the donor community, the microfinance sector started to evolve and the

NGOs and other microfinance institutions started experiencing the following two changed external environmental disturbances.

1.2.1. Emphasis on Profitability and Self-Sustainability.

Microfinance Institutions throughout the world have to cope with the changing external environmental circumstances that have resulted in the movement of the microfinance sector out of the heavily donor-dependent arena of subsidized funding into one in which MFIs become part of the mainstream regulated financial system and have to base their operations on the principles of commercialization. Figure 1.2 below depicts this situation.

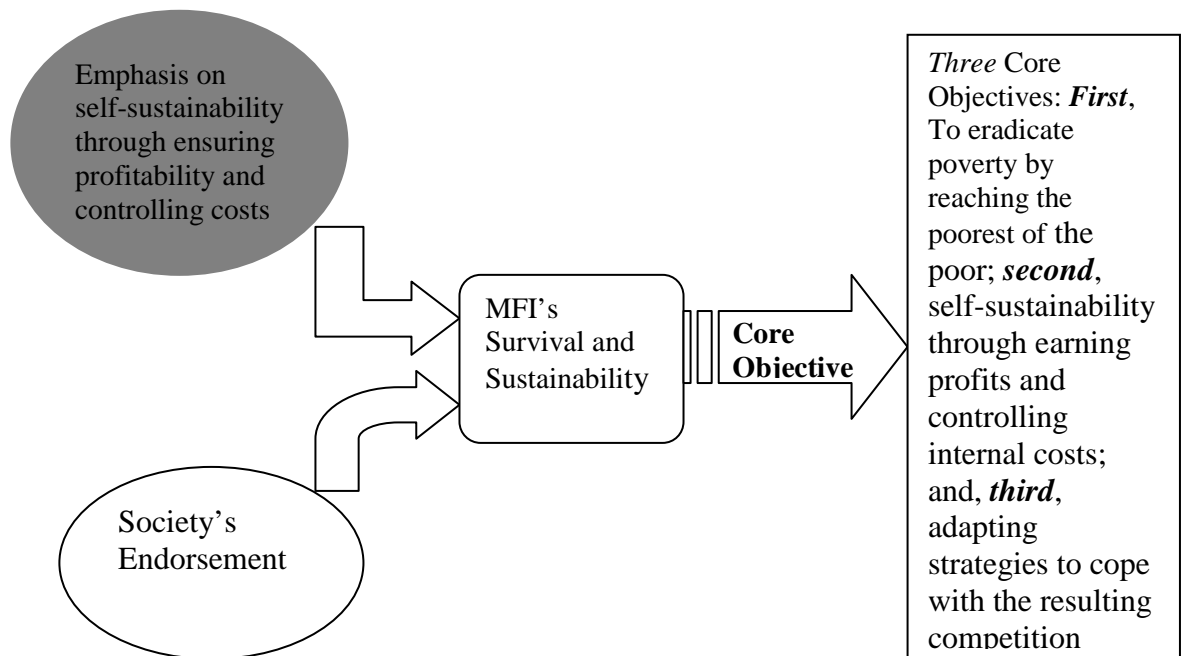


Figure 1.2: Diagrammatic representation of the MFIs' sustainability arrangements *after* the changed environmental conditions.

The literature suggests that microfinance institutions will not reach their optimal level of operational and financial efficiency unless the facility of subsidized funding to the sector is withdrawn. To improve the efficacy of microfinance institutions' operations in terms of profitability, they should be made self-dependent as far as their capital requirements are concerned. In order to ensure maximum possible outreach to the world's poor with a variety of financial services, the microfinance sector, under the changed approach, has to seek commercially available funds instead of looking for subsidized resources. Taking savings deposits from the general public and attracting private sector investment through showing high rate of return on investments are the two available options for microfinance institutions to meeting their capital needs (Hubka and Zaidi, 2005; Morduch, 1999).

As mentioned above, the emphasis on self-sustainability on the part of microfinance institutions from the donor community, initiated during the period from the beginning to the mid-1990s posed a new challenge to microfinance institutions around the world. The objective of MFIs under the approach is two-fold: *first*, to reach large numbers of the poor and, *second*, to ensure their long term survival and sustainability through efficient operations (Robinson, 2001 and 2002; Gurgand *et al*, 1996).

1.2.2. Competition among MFIs and New Government Regulations.

In the early stages most microfinance programs have had little direct competition and/or intervention by the government regulatory sector, and their main challenge was to reach the poorest of the poor and provide efficient services to their clients. The literature suggests that the sector used to be mainly limited to a single product of extending small

loans to poor households (Hulme and Mosley, 1996a; Hulme, 2000). The donor community's changed thinking as to the sustainability of microfinance institutions around the world and the resulting changed external environmental conditions contributed to increased competition among microfinance institutions. These new operating conditions have had considerable impact on their operations, in turn pushing them hard to look for more business, new clients, and alternative avenues for increasing profitability, and emphasize cost control, customer service, product innovation, and professionalism in operations. New government regulations for the sector were another challenge for the microfinance sector after its gradual movement towards commercialism was initiated and the MFIs started deposit mobilization.

These days microfinance is not without competition. Like most other forms of financial institutions, microfinance institutions face severe competition from other rivals in the industry. Without conducting market research and emphasizing product innovation in today's highly competitive market, it is very unlikely that the MFIs can sustain themselves in the long-run (Hulme, 2000). Microfinance institutions cannot expect the donor community to keep providing them with a life-long financial support for their operations. In order to survive, they have to explore every possible alternative to ensure their operational and financial self-sustainability.

1.3. The MFIs' Response to the Changed External Conditions.

Microfinance Institutions had to adapt, reorient, and/or transform in response to the changed environmental conditions. Microfinance institutions that are still operating without altering their organizational structure and making it compatible with the prevalent circumstances find it hard to cope with the current situation of a

commercialized environment. Every MFI has neither the resources nor the capacity to transform into an entirely formal commercial institution which would enable it to mobilize public savings and thus generate enough funds for its operations. MFIs that have not been able to adapt to their changed environmental conditions have to operate with a low amount of capital because legally they are not eligible to take voluntary deposits from the general public or to access funds from the mainstream commercial institutions (Gallardo *et al*, 2003).

While small numbers of MFIs have transformed themselves into formal commercial financial institutions⁵ to cope with the changed environment, many are still struggling to adapt and reorient themselves to the new situation through controlling their costs and generating enough income from their operations while keeping their existing structure.

1.4. The Case Study.

The main purpose of this study is to explore the adaptation, reorientation, and subsequent transformation of the Aga Khan Rural Support Programme's Microfinance Division, in Pakistan, in response to the changed external environmental conditions discussed above. Many studies of organizational adaptation and/or transformation in different sectors and industries have so far been conducted; for instance, railways (Tyrrall and Parker, 2005; Laughlin, 1991; Erakovic and Wilson, 2005), churches (Laughlin, 1991), telecommunications (Erakovic and Wilson, 2005), and privatization of state-owned enterprises (Dean, Carlisle and Baden-Fuller, 1999; Springdal and

⁵ The transformation of ProDem, an NGO in the microfinance sector, into BancoSol, a fully-fledged commercial bank during the 1990s was the first successful transformation of an NGO to a commercial bank in Latin America. Within a short of span of two years of its transformation, the BancoSol became a self-sustaining microfinance provider (World Bank, 2002).

Mador, 2004). Similarly, there are studies of organizational change with particular reference to the role of ‘accounting/accountants’ in triggering a change (Gray *et al*, 1995), and ‘environmental accounting’ (Larrinaga-Gonzalez *et al*, 2001).

Organizational adaptation and reorientation in response to the environmental ‘disturbances’, ‘kicks’, or ‘jolts’ (Laughlin, 1991), in the microfinance sector, has not been studied and analysed in detail so far and is an interesting area to research; especially to one who is a banker by profession⁶.

1.4.1. The Microfinance Sector in Pakistan.

There is a large number of poor households in dire need of financial services in The Islamic Republic of Pakistan — a country where different Non-Government Organizations (NGOs) and government have been involved in microfinance efforts for more than three decades. These NGOs and other financial institutions have been actively providing microcredit services in rural and urban areas on similar lines for many years. The Asian Development Bank in one of its reports to the Government of Pakistan estimated that, in 2000, about 6.5 million poor households in Pakistan could be classified as extreme poor and in urgent need of financial support. These figures represented the potential demand for the microfinance services in the country. Despite microfinance being present in the country, although in its ancient form, for many years, the gap between the supply of these services and the potential demand for them was still significantly high (ADB, 2000; GoP, 2003).

⁶ The author is a commercial banker by profession and has served in the commercial banking sector in Pakistan from March 1995 to February 2003.

This appears to be still the situation. However, there is a positive sign for the microfinance services providers in the country. In recent years Pakistan's rates of growth have been encouraging which may be expected to contribute positively to the effort of fighting poverty. The performance of Pakistan's economy is briefly discussed in Chapter 3.

The microfinance sector of Pakistan, as in the rest of the world, was heavily dependent on the subsidized financial resources from the international donor agencies and the government. Subsidized microcredit was provided in rural areas under a government scheme for subsidized agricultural credit in the 1970s and 1980s but the project did not achieve its objective of reaching the most deserving poor (Ahmad and Nicholas, 1994).

In 1982, the Aga Khan Rural Support Program (AKRSP) was established in the northern region of the country, which was isolated from the rest of the country and where government needed help in overcoming poverty and building infrastructure. The AKRSP through its innovative and unique programs contributed highly to the area's economic uplift (GoP, 2003). The success of the AKRSP in the northern region inspired the government to establish more Rural Support Programs (RSPs) in other parts of the country, which largely replicated the AKRSP's approach in their overall policies and procedures. These RSPs remained the primary form of microfinance efforts in the country during the 1980s and part of the 1990s (GoP, 2003).

According to the Social Policy and Development Centre⁷ (SPDC) the overall impact of the microfinance efforts in the country has not been encouraging. The Centre quoted

⁷ The SPDC was incorporated as a not-for-profit company with a limited liability in April 1995 with the main objective of conducting research into a variety of social development issues and has documented influences on government policies on the issues. It is one of the reputed research institutes in the country (www.spdc-pak.com).

two major microfinance institutions, the NRSP (National Rural Support Program) and the OPP (Orangi Pilot Project), in their report of 2001. During the early 1990s, realising that there was a limit to the provision of subsidized financial resources to the sector, donor agencies started emphasizing self-sustainability on the part of MFIs (Robinson, 2001 and 2002; CGAP, 1996; Gonzalez-Vega and Schreiner, 1997; Von Pischke, 1997). These changed circumstances exerted additional pressure on the MFIs in the country. Thus the microfinance sector in Pakistan had to transform itself to cope with the changed circumstances. Policies and practices had to be adapted or reoriented in such a way that not only could the MFIs achieve self-sustainability but also the poor were able to benefit from them.

1.4.2. The Research Site.

The changed thinking and approach of the donor community and the resulting consequences for the microfinance institutions, as discussed above, inspired this research, and the Aga Khan Rural Support Programme was selected as a case. The AKRSP⁸ has been in operation in the northern part of Pakistan since its inception in 1982. It has been actively involved in providing microfinance services in the area through its Microfinance Division over these years. The reasons for choosing this MFI are: i) The AKRSP is pioneer in the field of microfinance in Pakistan (Hussein and Plateau, 2003; Gloekler and Seeley, 2003) and, ii) after experiencing the external environmental ‘disturbances’ during the 1990s, as discussed above, the AKRSP’s Microfinance Division successfully adapted, reoriented, and subsequently transformed itself to the new environmental conditions (Hussein and Plateau, 2003).

⁸ Aga Khan Rural Support Programme (AKRSP) was established in 1982 in the northern region of Pakistan with the primary objective of eradicating regional poverty.

1.4.3. The Research Issue.

A detailed account of the Aga Khan Rural Support Programme will be given in Chapter 6. This section will discuss briefly the different phases the AKRSP went through during its life cycle as a microfinance institution.

The AKRSP began its operations in 1982 in the northern side of Pakistan, mostly referred to as the Northern Areas and Chitral (NAC) in the microfinance literature. The MFI's primary objective was to alleviate poverty in the area of its operations and the unique approach it adopted for accomplishing this objective was to develop village-based 'Village Organizations' (VOs) and 'Women's Organizations' (WOs)⁹(Campos *et al*, 2004). The AKRSP implemented and carried out most of its programs and development projects through these organizations. As discussed earlier, during the period from the beginning to the mid-1990s the new approach of commercial microfinance started gaining momentum. The donor community began emphasizing cost control as well as efficiency in operations, profitability, and self-sustainability on the part of microfinance institutions.

Until 1995, the AKRSP's microfinance operations, although large in volume, were not managed with a focus on achieving financial self-sustainability. Subsidized financial resources were flowing in from the international donor community and it was functioning like a social service organization in the microfinance sector with the main purpose of serving the poor population in the areas of its operations. During the 1990s the microfinance scenario changed as discussed above. Like other microfinance institutions, the AKRSP had to cope with changed environmental conditions. During

⁹ The *modus operandi* of these Village/Women's Organizations is discussed in detail in Chapter 6.

1996 to 2001, the AKRSP adapted and reoriented towards financial ‘self-sustainability’ (Campos *et al*, 2004). By 2000, under a major plan developed by the AKRSP’s management to transform the microfinance program of the AKRSP to an independent commercial microfinance bank, the microfinance operations of the AKRSP were separated from the rest of its operations and were operated as a separate entity within the AKRSP. In 2002 the Microfinance Division of the Aga Khan Rural Support Programme was transformed to a new independent commercial set-up — The First Microfinance Bank, and began operating on commercial grounds.

This study will explore the AKRSP’s adaptation, reorientation, and subsequent transformation to a commercial setup in response to the changed external conditions in the light of two theoretical frameworks — Laughlin’s (1991) Model of Organizational Change and Institutional Theory (DiMaggio and Powel, 1983).

1.5. The Theoretical Framework for the Study.

The literature on organizational studies suggests that organizations are generally assumed to try to resist a change and stay unchanged in their original balanced state. They will only change when ‘forced’, ‘kicked’, or ‘disturbed’ by the external environment (Laughlin, 1991). Even if they are moved to a changed position with respect to their different organizational elements, the literature suggests that they will try to revert back to their original balanced state, if possible, after the environmental disturbance is over (Miller and Friesen, 1984).

Microfinance institutions (MFIs), in their policies and practices, are not expected to be rigid and unsusceptible to external environmental pressures. They have to tailor their

policies and practices and adapt and reorient to the demands of a changed external environment. The changed external environment exerted pressure on these MFIs to adjust their policies, practices, rules, norms, objectives, goals, and overall structure and harmonise them with externally dictated conditions. Thus, in order to ensure their long-term survival and sustainability, most of these institutions had to adapt, reorient, and/or transform in response to the changed external circumstances.

External environmental disturbances/kicks/jolts (e.g., competition, a stress on self-sustainability by the donor community, and new government regulations) penetrate an organization causing it to instigate organizational transition and transformation. The literature suggests that this 'jolt', 'noise', 'kick', or 'external disturbance' causes an organization to adapt its structure and bring it in harmony with the externally dictated conditions. The organization continues to make changes in its internal tangible and intangible elements unless they are deemed to be complete in harmony with the changed external conditions (Laughlin, 1991; Pettigrew, 1987; Greenwood and Hinings, 1988).

The AKRSP's adaptation, reorientation, and transformation in the process of coping with the changed external conditions will be examined from two different and unrelated angles: *first*, from the perspective of the actual change in its different organizational elements to best cope with the changed external circumstances and, *second*, from the point of view of its passive submission to the externally dictated new conditions. That is, the reasons for its not trying to resist the external conditions dictated by the external environment. Since any one theoretical framework could not throw light on both these two independent aspects of the AKRSP's reorientation and transformation process, two theoretical frameworks are used to explain and analyse the empirical data.

The empirical data pertaining to the change in the Aga Khan Rural Support Programme's tangible and intangible organizational elements during its adaptation, reorientation, and subsequent transformation in response to the changed environmental conditions are analysed through the lens of Laughlin's (1991) Model of Organizational Change. The analysis of the data pertaining to the AKRSP's passive submission to and acceptance of the changed external conditions was carried out using the theoretical underpinnings of Institutional Theory (DiMaggio and Powell, 1983). However, since the main emphasis of the case study is on the change process at the AKRSP, the major portion of the empirical data pertained to this aspect is explained through Laughlin (1991) Model.

Laughlin (1991) argues that an organization keeps functioning in a 'balanced' state of its three main organizational elements — 'design archetypes', 'interpretative schemes' and 'sub-systems' — unless 'disturbed/kicked/jolted' by an external environmental turbulence(s), stirring its existing 'balanced' state and compelling it to adapt, reorient and/or transform itself in order to cope with the new environmental conditions. The external environmental disturbance(s) initiates a change in the organization's 'design archetype' (the organization structure, decision processes, communication systems), which, in turn, leads to a change in its 'interpretative schemes' (the mission/objectives, beliefs/values/norms/culture, and the organization rules and policies) and 'sub-systems' (tangible organizational elements, like buildings, premises, machines, finances, locations).

Figure 1.3 below depicts Laughlin's (1991) Model.

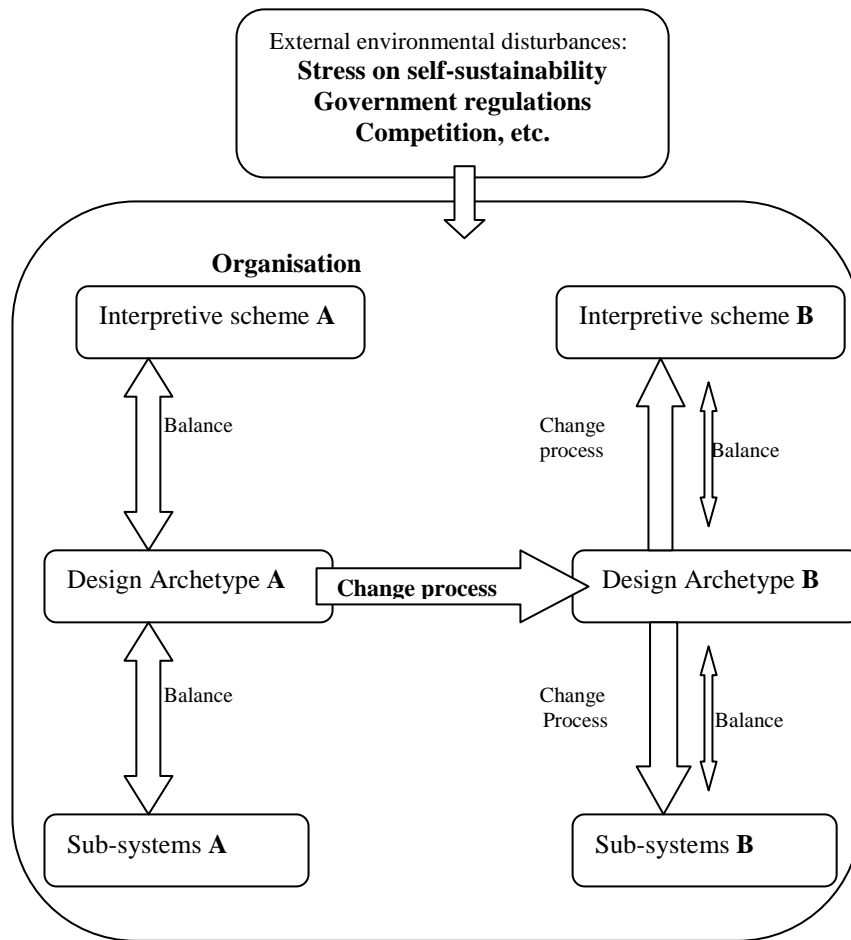


Figure 1.3: Laughlin's Model of Organizational Change (1991).

Source: Adapted from Laughlin (1991), p. 219.

The organization, after adapting, reorienting, and/or transforming (depending on the severity of the external disturbance) in response to the changed external conditions, settles or attains a new 'balanced' state of its organizational elements.

1.6. The Research Method.

Qualitative research, being a flexible approach to a research endeavour, allows several research methods, such as grounded theory, ethnography, and case study to undertake a research (Franfurter and McGoun, 1996). This thesis uses 'case study' as the method of

research. A case study research is different to other forms of research. It is an inquiry type of study where a researcher's focus is on describing, understanding, predicting, and/or controlling an individual entity in its real life context (Woodside and Wilson, 2003). Yin (2003, p. 13) defined a case study research methodology as:

an empirical enquiry that investigates a contemporary phenomenon within its real-life context and in which multiple sources of evidence are used.

For a case study to be effective, the researcher must not leave any loophole in the process of observation of real life events. The conclusions drawn from a case study takes into account the perceptions and views of all the actors involved in the research process including the researcher (Zonabend, 1992). Case study methodology is often resorted to when researchers try to answer 'how' and 'why' questions (Yin, 1994). There are different types of case studies. A case study can be categorized as exploratory, descriptive, and/or explanatory. An 'exploratory study' is basically conducted to explore reasons for particular practices observed in a real life setting. A 'descriptive study' is often used to describe contemporary practices, may be to develop a new practice or polish an existing one. An 'explanatory study' is conducted mainly to explain the reasons for observed practices. Any one study can also be categorized as having all, exploratory, descriptive, and explanatory, aspects (Yin, 2003).

This study can be grouped with 'exploratory' case studies, as it tries to 'explore' the adaptation and reorientation of an organization in response to external 'shocks' or environmental pressures.

1.7. Objectives of the Study.

Objectives of this study were derived from and surround the three external environmental disturbances which impacted upon the Aga Khan Rural Support Programme (AKRSP) during the 1990s and how the AKRSP responded to these ‘disturbances’. The first ‘disturbance’ was the changed thinking and approach on the part of the international donor community, with regard to the long-term sustainability of microfinance institutions, from providing subsidized financial resources to the sector to an emphasis on profitability and self-sustainability on the part of MFIs. The second was the resulting competition among MFIs, and the third, the resulting changes in Government Regulations¹⁰ for the microfinance sector. An estimated 40 microfinance institutions currently operate in Pakistan (CGAP, 2006), which indicates a state of stiff competition among MFIs. All these changes constituted ‘environmental disturbances’, as per Laughlin’s (1991) model of organizational change, for the AKRSP.

In this case study the primary focus is on the actual changes in the AKRSP’s ‘tangible’ and ‘intangible’ organizational elements — the ‘interpretative schemes (objectives, missions, beliefs, norms, values, culture, rules, philosophy), the ‘design archetypes’ (overall organization structure, decision processes, communication systems), and the ‘sub-systems’ (tangible organizational elements like staff, departments/divisions, business premises) in response to the changed environmental conditions. Although, Chapter 8 will discuss to a limited extent the positive outcomes of the transformation of the Microfinance Division of the Aga Khan Rural Support Programme to an independent commercial microfinance institution in terms of its gradual movement

¹⁰ Upon the entrance of some of the Microfinance Institutions (MFIs) to the formal commercial financial sector, the Government of Pakistan introduced a separate set of Prudential Regulations for Microfinance banks/institutions on October 14, 2002.

towards operational and financial self-sufficiency, gauging the impact of the microfinance institution on poverty alleviation in the area of its operation is beyond the scope of this study. The focus instead is on how the AKRSP's microfinance division successfully adapted, reoriented, and then subsequently transformed to an independent commercial setup in order to cope with the changed external circumstances.

In the light of above discussion, the main underlying objectives of this research endeavour are summarized below.

- To explore the AKRSP's microfinance division's successful coping with the changed environmental conditions.
- To explore the actual change in the AKRSP's microfinance division's tangible and intangible organizational elements in response to the changed external circumstances.
- To explore the reasons for the AKRSP's microfinance division's acceptance and passive submission to the changed environmental conditions.
- To explore the possibility of a change in theory/model in the context of organizational change in the microfinance sector in Pakistan.
- To make a positive contribution to the existing literature on microfinance in the light of changed external circumstances facing the microfinance institutions.

1.8. Significance and Expected Outcomes.

Disturbances of different sorts, for instance, competition from rivals, government regulations, changing industry rules, values, and objectives, occur in different parts of the world from time to time. Organizations have to adjust or adapt according to their changed circumstances for ensuring their long-term survival and sustainability. Being dependent on the financial and non-financial support from international donor agencies,

microfinance institutions also have to adjust to different approaches adopted by international donor agencies at different points in time.

This study describes a microfinance institution's struggle to adapt and reorient in response to its changed external environmental conditions as mentioned above. The study is of significance in three ways: *First*, it will provide an insight into how MFIs can successfully adapt/adjust and reorient when faced with unavoidable external environmental disturbances. *Second*, the study will provide existing MFIs and those new in the field which are established under the prevailing (changed) circumstances with an exemplar (in policies and practices) in order to best cope with the current commercialized environment facing MFIs. *Third*, this study will add to the existing literature on microfinance as there are few, if any, studies of the adaptation, reorientation, and/or transformation of MFIs in response to changed external circumstances.

1.9. Organization of the Thesis.

The whole research process followed in this study comprised of six fundamental stages described by Hussey and Hussey (1997, p. 15) in their book. These were: identifying the research topic, defining the research problem, determining the research procedure, collecting the empirical data, analysing and interpreting the data, and writing of the thesis.

The thesis comprises a total of nine chapters. This section outlines the remaining eight chapters of the thesis. Chapter 2 presents a literature review of microfinance. The first part of the chapter introduces the overall concept, meaning, and the need for

microfinance before throwing some light on whom the microfinance dogma is meant for and who are behind the effort. The second part of the chapter discusses some of the most prominent microfinance models used and replicated all over the world. The last part of the chapter talks about the success/failure of the microfinance effort in terms of its outreach, impact, and sustainability from the viewpoint of two opposing schools of thought — the ‘welfarist’ and the ‘institutionist’. This section concludes the chapter by discussing the issues/problems facing microfinance and the reasons for the donors’ gradual shift in approach and thinking regarding the long-term sustainability of the microfinance sector from the old paradigm of making subsidized credit available to the sector to the new paradigm of commercial and self-sustainable microfinance sector. Chapter 3 presents the overall picture of the microfinance effort in Pakistan. It refers to the extent of demand for microfinance and its success/failure in the context of Pakistan, the country’s demographic and geographic conditions, and concludes with a discussion on future directions and the state of government regulations for the sector.

Chapters 4 and 5 refer to the research method and the theoretical framework for the study respectively. The first part of Chapter 4 establishes a link between the case study and its theoretical base. Institutional Theory and its different pillars dominate this part of the chapter. The second part of the chapter covers the different aspects and levels of Laughlin’s (1991) Model of organizational change and its relevance to the case study. Chapter 5 throws light on the ‘case study’ methodology of research. The first part of the chapter justifies the use of the case study method for this research and proceeds to discuss the research site, collection of the empirical data, and the research design for the study. The second part presents the characteristics of the interview technique for data collection, different alternatives available for selecting an interview type, and the

process of effective interviewing. The last part of the chapter discusses the method and the process utilized for the analysis of empirical data.

Chapters 6, 7, and 8, are the empirical chapters of the thesis. They are built on the empirical data collected for the study and constitute the crux of the thesis. These three chapters represent the analysis part of the thesis. These three chapters divide the life of the Aga Khan Rural Support Programme (AKRSP) into three distinct phases.

Chapter 6 presents Phase-I (1982-1995) of the AKRSP's life which covers the time period before the external environmental 'disturbances' impacted on the AKRSP's 'balanced' state of organizational elements. The chapter throws light on the distinctive demographical and geographical characteristics of the areas of the Aga Khan Rural Support Programme's operations — the northern part of Pakistan. It then discusses the circumstances necessitating the inception of the Programme, the unique approach adopted by the microfinance institution in accomplishing its objectives, the resources and constraints for the Programme, and concludes with some discussion on Programme's qualitative and quantitative achievements. Chapter 7 presents the Phase-II (1996-2001) of the AKRSP's microfinance division's life. The first part of the chapter builds its background by discussing the new era of the commercialization of microfinance and its implications for the sector. The second part, utilizing the relevant portions of the empirical data, presents the adaptation and reorientation of the Programme in response to the changing external circumstances; changes both in the tangible and intangible organizational elements of the MFI are presented in this part. The changes, in the last part of the chapter, are then coded as 'observed patterns', placed close to their respective 'theoretical' patterns, and then discussed and analysed in

Chapter 9 — the last chapter of the thesis. Chapter 8 presents the phase-III (2001¹¹ onwards) of the AKRSP's life. It discusses the time period after the Programme's transformation to an entirely different entity — an independent private-sector commercial bank. The chapter, using the relevant empirical data, develops some more sets of 'observed patterns' on grounds similar to those developed in Chapter 7.

Each of these three chapters utilises the empirical data relevant to a particular AKRSP life-phase, builds a basis for Chapter 9 which then concludes the analysis using the Trochim (1989, p.356) model.

The final chapter, Chapter 9, building upon the previous three chapters, discusses the outcomes and concludes the thesis by pulling together all the chapters. The chapter discusses the accomplishment of the study's objectives and concludes by giving a brief account of the limitations of the study, its significance, and the contributions it made to the existing literature on microfinance. Finally, the chapter concludes the thesis by giving some indications for future research on related issues.

¹¹The year 2001 overlaps in the two phases of the AKRSP — Phase II and Phase III as depicted by the empirical data.

CHAPTER 2: MICROFINANCE — A LITERATURE REVIEW

Various aspects of microfinance and microfinance institutions have so far been covered in the vast body of literature on the subject. To make the discussion more compact, this chapter reviews the literature on microfinance in general and on issues that are particularly relevant to this study. The study explores the adaptation and reorientation of the microfinance division of the Aga Khan Rural Support Programme¹² in response to the donors' changed approach as to the sustainability of microfinance institutions, which finds its origin in the period from beginning to the mid-1990s. Therefore, to establish a background for the study, most of the literature referred to here points to that period and onwards.

2.1. Microfinance — A Preview.

The role that micro-enterprises can play in creating employment opportunities for the poor has increasingly become an important issue attracting widespread attention from the policy makers, donors, and researchers (Hermes and Lensink, 2007). Millions of people in developing countries, who are either involved in income-generating activities or are willing to engage in such activities, often find it difficult to access financial services from the mainstream financial institutions. Lack of collateral to secure their financial obligation and the high cost of dealing with a large number of poor scattered around in rural areas are among the main reasons for the mainstream financial institutions' inability and/or unwillingness to serve the poor class of society (Hermes and Lensink, 2007). To solve this problem, international development agencies have

¹² The name 'Aga Khan Rural Support Programme', wherever mentioned in this thesis, refers to the 'microfinance division' of the AKRSP.

adopted the microfinance strategy to combat poverty all over the world. The strategy works through different programs in under-developed and developing countries around the world emphasizing small-sized loans to the poor to help them start a small business and suitable training to improve their business skills (Adams and Von Pischke, 1992; Raheim, 1996).

Traditional mainstream financial institutions in most of the developing countries served only 5 to 20 percent of population. The poor households which constituted the major portion of population were left unserved by this sector. Since this poor households segment of population had different financial needs, microfinance strategy was introduced specifically to serve this neglected segment of society. Before the introduction of the microfinance sector, this segment of society was largely dependent on informal sources of finance such as local landlords, informal money lenders, and relatives and neighbours (Fernando, 2006; Gallardo *et al*, 2003). The *modus operandi* of the strategy was to create employment opportunities for the poor through promoting small businesses. The idea was to engage the poor in different income-generating activities, and, thus, help them get out of the poverty cycle. Different microfinance programs initially began operating in the under-developed and developing countries of Asia, Africa, and Latin America (Adams and Von Pischke, 1992; Rahman, 1999; Rhyne and Otero, 1994; Schreiner, 1999). Microfinance programs such as the Grameen Bank in Bangladesh, the Self-Employed Women's Association (SEWA) in India, the ACCION International in Latin America, the Banco Sol in Bolivia, and the Bank Rakyat in Indonesia are among the most prominent microfinance programs in the world, and pioneers in the field of microfinance (Hermes and Lensink, 2007; Ssewamala and Sherraden, 2004).

The concept of a joint liability in microfinance wherein all recipients of a loan in a group are jointly and severally liable for the repayment of borrowed funds is the distinguishing characteristic of microfinance. It makes microfinance a different financing module from mainstream commercial and investment banks (Hermes and Lensink, 2007). Similarly, rewarding good microfinance clients in terms of the utilization of borrowed funds through, say, increasing the size of loan, implementation of a schedule for repayment, and the use of forced savings as collateral to secure their financial obligations are other characteristics of microfinance which differentiates it from formal commercial banks and other financial institutions' sector (Hubka and Zaidi, 2005).

The practice of microfinance is relatively new “without a body of established theory to guide us”. About fifty microfinance institutions were covering the whole Asia-Pacific region for a major portion of its microfinance activities, and that too started after 1970 (Getubig *et al*, 2000, p.4). Ledgerwood (1999) traced the origin of formal microfinance to the early 1980s.

2.1.1. What is Microfinance?

There is no one universally accepted definition for microfinance as different related variables like ‘poverty’, ‘loan size’, ‘the poor’, and ‘the poverty line’ carry different meanings in different countries. Different authors have defined the term in different ways. According to Ledgerwood (1999, p.1) the term refers to the provision of

financial services (generally savings and credit) to low-income clients¹³. Some microfinance institutions also provide ‘insurance’ and social intermediation services such as ‘group formation’, ‘development of self-confidence in group members’, and ‘training members of a group’ (Ledgerwood, 1999). Microfinance has also been defined as a credit methodology that uses different collateral substitutes to extend and recover small, short-term working capital loans to poor households (CGAP, 2003a). Rao (2003, p. 53) has defined microfinance as “the provision of credit on a small scale to individuals, households, and economic entities that qualify under relevant norms of lending”. The Asian Development Bank (ADB) defines microfinance as the provision of a wide range of financial services like savings, loans, money transfers, payment services, and insurance to low-income households and the poor and their micro enterprises (ADB, 2000, p.6).

Microfinance is usually termed as a ‘bottom-up approach’ as the eligible poor households avail a credit facility in order to elevate themselves from poverty and raise his/her standard of living (Rao, 2003). Some of the important players in the field of microfinance are the Government (setting up policy for the microfinance industry), Credit Unions (CUs), Cooperatives, Commercial Banks, Non-governmental Organisations (NGOs), and small informal self help groups (CGAP, 2003a).

Microfinance has existed in different informal forms for many decades. Traditionally, informal money lenders were the main source resorted to by the poor for meeting their financial needs, as the formal sector’s main stream commercial banks were not catering to their unique needs. In addition, friends, family members, and neighbours were also

¹³ Ledgerwood (1999) identifies small traders, street vendors, small farmers, services providers (rickshaw drivers, hairdressers, etc.), and artisans and small-scale producers, such as seamstresses and blacksmiths as generally the microfinance clientele.

informal sources of finance for the poor. These sources, in fact, constituted the main sources for many poor households as they, being an integral part of the local community, reached the poor in times of need (Fernando, 2006). The present structure of microfinance is the developed shape of the traditional informal systems of credit for the poor. Many elements of the current microfinance practices seem to be largely influenced by these informal lending procedures (Hasan, 2002). While, the informal money-lender segment of the traditional microcredit practices was mainly interested in their earnings and always exploited the needy poor and charged them exorbitantly high interest rates. Friends, family members, and neighbours, whose primary motive was to provide support, remained a good source of financial help to poor households in times of need (Hasan, 2002).

The present-day microfinance is the developed form of these traditional informal microfinance practices. However, to bring the practice to its present developed form has been a treacherous job for many organizations, such as donor agencies, international NGOs, universities, and research institutions. The literature suggests that the advancement of microfinance practices to their present form was because of the limited success of governments and donor-funded Non-Governmental Organizations (NGOs) in helping the poor and eradicating poverty in rural areas. At the initial stages of the formal microfinance programs, governments used to help poor households by extending them small loans for agriculture related activities. Under the programs, the government would support formal-sector agricultural banks in making subsidized credit available to the local poor farmers and making it obligatory upon commercial banks to direct a specific percentage of their entire credit portfolio to a particular economic sector (World Bank, 2003; Remenyi and Quinones, 2000). These programs did not succeed in the accomplishment of their primary objective of eradicating poverty because of various

reasons, such as inability of the deserving poor to get access to these loans, intervention from wealthy farmers directing the flow of funds under the programs to their wealthy peers, writing-off of loans, and low repayment rates (Robinson, 2001; Besely, 1994; Yaron, McDonald, and Charitonenko, 1998). Today's microfinance is highly dominated by the elements of commercialism, self-sustainability and profitability, and competition among microfinance institutions (Goodman, 2006; Robinson, 2002).

2.1.2. Why Microfinance?

The ever increasing poverty around the world prompted developed countries to formulate and implement a variety of policy frameworks. It was a point of great concern for them that only few countries showed an encouraging pace of economic growth after World War II (Gurgand *et al*, 1996). Many policies formulated by developed nations for the economic uplift of the world's poor did not achieve their objective of eradicating poverty in the world. This failure shifted the main focus of these nations' development policies to the microfinance sector, resulting in many innovative approaches being developed and implemented by the sector to eradicate poverty in underdeveloped and developing countries (Woller and Woodworth, 2001).

Since, in an overall world context, mainstream commercial banks avoided providing saving and credit services to the poor, mainly due to lack of collateral to secure the loan, the poor borrowed from informal money-lenders at exorbitantly high interest rates (Aleem, 1990). Fernando (2006) also mentioned in his book that before the introduction of microfinance, the poor had to rely on money lenders, neighbours, and family friends for meeting their financial needs. The microfinance strategy, therefore, served as a light

of hope for more than a billion poor around the world. The least advantage of the introduction of formal microfinance was that the poor were not compelled to borrow from informal sources, which helped them in the short-run to meet their immediate financial need but pushed them further into poverty in the long-run. As Roa (2003) asserted that:

with about a third of the population of the world living in poverty, and more than one billion people surviving on less than US\$1 per day¹⁴, the role of development finance deserves greater attention in the interests of the poor as well as the non-poor (Rao, 2003, p. 2).

Poverty around the world is not just in terms of lack of financial help. The main problem facing the microfinance sector is the prevalence of multiple forms of poverty, such as income poverty, capacity poverty, food poverty, and environmental poverty (ILLUME quarterly, 2005). This was one of the main reasons behind the introduction of principles of commercialism in the sector. Since the outreach of most of microfinance institutions was limited, the sector needed innovative approach to increase its capacity to help a larger number of poor households (Robinson, 2002). Moreover, policies of research on product innovation in many microfinance institutions with commercially-driven operations are helping the sector in overcoming the different forms of poverty mentioned above.

The purpose of the formal microfinance sector is to help the poor start a small business and thus try to improve their economic wellbeing. Therefore, microfinance serves as an important player in developing countries. Microfinance institutions are specialized financial institutions created with the objective of serving the poor in a particular locality. They specialize in extending small loans to the poor and, thus, are able to lend

¹⁴ About 800 million people in Asia only (ILLUME quarterly, 2005).

money to poor rural households at rates below that of informal money-lenders. Due to their unique setup, they can extend loans to the poor, and by charging a higher interest rate, although less than that charged by the informal money-lenders can generate enough revenues to ensure their survival and sustainability (Khandkar, 1996). After the introduction of principles of commercialization into the sector during the 1990s, microfinance institutions experienced stress from the donor community to gear their operations towards profitability and self-sustainability (Goodman, 2006; Robinson, 2001 and 2002; Fernando, 2006). The literature supports the gearing of microfinance institutions from a social-service towards a business-oriented role and suggests that microfinance institutions can charge higher interest rates on their loans, although still less than that of informal money lenders (Robinson, 2002; Holt and Ribe, 1991; Short, 2000; Khandkar, 1996).

2.2. The Terms ‘Poor’ and ‘Poverty’.

Traditionally ‘the extreme poor’ or ‘the poorest’¹⁵ have been the focus of most microfinance activities around the world. The problem is to distinguish, on the basis of some distinctive characteristics, between ‘extreme poor’ and other groups of poor. Remenyi (1991) represented different categories of the poor in the form of a pyramid (see Figure 2.1 below).

¹⁵ The Microfinance Summit Campaign (2005) defines “the poorest” or “the extreme poor” as those in the bottom half of those below their respective nation’s poverty line.

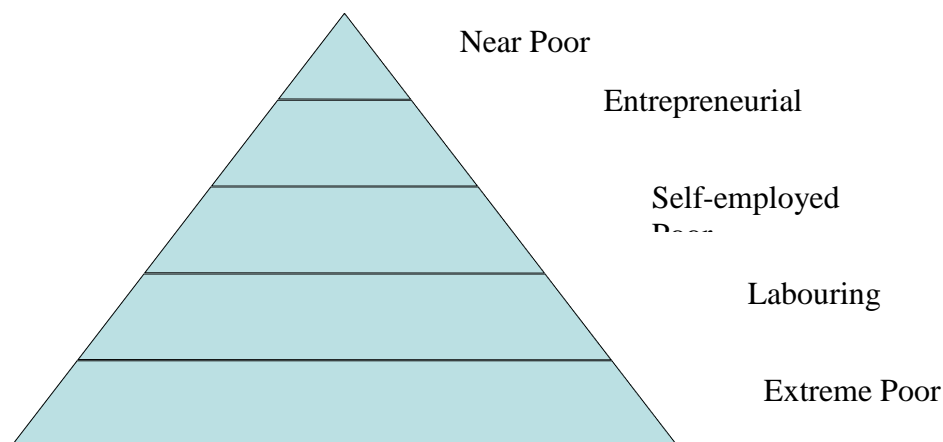


Figure 2.1: Poverty Pyramid.

Source: Adapted from Remenyi (1991).

The literature on microfinance suggests that microfinance efforts have been mainly focused on the bottom section of the poverty pyramid, that is, the ‘extreme poor’ category. The poor in some of the upper categories, such as the ‘labouring’ are not grouped in the ‘extreme poor’ category. This may limit the number of poor on the priority list of the international donor community but they are among the highly vulnerable poor who can slip into the ‘extreme poor’ category with a slight adverse shock in their life, such as getting sick or the death of a family member (Remenyi, 1991). The ‘Extreme poor’ category represents poor that suffer from several dimensions of poverty, not just their low income levels. For some households food is not sufficiently available to meet the basic needs of all the family members. This is one form of poverty. A low level of assets and the inability to give basic education to their children are other dimensions of poverty. In the case of Bangladesh, if poor households are not able to afford to own at least two *sarees* (local clothing) with no pair of shoes, depend on seasonal work for earning their living, and, in case of no work, make one of the family members beg to support the family, they are categorized as ‘extreme poor’ (Matin, 2001).

Keeping in view the ever increasing poverty in its different forms and dimensions and the high population growth rate around the world, the goal to eradicate poverty on a large scale seems to be an unrealistic one. It could be made realistic if the specific needs of the poor are identified, and understood, and financial services tailored accordingly. For this purpose the best pathway to follow is to involve the poor in the process of identifying their needs and formulating policies for addressing these needs. For effectively tackling world poverty, financial services will have to be tailored according to the specific requirements of the poor particularly considering the social and geographical circumstances they live in. In addition, research should be devoted to identify avenues for proper utilization of the proceeds of the small loans that will ensure long-term self-employment for the poor borrowers and create employment opportunities for their fellow poor households.

These diversified forms of poverty prevailing in many parts of the world suggest that policy-makers and researchers need to consider and address the main issues that cause poverty in addition to concentrating directly on the poor (Matin, 2001). Research suggests that all the poor cannot be categorized as 'always poor'. Some segments of poor, in fact, go into and come out of poverty at different intervals of time. The segment is sometimes referred to as part-time poor. Different factors with positive and negative influences on their financial footings push this segment of the poor into and out of poverty. The literature suggests that this later segment represents a larger portion of the world poor (Baulch, and Hoddinot, 2000). Different tailor-made policies are needed to be designed and implemented to deal with these different forms of poverty.

In developing countries such as Pakistan the political intervention by many politicians and bureaucrats in the banking systems render the repayment of large loans from the

traditional mainstream commercial and investment banks, particularly in the public sector, very low. The literature suggests that repayment rates in case of microfinance are high (Wenner, 1995; Wydick, 1995). These scholars endorse the credibility of the poor as far as the willingness to repay and actual repayment of loans on the part of poor households. Wenner (1995) and Wydick, (1999) suggest that the poor have the zeal and spirit to overcome their poverty and improve their lives. All they need is access to financial services that are specifically designed to meet their particular needs.

2.3. Microfinance Institutions (MFIs) — the Intermediaries.

Microfinance institutions are the ones which, with the help of government or international donor agencies (IDAs), provide lending services to the poor of their respective locality. There is a huge body of literature which suggests that the microfinance sector arose as a result of the failure of the mainstream financial institutions to cater to the specific needs of the poor (Aleem, 1990; Ghatge, 1992b). Ghatge (1992b, p.16) particularly blamed the traditional commercial institutions for not coping with the requirements of the poor segment of society, particularly in the rural areas of developing countries. In another of his studies, Ghatge seemed to realize and mention the main factors behind the inability of the mainstream commercial financial institutions and attributed the failure of traditional commercial banks to cater to the specific needs of the poor. In this study Ghatge mentioned different legal requirements for these institutions to divert a specified portion of their credit portfolio to specified sectors and keep a specified percentage of their total demand and time liabilities as compulsory deposit with the country's central bank. In addition, regulations limiting these institutions' ability to set their own minimum and maximum level of interest rate on the general public deposits and their lending, and high stakeholders' expectations to

maintain a sound financial footing with operations geared towards profitability and cost control also limit their ability to reach and serve the poor class of society (Ghate, 1992a, p. 860).

A Microfinance institution (MFI) may be a bank, a cooperative, a credit union, a non-government organization, or of any other type of organizational structure (Hasan, 2002). Any financial institution whose main, or any portion of, operations are tailored to serve the poor segment of society and which serves as intermediary between the donor community and the poor recipients of loans may be regarded as a microfinance institution. A microfinance institution's operations are usually concentrated in a limited geographical area and mostly close to the small business ventures of its poor borrowers. These MFIs operate in a small locality and, therefore, over years of operations become part of it. Mostly they adapt their policies, procedures, and products according to the specific requirements of the local poor. Simple and easily intelligible loan application forms are used and loans are disbursed quickly as compared to traditional mainstream commercial banks at these institution. Unlike the mainstream financial institutions whose operations are mostly regulated, the MFIs' rules and procedures are not supposed to be rigid and inflexible in order to make it easy for new poor borrowers to get into their system (ADB, 2000).

Microfinance institutions engage in providing a wide variety of services to their poor clientele, including the following (Hasan, 2002):

- Extending small loans with any material collateral to secure the loan. Guarantees from group members in case of a group loan or loans terms and conditions which include keeping compulsory savings with the MFI, serve as collateral through which the MFI secure its position against any default;

- Providing their clients with safe deposit services, or channelling their savings to other institutions if they are not authorized to keep their deposits;
- Provision of insurance services to secure the MFI's position against default in case the poor borrower defaults on his commitment to repay for any reason; and,
- Consultancy services, whereby MFIs advise the poor clients on different issues such as the way to efficiently utilize the proceeds of their loans.

The formal microfinance institutions perform the role of intermediaries between the international donor community and the poor. From their initial stage of inception until the early 1990s these microfinance institutions used to charge a subsidized interest rate on their loans to the poor. After the early 1990s, with the introduction of commercialism to the sector, these institutions started charging a higher interest rate on their loans in order to cover their operational and administrative costs and ensure their survival and self-sustainability. After the change in the donors' approach as to the sustainability of microfinance institutions, the interest rate charged by many microfinance institutions was generally higher than that of traditional mainstream financial institutions, although still much lower than the rate informal money lenders used to charge from their poor clients (Fernando, 2006; CGAP, 1996).

In recent times there has been more stress on commercialism in microfinance operations with emphasis on cost recovery and profitability, so a challenging task for MFIs around the world is to make microfinance a sustainable practice. Microfinance institutions need to conduct research in order to identify the specific needs of their clients and tailor their existing products and design new ones to get an edge over other rival institutions. Innovations are needed to increase the scope of MFIs' in terms of their outreach, impact of their programs on the well-being of borrowers, and depth of their reach to the poorest of the poor. These innovations should make microfinance institutions capable of

reaching all levels of the poor, particularly the extreme poor, on a sustainable basis (CGAP, 2003b).

To achieve sustainability, increasing profitability is the only alternative for microfinance institutions to resort to. Controlling operational and administrative costs, efficient and professional management of credit portfolios with a vigilant eye on the recoveries of loans, identifying lucrative business opportunities for their poor clients, and improving their poor clients' skills and capacity to prudently utilize the proceeds of loans contribute to improving the profitability of microfinance institutions. Microfinance institutions now have a dual objective of achieving self-sustainability and eradicating poverty, and they need to resort to an 'integrated' approach to accomplish this objective (Ledgerwood, 1999, p.64). Thus, microfinance institutions should not only concentrate their efforts on extending and recovering loans to their poor clients, as was the situation in the early stages of its development, but also explore avenues to develop and provide a range of other financial services suitable to the specific needs of their poor clients. In addition, they should also focus their efforts on building the capacity and business skills of their clients by providing them with suitable training in order to enable them to utilize their loans prudently and more efficiently and better manage the financial affairs of their small businesses (Ledgerwood, 1999). Resorting to this approach will smoothen the way for microfinance institutions to accomplish not only their objective of poverty eradication but also make it possible for them to ensure their financial and operational self-sustainability in the long run (Ledgerwood, 1999, Morduch, 1999 and 2000; Snow, 1999).

2.3.1. Significance of MFIs in the Financial Sector.

Lack of access to suitable financial services on the part of poor households in underdeveloped and developing countries is the main hurdle in their way out of poverty. The inability and unwillingness of the traditional mainstream financial institutions to serve the poor segment of society has contributed to limiting the ability of the poor to improve their income levels and have access to basic necessities of life such as food, clothing, education, medical services, and housing. These institutions have totally different objectives to follow and as such they need to be structurally adapted to serve the poor. The provision of microfinance services is quite costly and a number of factors are responsible for the mainstream financial institutions' unwillingness and inability to serve the poor class of society. These factors include the lack of collateral to secure their credit position, the high cost of delivering financial services to them and, keeping in view the potential number of transactions and the size of each, high administrative and financial cost per transaction (Hermes and Lensink, 2007; Ghate, 1992a; Ghate, 1992b). Thus, a specialized sector was needed to cater to the peculiar needs of this class of society and, as discussed above, the microfinance sector was developed with microfinance institutions serving as specialized financial institutions designed and developed with the very purpose of serving the poor.

The literature suggests that mainstream financial institutions and microfinance institutions chase different sets of objectives and can show operational and financial efficiency only in their respective areas of operations (Ghate, 1992b, p. 17). Ghate (1992b) explains that mainstream financial institutions have a larger capital base because of their ability to attract deposits from the general public and commercial funds

from open market operations. This allows them to accommodate large and longer-term loan applications which promise high returns and low per transaction costs. On the other hand, microfinance institutions mostly rely on scarce subsidized financial resources from the donor community and governments, hence are unable to provide large and long-term loans. This places a scrupulous check on their chances of improving their profitability. In the case of the microfinance sector in Taiwan, for instance, Tang (1995) claimed that while microfinance institutions served the poor segment of society and mainstream commercial financial institutions focused their energies on large-scale business, both of these different types of financial institutions with different sets of objectives complemented each others' operations. Thus, microfinance institutions were filling the gap left by mainstream commercial institutions and vice versa (Tang, 1995).

To highlight the significance of the microfinance sector in fighting the world's poverty, the United Nations nominated 2005 as the International Year of Microcredit and aimed to halve the present level of poverty in terms of number of poor households by 2015 (Hermes and Lensink, 2007).

2.4. Size of the Microfinance Industry.

The role of microfinance institutions as providers of financial services tailored to the specific needs of the poor in underdeveloped and developing countries cannot be overemphasized. As the traditional mainstream financial institutions are unable to meet the financial needs of the poor these microfinance institutions form an integral part of the financial sector. According to the most recent estimates, more than 10,000 microfinance institutions operate around the world (Castello, 2004). Studies, such as Ghate, 1992a, and Ghate, 1992b point to the large size of the microfinance industry in

underdeveloped and developing countries. These studies depict the heavy involvement of microfinance institutions in lending operations, particularly in rural areas. According to recent estimates the overall market demand for microfinance services is more than US\$ 300 billion while the supply stands at a meagre US\$ 4 billion. In terms of number of people, there are about 1.2 billion people living in abject poverty — living on less than US\$ 1 a day (Meehan, 2005). Thus the unmet demand for the services is still significantly high.

The microfinance literature portrays the microfinance industry to be quite big in size. By the year 2001, the outreach of the world's more than 10000 microfinance institutions was about 20 million borrowers. These figures, although big in absolute terms, however, cover only a fraction of the world's poor. In Bangladesh, for instance, the outreach of all microfinance institutions covers about 18.4 percent of the poor. In the case of Brazil the percentage of poor households covered under the umbrella of microfinance stands at only 0.4 percent (World Bank, 2003). The figures point to the huge size of the unmet demand for microfinance services all over the world.

2.5. The Extent of Success of Microfinance.

Microfinance proved to be effective in alleviating poverty around the world through enabling the poor to have access to financial services. The strategy allowed the poor to get a small amount as a loan from a microfinance institution, utilize it in some productive avenues, and, thus, try to get out of poverty (Kloppenburger, 2006; Hasan, 2002). Before the sector was formally instigated, the poor, in times of need, had to resort to the services of informal money lenders for financial help and were charged exorbitantly high interest rates on their small borrowings. This gave rise to the formal

microfinance sector during the 1980s to save the poor from being exploited at the hands of informal money lenders (Ledgerwood, 1999).

According to the World Bank (2003), if there was undue intervention from the government officials in the lending process, the repayment rate would go down among borrowers, which in turn would negatively affect the performance of the microfinance institution concerned. There was disagreement among researchers as to the success of microfinance in terms of improvement in the wellbeing of poor borrowers (Fernando, 2006; Morduch, 1999; Short, 2000). In the case of Thailand, for instance, Coleman (1999) argued that microfinance institutions had failed to bring improvements in the lives of poor borrowers, and the availability of subsidized financial resources from the donor community had not only reduced the scale of their operations but also hampered the efficiency of their services. Fernando (2006, p. 23) claimed that women constituted the majority of the world's poor and the impact of microfinance on their social status was not proven. He further argued that:

Numerical visibility of women in microcredit programs is a highly misleading indicator of qualitative dimensions of their empowerment. The numerical strength of women in these credit programs does not automatically translate into qualitative changes in their status (p. 27).

The success of microfinance institutions in terms of accomplishment of their primary objective of fighting world poverty can be looked at from the following two perspectives.

2.5.1. Theoretical Perspective as Discussed in the Literature.

The literature suggests that microfinance institutions can ensure their success in the long run if they tailor their operations according to the demands of time, adapt their collateral requirements according to the individual client's specific circumstances, and increase their expertise in managing a credit portfolio consisting of many loans of very small amounts (Ghate, 1992b).

According to Getubig *et al*, (2000), the prerequisites of success changed after the introduction of commercialism to the sector. They identified a different set of six characteristics of a successful microfinance institution. They argued that the success of a microfinance institution highly depended on: *first*, how successfully it could secure its loans without a tangible collateral from the borrower; *second*, how much expertise its staff possessed to find an ideal balance between risk and profitability in its lending operations; *third*, how efficient its operations were in terms of controlling costs and attracting deposits from the general public; *fourth*, how effective were its policies of loan recovery, and how effectively it could implement these policies; *fifth*, how efficient was its product innovation department in terms of innovating new products and tailoring its existing products according to the specific needs of the poor; and *sixth*, how effectively it could manage to serve the not-so-poor segment of society to boost its profitability, but without losing its grip on the poor segment.

2.5.2. Real Life Perspective — Mixed Evidence of Success.

The microfinance strategy rose to prominence on the international scene and inspired developed nations to use it throughout the world in developing and underdeveloped countries as a poverty reduction tool. The high achievement of the Grameen Bank of Bangladesh and the Banco Solidario of Bolivia (known as BancoSol) in terms of the impact of their operations on poverty in their respective countries was the driving force behind making microfinance an internationally acknowledged poverty reduction tool (Khandker and Shahidur, 1998). However, the real essence of microfinance in terms of the accomplishment of its primary goal of alleviating world poverty was still not witnessed by many of the poor countries. The practices, procedures, and policies of many of the world's microfinance institutions were not entirely geared towards achievement of their objectives and the strategy was regarded by many scholars and practitioners as unsuccessful in fighting world poverty (Megicks *et al*, 2005; Woller and Woodworth, 2001; Morduch, 1998; Short, 2000). The research suggested that the claim of microfinance to be an effective tool in socially upgrading the status of the poor was not materialized (Fernando, 2006). The success of the strategy was still not ascertained as far as the percentage of the poor households covered under its umbrella, the real dent it could make on the level of poverty, and the extent of microfinance institutions' sustainability were concerned (Short, 2000).

The improvement of the performance of these institutions and the achievement of encouraging results requires that their practices and procedures be brought in line with the international standards. Case studies by Wenner (1995) and Wydick (1999) concluded that if due attention was paid to the process of selecting poor borrowers for a

program and the stock of local social capital was prudently resorted to as a collateral to secure their financial obligations, the institution concerned was bound to experience a good repayment rate of its loans and, thus, long-term success.

Udry (1990) conducted a survey to analyse the performance and activities of the main players in the financial market in different villages in Nigeria. He concluded that neither commercial banks nor microfinance institutions were an effective part of the market with both contributing a meagre 7.5 percent of the total credit transactions. Most of the potential clients of these two types of institutions were depending on each other for meeting their day-to-day financial needs. Udry (1990) studied the situation in four villages and found that 97 percent of all credit transactions took place among individuals — relatives or friends, over a long period of time without involving any of the formal financial institutions.

The Microfinance Summit Campaign data for 2005¹⁶ indicates that the microfinance industry has failed to close the gap between the supply and demand for the services. The Report indicates that despite 30 years of microfinance efforts, more than 400 million poor families (about 80 percent of the potential microfinance clients) still do not have access to financial services. Based on the current growth rate, the Report predicts that the gap will remain unclosed for decades. The prediction indicates that by 2010, the gap will be slightly narrowed to 395 million unserved poor families (about 72 percent of the potential microfinance clients).

The Report further complains about the very small size of most of the MFIs, as indicated in Table 2.1.

¹⁶ Microfinance Summit Campaign Report, 2005 (available online at www.microcreditsummit.org).

Please see print copy for Table 2.1

Table 2.1: Business Coverage by MFIs.

Source: Microcredit Summit Campaign Report, 2005.

The literature suggests that, in order to make microfinance a reliable tool in eradicating world poverty and close the wide gap between the supply and demand for microfinance services, microfinance institutions should be made part of the mainstream financial system with operations geared towards controlling costs and achieving financial and operational self-sustainability. They should be regulated like the mainstream financial institutions. In addition, they must focus on product innovation going beyond credit and making a wide variety of financial services available to the poor (Megicks *et al*, 2005). For many scholars, practitioners, and international development agencies, the gradual shift from dependence on subsidized financial resources towards the commercialization of the microfinance sector was a step towards making microfinance a successful tool in eradicating poverty and reaching a maximum number of the world poor.

2.6. The Need for Efficient Management of Microfinance Programs.

2.6.1. Replication of Good Practices.

With the paradigm shift in the microfinance sector during the 1990s from high dependence on the provision of subsidized financial resources from the donor

¹⁷ Covers only those poor households who live on less than US\$ 1 a day, representing those who are counted in the bottom half of those living below their respective national poverty line at the time of disbursement of first loan to them.

community to self-sustainability the objectives of the sector changed. Under the changed circumstances, the sector needs more competence and efficiency in managing day-to-day affairs on the part of microfinance institutions. These institutions need to concentrate more on developing new financial products which could meet the specific needs of the poor (Megicks *et al*, 2005; Short, 2000).

As the literature suggests there is a high degree of variance in the performances of different microfinance institutions in different parts of the world. If some practices prove to be effective under a particular set of circumstances, they should be disseminated forthwith to enable other microfinance institutions with more or less similar circumstances to benefit from them. Good and more fruitful practices should not be kept by innovators as a private property. Emphasizing the need for a gradual shift towards commercialization in the microfinance sector, the Microfinance Summit (1996) concluded that the strategy could reach 100 million of the world's poorest families by the year 2005 (Microcredit Summit, 1996), which, as discussed later in the chapter, did materialize. The United Nations' current goal in this regard is to halve the world poverty by 2015 (Hermes and Lensink, 2007). Thus, microfinance institutions need more efficient management of their affairs and adoption of innovative practices to improve the depth of their outreach. If a noticeable success is achieved using a particular course of action, the same should be communicated to all concerned without delay.

2.6.2. Ensuring Low Default Rates.

Where credit is involved, the first priority of lending institutions is always to secure its principal amount and then struggle to recover interest on the amount. The main reason behind the unwillingness on the part of mainstream commercial institutions to serve the poor is that the poor cannot offer any assets as collateral to secure their financial commitment.

Microfinance institutions secure their loans through adopting a strategy of group lending, where loans are given to a group of individuals who are held jointly and severally responsible for the scheduled repayment of the loan. A group leader, nominated by the microfinance institution, monitors the performance of each member in terms of utilization of his share of the loan (Hubka and Zaidi, 2005). Any future financial assistance to the group depends on the performance of the group in terms of the prudent utilization of the proceeds of the loan and timely repayment thereof. This exerts pressure on the group members to utilize their borrowed funds in the most productive manner. With group lending programs, initially adopted by Grameen Bank and subsequently replicated by many others, the poor are more focused and feel highly responsible, thus doing their best to utilize the loan amount more efficiently (Hermes and Lensink, 2007; Hubka and Zaidi, 2005).

The real essence of the ‘group lending’ strategy lies in the concept of joint liability, which helps to overcome: *first*, adverse selection, as borrowers in the group reside in close vicinity and know each other very well. Thus, they can inform the institution about any of the members who may put the group’s credit worthiness at a risk; *second*, moral hazard, as the whole group’s credit worthiness is at a stake, members closely

monitor each other's performance and ensure that all members repay their share of the loan. In case a member defaults, the group ensures that the defaulter's financial crises were genuine; and *third*, repayment problems, as every member's activities are closely monitored by other group members, they are quick to identify any default risk and enforce timely repayment of borrowed funds (Hermes and Lensink, 2007; Ghatak and Guinnane, 1999; Besley, 1994). Hermes and Lensink (2007) also associated curtailment of agency costs for microfinance institutions with the concept of joint liability.

The concept of joint liability in a group lending strategy is generally of immense significance in the microfinance sector in the absence of other tangible forms of collateral to secure credit transactions. In the case of countries with a weak state of contract enforcement laws, the concept becomes of even more significance for microfinance institutions to enforce repayment of their loans through the group's peculiar dynamics. The group, using its dynamics, enforces a high level of commitment on the part of group members. In case of unwillingness to pay by any of the group members without any genuine reason the group uses different kinds of social sanctions to rectify the situation. Therefore, the group lending strategy provides microfinance institutions with a unique power to enforce repayment of loan even if they are unable to prosecute wilful defaulters on the basis of formal written contracts using their normal legal channels (Ghatak and Guinnane, 1999; Besley, 1994).

2.7. The Success of the Microfinance Effort.

After the paradigm shift in the microfinance sector, discussed above in section 2.6.1, the definition of a successful microfinance institution also changed. A microfinance institution is now regarded as successful if its operations demonstrate greater *outreach*,

high *impact*, and are sufficiently geared towards achieving operational and financial *self-sustainability*. Researchers agree with a microfinance institution claiming to have greater *outreach* only if its financial services are reaching a large number of poor households, particularly the poor in the ‘extreme poor’ category (Conning, 1999). Microfinance institutions’ *impact* of operations point to the *extent* to which their operations result in raising the overall income levels of their program participants. The term *self-sustainability*, on the other hand, refers to the success of microfinance institutions in covering their full operational and administrative costs and also provide for a surplus in the form of profits to finance their day-to-day operations and future expansion plans without a life-long financial support from donor agencies (Conning, 1999).

Keeping in view the level of the world poverty, the literature suggested that there was no evidence of overall success of microfinance institutions (MFIs) in terms of eradicating poverty using subsidized financial resources provided by the international donor community (Rhyne and Otero, 1994). Many microfinance institutions, while trying to secure their position, impose a condition of providing some assets as collateral on the poor borrowers. This apparently excludes the main category of poor households — the poor in the ‘extreme poor’ category, for whom the formal microfinance effort was originally initiated, as this category of the poor normally do not possess any assets acceptable as collateral. In the case of Bangladesh, for instance, microfinance institutions have been potentially excluding many of the deserving poor households. The overall *outreach* of MFIs in the country in terms of reaching the number of poor in the ‘extreme poor’ category can be ascertained from the fact that only about twenty five percent of all the clients of all microfinance institutions can be grouped as ‘extreme poor’ (Morduch, 1999). Thus, microfinance institutions cannot claim success in terms

of the achievement of their primary objective of eradicating world poverty (Christen and McDonald, 1998).

Braverman and Huppi (1991), and Morduch, (1999) also condemned microfinance institutions for their apparent failure to accomplish their original objective of helping the poorest of the poor, thereby eradicating poverty. Zaman's (1999) findings also endorse the fact that the microfinance sector did not fulfill its promise of eradicating world poverty. He studied the effects of the microfinance operations of the BRAC — a prominent microcredit provider in Bangladesh, on the overall level of poverty in the areas of its operations. He did praise the MFI's contribution to poverty reduction in the region but claimed, at the same time, that its success was not unconditional. Zaman (1999) concluded that the positive impact of the program was conditional on two factors: *first*, the size of the loans, as the increase in income of the poor recipients of the BRAC's loans varied substantially from borrower to borrower depending on the size of loan sanctioned to each borrower and, *second*, the level of poverty of the household at the time of receiving loan. Similarly, Servon and Bates (1998) argued that performance of small business enterprises could be enhanced if a bigger amount of capital is invested to start with. They found a positive correlation between a small business's performance in terms of profitability and the size of capital initially invested to start the business.

The success of the microfinance effort can be looked at both from the microfinance institutions' perspective and the borrowers' perspective.

2.7.1. From the Microfinance Institutions' Perspective.

The primary purpose of microfinance is to provide loans to poor people at an affordable interest rate in an attempt to enable them to get out of the poverty in which they are entangled. However, after the paradigm shift, microfinance institutions not only have to strive to accomplish their primary objective but also keep their other stakeholders happy and content. Thus, MFIs have to show profits to prove that their existence is not at the expense of their stakeholders — the donor community, the MFIs' staff, and the society in general. To be considered successful, therefore, microfinance institutions have to serve the poor and, through effective cost control policies, provide an acceptable return on investment (Rhyne and Otero, 1994; Christen and McDonald, 1998; Megicks *et al*, 2005). This will enable them to gain the confidence of the poor as well as other stakeholders which, in turn, will boost their chances of attaining long-term sustainability and success (Schreiner, 2002; Megicks *et al*, 2005).

The poor want continuous support in the form of subsidized financial services and it is not possible for the donor community to continue extending subsidized financial resources to the sector. After the introduction of commercialism to the sector, the stress is more on pursuing sustainability through lowering organisational costs and raising interest rates (Rhyne and Otero, 1994; Christen and McDonald, 1998). Rao (2003, p. 53) asserts that:

the main objective of microcredit schemes is to provide sustainable microfinance with economic development goals. If credit lending institutions can operate profitably and efficiently by targeting lending priorities for the asset-poor in order to elevate the economic status of such borrowers (often to remain above applicable poverty line) and without dependence on any significant financial subsidies, then the microfinance scheme may be deemed to operate as a sustainable microfinance.

The literature suggests that many of the MFIs do not fit into the new definition of successful microfinance institutions, which entails serving the poorest of the poor in large numbers as well as showing profits from operations (Morduch, 1999; Short, 2000). The poor expect to pay an interest rate on their loans which is normally insufficient to cover all of the MFIs' costs. Thus, expenses surpass revenues and they remain financially dependent on the donor community (Morduch, 1999). Their financial products are not market-driven and do not meet the specific requirements of the poor which hampers their outreach (Megicks *et al*, 2005). The few MFIs that have been judged as successful have achieved that status because they were almost financially self-sufficient (Schreiner, 2002).

The analysis of this situation reveals that there is a contradiction between the ultimate objectives of these institutions and those of the poor. The struggle of MFIs to earn profits and thus ensure their long-term survival proves to be in conflict with the objectives of the poor to secure cheap financial assistance and help themselves to get out of poverty. Since these institutions mostly provide services in remote rural areas and deal in very small amounts, their transaction cost per borrower is normally very high. In order to cover their costs and also provide a steady return on their investments, these institutions must charge higher than the market interest rate, thus, shifting the costs to the already vulnerable poor households. Apparently such a high interest rate for them would be beyond their means (Khandkar, 1996).

2.7.2. From Borrowers' Perspective.

The success of MFIs can also be looked at from the borrowers' perspective. The literature on the performance related aspects of MFIs suggests that their success in terms of accomplishment of their intertwined objectives of poverty eradication and self-sustainability is still not ascertained. Some researchers claim these institutions to have been successful in eradicating poverty (Kloppenburger, 2006; Khandker and Shahidur, 1998); on the other hand there is also some research, which concludes that the effort has had minimal impact on poverty eradication (Morduch, 1998).

While studying the poverty and famine issues in India and Africa, Dreze and Sen (1991) concluded that the poor all over the world were not alike in dealing with their poverty issues. They adopted different complex strategies to fight poverty and manage their available financial resources according to their particular circumstances. The scholars conceded in their book that due to this heterogeneous behaviour they are very unlikely to be brought out of poverty using a single credit-dominated financial strategy. They rather need a variety of tailor-made financial services to fit into their specific circumstances (Dreze and Sen, 1991).

Before the 1990s microfinance was believed to be reaching the deserving poor. Later on, however, evidence did not endorse this thinking. In the case of Bangladesh — the original hub of formal microfinance, for instance, researchers concluded that many of the microfinance institutions were not serving the poor in the 'extreme poor' category. A study by the BRAC's Research and Evaluation Division (RED) analysed the performance of its Rural Development Programs (RDPs). It revealed that about 41 percent of the most deserving poor were not covered by any of the microfinance

programs (Hasan, 2003; Matin, 2001). The study pointed to the apparent failure of these programs to serve the extreme poor who were the main target of microfinance. Few MFIs were incorporating innovative approaches to strengthen their operations and achieve their ultimate objective of fighting poverty by covering the really deserving extreme poor under their umbrella. While the ultimate objective of all microfinance efforts was to reach the poorest of the poor, the overall outcome was not encouraging, and the extreme poor were not given due access to financial services (Hasan, 2003).

This failure on the part of formal microfinance institutions to reach the extreme poor necessitated innovations in the field to overcome the existing short-comings and making it lucrative for all levels of the poor. With the paradigm shift in the sector, microfinance institutions have to struggle with not only reaching the poorest of the poor but also providing enough resources for ensuring their self-sustainability in the long-run. Thus, two alternatives that these institutions are left with under the changed circumstances are: *first*, charge an interest rate on their loans high enough to cover their operational and administrative costs, including bad loan losses, and also provide a steady rate of return on their investments and, *second*, take all possible steps to keep their costs at a minimum possible level (Conning, 1999).

Close monitoring of their loan portfolios can complement microfinance institutions' struggle for long-term sustainability. As loans in the case of mainstream financial institutions are sufficiently covered by collateral, the level of security of loans against defaults is much higher when compared to institutions in the microfinance sector. The concept of group lending which is based on the element of joint liability of all group members covers microfinance institutions against such risks by reducing or eliminating possible bad loans losses. In such types of lending the social relationships among

members of the group serve as collateral to secure the loan (Ghatak and Guinnane, 1999).

2.8. Emphasis on Self-Sustainability.

Emphasis on self-sustainability on the part of donors was initiated and expanded upon during the period from early to the mid-1990s and has given a new direction to the practices of microfinance players around the world. According to the CGAP (1997) all microfinance institutions have to depict two kinds of self-sustainability before claiming to be self-sustainable: *first*, the ‘operational self-sufficiency’ wherein all MFIs are required to depict full coverage of all their operational and administrative costs, including losses from bad loans, from their revenues from operations, and *second* the ‘financial self-sufficiency’, wherein all microfinance institutions have to prove that they are meeting all their financing requirements through funds generated from internal operations and other commercial sources, and covering all their financing costs. Thus, MFIs not only have to cover all their costs but also provide for their financing needs from their own operations without depending on help from outside entity. In addition, these institutions must treat all funds at their disposal as commercial funds with a cost to investors (CGAP, 1997; Edgcomb and Cawley, 1994, p. 86). The CGAP, however, concedes that in practice few microfinance institutions fulfill these conditions to be eligible for being treated as fully sustainable (CGAP, 1997).

If a microfinance institution is able to ensure a consistent flow of profit to all investors over many years without hampering its liquidity, it is regarded as a self-sustainable institution (Edgcomb and Cawley, 1994, p. 77). A microfinance institution to be accepted as a self-sustaining financial institution must not expect any subsidies from

any third party. Thus, considering the 1990s shift in the microfinance paradigm, microfinance institutions now have a two-fold objective of not only reaching large numbers of the poor but also accomplishing this aim in a self-sustaining manner (Gurgand, Pederson, and Yaron, 1996).

The new approach, which advocates self sustainability on the part of MFIs as the most important element of microfinance programs, has divided the academicians into two opposing schools of thought — the ‘welfarists’ and the ‘institutionists’. These two Schools advocate the following two opposing approaches as to the sustainability of MFIs in the long run.

2.8.1. The Welfarists’ Approach.

According to the Welfarists’ school of thought the emphasis on self-sustainability and commercialism is diverting the sector from its main objective of alleviating poverty. Advocates of the welfarist approach argue that the very purpose of microfinance entails reaching a large number of poor households, not achieving self-sustainability. They suggest that the overemphasis on recovering all costs and showing profits on the part of microfinance institutions would divert their efforts from the poor in the ‘extreme poor’ category because reaching this group of poor with suitable financial products is apparently the most costly endeavour (Hulme and Mosley, 1996).

Advocates of the welfarist approach claim that the commercialization of microfinance would lead to a drift from the main mission of all microfinance efforts. In other words, the MFIs’ eagerness to ensure profitability would make microfinance institutions ignore their original aim of providing social services in the form of cheap financial assistance

to the society's most deserving class (Woller *et al*, 1999). Moreover, it was argued that the stress on profitability would lead microfinance institutions to shift their financial and non-financial resources, which were already insufficient compared to the demand for them, to more profitable avenues ignoring the needs of the extreme poor for them (Woller *et al*, 1999). Some scholars even went further and suggested that the new approach to microfinance highly emphasizing profitability on the part of microfinance institutions was not helping their original mission in any way. To cover all their costs in the pursuit of profitability and self-sustainability, these MFIs charged an interest rate, which was too high for the extreme poor to earn from their small business endeavours, and their coverage of the extreme poor under their umbrella was extremely limited (Morduch, 1998 and 1999).

2.8.2. The Institutionists' Approach.

The advocates of the institutionist approach to microfinance argue that most of the microfinance institutions have failed to utilize the scarce financial resources of the donor community for helping the poor around the world. Subsidized funding of the operations of these institutions over the past about two decades did not produce any material benefit in terms of eradicating world poverty (see, for instance, Gonzalez-Vega, 1994). With the paradigm shift in the sector the criteria for judging microfinance institutions' performance changed too. Now, for a microfinance institution to be grouped with successful microfinance institutions must show self-sustainability, both operational and financial, in addition to meeting the financial needs of the poor in the vicinity of its operations (Yaron, 1994, p. 49).

Supporters of the institutionist approach maintain that to achieve self-sustainability in the long-run, MFIs have to adopt the financial system approach¹⁸, incorporating predominantly market principles of ensuring cost control and profitability in all aspects of operations. Donors want MFIs to refrain from totally relying on their support, and ensure their own survival through generating income from operations and controlling all organizational costs (CGAP, 1996; Gonzalez-Vega and Schreiner, 1997; Goodman, 2006; Dichter, 1996; Rogaly, 1996). The approach has received trenchant criticism from many scholars advocating the welfarist approach in all microfinance operations (see, for instance, Morduch, 1998; Christen and McDonald, 1998).

The main debate among the advocates of these two opposing Schools of thought is mainly about the level of interest rates on loans. Besley (1994, p. 29) argues in this regard that the rate of interest on microfinance transactions should be left loose to be determined by the forces of demand and supply, as in the case of the mainstream commercial credit market. At the early stages of the development of microfinance one of the objectives of MFIs was to make cheaper credit available to the poor households but later on the stress on self-sustainability changed the trend. A lower interest rate is being charged now in the case of conventional credit and, on the contrary, a higher interest rate in the case of microcredit after the initiation of commercialism in the microfinance sector. Megicks *et al*, (2005) in their study analysed different factors that potentially influence a microfinance institution's drive to adapt to commercial market principles and the subsequent impact of this adaptation on the institution's performance in terms of outreach. they concluded that under the prevailing circumstances of a high

¹⁸ Microfinance, before the paradigm shift during the 1990s, was following a poverty lending approach which mainly emphasized extending and recovering small loans to poor households. The financial system approach, on the other hand, emphasizes extending small loans to the economically active poor who have the ability to productively utilize these loans and repay them to lending institutions along with a profit. In addition, the approach entails a variety of financial services for the poor, not just credit (Robinson, 2002).

stress on commercialization and orientation towards principles of commercial businesses, these microfinance institutions need to focus more on their own survival in terms of sustainability and profitability, as it is only after attaining self-sustainability that they can serve the poor (Megicks *et al*, 2005).

As discussed earlier, the emphasis on self-sustainability on the part of donors, initiated during the period from the beginning to the mid-1990s (Robinson, 2001 and 2002; Fernando, 2006; Conning, 1999; Von Pischke, 1997; Baydas *et al*, 1997; CGAP, 1996; Gonzalez-Vega and Schreiner, 1997; Dichter, 1996; Rogaly, 1996; Hulme, 2000; Woller, *et al*, 1999), posed a new challenge to the MFIs around the world. The microfinance market was big and the financial resources that must be committed to the sector were far beyond the ability of the donors to provide. It was beyond the means of the donors to keep on extending subsidized credit to the sector. This caused the paradigm shift in the sector and the donor community realized that the shift towards commercialization on the part of microfinance institutions was the only solution to keep the struggle going. Self-sustainability and profitability on the part of MFIs were thus made the top priority as they were expected to attract the much-needed private investment to the sector, which, in turn, was essential for enhancing the performance of microfinance institutions in terms of outreach (Robinson, 2002; Rhyne and Otero, 1994).

Donors are, thus, interested in extending financial assistance on the basis of performance in terms of profits and self-sustainability. The Consultative Group to Assist the Poorest (CGAP) and the United States Agency for International Development (USAID), two prominent donors in the microfinance sector, are the main proponents of the approach (Von Pischke, 1997).

2.9. The Reasons for the Shift in the Microfinance Paradigm.

As discussed above, advocates of the ‘welfarist’ approach want the international donor community to keep extending subsidized financial resources to the microfinance sector and let it concentrate on its primary objective of reaching the poorest of the poor, instead of focusing on cost control and profitability. The institutionists, on the other hand, want the sector to become self-sustainable and independent of any kind of financial support (Hermes and Lensink, 2007).

Despite substantial investment from the donors and complementary efforts from many governments in the form of different subsidized credit programs over the years, experience showed that these efforts failed to accomplish their primary objective of eradicating poverty (Holt and Ribe, 1991; Short, 2000). The examples of microfinance efforts in Africa, Asia, Latin America, and Bangladesh presented a discouraging picture of inefficient utilization of scarce subsidized financial resources, poured into the sector by different governments and the donor community, on the part of microfinance institutions. The combined outreach of all microfinance programs in Africa was about a meagre 5 percent of the poor households. The percentage stood at 15 percent in the case of both Asia and Latin America. Bangladesh, host to many world renowned microfinance institutions, did not show encouraging results either where the total outreach of all microfinance institutions over a period of about 10 years was just 7 percent of the extreme poor who did not own any piece of land; the percentage stood at 15 percent in the case of poor households who owned a small piece of land (Holt and Ribe, 1991). The progress of these programs in the case of Nepal in terms of percentage of outreach to poor households showed a declining trend over time (Holt and Ribe, 1991).

Institutionists want all microfinance programs to be carried out purely on a commercial basis. Donors' financial and non-financial resources are not unlimited and to tackle the overwhelming task of eradicating world poverty, donors need support from the private sector. To attract private investment and hence expand the outreach of microfinance efforts, microfinance institutions should observe commercial principles of doing business and show profits. In other words, they should operate very much like a commercial business where investments must yield an acceptable level of returns. Donors opine that even if higher interest rates are charged on microfinance loans, it would still be less than those charged by the informal money lenders. They quote the case of the Bank for Agriculture and Agricultural Cooperatives (BAAC) of Thailand as an example which successfully managed to charge 20 percent interest rate on its micro loans (World Bank, 1990a; Holt and Ribe, 1991).

2.10. The Ideal Course of Action for MFIs after the Paradigm Shift.

Ever since the gradual shift of the microfinance sector from one heavily dependent on governments' and donors' subsidized funding to the one which is geared towards profitability and self-sustainability, microfinance literature has focussed on how to make the shift a success. As discussed above, in setting up an acceptable level of interest rate to be charged on micro-loans, Besley's (1994) opinion should be resorted to. He advises that the matter should be left open to the forces of demand and supply. This means that a microfinance institution will be able to charge an interest rate which it can justify on the basis of the quality and acceptability of its products to its poor clients. Otherwise, clients would switch to other microfinance institutions, which may be charging justifiable interest rates on their loans.

Braverman and Huppi (1991) and Herath (1996) argue that despite the lack of tangible collateral in the microfinance sector to secure the lending institution against the default risk, the rate of repayment of loans in the sector is much higher than in the case of mainstream commercial banks. They argue that over years of serving poor households in close vicinity, microfinance institutions become a part of the local community. This close intimacy with the locals puts them in an advantageous position with respect to securing accurate and relevant information on their prospective borrowers. Most of the microfinance institutions are established to cater to the financial needs of poor households in a particular locality or a region, because of which relevant information on prospective borrowers can be readily accumulated from many sources in the community, thereby minimizing the default risk to a great extent (Herath, 1996).

Besley (1994) points to another aspect of the microfinance sector's failure to reach the desired performance level. He maintains that the insurance services sector could complement the microfinance sector to minimize the risk of default by making sure that unforeseen events, such as the illness of a family member or any other natural calamity, do not unexpectedly take away a chunk of the poor borrowers' hard earned income, leaving them with insufficient income to service their loan.

Furthermore, to improve the quality of credit related decisions, and hence lowering the risk of default, Besley (1994) advises microfinance institutions' credit staff to take every possible step to get informed about the reliability and creditworthiness of their prospective borrowers before sanctioning loans. However, first of all the sector needs to establish such a system of sharing information among all microfinance institutions (Besley, 1994). Besley (1994) argues that developing and fostering such a system needs

support at the government level in the form of putting in place appropriate policies and proper implementation thereof.

2.11. Summing Up.

The donors' and governments' policies to ensure continuous flow of subsidized financial resources to the poor through different programs have largely failed to achieve their objective of alleviating poverty.

It is argued in the literature that under the prevailing circumstances of meagre supply of and heavy demand for microfinance services all over the world, developing a viable microfinance sector which is entirely governed by the principles of commercialism and in no way dependent on any third party for either financial or non-financial resources or both, may be the best course of action to follow to help the poor and make optimal use of the society's scarce available resources.

It is argued that the performance of microfinance institutions should be assessed on the basis of the achievement of their primary objective — to help the poor get out of poverty. However, the paradigm shift in the sector from highly subsidized operations to a strong emphasis on commercialism and achievement of profitability and self-sustainability on the part of microfinance institutions gave rise to two opposing schools of thought — the welfarist and the institutionist. While followers of the welfarist approach evaluate microfinance institutions' performance mainly through how efficiently they fulfill the needs of the deserving poor in terms of poverty eradication, institutionists measure MFIs' performance through the yardstick of their profitability and self-sustainability. Institutionists assume that only self-sustainable microfinance

institutions are likely to reach a maximum number of the poor and thus contribute to poverty eradication. Ever since the donors changed their thinking and approach as to the sustainability of microfinance institutions, the two-fold criterion of outreach and self-sustainability has been used by the performance evaluators to gauge the performance of microfinance institutions all over the world (Yaron, 1994; Chaves and Gonzalez-Vega, 1996, Yaron *et al*, 1998; Ledgerwood, 1999).

This case study is on The Aga Khan Rural Support Programme — a prominent microfinance institution in Pakistan, and its adaptation, reorientation, and subsequent transformation into an independent commercial setup in response to the changed external circumstances. It surrounds the changed donors' thinking and approach as to the sustainability of microfinance institutions and their coping with the changed external circumstances.

The next chapter will throw some light on Pakistan's microfinance sector: its scope, characteristics, strengths, weaknesses, and future direction.

CHAPTER 3: Microfinance's Task in Pakistan

3.1. Brief Country Profile.

Pakistan is in the northwest part of South Asia and is the seventh most populous country in the world. Figure 3.1 shows a map of Pakistan.

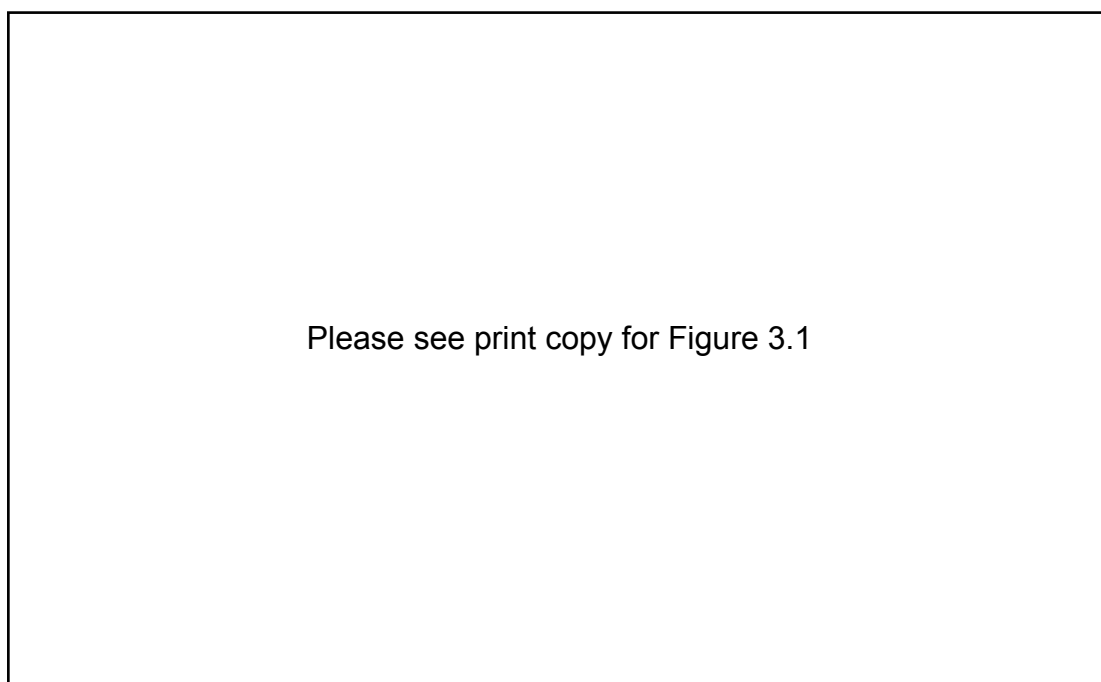


Figure 3.1: Pakistan.

Source: Available online: http://travel.yahoo.com/p-travelguide-577848-map_of_pakistan-i

With an area of 796,095 square kilometres (307,374 square miles) and a population of 152.1 million¹⁹, the population density is 187 people per square kilometre, which is

¹⁹ 2004 estimate by The World Bank Group. Available online: <http://devdata.worldbank.org/external/CPPProfile.asp?PTYPE=CP&CCODE=PAK>, date accessed: June 8, 2006.

much lower than most other South Asian countries²⁰. Pakistan holds seventh position in the world in terms of high population (PMN, 2002).

3.2. Overview of Pakistan's Economy.

Since the study is about a case in Pakistan's financial sector, it seems logical to give a brief introduction to the country's economic performance in the recent history. This section will briefly discuss Pakistan's:

- economic structure
- demography
- economic growth and performance, and
- poverty levels — achievements and future challenges.

3.2.1. Economic Structure.

The agriculture sector and the tertiary²¹ sector employ more than 40²² percent each of Pakistan's work force. The remaining 20 percent is accommodated by the industry sector. Over a period of five years from 1999, the work force in the agriculture sector fell to less than 35 percent of the total. Two thirds of the work force that quit the agriculture sector was covered by industry and the remainder by the services sector. The trend of the country's labour force to join a particular sector almost matches that of other poor Asian countries (USAID, 2005, p.7).

The percentage of the population living in rural areas is around 66 percent of the total and most of them, directly or indirectly, earn their living from engaging in agricultural

²⁰ Pakistan Country profile from National Geographic MapMachine (Country Profiles), available online at <http://plasma.nationalgeographic.com/mapmachine/profiles/pk.html> , Date accessed: May 2, 2006.

²¹ Pakistan's tertiary sector is made up of several industries like legal services, accounting, finance and stock broking, catering, and tourism.

²² Reported at 44.8 percent for the agricultural sector in PRSP, 2006.

activities. Thus, performance of the agriculture sector is the main determinant of the fluctuations in poverty in the country's rural areas (PRSP, 2006).

3.2.2. Demography.

The rate of population growth in the country during the early 1990s was more than 2.5 percent per annum. However birth rates indicated a declining trend during the same period. According to the official figures for 2003, the population grew at about 1.9 percent per annum. More emphasis on and increased awareness about health care issues, and the encouraging performance of the economic sector contributed to the country's reduced death rates (USAID, 2005). While, the population growth rate is quite close to that of other Asian countries with similar income levels, it was an issue of high concern to the Government because it was responsible for an increased supply of labour into the market merely adding to the list of already unemployed millions (USAID, 2005, p.7).

3.2.3. Economic Growth and Performance.

The performance of Pakistan's economy has not been smooth over recent history. Noticeable variations can be observed in Pakistan's economic performance over the past decade. Pakistan's economic growth rate has not been encouraging during the 1990s with Gross Domestic Product (GDP) growth rate hovering around 3 percent per annum (GoP, 2003). In recent years, however, the country's rates of growth have shown an encouraging trend. The average GDP growth rate was 4.0 percent over the five year period preceding fiscal year 2003-2004. The rate has risen steadily and exceeded 6 percent in 2003-2004 (USAID, 2005; IMF, 2005), and reached 8.6 percent in 2004-

2005 (SPDC, 2006). The average growth rate for the country's GDP remained stable around an average of 7 percent during the period from 2003 to 2006 (PRSP, 2006). The Social Policy and Development Centre (SPDC) annual review for the financial year 2005-2006 reveals that Pakistan's economic growth rate has slowed down to 6.6 percent in the financial year 2005-2006²³ but was still encouraging keeping in view the slow GDP growth rate of below 4 percent in the recent past (SPDC, 2006).

According to the SPDC's review, the services sector grew at a high pace of 8.5 percent. The SPDC's internal analysis of Pakistan's economic growth trend predicts a growth of around 23 percent in the financial year 2006-2007 in the services sub-sector of finance and insurance (SPDC, 2006). For 2004 Pakistan's per capita income was US\$ 538, which on average pointed to a reasonably higher living standard of its population if compared with other Asian countries²⁴ with more or less a similar income levels at US\$ 494²⁵ (USAID, 2005). The per capita income rose to US\$ 742 in 2004-2005 reaching a high US\$ 847 in 2005-2006 (PRSP, 2006). Many factors such as, the government's improved macroeconomic policy, better management and control of its fiscal deficits, improved performance of exports, especially in the textile sector and less reliance on imports, improved inflow of tax to the government's treasury, and successful check on the level of inflation contributed the country's improved growth rates (USAID, 2005).

An improved export sector's performance largely contributed to improved balance of payment position and relief in the country's debt burden (USAID, 2005). Inflation, however, remained a serious issue in Pakistan, negatively impacting on the poverty

²³ Agricultural sector growth rate decreased from 6.7 percent to 2.5 percent, while manufacturing sector growth rate slowed down from a whopping 12.6 percent to 8.6 percent during the year (SPDC, 2006).

²⁴ For example, Thailand and Indonesia.

²⁵ The figures are US\$ 2265 and US\$ 1864 respectively in terms of Purchasing Power Parity.

levels. Inflation remained stable and controlled at 5 percent during 2000 through to 2003 (Khan and Schimmelpfennig, 2006). Improved export sector performance pushed money supply. Inflation, chasing high money supply, increased sharply reaching a staggering 11 percent in April, 2005, pushing the prices up and hitting the poorest of the poor harder. It, however, slowed down later on, getting steady around an average of 8 to 9 percent per annum by September 2005 (Khan and Schimmelpfennig, 2006; USAID, 2005). The category of core inflation, which does not take into account food and energy sectors stood at 7.2 percent in the current financial year (SPDC, 2006).

Dr. Shaghil Ahmed, Acting Managing Director of the Social Policy and Development Centre, stressed in his message in the SPDC's annual report that some factors were posing threats to the country's economy in the form of macroeconomic imbalances. These imbalances could cause a hike in trade deficits. It may also result in a sharp increase in domestic demand, which, when not met with a similar level of supply, could result in severe economic problems (SPDC, 2006). The SPDC review acknowledges that effective policies were not put in place to switch public expenditures and increase inflow from various taxes to finance and thus help curtail these macroeconomic imbalances.

3.2.4. Poverty Levels — Achievements and Future Challenges.

The poverty level in the country is alarming and represents one of the major problems facing Pakistan. Every successive government has tried to fight poverty in the country whether using its own resources or through donor-assisted programs but the incidence of poverty still exists and is prevalent in the country at a mass level (Hussein and

Hussain, 2003). The poverty and inequality rate showed a continuous upward trend during the 1990s (PRSP, 2006). At the start of 2001, about one-third of the population was living in poverty. According to Pakistan's official poverty line²⁶ about 51 percent of the country's rural population can be categorized as poor; the rate is about 11 percent in the case of the urban population (GoP, 2003; ADB, 2002).

The highest level of growth in poverty and unemployment was witnessed during the period from 1999 to 2001. The Social Policy and Development Centre report 2001 revealed that during a short span of two years since 1999 about 350,000 people became unemployed while 7 million others were pushed below the poverty line (SPDC, 2001). The unemployment rate in 2001-2002 was 8.3 percent. The country's good economic performance in the recent past, as discussed above, managed to bring the rate down to 7.7 percent during 2003-2004. For the period from July to March of 2005-2006, the rate stood at 6.5 percent, reflecting on the country's good economic performance (PRSP, 2006). The percentage of population below the poverty line was 31 percent in 1979. It fell down by 14 percentage points to 17 percent by 1998, but rose again to 33 percent in 1999. The report further stated that in 2001 about 38 percent of the country's population subsisted below the national poverty line (SPDC, 2001).

The incidence of poverty showed a declining trend in the 1970s and 1980s. However, a sharp rise in the poverty levels in Pakistan was experienced during the 1990s (PRSP, 2006; ADB, 2002). Measured from the angle of calorie intake per person²⁷, more than 32 percent of the country's adult population lived in poverty during the fiscal year

²⁶ The Pakistan official poverty line is Rs. 748.56 per adult per month as reported in Economic Survey 2003-2004 (Government of Pakistan); no rural and urban difference in poverty lines is given in the survey.

²⁷ Translated into an expenditure of Rs. 682 per month per adult in 1998-1999.

1998-1999. In 1992-93 this percentage was less than 27 (Hussein and Hussain, 2003; GoP, 2003; ADB, 2002). The country's encouraging performance both in terms of economic growth and reduced unemployment levels brought poverty in the country down to around 24 percent by 2004-2005 from 34.46 percent in 2000-2001²⁸ (PRSP, 2006). Other factors that contributed to this decline in poverty included an increase in remittances from Pakistanis working abroad, microfinance services, and an increased flow of money to the poor from different sources of *Zakat* (PRSP, 2006). The Government has set a target of bringing the percentage of poor households below the national poverty line to 16 percent of the population by 2015 (USAID, 2005).

However the government has to overcome many challenges to accomplish its set goals (PRSP, 2006). Various measures will have to be taken to make this substantial dent on the prevailing poverty levels. These measures may include improving tax collections, widening the country's tax base by covering more of its wealthy population under the tax net, improving the balance of payment situation through increasing exports and reducing imports in addition to creating a suitable environment for the country's microfinance institutions to flourish in terms of accomplishment of their primary objectives of eradicating and ensuring self-sustainability.

Poverty levels in Pakistan are not very high compared to internationally prescribed levels for extreme poverty but still high enough to justify an urgent need for remedial actions on the part of government (USAID, 2005, p. 6). According to the World Bank, extreme poverty is spread widely in the country with about one-third of the population living in poverty (World Bank, 2002). Recent official data on poverty, as discussed

²⁸ The percentage of the poor in the 'extreme poor' category was about 1.1 percent of the population in 2000-2001, which fell to 1.0 percent by 2004-2005. The percentages in the 'ultra poor' and 'poor' categories fell from 10.8 and 22.5 in 2000-2001 to 6.5 and 16.4 respectively by 2004-2005 (PRSP, 2006).

earlier in the chapter, hints towards a decrease in poverty in the four years from 2001 to 2005. This decrease in poverty is depicted in the encouraging growth in economic indicators and the resulting increased flow of public expenditure towards development projects in recent years (SPDC, 2006).

After its independent analysis of the poverty situation, the SPDC, however, concluded in its 2005-2006 annual review that the government's figures on poverty unduly overestimated its achievements in terms of a reduction in the level of poverty. The SPDC claimed this on the basis of some factors which, although not taken into account by the government officials, were substantially offsetting the country's achievement in respect of poverty reduction.

These factors listed by the SPDC in its 2005-2006 annual review included the alarming level of inflation, the ever-increasing gap between the rich and the poor, and the disproportionate flow of the share of the increase in national income to all the population. In other words, despite the overall encouraging rates of economic growth, the extreme poor in the country remained at the end of queue to get a their slice. The USAID (2005) also remarked in their report that although the country's economic situation has improved in recent years, the level of poverty suggests that poverty eradication was still a top priority for the government (USAID, 2005).

One-third of the population lives in poverty. Table 3.1 gives estimates of the percentage increase in income required to move people out of poverty in Pakistan, which hints to the enormous task for the microfinance sector to accomplish.

Table 3.1: Percentage Increase in Income Required to Move People Out of Poverty.
Source: Hussein and Hussain, 2003, p. 36.

Please see print copy for Table 3.1

Keeping in view the scarce resources that could be allocated to the sector, it is necessary to follow the strategy of commercialism and self-sustainability in the sector in order to enhance its outreach and impact on the welfare of the beneficiaries. Partnerships between public and private sectors are needed to help increase the flow of the much needed monetary as well as non-monetary resources to the sector (GoP, 2003). The low literacy rate of 49 percent²⁹ adds to the microfinance sector's overwhelming task. The challenge is not just of low literacy levels in the country but also about the quality of education. With a clear objective of ensuring everyone's access to quality education, the Government of Pakistan is heading towards achieving its target of taking the literacy rate to 60 percent by 2015 (GoP, 2003).

²⁹ The wide gap between male literacy at 61 percent and female at about 37 percent point to the differential treatment among genders at individual household level (GoP, 2003).

3.3. Microfinance Efforts in Pakistan – an Overview.

3.3.1. Background.

The idea of microfinance is not new in Pakistan. The origin of the government's efforts in the form of many subsidized microcredit³⁰ services, particularly in the agriculture sector can be traced back to the 1960s. In addition, many Non-Governmental Organizations (NGOs) and financial institutions have been involved in providing these services in rural and urban areas for many years now. The Orangi Pilot Project (OPP) in Karachi and the Health and Nutrition Development Society (HANDS) in the Hyderabad and Thatta districts have been offering microfinance services for more than a decade (Rehman, 2002).

The initiation of a formal form of microfinance efforts was witnessed during the early 1980s when the Orangi Pilot Project (OPP) was established in the country's largest city, Karachi. This was followed by the launch of the Aga Khan Rural Support Program (AKRSP) as a private sector rural development program in 1982, which later on established itself as the most reputable microfinance model in Pakistan. When compared with the Non-Governmental Organizations sector, the AKRSP's microfinance wing accounts for around 70 percent of total microfinance coverage in the country in terms of number of poor households served (CGAP, 2006, p.6).

Until the early 1990s, Pakistan's microfinance sector, as in most other countries, provided mainly microcredit services. In other words, the *modus operandi* of the

³⁰ The term 'microcredit', as opposed to 'microfinance', is deliberately used here to refer to the initial poverty eradication efforts when the sector was mainly dealing in small loans for the poor. The term 'microfinance' replaced the term 'microcredit' in the literature when the sector started providing a wide range of financial services to the poor in addition to extending small loans.

microfinance providers was to secure subsidized financial resources from international donor agencies and extend cheap/subsidized loans in small amounts to poor households with a view to help them start a small business and thus change their social status. During the 1990s, with the paradigm shift in the sector, many NGOs began providing their poor clients with a variety of financial and non-financial services, not just microcredit. The ‘Kashf Foundation’ and the ‘Asasah’, present a picture of the sector’s changed circumstances. These Non-governmental Organizations were established in the private sector in 1996 and 2003 respectively and operate under the new ‘commercial microfinance’ paradigm. Their focus is not only on providing a range of financial services to the country’s poor but also on ensuring their own self-sustainability through a high emphasis on cost control and profitability in all aspects of their operations (CGAP, 2006).

Before the principles of commercialism and self-sustainability were introduced, these programs were all struggling to improve their performance in terms of reaching a high number of poor households. Their outreach was extremely limited and only a small portion of the total demand was being met. As of June, 2002, total coverage of microfinance programs in the country in terms of the poor reached was approximately 181,000 with the poor borrowers’ total outstanding loan obligations amounting to around Pak Rupees 1.1 billion (PMN, 2002).

3.3.2. Demand for and Supply of Microfinance Services.

Pointing to the huge demand for microfinance services in the country, the Asian Development Bank's Microfinance Sector Development Review³¹ asserted that the potential demand for the services in terms of the number of poor households was approximately 6.5 million. The sector's services were in high demand while the supply was struggling to cope with the demand (ADB, 2000; GoP, 2003). According to the Pakistan Microfinance Network (PMN), as of June 2004, the total coverage of all the microfinance institutions was about 718,000 in terms of active microfinance clients. This was about 12 percent of the potential target of 6.5 million. These poor borrowers owed about US\$ 99 million in unpaid liabilities in respect of their loans (PMN, 2004). This showed the number of unserved potential microfinance clients in the country and the need for concrete efforts to make microfinance a more effective tool to tackle the level of poverty in the country (CGAP, 2006).

Realizing the fact that the resources available to the microfinance sector are not unlimited and to meet the potential demand for the services, the government of Pakistan pinpointed in its Poverty Reduction Strategy Paper of 2003 that private sector investment is crucial. It cited the Pakistan Poverty Alleviation Fund as a classic example of public-private partnership in the microfinance sector (GoP, 2003; APPC, 2007). The Government of Pakistan asserts that the Fund, which has operations in 87 districts of the country, operates on innovative grounds, and it does not rely on simply extending micro loans. It operates from three windows: *first*, it has a Credit and Enterprise Development unit which provides financial assistance in the form of a credit

³¹ Report and Recommendation of the President to the Board of Directors on the proposed loan to the Islamic Republic of Pakistan for the Microfinance Sector Development Program (November, 2000).

line to microfinance institutions for the purpose of the expansion of their microfinance operations, *second*, it has a Community and Infrastructure unit which extends financial assistance on a cost sharing basis for physical infrastructure development within a community, and *third*, it has a Human and Institutional unit which gives financial assistance to its partner organizations for institutional capacity building (GoP, 2003).

The elements of commercialism and self-sustainability in operations of most microfinance institutions in the country have helped them remarkably increase their outreach. While all microfinance programs in the country currently reach about one million poor households, the government's current poverty reduction strategy aims to cover an additional two million poor households by 2010. The current high recovery rate of outstanding loans among most of the country's microfinance institutions is also encouraging and point to their enhanced capacity of reaching more poor households in the future (APPC, 2007).

3.3.3. Why Microfinance?

The poor's access, under the microfinance programs, to credit and other financial services was extremely low in Pakistan. This limited access to financial services was similar to other parts of the world. The many difficulties associated with dealing with the poor such as lack of collateral to secure the lending institutions' credit position and high costs in reaching them deterred the mainstream formal financial institutions from serving this segment of society (Hassan, 2002). The poor, therefore, sought help from informal sources to meet their financial requirements. These informal sources included neighbors, family members, and money lenders. The informal money lenders among

these sources usually charged the poor extremely high interest rates for their financial assistances (Dehejia *et al*, 2005).

Despite efforts from many NGOs and other financial sector institutions to help alleviate the poverty problem in Pakistan, many researchers and experts did not consider the approach to be successful in the accomplishment of its objectives (Bokhari *et al*, 2004). Some researcher blamed the high rate of interest, which in most of the cases is more than 20 percent, for the apparent failure of the approach to get many of the poor out of poverty (Khandker, 2003). This, however, did not mean that microfinance was of no use. A generally accepted assumption about microfinance, all over the world, was that it was helping the poor. Researchers agreed that the only alternative available to date to help the poor to overcome their poverty and improve their social status was to let them have access to a full range of financial services (Coleman, 1999; Yousaf *et al*, 2004; ADB, 2000).

3.3.4. The Modern Microfinance Movement.

The present government is highly focused on eradicating poverty and the microfinance sector is given high value in this regard. The sector is being resorted to as a reliable instrument to enhance the present outreach of microfinance institutions which, at present, is far behind the potential demand of about 6.5 million poor households for microfinance services (CGAP, 2006). The outreach of 15 out of the total about 40 microfinance institutions is about 99 percent of the whole microfinance market. Thus, there is need to broaden the client base of most of the country's microfinance institutions (CGAP, 2006). As discussed in earlier in Chapter 2, it was realized by the

donor community that to increase the outreach and meet the huge demand for the microfinance services, the microfinance institutions must adopt a commercial approach to microfinance.

The current strategy resorted to by the Government of Pakistan for fighting the country's poverty highly emphasized the role of microfinance (Rehman, 2002). Pakistan's microfinance sector was still comparatively underdeveloped and thus needed support from government (Montgomery, 2005). The present government's efforts to prudently utilize the sector's services caused a major shift in the microfinance landscape. Efforts were made to provide a fully conducive environment for the sector. The Pakistan Poverty Alleviation Fund (PPAF) was fully operationalized to provide support for the country's microfinance institutions (PMN, 2004; CGAP, 2006). The coming into being of the Khushhali Bank, a specialized commercial microfinance bank, through a special Ordinance called the Khushhali Bank Ordinance, 2000 was also a step in this direction. The Microfinance Ordinance was issued in 2001 to govern the operations of the country's all microfinance institutions in the commercial sector.

The promulgation of the Ordinance stimulated the growth of the microfinance sector. The First Microfinance Bank Limited (FMFBL), which was established from the transformation of the microfinance division of the Aga Khan Rural Support Programme, was also facilitated by the Ordinance (Montgomery, 2005; PMN, 2004). Similarly, the Kashf Foundation, which operates on commercial grounds, showed high success in terms of reaching a large number of poor borrowers, maintaining high repayment rates among its borrowers, and ensuring its self-sustainability through controlling costs and improving profitability. Some of the mainstream commercial banks such as The First Women's Bank and the Bank of Khyber also progressed in the microfinance sector in

addition to maintaining their mainstream commercial banking operations. These banks adopted a strategy of establishing formal links with other formal microfinance institutions in the country in their attempt to cater to the needs of the poor (PMN, 2004).

3.4. Assessing Microfinance Success in Pakistan.

The idea of assessing the performance of microfinance institutions at a unit level and as a whole in terms of their real impact on poverty levels has emerged relatively recently. Most of the studies on this aspect of the country's microfinance efforts were instigated after the year 2000 (Hussein and Hussain, 2003). Despite the long-term association of many microfinance institutions — NGOs³², and government-sponsored rural support networks³³, with the sector, according to Mr. Haroon Jamal, head of Poverty Unit at the Social Policy and Development Centre (SPDC), Karachi, poverty has actually increased (Montgomery, 2005). Hari R. Lohano and Haroon Jamal of the SPDC could not confirm in their Research Report No. 48 (2003) that the microfinance efforts of the two leading microfinance schemes — the National Rural Support Program (NRSP) and the Orangi Pilot Project (OPP), did yield any long-term benefits for the country's poor; their efforts remained fruitless in terms of employment generation for the poor (Lohano and Jamal, 2003). In addition, as referred to earlier in the chapter, the country's microfinance ventures were still lagging far behind the total demand for microfinance services (CGAP, 2006). The situation suggests that drastic changes need to be introduced to the sector, which needs to resort to innovations in the products being offered as well as the approach being followed. The country's financial as well as non-financial resources are

³² The major NGOs providing microfinance services in Pakistan are Development Action for Mobilization and Emancipation (DAMEN), Sungi Development Foundation (SUNGI), Taraqee Foundation (Taraqee), Orangi Pilot Project (OPP), Sindh Agricultural and Forestry Workers Coordinating Organization (SAFWCO), Asasah, and Kashf Foundation (Kashf) (Montgomery, 2005)

³³ National Rural Support Program (NRSP), Punjab Rural Support Program (PRSP), Sarhad Rural Support Program (SRSP), and Thardeep Rural Development Program (TRDP) (Montgomery, 2005).

limited and research needs to be conducted to identify and implement suitable projects to put them to an optimal level of benefit (Rehman, 2002).

The literature suggests that some factors depicting good performance on the part of microfinance institutions may not always prove to be true indicators of their performance. For instance, performance indicators such as high rates of repayment of loans among borrowers and the sanctioning of additional loans have been used by many microfinance institutions in Pakistan and Bangladesh to portray their own performances as a success in terms of poverty eradication (Montgomery and Weiss, 2003; Hussein and Hussain, 2003). In general, loan repayments by the poor borrowers and in turn larger loan disbursements by microfinance institutions are considered to be a reflection of good performance on the part of MFIs (Yaron, 1997). Loan portfolios at many microfinance programs in Pakistan such as The Bank of Khyber, The First Microfinance Bank Limited (FMFBL), the National Rural Support Programme (NRSP), and the Punjab Rural Support Programme (PRSP) were growing and the loan amounts were being well circulated between these institutions and their respective clients. Therefore, these programs were considered to be successful in terms of poverty eradication (Hussein and Hussain, 2003).

The assumptions about the performance of microfinance institutions in terms of making their programs fruitful for the poor in real terms have changed. The donor community now is interested in the reliable assessment of these institutions' performance. 'Repayment' of loans on the part of borrowers, although very important for the long-term sustainability of microfinance institutions, is no longer recognized as a reliable indicator of the success of a microfinance program in terms of its impact on poverty eradication. The repayment of a loan by a borrower according to a pre-determined

schedule does not necessarily mean that the loan amount has been put to its optimal use in profitable ventures and that the flow of income is from the business ventures in which the proceeds of loans were invested (Zafar and Abid, 1999; Hussein and Hussain, 2003; Lohano and Jamal, 2003).

Thus, it makes sense that if the amount to repay a microfinance loan is coming from a source other than the small business venture of the poor borrower, then although the microfinance program's performance in terms of its own figures in the financial statements may look encouraging, yet its success in terms of poverty eradication becomes questionable. The Kashf Foundation is an example of such a success. The MFI is being run on a commercial for-profit basis and cost control in operations and loan recoveries are highly emphasized. The terms and conditions of the loan agreement make it obligatory for its borrowers to repay on time even if the poor borrowers have to resort to avenues other than their business activity where the proceeds of the loan were invested (Hussein and Hussain, 2003).

Keeping in view the number of potential borrowers in the microfinance sector, the cumulative coverage of the microfinance institutions has not been encouraging so far. According to a survey conducted in 2001 the outreach of the microfinance programs was limited to only 35.6 percent of the urban poor households and 16 percent of the rural. The survey concluded that almost same results were observed in the case of 'poor' and 'extremely poor' categories of the households (PNHDR, 2003; Hussein and Hussain, 2003). Discussing the vulnerability of the extremely poor in rural areas in the country, the Pakistan National Human Development (PNHD) report observed that landlords are in a position to easily exploit poor households. More than 52 percent of extremely poor live as tenants to big landlords putting them in a situation where the

landlords can control them through slightly changing the terms and conditions of tenancy agreements. Due to inaccessibility to formal credit these poor households, being heavily dependent on the local landlords, have to borrow from them. In return, they are required to perform work for the landlords without being paid (PNHDR, 2003).

3.5. Islam's View on Poverty Eradication.

In a predominantly Muslim country like Pakistan, microfinance is not the only means of helping the poor. The third basic pillar in Islam is the payment of obligatory tax called *Zakat* by affluent Muslims to the eligible poor. It is the only compulsory financial obligation on Muslims which they must pay once every year on their possessions of cash and other assets. Different rates of payment apply to different kinds of assets such as cash, investments, harvest, and livestock (Dean and Khan, 1997).

The word *Zakat* is Arabic word which means 'purity'. An effective implementation of a *Zakat* system in a country provides a reliable source to protect the poor socially as well as morally (Ahmad, 1991). The compulsion of payment of the *Zakat* distinguishes it from a charity which any one can pay to the poor voluntarily and at any time of their own will (Dean and Khan, 1997). One of the purposes of making the payment of *Zakat* a compulsory duty on Muslims is to redistribute wealth within a society. In other words, *Zakat* ensures the circulation of wealth and the promotion of opportunities for the social betterment of the poor (Ahmad, 1952). The rule of *Zakat* is not enforced by coercion, but through convincing Muslims to accept it as a moral obligation to help their poor counterparts in providing them with the means for a basic livelihood, and to pay it giving the neediest poor a priority (Hussain, 1947; Dean and Khan, 1997). *Zakat* brings

the poor and the rich closer to each other and thus promotes a sense of love between them (Ali, 1993, p. 88).

Although the payment of *Zakat* is a compulsory duty on Muslims from a religious point of view, its non-payment is not penalized by the state. Muslims pay it voluntarily depending on their individual conscience. In several predominantly Muslim countries, concerned government agencies collect *Zakat* through the country's internal banking channels and distribute it among the poor through a system involving an intermediary organization. In Pakistan *Zakat* is collected every year under a similar system of *Zakat* collection and distribution (Dean and Khan, 1997).

Thus, in a Muslim country, *Zakat* serves as a timely relief from financial difficulties for the poor population of the country. Particularly for that segment of the poor which self-exclude from microfinance programs on religious grounds or for some other reasons, as discussed in the following sections, *Zakat* can prove to be the biggest timely financial aid if collected from the wealthy and distributed to the poor according to the procedures prescribed in Islam (Dean and Khan, 1997).

Since the poor do not have to pay back the amount they receive as *Zakat*, the proceeds are usually consumed by the poor in meeting their day-to-day consumption requirements without any long-term benefits for the poor. Therefore, a prudent centrally controlled system for the efficient utilization of *Zakat* funds, which may amalgamate the rules of the modern microfinance with the rules of management of *Zakat* funds (with the exception of interest, of course), needs to be established and implemented at the government level. Under the system, establishing a priority list of all the poor, comparatively larger amounts may be given to the most deserving poor, starting with

the one on the top of the list, along with expert advice and necessary training to utilize the money in some productive way instead of consuming it straightaway. The amount should be large enough to help the poor start a small business. The expenses of such a system may be met by the government from the same *Zakat* funds. This system, however, is a new and unique idea which needs to be researched thoroughly and developed through implementing a strategy of ‘learning from experience’³⁴.

3.6. Characteristics of Microfinance Programs in Pakistan.

Looking at the current microfinance practices we find that most of the commercial banks and NGOs in Pakistan, involved in microfinancing activities, stress, mainly, the recovery of the loan. As soon as a loan is extended its recovery becomes their primary objective (Ahmad and Nicholas, 1994; Hussain and Hussein, 2003). In addition, before sanctioning a loan, the borrower’s particular context is not looked into. Some borrowers spend the loan money on their cultural and health related issues, which ultimately leads them to default on their loans. They then resort to alternative avenues to secure financial assistance to service their existing loans and meet their other financial needs (Ahmad and Nicholas, 1994).

In addition, where the poor borrowers’ small businesses venture suffers financial difficulties for genuine reasons, it may be possible to bring them out of those crises by extending further financial help and, thus, enable them to service both their old and new financial obligations as well as keep their business ventures going. But unfortunately

³⁴ The author strongly desires to introduce such a system in his country and intends to conduct extensive research on it.

this re-scheduling analysis is not carried out before efforts for recovery are initiated and the recovery of existing loans vigorously followed.

Contrary to the situation in Pakistan, research in other countries has proved otherwise. Copestake *et al* (2001), in their research study, found that recipients of a second loan from a microfinance program performed well in terms of the profitability of their businesses. In addition, they also showed positive signs in terms of growth in their business. By contrast, in Pakistan, extending a second loan is very rarely considered even if borrowers demonstrate sufficient potential for recovery from their financial crises and growth if provided with additional financial assistance (Ahmad and Nicholas, 1994).

It is difficult to observe the real essence of microfinance in Pakistan (Hussain and Hussein, 2003). In most cases, if poor households apply for a loan under a microfinance program, they are asked for collateral in some form by the microfinance institution. For example, at The Bank of Khyber, Peshawar, Pakistan, there is a separate Microfinance Unit (MFU) but it avoids extending loans to any poor people without collateral³⁵. A similar situation could be observed in the case of many of the microfinance programs being run in the country (Ahmad and Nicholas, 1994).

It is generally recognised that the microfinance efforts in Pakistan can be characterised by the following factors.

³⁵ The author was an employee of The Bank of Khyber from October 1999 to February 2003.

3.6.1. Religious Thought — the Prohibition of ‘Interest’.

One of the most prominent factors affecting microfinance efforts in Pakistan is the ‘interest’ factor. Pakistan is predominantly a Muslim country and, in Islam, the charging and paying of interest is strictly prohibited (Choudhury and Malik, 1992). The mainstream commercial financial institutions charge interest on their loans irrespective of whether borrowers earn profits or suffer losses. On the contrary, in the Islamic banking system, the lending institution invests in the borrowers’ business ventures and either earns an income or suffers a loss to the extent of its investment depending on whether its borrowers’ businesses earned income or suffered a loss (Choudhury and Malik, 1992). Thus, the Islamic banking system avoids charging interest on loans but does not eliminate the profitability motive of carrying on a business.

The establishment of the first formal Islamic commercial bank can be traced back to Egypt in the 1960s (The Banker, 1989). Since then, many Muslim countries such as Pakistan, Iran, and Sudan have tried to harmonize their banking system with the Islamic law of *Shari’ah* (Aftab, 1986; The Economist, 1992a). Islamic banking grew into an industry with US\$ 80 billion in deposits and more than 100 banks and finance houses all over the world (Khalaf, 1995). According to more recent estimates, the number reached more than 265 by 2005, with a market capitalization in excess of US\$ 13 billion, total assets of over US\$ 262 billion, and financial investments above US\$ 200 billion (Al-Ahram Weekly, 2005).

The success of mainstream Islamic commercial financial institutions demonstrates that the same rules may be applied to the field of microfinance in predominantly Muslim countries, in order to reach those segments of the poor who do not participate in the

microfinance programs because of their strict adherence to religious beliefs. Loans may be provided to poor households without a predetermined interest rate in accordance with the teachings of Islam. If poor households are able to generate profits, a certain portion of that will go to the microfinance institution. The rest will be kept by the borrower. In case of a loss, however, the financing institution will have to share a portion of the loss as well. There are numerous other modules of Islamic banking which may be adapted to the specific needs of the microfinance sector and applied accordingly.

3.6.2. Low Coverage and Targeting Inefficiency.

The meagreness of financial resources that can be allocated to the sector deters it from enhancing the capacity of microfinance institutions to reach a maximum number of the poor (Hussein and Hussain, 2003). That is the main force driving the sector to establish itself purely on commercial grounds, gearing all its efforts towards self-sustainability and profitability, in order to secure public deposits, attract private capital, and, thus, increase the outreach of its constituents.

In addition, the poor in the 'extreme poor' category are left out of most of the microfinance programs in the country and, thus, the basic goal of microfinance efforts remains unaccomplished. The credit portfolio of most of these institutions does not demonstrate enough coverage of the extreme poor (Hussein and Hussain, 2003). Thus, microfinance efforts remain concentrated around the poor in the 'not-so-poor' category leaving the core purpose of microfinance, that is, to reach the poorest of the poor, unaccomplished (Ahmad and Nicholas, 1994).

3.6.3. Inadequacy of the Financial Support.

The size of the loan extended is insufficient to cover the working capital requirement of the poor borrowers and thus most of them remain in financial crises throughout their business endeavour and finally lose their borrowed money. As a result, they are pushed further into poverty and the financial institution suffers as well (Hussein and Hussain, 2003).

3.6.4. Dependence on Donors.

Pakistan is a developing country and faces huge resources constraints, financial as well as non-financial. There are numerous areas with varying degrees of priority wherein the government has to allocate the limited financial resources at its disposal. Thus, the government is compelled to depend on the donors' support for different needy areas including microfinance (Hussein and Hussain, 2003). The sector, therefore, is not self-sufficient as far as financial resources are concerned and the full impact of its programs cannot be gained. There are chances for the sector to overcome its issues of limited resources if its current efforts to make all microfinance institutions profitable and self-reliant are successful.

3.7. Future Directions for Microfinance Programs in Pakistan.

Pakistan's microfinance sector lacks innovations and most of the microfinance institutions remain focused on a single product of sanctioning and recovering small loans. The sector's performance in terms of outreach and self-sustainability remains

unproven, and most of its constituents have failed to demonstrate the efficacy of their operations in closing the wide gap between the supply of and demand for microfinance services (CGAP, 2006). As discussed earlier, a comprehensive survey covering 300 poor households found discouraging results as to the performance of two major microfinance institutions (Lohano and Jamal, 2003).

Thus, the state of the country's microfinance depicts that most of the MFIs' operations are not sufficiently geared towards achieving success in reaching a maximum number of the poor. Furthermore, the paradigm shift of the 1990s in the sector which emphasized self-sustainability on the part of microfinance institutions (Fernando, 2006; CGAP, 1996; Gonzalez-Vega and Schreiner, 1997; Von Pischke, 1997; Robinson 2001 and 2002) exerted additional pressure on MFIs to concentrate on self-sustainability and profitability. Thus microfinance institutions need to adapt and reorient their operations to the sector's changed paradigm. Policies and practices need to be tailored in such ways that not only can the MFIs achieve self-sustainability and increase their outreach but also the poor are able to benefit from them.

3.8. Regulations for the Microfinance Sector.

During the early development stages of formal microfinance in Pakistan, microfinance institutions needed to be registered with concerned government authorities. Until the late 1990s, unlike players in the formal banking sector with statutory authority to mobilize public deposits, no government authority was supervising or regulating the microfinance sector (Hubka and Zaidi, 2005). The paradigm shift in the industry during the 1990s, that is, the introduction of the concepts of commercialism, profitability, and

self-sustainability, necessitated the introduction of regulations in the sector to monitor the MFIs' operations.

Since 2000, the overall approach to microfinance in Pakistan has witnessed a considerable change. Since then new reforms and regulations have so far been introduced in the sector. The present government demonstrated its interest in the microfinance sector as a tool to fight poverty in the country through these changes. It was this interest on the part of government that resulted in the full revival of the operations of the Pakistan Poverty Alleviation Fund (PPAF) and the formulation and promulgation of the MFIs Ordinance 2001. The Ordinance monitors and regulates the MFIs' operations in the country (GoP, 2003). In addition, the Microfinance Sector Development Program was launched specifically with the purposes to enhance the outreach of microfinance institutions within the country, improve their self-sustainability, and encourage innovations in products and services for their target population (Montgomery, 2005). Realizing the shortcomings of the microfinance sector in fully harnessing the potential of the strategy, the government took an initiative to introduce programs to build capacity and develop the skills of potential microfinance clients. The idea was to make the poor capable of utilizing the borrowed funds for productive purposes before handing them funds (GoP, 2003).

After the paradigm shift and introduction of a stringent principle of commercialism in the microfinance sector, a need was felt to somehow regulate the sector to make it transparent and prevent chances of fraud. The Government of Pakistan promulgated the Microfinance Ordinance in 2001 to regulate the sector. Different rules and regulations concerning the operations of the microfinance sector were enforced through the Ordinance (PMN, 2002). In October 2002, the State Bank of Pakistan, the country's

central bank, introduced a separate set of Prudential Regulations³⁶ to regulate the microfinance sector.

Before the introduction of the principles of commercialism and self-sustainability to the sector, the operations of most of microfinance institutions were limited to particular localities and regions. One of the purposes of these regulations was to provide a conducive legal environment for spreading the network of microfinance institutions to cover all parts of the country through encouraging the establishment of new microfinance institutions and enabling existing ones to spread their operations and increase outreach (Montgomery, 2005).

3.9. Summing Up.

The growth trend of the microfinance industry in Pakistan in recent years is encouraging; however, its performance has not been up to the mark so far. Microfinance institutions are still struggling to achieve operational as well as financial self-sufficiency prescribed by the Consultative Group to Assist the Poor (CGAP) for the sector under the new ‘commercial’ or ‘financial system’ approach. The CGAP acknowledges the achievement of the sector in terms of cost control but is not impressed with the outreach of its constituents. Microfinance institutions are still struggling to organize their operations to demonstrate profitability and self-sustainability. Although the microfinance sector is highly transparent, a low stress on profitability, low leverage, and little private sector investment and savings mobilization hinder the sector’s drive for self-sustainability (CGAP, 2006).

³⁶ A different set of State Bank of Pakistan’s Prudential Regulations govern the operations of mainstream commercial banks and other financial institutions.

Under the prevailing circumstances of a high stress on improved performance and self-sustainability on the part of microfinance institutions, the sector must charge interest on loans and fees on services high enough to cover all their costs and also provide for its profitability (CGAP, 2006). Keeping in view the extent of coverage that microfinance institutions currently enjoy in proportion to the total demand for the services, it is argued that the main challenge for the microfinance sector in Pakistan is to vigorously follow the principles of commercialism while ensuring to reach the maximum number of poor households. With the change in donors' thinking and the approach adopted during the 1990s as to the sustainability of microfinance institutions, from providing subsidized financial resources to emphasizing self-sustainability, the microfinance division of the Aga Khan Rural Support Programme set the first example in the country of a successful adaptation, reorientation, and subsequent transformation to an independent commercial microfinance bank — The First Microfinance Bank Limited, for its other counterparts in the industry.

This chapter, along with Chapter 2, built a background for the study. The next chapter will throw light on the theoretical framework for the study.

Chapter 4: Theoretical Framework

Chapter 3 covered the state of microfinance in Pakistan, its strength and weaknesses, and future prospects in the light of changed external circumstances as to the long-term sustainability of the microfinance institutions around the world. This chapter will cover the theoretical framework³⁷ for the study, which is based upon a combination of two theoretical frameworks — Laughlin's (1991) Model of Organizational Change and Institutional Theory (DiMaggio and Powell, 1983).

4.1. Background.

A microfinance institution, in its policies and practices, is not expected to be rigid and unsusceptible to external environmental pressures. It has to tailor its policies and practices and adapt to the demands of the external environment. The external environment, if it gets turbulent, exerts pressure on a microfinance institution to adjust its policies, practices, rules, norms, objectives, goals, and overall structure and make them harmonised with externally dictated conditions. The literature suggests that organizations try to resist a change and stay unchanged in their current balanced state (Laughlin, 1991). Moreover, they will show inertia and try to click back to their original state, if possible (Miller and Friesen, 1984). They will only change when 'forced', 'kicked', or 'disturbed' by the turbulent external environment (Laughlin, 1991).

Organizational change and its dynamics have remained a hot topic in the literature and many studies have covered many aspects of changes and the reasons thereof in

³⁷ "A theoretical framework is a collection of theories and models from the literature which underpins" a research study. As opposed to a quantitative research study, it may not be very clear in structure in case of a qualitative research study (Hussey and Hussey, 1997, p. 123). It is of utmost significance to resort to a theory in analysing the empirical data in the case of a qualitative research. Its importance, however, varies from case to case (Rice and Ezzy, 1999, p. 9).

organizations in a variety of industries. Previous studies on organizational change have been concerned with different contexts, types of organizations, and industries such as railways (Tyrrall and Parker, 2005; Laughlin, 1991), churches (Laughlin, 1991), telecom (Erakovic and Wilson, 2005), and privatization of state-owned enterprises (Dean, Carlisle and Baden-Fuller, 1999; Springdal and Mador, 2004). Similarly there are studies of organizational change with particular reference to the role of ‘accounting/accountants’ (Gray *et al*, 1995), and ‘environmental accounting’ (Larrinaga-Gonzalez *et al*, 2001).

The primary focus of this study is on the actual visible changes in the Aga Khan Rural Support Programme’s ‘tangible’ and ‘intangible’ organizational elements — the ‘interpretative schemes’ (mission, purpose, beliefs, norms, values, culture, rules, philosophy), ‘design archetypes’ (overall organization structure, decision processes, communication systems), and the ‘sub-systems’ (tangible organizational elements such as staff, departments/divisions, business premises) — in response to the external ‘disturbances’ or changed external circumstances. In this case study, the donor community’s changed thinking and approach as to the long-term sustainability of the microfinance institutions (MFIs) from providing subsidized financial resources to a strong emphasis on self-sustainability on the part of the MFIs, the resulting competition among the MFIs, and increased government regulations, all constitute external environmental ‘disturbances’.

External environmental disturbances/kicks/jolts (Laughlin, 1991), such as those discussed above, following a particular pathway or track (Laughlin, 1991), penetrate through the organization causing it to initiate internal adaptation and reorientation to the changed external circumstances. The literature suggests that these ‘jolts’, ‘noises’,

‘kicks’, or ‘external disturbances’ — as named by different scholars, trigger a change within different elements of an organization and cause it to adapt, reorient, and/or transform accordingly (Laughlin, 1991; Pettigrew, 1987; Greenwood and Hinings, 1988).

4.2. The Environmental ‘Disturbance’ or ‘Impetus’ or ‘Jolt’.

In the early stages most microfinance programs have had little direct competition and their main challenge was to reach the poorest of the poor and provide efficient services to their clients (Rhyne, 2001). The main critique of many academicians about the industry has been about its single-product nature. The industry has been blamed for its lack of innovations and dealing mostly in a single product — extending and recovering micro loans to poor households (Hulme and Mosley, 1996; Hulme, 2000). The stress on self-sustainability on the part of donors, which can be traced back to the period from the early to mid-1990s (Fernando, 2006; Robinson, 2001 and 2002; Baydas *et al*, 1997; CGAP, 1996; Gonzalez-vega and Schreiner, 1997; Dichter, 1996; Rogaly, 1996), posed a new challenge to the microfinance institutions around the world. Instead of looking for subsidized financial resources from international donor agencies, microfinance institutions now have to rely on good and commercial banking practices to achieve self-sustainability and thereby ensure their long-term survival.

Donor agencies emphasize reducing operational costs, charging a market rate of interest (or even more), and improving profitability. The microfinance institutions’ objective is, thus, not only to reach large numbers of the poor, but also to ensure their own survival and sustainability through adopting prudent commercial practices (Gurgand *et al*, 1996). Sustainable organizations ensure a positive rate of return on all the stakeholders’

investments (Edgcomb and Cawley, 1994, p. 77). Edgcomb and Cawley (1994, p. 86) further argue that sustainable institutions do not need subsidized financial resources from outside sources, and are able to generate enough profits from their operations to fully meet their present and future financing requirements. These organizations are not dependent on the donor community for subsidies.

The new ‘commercial’ approach on the part of the donor community has resulted in a competition among microfinance institutions; they have to compete with each other for more clients, trying to get an edge over others on the basis of better services, flexible product-line, and more efficient utilization of the available resources. Thus, microfinance, now-a-days, is not without competition. Like most other forms of financial institutions, microfinance institutions face severe competition from rivals in the industry. Not conducting a well-informed market research and introducing innovative products in today’s highly competitive market would jeopardize today’s microfinance institutions’ long term survival and sustainability (Hulme, 2000).

4.3. The Case of the Aga Khan Rural Support Programme.

The Aga Khan Rural Support Programme (AKRSP) came into being in 1982 and started operations in the northern areas of Pakistan as a private sector microfinance institution to help eradicate poverty in the region. Like other microfinance institutions, the AKRSP had to continuously rely on international donors’ support for its survival and sustainability. During the 1990s the AKRSP witnessed a change of approach on the part of the international donor community from providing subsidized financial resources to a stress on self-sustainability, and the resulting competition from rivals in the industry. The AKRSP, therefore, had to adapt or reorient to the changed circumstances. This

adaptation and reorientation on the part of the AKRSP can be explained from two theoretical perspectives. First, the study will explain the ‘acceptance’ or passive ‘submission’ to the external environmental pressures by the Aga Khan Rural Support Programme using the theoretical underpinnings of Institutional Theory; and, second, the internal adaptation and reorientation of the MFI in response to the environmental disturbances will be explained using Laughlin’s (1991) Model of Organizational Change.

The remainder of this chapter will try to establish a theoretical base on which to analyse and interpret the empirical data about the Aga Khan Rural Support Programme. Institutional Theory, a specific way of looking at organizations (Scott, 1995), provides a theoretical base for organizing and analysing information about an organization. First Institutional Theory will be discussed in brief and then it will be used to explain why the AKRSP passively accepted the external environmental pressures and why it did not resist them.

4.4. The Essence of Institutional Theory.

The origin of Institutional Theory can be traced back to around the 1950s. It has been widely used in research studies in the field of economics, political science, and sociology (Scott, 1995). Describing the theoretical underpinnings of institutional theory, Weick (1996, p. 567) claimed that social contexts in which microfinance institutions operate have considerable control over them and are capable of tailoring their tangible and intangible organizational elements to a large extent.

Selznick (1957, p. 16) defined “institutionalization” as:

something that happens to an organization over time, reflecting the organization's own distinctive history, the people who have been in it, the groups it embodies and the vested interests they have created, and the way it has adapted to its environment.

Scott (1995, p.13) described the structures of organizations as “shared knowledge and belief systems”. The essence of Institutional Theory is that an organization of a particular type experiences a kind of pressure that compels it to adopt certain policies and procedures if it is to be seen as a good member of that particular industry (Barley and Tolbert, 1997). If an organization is willing to be known as part of or a legitimate member of a particular group of organizations in the same industry, it has to inculcate the norms and values associated with that particular industry by the general public, referred to as “rules of knowing” (Mills and Murgatroyd, 1991, p.1) into its organizational structure.

Several studies in the management field have linked the survival and sustainability of a business enterprise to its proper amalgamation with the institutional environment it is operating in. To ensure a firm's long term survival and sustainability it should be linked to or merged in prevalent local institutions within the same industry. It must conform to industry norms and values, and the expectations of the society at large (DiMaggio and Powell, 1983; Meyer and Rowan, 1977; Baum and Oliver 1991; Oliver, 1997). Snow (1999) also, while discussing the sustainability issues of a microfinance institution, hints towards its prudent adoption of industry norms and values. To make microfinance institutions self-sustainable in the long run, they have to be harmonized with other institutions in the same industry with respect to their policies and practices and other organizational elements. In other words, they should not look like standing alone but should appear to be part of the mainstream local institutions (Snow, 1999). Cernea (1993), while analysing the causes of failure of most of the World Bank's poverty

reduction projects in Asia, Africa, and Latin America, blamed the lack of incorporation of social factors such as local norms, values, practices, culture, and people's interaction and dealings with each other — all regulating forces behind their specific behavioural patterns, in the implementation of these programs for their failure.

This case study concentrated on the internal adaptation and reorientation of the Aga Khan Rural Support Programme (AKRSP) in response to external environmental disturbances to ensure its long term survival and sustainability³⁸ and to prove its beneficial and legitimate existence to other organizations on which it was dependent for resources — financial and non-financial support, and to the society at large. The AKRSP passively submitted to the new external environmental conditions because to remain in the industry it had to accept the “rules of knowing” (Mills and Murgatroyd, 1991, p. 1) that had started to prevail in the industry. It had to tailor its policies and rules, objectives, and overall organizational structure to prove itself as a legitimate member of the industry. In other words, it had to show itself as a proper carer of industry norms and values.

Institutional Theory best explains this part of AKRSP's adaptation and reorientation to changed external conditions. Actual changes in the AKRSP's organizational elements — both tangible and intangible, will be looked at from the theoretical perspective elaborated by Laughlin's Model of Organizational Change (1991).

³⁸ In very broad terms, organizations could be referred to as 'self-sustainable' if the society is deemed to be receiving benefits, net of all costs, from their existence (Cernea, 1993).

4.5. Institutional Elements and Organizations.

The use of the term ‘institution’ is commonplace in literature pertaining to organizational studies but still lack an unequivocal meaning (Neale, 1987). Three main institutional elements, with varying degrees of importance in different contexts, have so far been identified in the literature. These are ‘coercive’, ‘mimetic’, and ‘normative’ influences (DiMaggio and Powel (1983). Scott (1995), adopting the same three institutional influences with different names³⁹, explains how these institutional elements become part of organizational structure. He went on to say that:

institutions consist of cognitive, normative, and regulative structures and activities that provide stability and meaning to social behaviour. Institutions are transported by various carriers – cultures, structures, and routines. As these institutions shape social behaviour, they are inevitably incorporated into organizations, and are such powerful forces that they appear as objective reality, even though they are socially constructed (Scott, 1995, pp. 33-34).

The three original institutional elements identified by DiMaggio and Powel (1983) are briefly discussed below.

4.5.1. The Coercive Influence.

Organizations function in a balanced state unless disturbed by external environmental pressures, kicks, or jolts (Laughlin, 1991). Externally dictated ‘coercive’ influences on organizations compelling them to adapt or reorient in a particular way may prove to be ‘disturbing’ for some organizations. These organizations, if not equipped with unique powers or privileges, have to respond positively to these external disturbances to ensure their survival in the long run. Coercive influences on an organization may be from

³⁹ He has used the same name for ‘Normative’ influences, but re-named coercive influences ‘regulative’ and mimetic ‘cognitive’.

formal or informal sources. There are ‘formal’ pressures on organizations, such as from an entity with an authority from the state in the form of rules, regulations, and sanctions. Formal interventions by a country’s central bank on formal financial institutions are an example of ‘formal’ coercive influences on these institutions’ behavioural patterns. Informal pressures, such as from donor organizations requiring microfinance institutions to prove their legitimate existence and eligibility for financial and non-financial support, constitute ‘informal’ coercive influences for these institutions. Thus, ‘coercive’ influences compel organizations not only to follow rules and regulations from authoritative entities but also conform to what is generally expected of them as business enterprises (Oliver, 1997).

The general public will bestow legitimacy on organizations that explicitly conform to rules and regulations stipulated by an authoritative entity or any conditions dictated by an external entity on which they are dependent for resources (DiMaggio and Powel, 1983). Organizations abide by these regulative measures primarily because of their financial and non-financial dependence on the regulative bodies. The persistent conformity to these ‘regulative’ institutional influences over an extended period of time on the part of an organization inturn gets it a legitimizing authority in its field, which it can use on new-comers in the industry.

A newly established commercial bank is a classic example of an organization which, after coming into being, finds itself facing the rigorous ‘coercive’ influences in the form of rules and regulations and societal expectations to ‘behave’ like other ‘successful’ mainstream commercial banks. It has to positively respond to the ‘coercive’ influences which come in the form of different regulations from the country’s central bank and other concerned government authorities and the societal expectations. Shirking any

obligation set by these authoritative entities could result in immediate disciplinary action against the bank concerned.

4.5.2. The Mimetic Influence.

DiMaggio and Powell (1983) identified a mimetic institutional influence as a force that tends to influence an organization and tailor its policies and practices in accordance with the circumstances currently prevailing in the industry of which it is a part. Mimetic pressures work best in situations where organizations function in a state of uncertainty. Because in such a situation most organizations are already inclined to portray themselves as an integral part of the group instead of trying to stand alone (DiMaggio and Powell, 1983). Scott (1995) called these forces 'cognitive' influences.

Some researchers argue that organizations do not wilfully and actively accept mimetic influences, maintaining that other well established and socially accepted organizations in the same field impose these influences on them. However, organizations will perceive their policies to be deleterious for their own survival and wellbeing in the long run if they would opt out from the mainstream organizations in the same field by trying to neglect these influences (Covaeski and Dirsmith, 1988a; Meyer and Rowan, 1977; DiMaggio and Powell, 1983). Others, however, comment differently on the adoption of these influences and postulate that organizations relish responding positively to these influences. These scholars argue that these organizations view themselves as a unique entity after wilfully adapting their policies and procedures to these well-established drivers of behavioural patterns in the industry (Scott, 1995). Thus, every organization in a particular field will tend to absorb mimetic influences into its tangible and intangible

elements. It will adopt or adapt to all established, legitimated procedures, and will try to model itself after other perceived to be well-established and legitimate organizations in its field.

4.5.3. The Normative Influence.

In addition to ‘coercive’ and ‘mimetic’ institutional influences on an organization, there are other influences that are more obscure. These less easily identifiable pressures are termed ‘normative’ influences. Existing players in an industry, through rigorously following industry norms over long period of time, establish themselves as the main constituents of the industry. They try to internalize and impose their specific organizational policies, rules, and procedures on other industry constituents as well-established socially acceptable norms and values of the industry. Any new-comer in the field is obliged to adopt these industry norms and values and follow them in letter and spirit in order to be accepted as a genuine member of the group and, thus, ensure its long term survival and sustainability (Scott, 1995). DiMaggio and Powell (1983) posit that mutual achievement of the existing players in an industry in setting up industry norms and values over a period of time thereby defining ‘acceptable’ behavioural patterns for new-comers to the industry to follow, is categorized as ‘normative’ influence.

Normative controls or pressures on a new organization’s behaviour are more likely to be internal. The organization opts to conform to these internal pressures because it perceives itself to be rewarded for it by the leading organizations in the industry and the society at large. On the other hand, ‘regulative’ controls are imposed on organizations

by outside entities that have latent powers over them. They have to follow these influences to avoid any disciplinary action against them (Scott, 1995).

4.6. Organizational Response to Institutional Pressures.

The response of different types of organizations to each of these three institutional influences has been found to vary among organizations in the same field. The extent of each organization's response also varies depending on the size, strength, and the level of its dependence on other entities. For instance, Ang and Cunnings (1997) found that different banks with varying circumstances responded differently to institutional influences. They found that banks are more inclined to conform, whether willingly or unwillingly, to 'regulatory' influences without any resistance. But, depending on their size and strength, they will try not to accept the influence of 'mimetic' pressures. Similarly, DiMaggio and Powell (1983) found a strong link between the level of professionalism of an organization's staff in terms of experience, academic qualification and participation in professional activities and the extent of the organization's conformity to 'mimetic' influences. They argue that organizations with highly professional and shrewd staff are more likely to become similar to other organizations in the same field. Powell (1991) maintains that an organization's willingness or unwillingness to respond positively and to a particular extent, depend on the type and source of the institutional pressure that is trying to induce a change in its organizational elements. Oliver (1997), in her study, refers to voluntary government agencies and professional bodies as immutable to normative and mimetic institutional pressures.

The strength of any of these three institutional pressures, discussed in above sections, is not fixed or a universally accepted rule. Different researchers' interpretations and

perceptions of members of organizations in question may give a varying degree of strength to each of these institutional pressures. In other words, the extent of significance of these pressures is not only subject to their origin but also the perceptions and interpretations of the organizational actors or, in the field of research, researchers. Figure 4.1 describes the influence of the three institutional elements on an organization.

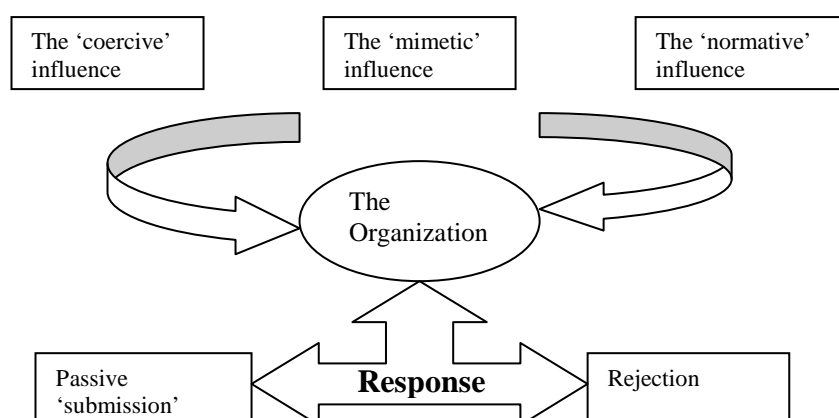


Figure 4.1: Institutional elements and organizational response.

4.7. Institutional Isomorphism.

In simpler words, institutional isomorphism, one of the fundamental concepts of Institutional Theory, is the process through which organizations in the same field become similar to each other. Meyer and Rowan (1977, p.340) defined institutional isomorphism as:

the process by which organizations are driven to incorporate the practices and procedures defined by prevailing rationalized concepts of organizational work and institutionalized in society.

Institutional isomorphism among organizations occurs when there is competition, which drives organizations to follow institutional norms and values set by leading players in

the same industry in order to ensure their long term survival and sustainability. Institutional theorists posit that willingness to submit to the institutional influences on the part of organizations is the essence of institutional isomorphism. These institutional influences, which shape organizational behaviours, lead to achieving sustainability, legitimacy, and social support. These influences include, but are not limited to, a country's regulatory structures, and rules and laws of concerned government agencies (Oliver, 1997).

In order to achieve long term sustainability an organization must also earn a general perception of a 'legitimate' existence from the society in addition to showing a sound financial footing in terms of monetary achievements. In the literature, we encounter two types of 'organizational legitimacy': *first*, that which is granted by regulatory agencies and *second*, that which is bestowed upon the organization by the general public in form of endorsement of its rules, norms, values, and overall organizational behaviours (Deephouse, 1996). Deephouse (1996) found that organizations benefit from organizational isomorphism in the form of increased legitimacy in the sight of the general public. He further observed that both groups, which were capable of bestowing legitimacy upon organizations, that is, the concerned government regulatory agencies and the general public, accepted and recognized those organizations as having a legitimate existence that actively submitted to and conformed to the strategies and practices adopted by other organizations in the same field. These organizations relished their treatment from the legitimizing agencies as being "more legitimate than those that deviate from normal behaviour" (Deephouse, 1996, p. 1033). Meyer and Rowan (1992) argue that the success of an organization is more than success in terms of achieving high profitability; it should also be viewed in terms of survival and achievement of

legitimacy in the eyes of donors and other organizations on which it is dependent for monetary and non-monetary resources.

4.8. Viewing Microfinance from an Institutional Perspective.

Many theoretical frameworks have so far been used to conduct research on different issues in the field of microfinance. Mostly theories that fall in the realm of human capital, social capital, and financial assets have been utilized to provide most studies in the sector with a theoretical base (Servon and Bates, 1998; and Hulme and Mosley, 1996). These theories mostly concentrate on the influence of individuals on the outcome of a program (Ssewamala and Sherraden, 2004). Ssewamala and Sherraden (2004) concluded in their study that institutional influences dramatically altered the outcome for participants of a microfinance program in terms of the impact of microfinance programs on the economic status of the poor. Therefore, they advised policy makers and international donor agencies to incorporate this close relationship between a program's outcome and the prevailing institutional norms, values, and beliefs in their policies to gear microfinance institutions towards long term sustainability.

Not all microfinance institutions are able to achieve success and sustainability unless appropriate adjustments are made in their different organizational elements in response to external pressures. While achievements in monetary terms has been widely accepted as the yardstick of microfinance institutions' success, non-monetary factors such as adherence to the local institutional pressures was a key to the programs' long term survival and sustainability. In the case where micro businesses, financed by microfinance institutions, have failed, some researchers blamed the poor in that regard for their lack of necessary business skills and determination to succeed (Nelson, 2000;

Ssewamala and Sherraden, 2004). This is probably the main reason for the frequent use of theoretical frameworks related to human capital, social capital, and financial assets in most studies on microfinance institutions' performance. However, these theories guide us as to the performance and sustainability of MFIs to a limited extent only (Ssewamala and Sherraden, 2004).

The theoretical underpinnings of Institutional Theory have been resorted to in many studies to ascertain the success of business enterprises. To be successful, sustainable, and a legitimate recipient of the scarce donors' resources in the long run, an organization has to adopt and comply, whether willingly or unwillingly, with the prevailing local institutional norms, beliefs, and rules and regulations enforced by the existing successful organizations and other entities in the society (Meyer and Rowan, 1977; Zucker, 1977). Neale (1987) argues that adherence to prevailing local institutions is a key to the long term success of a business enterprise.

4.9. Microfinance and Institutional Development.

While many researchers have so far researched a variety of aspects of microfinance programs and their impact on poor people's lives, little attention has so far been devoted to the functioning of microfinance programs and the success of its constituents from an institutional perspective. For instance, many studies have focused on education with an institutional perspective (Townley, 1997; Rowan, 1982; Meyer and Rowan, 1992). Other areas of research under the light of Institutional Theory have been 'health related issues' (Montgomery and Oliver, 1996; Covalleski and Dirsmith, 1986). Other studies focused on building firms (Oliver, 1997) and competition among banks (Ang and Cummings, 1997).

The microfinance sector could also substantially benefit if research efforts are devoted to the area to inform microfinance institutions about a possible boost to their chances of long-term success through adherence to the institutional elements.

4.9.1. Microfinance Programs and Local Institutions.

Microfinance programs can only be considered a viable alternative to helping the poor if they are fully self-sustainable, that is, they are able to meet their current and future financial needs through generating enough cash flow from their operations. In addition they must be embedded in the network of prevailing local institutions.

When microfinance programs become sustainable, that is, they are able to cover all their costs from their operations and show some profits too, they will be considered to be positively contributing to society (Snow, 1999). Thus, if the microfinance industry becomes fully self-sustainable and every individual player in the industry is contributing its own share, the country's economy is bound to benefit from the sector. In addition, this individual contribution from microfinance institutions is the primary condition for securing society's endorsement for their operations. This, in turn, contributes to the MFIs' survival and sustainability (Cermea, 1993). Thus, these three elements, that is, adherence to the local institutions, a country's economic growth, and the sustainability of individual microfinance institutions operate in a cycle, each one somehow benefiting the other.

The development of a sound network of microfinance programs strengthens local institutions, which, in turn, provide support to the sustainability of these programs (Howes, 1997). Although the functioning, management, and performance of

microfinance institutions have attracted considerable amount of research, limited attention has been devoted to the institutional environment in which these programs function (Howes, 1997; Cernea, 1993). Institutional Theory can be resorted to as a viable framework for understanding not only the linkages between microfinance programs and local institutions but also their (local institutions) significance in developing a sound microfinance sector (Howes, 1997; Cernea, 1993).

4.9.2. Combining Two Theoretical Frameworks to Better Explain Organizational Change.

This case study is about analysing the adaptation and reorientation of the microfinance wing of the Aga Khan Rural Support Programme (AKRSP) in response to unavoidable external environmental disturbances in pursuit of survival and sustainability. The AKRSP⁴⁰ was established in 1982 by the Aga Khan group's parent company, the Aga Khan Foundation (AKF)⁴¹ with the support of many international donor agencies (World Bank, 1995). It is the pioneer microfinance institution in Pakistan and is considered to be one of the successful institutions in the sector. After being 'disturbed' by the external environmental disturbances during the 1990s with the changed donor community's thinking and approach as to the sustainability of the microfinance sector, the Aga Khan Rural Support Programme had to adapt and reorient in order to cope with the situation. This study is intended to explore this adaptation and reorientation on the part of the AKRSP in response to these external environmental disturbances.

⁴⁰ The AKRSP has many areas of operations including microfinance. This study focuses on the adaptation, reorientation, and transformation of the "microfinance division" of the AKRSP in response to the changed external conditions.

⁴¹ The Aga Khan Foundation (AKF) is a private-sector philanthropic network established by His Highness the Aga Khan. It seeks to promote social development, primarily in low-income countries of Asia and Africa, through funding programs in health, education and rural development. The Foundation is registered in Switzerland (1967) and has its Head Office in Geneva. Its branch offices are in many countries all over the world. The Foundation selects beneficiaries without any regard to religion, race, or political preferences (World Bank, 1995, p.ii).

The literature suggests that the case of organizations undergoing radical changes in which they reorient and transform in response to external environmental ‘disturbances’ can be best elaborated by employing two theoretical lenses. Different studies have resorted to a combination of two theoretical frameworks. For instance, in analysing the key contributors to organizational transformation in five New Zealand public-sector enterprises, Erakovic and Wilson (2005) employed a combination of ‘Institutional Theory’ (DiMaggio and Powell, 1983) and ‘resource dependency’ theory (Pfeffer and Salancik, 1978). In exploring the competition issues in retail sales, Eisenhardt (1988) employed a combination of agency theory and Institutional Theory. Tolbert (1985) combined Institutional Theory and Resource Dependency theory to look at the data while studying organizational change in institutions of higher education. Thus, in a situation, where one theoretical framework fails to answer all aspects of the problem, researchers tend to apply a combination of two or more theoretical frameworks.

As will be discussed in Chapter 5, the empirical data about the adaptation, reorientation, and subsequent transformation of the microfinance division of the AKRSP suggest that the issue can only be fully addressed using a combination of two theoretical frameworks. Thus, this study applies a combination of two theoretical frameworks — Laughlin’s (1991) Model of Organizational Change and Institutional Theory (DiMaggio and Powel, 1983), to answer two different aspects of the research issue.

4.10. The Two Theoretical Frameworks Used in this Study.

In explaining organizational change in the Aga Khan Rural Support Programme, the study combines Institutional Theory (DiMaggio and Powell, 1983) and Laughlin’s (1991) Model of Organizational Change. This case study has two integral parts: *first*,

the passive ‘acceptance’ of and ‘submission’ to the external environmental pressures by the AKRSP, and *second*, the internal adaptation, reorientation, and transformation of the AKRSP in response to these environmental pressures. Laughlin’s Model cannot answer the first part. The study explains this part from an Institutional Theory (DiMaggio and Powell, 1983) perspective. On the other hand the second part of the case study cannot be explained using Institutional Theory. Therefore, the study resorts to the theoretical underpinnings of Laughlin’s (1991) Model of Organizational Change to explain this part. The combination of these two theoretical frameworks better explains the adaptation and reorientation of organizations in environmentally turbulent times.

4.10.1. Passive Submission to Environmental Pressures — Why Did the AKRSP Not Resist the Change?

Since the shift in the microfinance paradigm from dependence on subsidized resources on the part of microfinance institutions to a stress on self-sustainability by the international donor community, microfinance institutions have been seeing their long term survival in the recovery of all their costs through charging high interest rates on loans (Yaron, 1997). A sustainable microfinance program does not necessarily mean that there will be no need for further subsidies from the donor community. A microfinance institution, after attaining sustainability, has to prove itself as a legitimate recipient of subsidized financial resources for further expansion of its operations and spreading outreach.

Despite the change of approach on the part of the donor community from providing subsidized financial resources to stress self-sustainability, the AKRSP had to conform

to the donors' terms and conditions because it needed their support and society's endorsement for their future operations and expansion programs. The AKRSP had to adopt such policies and practices that it thought would positively influence the donors' perception about its operations and, thus, prove its legitimacy to society. Officially, international development agencies recognize the fact that financial sustainability does not necessarily depict a lack of need for financial support for MFIs. ACCION International, a pioneer in microfinance, stresses financial viability and sustainability on the part of MFIs but, at the same time, recognizes that these organizations still rely heavily on external support (ACCION, 1997). Thus, a microfinance institution, even after attaining financial sustainability, has to adopt such policies and practices that can prove it to be a legitimate recipient of scarce financial resources from the donors. This study resorted to the theoretical underpinnings of Institutional Theory to explain the compliance and passive submission to the changed external conditions on the part of the Aga Khan Rural Support Programme.

The 'coercive' pillar of Institutional Theory suggests that organizations which are directly or indirectly dependent on other independent entities for financial and/or non-financial resources, must respond positively to the changes in policies of these independent entities in order to survive in the long run. These changes in approach and policies serve as external environmental disturbances (Laughlin, 1991) for the dependent organizations. In order to ensure their survival and prove a legitimate existence, these organizations have to comply with the externally dictated conditions. As discussed earlier, there are 'formal' pressures on organizations, whereby organizations are penalized in different ways for not adhering to these regulations, and 'informal' pressures, from the society and donor community to which they have to prove their legitimate existence and eligibility for financial and other support. These

formal and informal pressures form part of the ‘coercive’ element of Institutional Theory. These ‘coercive’ influences exert pressure on these dependent organizations to conform to public expectations and demands. Rules, regulations, and state authority, all form part of the ‘coercive’ influences that tailor an organization’s behavioural patterns (Oliver, 1997). To gain legitimacy, organizations must conform to these rules and regulations (DiMaggio and Powel, 1983).

Organizations conform to regulative measures primarily because of their financial and non-financial dependence on the regulative bodies. The ‘regulative’ institutional influences can also grant legitimizing authority to some older organizations in the field as a result of their conformity to the set rules and regulations. The ‘coercive’ pillar of Institutional Theory, more relevant to understanding radical or punctuated changes in organizations (DiMaggio and Powell, 1983), is usually resorted to by the authority of the state or a parent organization. Through exercising their legitimate powers to formulate, tailor, and enforce laws and regulations, these authoritative entities are able to monitor and regulate dependent organizations’ behaviours (Scott, 1995). For instance studies by Tolbert and Zucker (1983) on different cities’ adoption of civil services’ regulations, and Dobbin, Sutton, Meyer, and Scott (1993) on the influence of government on dependent organizations, demonstrated that such ‘coercive’ pressures are usually exerted because of some organizations’ dependence, in a particular organizational field, on other independent organizations for different financial and non-financial resources, such as capital, technology, customers, expertise, legitimacy.

4.10.2. Organizational Transformation and Institutionalization.

An organization is an entity surrounded by different environmental elements, some relevant and others irrelevant to its functioning. Before an external environmental disturbance affects the organization, it is considered to be a mature entity with respect to its policies, procedures and other organizational elements. Its structure is considered to be socially acceptable and taken for granted as efficacious and necessary. For new comers to the industry, it serves as a guide for adopting a particular behaviour pattern (Zucker, 1977; Berger and Luckmann, 1967). When an environmental kick or jolt necessitates organizational adaptation and reorientation, the old structure, along with other tangible and intangible organizational elements, needs to be dismantled and replaced with a new one. The new organizational structure is deemed capable of sustaining the organization's life and proving its legitimate existence in the sight of parent organizations on which it is dependent for resources.

When an organization adapts and reorients in response to an external environmental disturbance, this process is referred to as institutionalization. A successful institutionalization process results in the development of those organizational activities and structures which are capable of giving meaning to and sustaining social behaviours in a particular organizational setting (Scott, 1995). Institutional Theory provides a relevant conceptual framework to seek help from when trying to analyse and understand the processes of adaptation and reorientation in an organization (Greenwood and Hinings, 1993).

Researchers argue that decision-makers in the organization will be reluctant to submit to the environmental pressure if they do not view the organizational adaptation and

reorientation as essential for the survival and sustainability of the organization. The resultant adaptation and reorientation is not in all the organizational elements (Eisenhardt, 1988). The change is inculcated into the culture of the organization in such a way that it confronts organizational members as an external and coercive fact (Berger and Luckmann, 1967, p. 58), and some members of the organization who do not know the original cause of the changes may treat them as socially imposed (Tolbert, 1985). The change is mostly accepted by the members. However, the extent to which an organization inculcates the changes into its structure and retains it depends on different factors. For instance, a group of members who are somehow adversely affected by the new structure may try to impact on the level of changes within the organizations, depending on their power and authority within and outside the organization and their ability to mobilize their collective resources against any aggression (Covaleski and Dirsmith, 1988; Rowan, 1982).

When an organization opts to adapt and reorient in response to external environmental disturbances, the process of its adaptation is influenced, at different stages, by a number of mediating factors, such as technology, markets, and the legal setting of the organization. These factors constitute the environmental context which may either prove helpful or detrimental to the change process (Pettigrew, 1987). They also are the main determinants of the degree of competition in their surrounding markets, which, in turn determines a particular path an enterprise must take to ensure its future survival and sustainability (Child and Smith, 1987).

Although top management is the driving force behind the process of an organization's adaptation, Cuervo and Villalonga (2000) argue that the management itself may undergo a change, depending on the extent of the severity of the external disturbances.

The management may itself go through the change process due to the overall effects of related changes in the organization's goals, missions, culture, incentives, and governance structure. Selznick (1957) also pointed to this aspect of organizational change, and argued that at the highest level of institutionalization, leadership issues within the organization become of utmost significance.

Some researchers claim that the change in leadership as a result of organizational transformation is inherently a political phenomenon and, thus, it entails an alteration of the internal political structure of the organization (Pettigrew, 1987). Others believe that this aspect of organizational change may meet resistance and may not be very smooth. The literature suggests that this change depends on how strong were the 'institutional values' of the organization at time of change. The stronger the institutional values, the more potent will be the resistance to change, and vice versa (Covaleski and Dirsmith, 1988; Rowan, 1982).

4.11. Organizational 'Transition' or 'Transformation'.

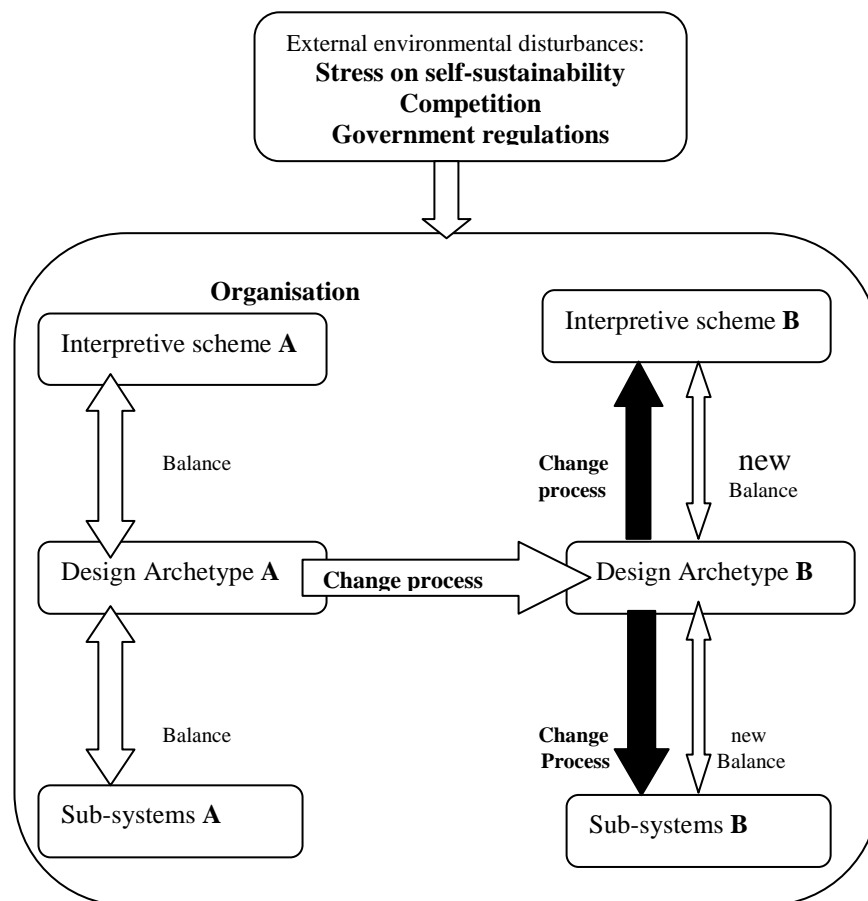
A number of frameworks have been devised by organizational and other researchers for the analysis of organizational change (Tyrrall and Parker, 2005). This case study used Laughlin's (1991) Model of Organizational Change (see figure 4.2) because it provides the most relevant explanation for an organizational adaptation, reorientation, and transformation in response to environmental disturbances, and looking at the empirical data it fits perfectly into this case study.

According to Laughlin's (1991) Model of Organizational Change, the external environmental disturbances instigate a change in the 'Design Archetype' (the

organization structure, decision processes, communication systems), which, in turn, leads to a change in ‘Interpretative Schemes’ (the mission/objectives, beliefs/values/norms/culture, and the organization rules and policies) and the organization’s ‘Sub-systems’ (tangible organizational elements, like buildings, premises, machines, finances, locations).

Figure 4.2: Laughlin’s Model (1991) for interpreting organizational change in response to external environmental disturbances.

Source: Adapted from Laughlin (1991).



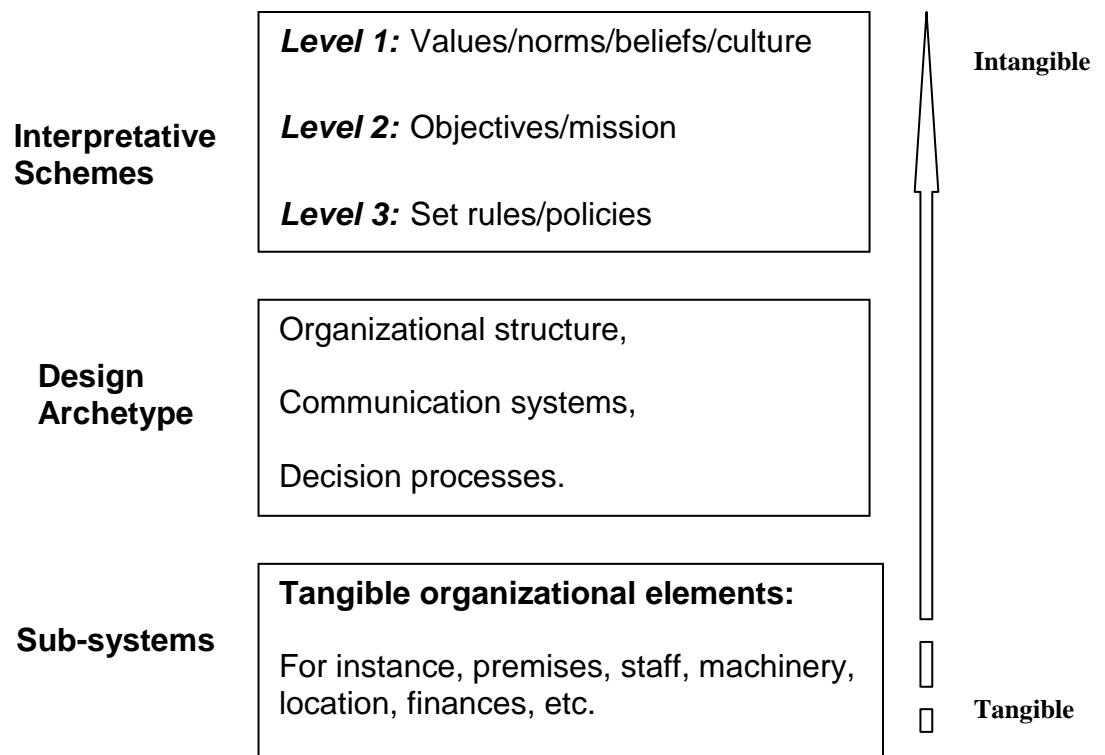
The change shifts the organization’s ‘Design Archetypes’, ‘Interpretative Schemes’, and ‘Sub-systems’ from positions A to their new respective positions B. The organization, over time, achieves balance and settles at position B. It keeps on operating at this new

balanced position unless it is again hit by another external environmental disturbance and the process continues.

Figure 4.3 explains these terminologies.

Figure 4.3: ‘Design Archetype’, ‘Interpretative Schemes’, and ‘Sub-systems’ and the nature of the elements in Laughlin (1991) Model.

Source: Adapted from Laughlin (1991).



4.11.1. The External ‘Disturbance’ — Penetration into the Structures.

It is an established premise in the literature of organizational studies that organizational change can be traced to the track or pathway an external disturbance takes through the organization (Laughlin, 1991). External environmental disturbances/kicks/jolts, following a particular ‘pathway’ (Laughlin, 1991, p. 209) or ‘track’ (Greenwood and Hinings, 1988, p. 294), penetrate into the organization, stirring its existing setup and

compelling it to tailor its organizational elements in response. Different terminologies have been used in the literature to name these changed external conditions, such as ‘kick’, ‘jolt’, or a ‘noise’ (Laughlin, 1991). Any of these names used in the literature refer to a turbulent situation for an organization wherein it has to respond to this ‘jolt’, ‘noise’, ‘kick’, or ‘external disturbance’ positively in order to survive and sustain its operations in the long run. Organizations, thus, instigate an internal adaptation and reorientation process of varying magnitude and pace along different ‘tracks’ or ‘pathways’ in order to tackle the changed external conditions (Laughlin, 1991; Greenwood and Hinings, 1988).

The literature suggests that all the three organizational elements remain in close connection to each other, each one supporting the other. A major change in one element necessitates a change of the same pace in the others (Greenwood and Hinings, 1988; Martin, 1992). In other words, they should “...bind the organization together and make it a coherent whole” (Laughlin, 1991, p. 213). According to Tyrrall and Parker (2005), however, the organizational change model given by Laughlin (1991) emphasizes more on the design archetypes of an organization. Since the adjusting and tailoring of design archetypes of an organization is a job that pertains purely to the senior management, Tyrrall and Parker (2005) argue that in most studies that resort to Laughlin’s model the focus is on looking at the organizational change from the top management point of view rather than other staff levels. The same is true for this case study where the author’s main emphasis is on the adaptation, reorientation, and subsequent transformation of the Microfinance Division of the Aga Khan Rural Support Programme (AKRSP) in response to the changed external business conditions. It is a particularly appropriate framework to apply in this study as the study’s main focus is on managerially-led

changes to the AKRSP's 'design archetypes', 'interpretative schemes', and 'sub-systems'.

4.11.2. Organizational Response.

A microfinance institution operates on the basis of certain policies and procedures for achieving its core objective of alleviating poverty and embracing prosperity and sustainability on a long term basis. After being hit by external environmental jolts, a change process is initiated within the organization. The resultant changes in the organizational setup in response to these disturbances are of a different velocity and magnitude. As discussed earlier, the change may be shallow and less intense, or it may go very deep into the organizational setting. Laughlin (1991) calls them morphostatic (first-order change) or morphogenetic (second-order change) changes respectively. Please see Table 4.1 below.

Table 4.1: Laughlin's typology of organizational change in response to external environmental 'disturbances'.

Source: Adapted from Gray *et al*, (1995).

i. No Change	Inertia
ii. First order change (Morphostatic)	'Rebuttal' / 'Reorientation'
iii. Second order change (Morphogenetic)	'Colonization' / 'Evolution' / Transformation

After a reasonable period of time in operation, the MFI achieves balance (Laughlin, 1991) and settles at a particular position with respect to its policies, practices, and overall organizational structure. As mentioned earlier, an MFI is not expected to be rigid and unsusceptible to external environmental pressures; it has to continuously tailor

its policies and practices and adapt to the demands of the external environment, especially when demands are pressed by an organization on which it is dependent for financial and other resources.

The external environment exerts pressure on the MFI to adjust its policies, practices, and overall structure and make them in harmony with externally dictated conditions. Erakovic and Wilson (2005) found in their study that response to environmental disturbances is different both in magnitude and speed among different organizations. They concluded that the scale and pace of change among different organizations will depend on a variety of factors, such as their relative sizes, ages, relationships with external environment, and strength of the surrounding institutional field. Oliver (1991) suggested different factors responsible for the size and scale of changes in different organizational elements in response to changed external circumstances. The organization will respond differently to different causes of pressures, such as social or economic. Their response will also depend largely on the nature of organizations which exert pressures, and the environment (level of uncertainty) surrounding them. For instance, organizations will respond differently to pressures from, say, the government, parent organizations, different interest groups, professions, or the general public. Similarly, response will also vary substantially among different organizations depending on factors, such as the extent and content of the pressure and the means of control by which pressures are exerted, such as coercive or voluntary. An organization may respond to the external environmental disturbances in one of the ways briefly discussed below.

4.11.2.i. Inertia.

A general assumption in the literature on organizational studies is that organizations are naturally change resistant (Laughlin, 1991), and will try to retain their original position or, if change has already initiated, get back to their original (unchanged) state, where possible (Miller and Friesen, 1984). Laughlin (1991) theorized that only those organizations are capable of showing inertia (Miller and Friesen, 1984) that strongly believe that they can successfully manage to avoid the environmental disturbances. Gray *et al* (1995) argue that organizations showing inertia indicate that they have ignored external environmental agenda and opted to stick to their present unchanged structure (Gray *et al*, 1995).

4.11.2.ii. Rebuttal.

Larrinaga-Gonzalez *et al* (2001) believe that in the case where the environmental disturbances fail to instigate widespread changes within an organization, the change is referred to as 'rebuttal'. In this change the basic equilibrium among the organization's 'design archetypes', 'interpretative schemes' and 'sub-systems' remains unaffected. When limited changes occur in an organization's 'design archetypes' only and its basic coherence remains undisturbed, Laughlin calls such changes 'morphostatic rebuttal'.

Many studies in the field of organizations and organizational change (for example Wilmott, 2000; Kikulis *et al.*, 1995) have found 'interpretative schemes' to be the most stringent of all organizational elements. They found them to be the most hard to disintegrate, as compared to other elements, in the face of external disturbances. Thus, as figure 4.4 shows, external disturbances shift the organization's design archetypes from position A to A1. But, Laughlin (1991) argues that the organization will shift its

design archetypes back from position A1 to A once the effects of these disturbances are nullified sometime in the future (the figure shows this by the broken arrow). Laughlin (1991) calls these types of changes ‘first order’ changes because they fail to break the basic balance and coherence among all the organizational elements.

Figure 4.4 demonstrates rebuttal change in an organization. Laughlin (1991) argues that under morphostatic rebuttal changes, organizations will try to accommodate the effects of environmental disturbances only to a limited extent, and will allow meagre changes in only their ‘design archetypes’. Other organizational elements — interpretative schemes and sub-systems, will be successfully protected by the organization from the effects of disturbances.

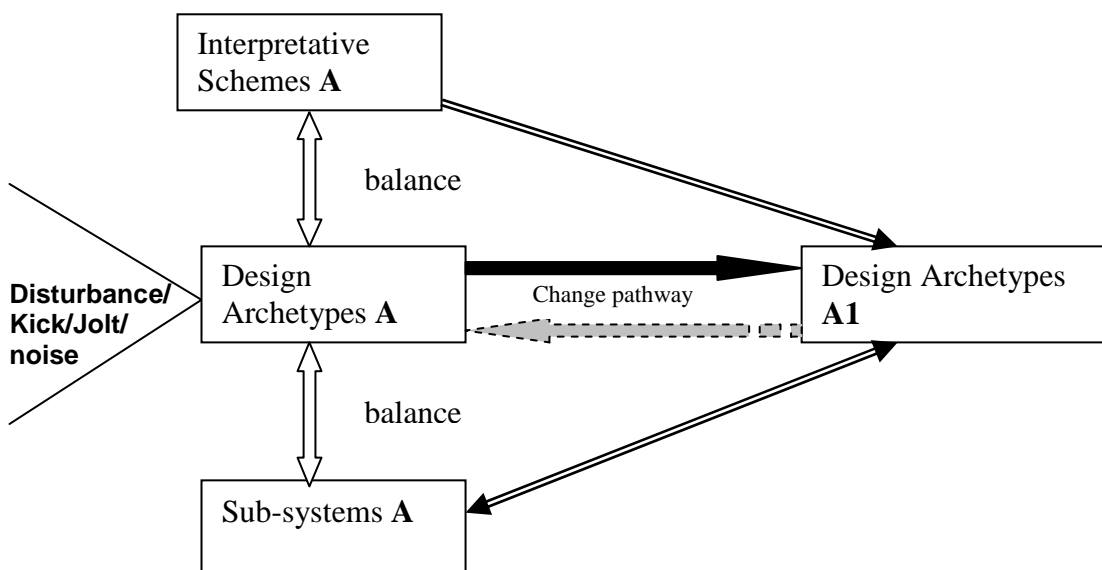


Figure 4.4: ‘Rebuttal’ changes in an organization.

Source : Adapted from Laughlin (1991) Model of organizational change.

4.11.2.iii. Reorientation.

If the environmental disturbances succeed in breaking the protective boundaries of the organization and penetrates into its organizational setting, Laughlin (1991) asserts that

they are first order changes and will alter the organization's 'sub-systems' in addition to moulding its 'design archetypes'. Its 'interpretative schemes', however, will tend to remain unaffected. Greenwood and Hinings (1993) have also witnessed similar types of changes in organizations, but described them with slightly different terminologies.

The environmental disturbances, in such types of organizational changes, compel organizations to inculcate them into their overall organizational structure. Although organizations unwittingly adapt their design archetypes and subsystems, they want to be seen doing it willingly. Gray *et al* (1995) maintain that the organization gives little room to these external disturbances allowing them to modify its design archetypes and sub-systems without affecting its interpretative schemes. 'Reorientation' type of change in a typical organization is diagrammatically demonstrated in figure 4.5.

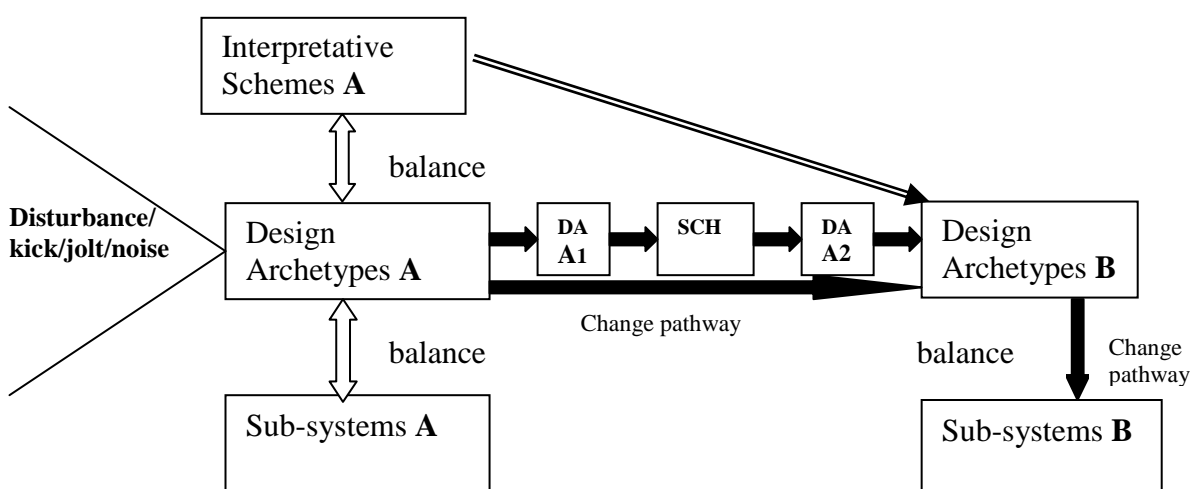


Figure 4.5: 'Reorientation' changes in an organization.

Source : Adapted from Laughlin's (1991) Model of organizational change.

Laughlin (1991) maintains that organizations do not swiftly shift their design archetypes and sub-systems in response to environmental disturbances. Rather, they stop at many points before reaching and settling down at a new changed position. It is like as if they want to shift these organizational elements on an incremental basis, and, after each incremental change, stop and see whether or not they are acceptable at this position by

the dictating authority. If yes, they happily settle at this new position after only one incremental change; if not, they give it another go and introduce another incremental change. The process continues until they reach a marginal point where the dictating organization is happy. All this process is demonstrated in figure 4.5 where DA A1 denotes design archetypes A1, SCH, schizoid, and DA A2, design archetypes A2. Greenwood and Hinings (1993) assert that at schizoid position, the organization is assumed to passively try to get back to its original position of the design archetypes (design archetype A in the figure) if possible. It will finally shift its design archetypes to externally acceptable position (shown as design archetype B in figure 4.5) if it loses its passive struggle to the environmental disturbance. As the figure shows, the new design archetypes then leads the organization to adapt and reorient its 'sub-systems' accordingly.

4.11.2.iv. Colonization.

When an organization fails to satisfy its external dictators with changes only to its design archetypes and sub-systems in response to changed external circumstances, the organization will consider and implement changes also to its basic coherence — the interpretative schemes in Laughlin's (1991) terminology. Larrinaga-Gonzalez *et al* (2001) have termed these types of organizational changes as non-elected, depicting discontent from some organizational members.

Laughlin (1991) assumes colonization type of change to have further two sub-classes. If the change is of a first order nature (or morphostatic in nature), it is weak enough not to disturb the organization thoroughly, and thus may be classified as a 'rebuttal colonization'. The resulting change looks like to be partial in magnitude. In its stronger

form which may bring about revolutionary changes within the organization, it may be referred to as a change of ‘reorientation’ nature. The later is also called a second order change (Laughlin, 1991). Laughlin (1991) calls this type of change morphogenetic colonization and argues that in this form organizations complete their shifting process. He maintains that the resulting changes are of a more permanent nature as compared to changes of reorientation nature. As diagrammatically demonstrated in figure 4.6, changes of ‘colonization’ nature are of a higher degree.

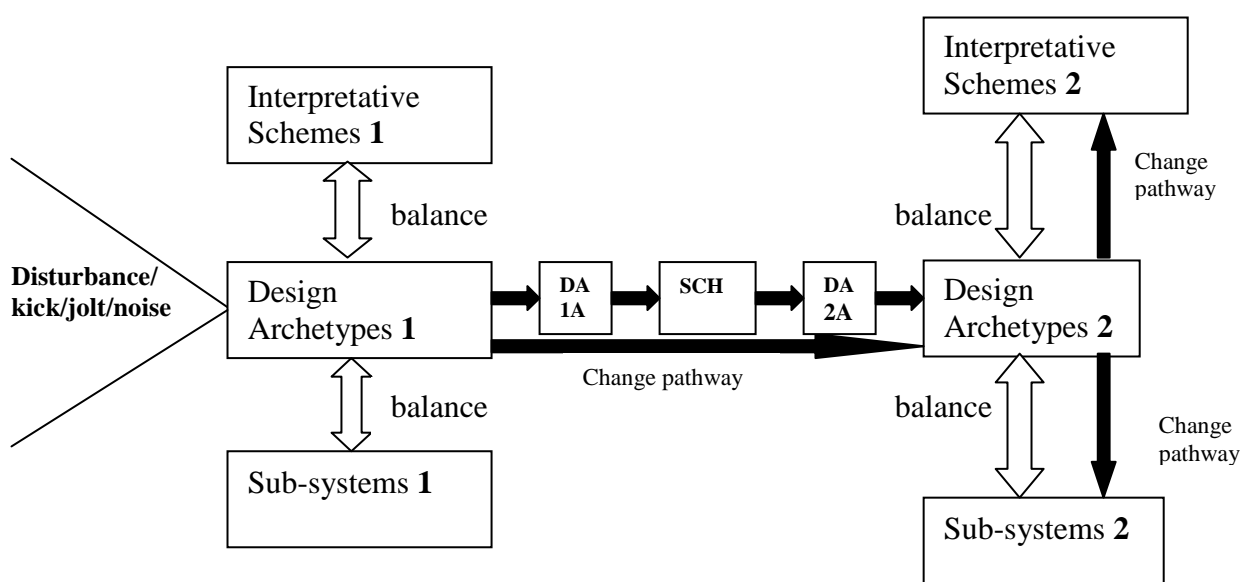


Figure 4.6: ‘Colonization’ changes in an organization.

Source : Adapted from Laughlin (1991) Model of organizational change.

As shown in figure 4.6, the environmental disturbance proceeds through the change pathway (from design archetype 1 to DA 1A, to SCH, to DA 2A, and finally to DA2) in the same manner as explained in the previous figure 4.5 for reorientation changes above. Design Archetypes DA2 then necessitates changes to the organizations Interpretative schemes and sub-systems (shifting them from positions 1 to 2).

Laughlin (1991) highlighted another distinguishing characteristic of such types of changes. He argued that as soon as external environmental disturbances instigate colonization type of changes in an organization, a small group of organizational members take hold of the situation, and start to promote them within the organization at the expense of other members. The change, in other words, is not unanimously accepted and promoted among organizational members. The unhappy organizational members are left with no choice but to accept the changes or leave the organization.

4.11.2.v. Evolution or Transformation.

Major changes in a country's economic and political scenario, overall functioning of markets, improvements in different aspects of industry, interrelationships among organizations in the same organizational field, government's policies and regulations, and the policies and practices of parent organizations, all constitute significant changes for a typical organization. Depending on how and to what extent an organization is affected by these types of changes, it has to significantly adapt and reorient its policies, procedures, rules, and overall organizational culture in response to the external turbulences (Tushman, Newman and Romanelli, 1986; Tushman and O'Reilly III, 1996). Evolution or transformation, the last type of change, occurs when the severity of external environmental disturbances does not leave the organization with any choice but to undergo revolutionary changes in its tangible as well as intangible organizational elements. Widespread changes in all the organizational elements in response to external disturbances are incorporated with a view to renew the organization's efficacy under the changed conditions and are referred to as radical or punctuated response on the part of an organization (Miller, 1982; Miller and Friesen, 1984). Organizations willingly choose to undergo changes of an evolution or transformation type in a bid to reshape or

polish their past tangible and intangible organizational elements in the light of changed external circumstances (Nadler and Tushman, 1989; Greenwood and Hinings, 1993).

This change pathway is demonstrated in figure 4.7 in a diagrammatic form.

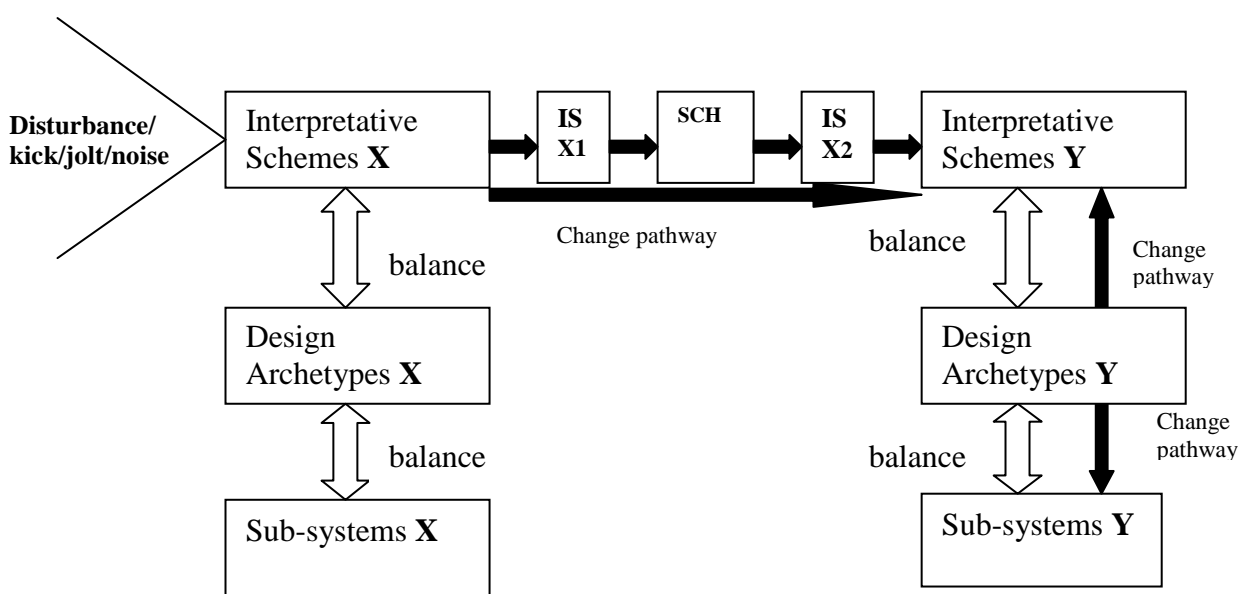


Figure 4.7: ‘Evolution’ or ‘Transformation’ changes in an organization.

Source : Adapted from Laughlin (1991) Model of organizational change.

According to Laughlin (1991), another prominent feature, unique to this type of change, is pathway that it takes to penetrate into the organization before settling and balancing it at an entirely new position. Environmental disturbances first of all stir the organization’s basic coherence, that is, its ‘interpretative schemes’. This leads to a new organizational ethos in the form of new set of ‘interpretative schemes’, which, in turn, render the existing sets of the organization’s design archetypes and the sub-systems. This necessitates changes in the organization’s ‘design archetypes’ and the ‘sub-systems’ (Laughlin, 1991).

The final ‘balance’ of all the three organizational elements is initially caused and then dominated by the changed ‘interpretative schemes’. The environmental disturbance

travels through the organization following the change pathway (from Interpretative schemes X to IS⁴² XI, to SCH, to IS X2, and finally to IS Y) in the same manner as explained in figure 4.5 for reorientation and colonization changes above.

None of organizational members resists this type of change. This final type of change path way followed by an organization is ‘evolution’ or ‘transformation’, which is a second order (morphogenetic) change (Laughlin, 1991). Under such a type of change the external disturbances compel the organization to introduce a major shift in its core element (Larrinaga-Gonzalez *et al*, 2001) of ‘interpretative schemes’.

The literature suggests that the ‘interpretative schemes’ (Laughlin, 1991) organizational element is the most intangible of all others. They represent the basic themes and the driving forces behind an organization’s overall business endeavour, and comprise of the explicit and implicit shared values of all organizational members (Tyrrall and Parker, 2005). External disturbances of an extremely severe nature instigate major changes of an evolutionary nature in organizations. The simple adaptation of existing processes and systems would fail to placate these types of disturbances. They will leave these organizations in a halcyon state only if changes incorporated by them are quite apparent and visible in *all* aspects of their operations (Tushman, Newman and Romanelli, 1986).

4.11.3. Why Laughlin’s Model?

Laughlin (1991) model is easily intelligible, and more refined and developed from the point of view of understanding intricate organizational changes (Gray *et al*, 1995). The Laughlin model views those organizations which are more familiar with their

⁴² IS stands for ‘interpretative schemes’.

organizational setting and know their internal issues very well as being more unwilling to introduce change in its organizational elements. However, they are not exempt from the effects of environmental disturbances (Gray *et al*, 1995).

If an organization is faced with external environmental disturbances, Laughlin's (1991) model does not indicate any particular outcome for the organization. Thus, the model is blind about the possible outcomes for an organization and that is one of the strengths of the model. The model even does not comment on the success or failure on the part of external disturbances to instigate a change process within the organization (Tyrrall and Parker, 2005).

4.12. Summing Up.

Any organization, depending on its strength, size, and the nature of its relationship with other organizations, has to adapt, reorient, and transform, when 'kicked', 'jolted', or 'disturbed' by turbulent environmental conditions, especially if the environmental turbulence is initiated/caused by an organization on which it dependent for resources: capital, customers, expertise, technology, etc.

Researchers argue that the process of organizational adaptation and transformation in response to external environmental pressures completes only with the organization settling down and achieving a new balanced state with respect to all its organizational elements, tangible and intangible. The next step would be for the organization to achieve harmony among these elements. Acceptable organizational transformation entails successful adoption of these changes (Isabella, 1990; Greenwood and Hinings, 1988; Gioia and Chittipeddi, 1991). Thus, organizational adaptation, reorientation, and

transformation have to be inculcated into the organizational culture, so that the organizational members find it easy, smooth, and rewarding to carry out their responsibilities. Moreover, the culture, routines, values, etc., should be adopted by the organization in such a manner that new incoming organizational members take them for granted, and do not feel any kind of incoherence among different organizational elements.

A combination of two theoretical frameworks to study and analyse organizational change is used to explain and understand the two different aspects of the internal adaptation of the Microfinance Division of the Aga Khan Rural Support Programme in response to changed environmental conditions. Institutional Theory (DiMaggio and Powel, 1983) best explains the AKRSP's passive submission to these environmental disturbances, and Laughlin's (1991) Model its internal adaptation, reorientation, and subsequent transformation to an independent commercial bank.

The next chapter will focus discussion on the 'case study' research method and its implications for and relevance to this research endeavour.

Chapter 5: Research Methodology

5.1. The Research Paradigms.

Theoretical and philosophical issues are considered to be of utmost importance in carrying out quality research. The literature suggests that the relationship between theory⁴³ and data⁴⁴ needs to be close and its understanding and appreciation by researchers is of vital significance for the success of their research endeavour. For improving the quality of a project, the researcher should consider the importance of connecting theory and data, although not doing so would not result in a total quality loss. Thus, it is important to throw some light on the main paradigm choice or the philosophical issues underlying this case study (Easterby-Smith *et al*, 1991, p.21). The purpose of the discussion in this section is to make clear as to why the qualitative research method or the phenomenological research paradigm was best suited for the analysis of the empirical data in this case study.

Hussey and Hussey (1997, p. 47) argued that a ‘paradigm’ was the advanced state of a recognized practice and found its roots in the philosophical thinking about the nature of knowledge and the world. Kuhn’s (1970) definition of the term was more intelligible. According to Kuhn (1970) one has to think about the achievement of a scientific school of thought about a model problem and its recommended solution in order to understand the nature and meaning of a paradigm. Thus, Kuhn thought of a paradigm as a beacon for researchers attempting to find a solution for a typical problem. Hussey and Hussey

⁴³A theory is “a set of interrelated variables, definitions and propositions that presents a systematic view of phenomena by specifying relationships among variables with the purpose of explaining natural phenomena” (Hussey and Hussey, 1997, p. 52).

⁴⁴The term ‘data’ refers to “known facts or things used as a basis for inference or reckoning” (Hussey and Hussey, 1997, p. 118).

(1997) advised researchers to get to know their research paradigm very well before embarking upon a research endeavour. Easterby-Smith *et al*, (1991, p.21) enumerated three reasons for a thorough understanding of the philosophical issues in research and the nature a research paradigm and recommended its use in a typical research effort. They suggested in that:

firstly, it can help to clarify research designs, and by ‘research design’ we mean more than simply the methods by which data is collected and analysed. [It guides researchers about]...what kind of evidence is gathered from where, and how such evidence is interpreted in order to provide good answers to the basic research question. Secondly,...[it] can help the researcher to recognise which designs will work and which will not...Thirdly, a knowledge of philosophy can help the researcher identify, and even create, designs that may be outside his or her past experience. It may also help the researcher to adapt research designs according to [the surroundings of his or her research]...arguments, criticisms and debates are central to the progress of philosophy.

Two research paradigms have been used in the literature and appear more frequently. These are the quantitative and qualitative research paradigms.

5.1.1. The Positivist or Quantitative Paradigm.

The quantitative paradigm, also known as the positivistic approach, has been mainly associated with research in the field of the natural sciences, such as physics, biology, botany, and chemistry. Under this paradigm researchers see knowledge objectively and reality as something tangible and not vague (Hussey and Hussey, 1997; Remenyi *et al*, 1998). Hussey and Hussey (1997, p. 52) argue that, according to positivists, “laws provide the basis of explanation, permit the anticipation of phenomena, predict their occurrence and therefore allow them to be controlled”. According to Rice and Ezzy (1999) positivists maintain that research in the context of social sciences can also be carried out in the same way as in physical sciences.

The four distinguishing characteristics of this paradigm are: *first*, its rigidity as to the findings of research, *second*, the expectations it attaches to the researcher conducting a research project using the approach, *third*, the controlling of variables pertaining to a real life situation and, *fourth*, the limiting of the number of variables to a manageable level. The findings of a research project under the approach must be quantifiable in order to be accepted as true and valid. Under this paradigm it is assumed that neither the research issue nor the subject exerts any kind of pressure or influence on the researcher nor the researcher tries to influence the research issue or the subject. Both act in an independent capacity. Tangible evidence is required of the researcher in order to prove something. The researcher must be able to quantify his findings and express them in a model or statistical form. These findings must be mathematically provable (Easterby-Smith *et al*, 1991; Remenyi *et al*, 1998; Hussey and Hussey, 1997).

Since the paradigm mostly resorts to a reductionist approach in conducting research, it may be regarded as one of the main shortcomings in its findings (Blalock, 1991; Dey, 1993). Critics argue that the real world is complex and the positivistic paradigm tries to simplify it by using a reductionist approach under which most of the intricate factors impacting negatively upon the smooth flow of the research process are excluded from the analysis, thus trying to make the process unduly simple and easy for the researcher to follow. Therefore, final results under the approach may be open to criticism (Easterby-Smith *et al*, 1991; Remenyi *et al*, 1998). Hussey and Hussey (1997) also have criticized the approach because of its struggle to simplify the intricate real life settings and reducing them down to few measurable variables. Hussey and Hussey further argue in their book that it is near to impossible to conduct research on any real life issue without the subjective judgement of the researcher having played a part, and this fact is totally ignored or neglected by the positivistic approach. Positivists believe that reality

or knowledge exists in the world and the research simply has to find it. Many of the basic assumptions of positivism do not stand true and verifiable under all circumstances. For instance, the positivists' assumption that a single reality can be divided into pieces for analysis purposes and that the whole (reality) is merely a sum of different parts, cannot always be held true. Similarly, their assumption that research results are always free from any kind of bias is not always true (Lincoln and Guba, 1985, p. 28).

Moreover, although the positivist approach has evolved into a distinctive paradigm over decades of vigorous research, yet there has been a lot of criticism regarding its applicability to social sciences. Hussey and Hussey (1997, p. 53) have discussed the issue from the point of view of the positivists too, and then, based on their (positivists') thinking and approach, enumerated some criticism of the approach. They quoted positivists claiming that they tend to explain things on the basis of universally accepted laws, which allows them to conclude about a phenomenon before it actually happens. Thus, laws that are widely accepted around the world guide their research endeavour. Easterby-Smith, *et al*, (1991, p. 22) argue that positivism is based on the key idea that the world and its realities exist and function independent of the researcher. Scientific methods which are based on universal laws and are independent of subjective influences are the only way to analyse their properties. It does not recognise the value of subjective methods, which resort to the researchers' intuition or sensation, in arriving at a conclusion about a particular real life phenomenon. They maintain (p. 33) that it is not possible for researchers to remain completely independent of what they are researching in a real life setting.

Hussey and Hussey (1997, p. 52) have identified four main criticisms of the paradigm: *first*, it is not possible to treat people as being independent of their social contexts.

People are bound by what they are mostly involved in, in their real life setting. Thus, to have a good understanding of them and their social issues, we have to understand their social contexts; *second*, as discussed earlier, a sophisticated positivist research design limits the real life phenomenon to few manageable variables which may impinge on the quality of findings of the study; *third*, researchers are part of what they observe and bring their own values and interests to the research endeavour, and thus cannot be regarded as objective as the positivists maintain. Thus, the researcher is thought to be like a machine, not capable of influencing the study with their own past learning, perceptions, and beliefs; and *fourth*, it is quite possible to arrive at a wrong set of conclusions if the study tries to limit a complex social phenomenon to an experimental setting.

5.1.2. The Phenomenological or Qualitative Paradigm.

Patton (2002, p. 145) refers to qualitative research as the “first and foremost” method of conducting research. The inception of the Phenomenological research paradigm, mostly named the ‘qualitative research paradigm’ in the literature, can be traced back to the research works in the fields of social science disciplines, including sociology, anthropology, nursing, education and health-related studies, business and economics, and psychology (Black, 2002; Fossey *et al*, 2002). In short, “social science research involves investigating all aspects of human activity and interactivity” (Black, 2002, p. 1). This type of research is largely influenced by the researchers’ own social surroundings and perceptions about a particular research issue (Hussey and Hussey, 1997; Patton, 2002).

The qualitative paradigm rose to prominence because of the stiff criticism of and the limitations of the positivistic approach to research issues pertaining to the field of social sciences. The paradigm is also known as phenomenological⁴⁵ because of its apparent approach to conducting research. The researcher using this philosophical package is allowed to use his sensations, intuition, and reflection in interpreting the research findings (Hussey and Hussey, 1997). Easterby-Smith *et al* (1991, p.23), while pointing to the distinguishing marks of the qualitative or phenomenological paradigm, argued that this paradigm considers knowledge, reality or truth as something constructed or brought into existence through the social interaction among people. In other words knowledge or reality, or truth is not something independent of mutual human interactions, rather it is there only because it is accepted and given meaning by human beings. It does not consider knowledge or truth about a real life phenomenon as something that exists in advance and needs to be discovered, while the positivist philosophical framework does. The positivistic approach considers every social situation as completely independent of other situations and as a ‘reality’ which needs to be found out about or researched in conjunction with the nature of its surroundings and the perceptions of the individuals involved (Easterby-Smith *et al*, 1991; Remenyi *et al*, 1998).

‘Qualitative research’ is not limited to a narrow range of research areas. It resorts to several methods to conduct research on issues pertaining to wide variety of topics in social settings. Moreover, the findings under this paradigm need not necessarily be expressed in quantitative terms (Strauss and Corbin, 1990; Fossey *et al*, 2002). Many well known researchers, for instance, Piore, 1983; Strauss and Corbin, 1990, Layder,

⁴⁵ The term ‘phenomenological’ stems from the word ‘phenomenon’ which means ‘a fact or occurrence that appears or is perceived’ in a particular context (Hussey and Hussey, 1997, p. 52).

1993, and Van Maanen, 1983, support the use of the qualitative research paradigm. They posit that the paradigm potentially can advance knowledge if properly resorted to in conducting research. Layder (1993), for instance, elaborate extensively in his book on the power and capacity of the paradigm to help build a new theory and/or modify an existing one. Under the paradigm researchers must base interpretation of their research findings on empirical data, their own experience and perceptions, and the existing state of knowledge on the research issue. Following these qualitative paradigm guidelines could potentially give rise to a new theory in the area of research, which, in turn, could extend the boundaries of human understanding on the issues.

Strauss and Corbin (1990) argue that, unlike the positivist paradigm, the qualitative research paradigm is not rigid and is adaptable to conducting research on a variety of social issues. If followed properly, the paradigm leads to exploring a real life phenomenon and advancing human knowledge regarding the issue to a new level (Strauss and Corbin, 1990). It helps researchers to understand and describe a social phenomenon in its naturally occurring state (Van Maanen, 1983). Where quantitative or positivists' research methods fail to come up with a way resolve an issue pertinent to a social setting, qualitative methods, due to their flexible approach to conducting research, can help researchers reach an amicable solution (Strauss and Corbin, 1990). Remenyi *et al*, (1998) point to the advantage of using the qualitative research paradigm and argue that, unlike the quantitative philosophical research base, its approach to research is holistic. It does not try to make the research endeavour unrealistic by simplifying the research issue through limiting the number of variables to a manageable level and controlling the research settings. Researchers resorting to the qualitative philosophical framework in conducting research can more convincingly claim their research to be more realistic keeping in view the fact that they carry out their research on a social issue

in their real life setting without manipulating or controlling any variables (Yin, 2003, p. 13).

5.1.3. Comparing the Two Paradigms.

A quantitative philosophical framework requires researchers to analyse empirical data through using statistical formulae or other mathematical techniques, and express their findings in a quantifiable way. On the other hand, scholars who advocate a qualitative research paradigm advise researchers to resort to an established theory to look at the empirical data, find observable trends, and explain the phenomena under consideration (Eisenhardt, 1989). Hussey and Hussey (1997, p. 52) define theory as,

“a set of interrelated variables, definitions and propositions that presents a systematic view of phenomena by specifying relationships among variables with the purpose of explaining natural phenomena”.

The main difference between the two paradigms is given in table 5.1.

Table 5.1: Distinguishing the Quantitative from the Qualitative Research Paradigm.

Source: Adapted from Hussey and Hussey (1997, p. 48)

Assumption	Factor	Quantitative	Qualitative
Ontological	The nature of 'reality'	'Reality' is objective and singular, apart from the researcher	'Reality' is subjective and multiple
Epistemological	Researchers' relationship to the research issue/problem	Researchers are independent from that being researched	Researchers cannot help interacting with that being researched

The two approaches are sometimes distinguished on the grounds of usage of final research findings. Positivists manipulate the behaviours of research participants in a very precise and systematic way (Yin, 1994). Since they select very precise data and express their findings in a quantifiable manner, it is easy for them to conceive a model

of their quantifiable findings and apply it to other similar research settings. On the other hand, phenomenologists' findings are more likely to be presented in a theoretical form, thus limiting the researchers' ability to conceive a generally applicable model out of them. Researchers using qualitative research techniques need not necessarily express their findings in the form of a model. Instead, expressing them in the form of a diagram is enough for them to conclude their research. Thus, many of the phenomenologists treat the positivists' approach to research with disdain (Hussey and Hussey, 1997; Remenyi *et al*, 1998).

Remenyi *et al* (1998), favouring the qualitative research techniques, further argue that the qualitative approach to research, compared to its rival approach, is capable of examining much more complex real life situations even with innumerable variables, a facility one cannot think of as a positivist researcher. The positivists go through a futile effort of isolating their research object from the researcher himself and other real life phenomena impacting upon the object. In the case of phenomenologists' research, researchers' own perceptions and life circumstances, and the allied real life phenomena are considered an integral part of the research process; conclusions about a research study are considered lacking in quality if enough attention is not devoted to these two factors that continuously influence the whole research process. At the end of the study, a phenomenologist researcher gives a more sophisticated conclusion about a real life phenomenon, as he/she looks at all the possible variables that could have bearing on the research process, and tries to reach the real essence of a social situation (Easterby-Smith *et al*, 1991; Remenyi *et al*, 1998).

In the literature we come across many researchers, such as Bailey (1978) and Best (1989), who like researchers to follow the quantitative or positivistic research

techniques. Other researchers, such as Blalock (1991) and Dey (1993) criticise the use of the positivist research paradigm and advise researchers to restrict its use. The findings of the research, they argue, will have limited authenticity because of the deductive nature of the paradigm. Researchers using the approach, advocated by the followers of the quantitative research paradigm, have limited chances of developing a new theory or advance an existing one. They have to play the game of research while adhering to the limits stipulated by an existing theory. Researchers cannot make any use of their intuition, perception, or past experience to support the research (Hussey and Hussey, 1997).

A qualitative researcher, on the other hand, does not remain confined to the limits of an existing theory, which makes it quite possible to develop or advance an existing theory or even come across a new one (Blalock, 1991). Some prominent researchers, such as Yin (1994), Strauss and Corbin (1990) and Jick (1983), however, like to see researchers take advantage of reaping the individual benefits of both quantitative and qualitative research paradigms in order to enhance the quality of their research findings. They advise researchers to make use of a combination of these two philosophical research paradigms. The method is often referred to as ‘triangulation’ (Rice and Ezzy, 1999; Yin, 1994), which “tries to overcome the potential bias and sterility of a single-method approach” (Hussey and Hussey, 1997, p. 74). Jick (1983) endorses the use of a combination of methods for ensuring the validity and reliability of a case study’s findings.

5.2. The ‘Case Study’ Research Strategy.

For undertaking a qualitative research a researcher may resort to a number of research methods, among them are grounded theory, ethnography, and case study (Frankfurter and McGoun, 1996). The positivistic and the phenomenological research paradigms being at the two extreme ends of a continuum, researchers may opt for a research methodology lying somewhere between these two extremes depending on their research objectives. ‘Case study’, one of the very commonly used research methods, is lying somewhere along the continuum.

The case study methodology is resorted to in many areas of research, such as public administration, political science, and organizational and management studies (Yin, 1994). A case study (Yin, 1989; Eisenhardt, 1989) method of research is regarded as the most flexible research method, and its flexibility may put it at either of the extreme positions or anywhere between the two extremes along the continuum (Remenyi *et al*, 1998, p.50). A case study tries to analyse and understand a single social setting (Eisenhardt, 1989). This thesis uses ‘case study’ as the method of research.

The popularity of the case study research techniques ranges from ‘frequent use’ to ‘no use’ during different periods of time. Europe is the place where researchers first started to apply the methodology in their research work. The Chicago School mostly advocated its use and remained its admirer as a fruitful and reliable research technique for a long period of time (Tellis, 1997). The methodology has become popular and one of the most frequently used research methodologies particularly in the field of social sciences over the period of time (Tellis, 1997). Many popular studies, for instance, Ballard *et al*,

(1997), Greenwood and Parkay (1989), among others, used case study as their research method.

A case study research is different from other research methods. It is a research technique wherein a researcher tries to describe, understand, predict, and/or control an individual (that is, process, person, animal, organization, household, industry, group, or culture) (Woodside and Wilson, 2003). McCutcheon and Meredith (1993, p.240) define case study, as a research methodology, as “an objective, in-depth examination of a contemporary phenomenon where the investigator has little control over events”. Yin (2003, p. 13) tries to clarify the term in the following words:

a case study is an empirical enquiry that investigates a contemporary phenomenon within its real-life context, especially when the boundaries between phenomena and context are not clearly evident. A case study copes with the technically distinctive situation in which there will be many more variables of interest than data points, relies on multiple sources of evidence, with data needing to converge in triangulation fashion, and benefits from the prior development of theoretical propositions to guide data collection and analysis.

Eisenhardt (1989, p.535) emphasizes the broad range of use of the case study research methodology that allows researchers to observe and examine multiple dynamics of a real life issue under a single research setting. Positivistic research techniques do not allow them to broaden their research range due to the limit on the number of variables that can be incorporated in the study under these methods. Woodside and Wilson (2003) advocate that this broader approach of the case study research methodology to research makes it feasible to employ for multiple research purposes.

Researchers using the case study research methodology are mostly concerned with ‘how’, ‘why’, and/or ‘what’ questions of their research endeavour. They do not control any variables pertaining to the research issue wherein their main focus is on

contemporary events of a real life phenomenon (Yin, 1994; Woodside and Wilson, 2003, p. 502). For a case study to be effective, the researcher must not leave any loophole in the process of observation of real life events. The conclusions drawn from a case study research takes into account the perceptions and views of all the actors involved in the research process including the researcher (Zonabend, 1992).

A case study research methodology can highly benefit researchers in studying different real life social issues. However, it should not be resorted to by researchers blindly under ever circumstance. Research questions must be carefully formulated and should reflect the overall objectives of undertaking a research (Yin, 1994, p. 69). The most importance prerequisite for its use is that research questions developed by a researcher for a particular case study must correspond to the overall research objectives of the study. Thus, before a researcher embarks upon a research endeavour, this issue of bringing the research questions in line with the research objectives must be addressed before hand. The issue may prove highly detrimental to the outcome of a research effort if not properly addressed (Yin, 1994).

5.3. Why the ‘Case Study’ Methodology?

“A case study is an extensive examination of a single instance of a phenomenon of interest and is an example of a phenomenological methodology” (Hussey and Hussey, 1997, p. 65). As discussed in Chapter 4, this case study has two different aspects relating to a single real life setting: *first*, the passive acceptance of the externally dictated changed conditions by the Aga Khan Rural Support Program, and, *second*, its reorientation to the changed external circumstances. Keeping in view the research

objectives, this study employs ‘case study’ research methodology as it is flexible and can be adapted to placate different issues relevant to a single real life social setting.

Case study research methodology is preferred by many researchers for a variety of reasons. For instance, some scholars prefer it because of its adaptability to different research settings and ability to make use of both primary and secondary data (Yin, 1994; McCutcheon and Meredith, 1993). Remeyi *et al* (1998, p. 165) mentioned two distinctive characteristics of the case study research strategy: *first*, it is capable of producing valid and reliable evidence. This evidence lends itself for verification from both qualitative and quantitative research perspectives, and can be resorted to for either supporting or contradicting a theory; *secondly*, a case study allows researchers to describe a situation about a research issue in a narrative style that represents their research outcomes. These findings pertain to a particular situation in a real life setting and, thus, add to the body of knowledge.

5.4. The Interview Technique for Data Collection.

“One of the most important sources of case study information is the interview” (Yin, 1994, p. 84). To obtain the most relevant information pertaining to a case study, the ‘interviews’ technique is the most appropriate method for researchers to resort to. Most qualitative studies use this technique to glean the most relevant information for their research (Fossey *et al*, 2002; Drew, 1993). In most qualitative research studies, researchers use the ‘interviews’ technique to entice participants to express their personal views, based on their experiences and knowledge, about a particular real life phenomenon (Rice and Ezzy, 1999; Fossey *et al*, 2002; Minichiello *et al*, 1995). In real life situations there are always some issues information about which is not available in

documents or other written materials. The ‘interviews’ techniques, in such situations, come to researchers’ help, which allow researchers a face-to-face interaction with participants. Researchers personally interact with participants and thus observe their behaviours in addition to extracting relevant information through interview questions. In addition, to be effective in gleaning the most relevant information, the ability of researchers to understand people in general is of utmost significance (Minichiello *et al*, 1995).

This study resorted to semi-structured interviews with the top- and middle-level management of the microfinance institution to collect primary data. Before discussing the actual data collection process, this section will first discuss the pros and cons of the interview technique for data collection, the reasons for choosing the technique, and the implications it bore for this case study. In addition, it will throw some light on different aspects of the ‘interview technique’ for data collection, the selection of interviewees, selection of a particular type of interview, constructing the semi-structured interview schedule, and the process of conducting interviews.

5.4.1. Reasons for Choosing the Interview Technique.

This study employed the ‘interview technique’ because it is the most commonly used method for collecting data for a qualitative research study and offers many advantages (Gorden, 1980), such as:

- a) while meeting face-to-face with interviewees, the researcher can convince them to share their views and perceptions about the research issue,
- b) it is a good means to make interviewees understand the real essence and purpose of the research,

- c) the researcher can be flexible in asking questions, thus, making the interviewee feel comfortable,
- d) the researcher remains in control and is able to conglomerate the most relevant information for the research issue,
- e) the researcher can judge the quality of the information obtained and is, thus, able to tailor the interview question accordingly, and
- f) the researcher is in a position to look for information not uttered by the interviewee but expressed in the form of body gestures.

Gorden (1980), however, cautioned researchers about some of the problems associated with the interview technique. The technique is relatively slow and may prove to be expensive. Another problem that may be more harmful to the research findings is that interviewees might give only that information which, according to their perception, the researcher wants to hear, or they may not be truly objective in giving information, especially if their job or reputation is at stake (Gorden, 1980).

Black (2002) and Bailey (1978) highly emphasize the consideration of the elements of reliability, validity, and objectivity while collecting data for a case study. In order to glean the most relevant and accurate information, the researcher must make sure that the interviewee is fully motivated for responding to the interview questions (Gorden, 1980). Further, using interview as a data collection tool, the researcher should help the interviewee understand the purpose of the question and get an appropriate answer. The researcher also has an opportunity to evaluate the validity of the information by paying attention to the attitude of the interviewees toward divulging information and by assessing the quality and quantity of the information derived and comparing one answer of the interviewee with another (Gorden, 1980). The researcher also has the flexibility of changing the sequence and wordings of the interview questions to suit a particular situation. The researcher also has control over the interview process which allows

him/her to make it interesting for the interviewee and to stop or continue as needed. For instance, if the motivation of the interviewee starts to decline, the researcher will ask one more question and indicate this to the interviewee and stop the interview. The ideal interview duration of at least 30 with a maximum of 60 minutes should be sufficient for the researcher to extract relevant information from the interview process (Gorden, 1980).

5.4.2. The Interview Process.

An ideal interview process takes the following steps and if each step is followed with vigour and zeal could result in the collection of the most relevant information for a case study.

5.4.2.i. Sampling and Recruitment.

Sampling is an important aspect of interviewing, and effective and appropriate sampling is pertinent to the success of a qualitative research. Sampling is, in fact, short-listing all prospective interviewees, and reducing the number of actual persons to be interviewed to a manageable level. “A sample is made up of some of the members of a population” (Hussey and Hussey, 1997, p. 144). In this process, however, researchers must exercise vigilance and ensure that, keeping in view the research objectives, the right people are short-listed for interviews, and people with the most relevant information are not missed out. Yin (1994, p. 84) names these people with the most relevant knowledge ‘key informants’.

As opposed to the purpose of sampling in the case of a quantitative research, sampling in the case of a qualitative research does not aim to generalize results to the population from where the sample is taken (Rice and Ezzy, 1999). Hussey and Hussey (1997, pp. 144-148) and Rice and Ezzy (1999, pp. 43-46) list many types of sampling strategies to select from. The literature guides us to employ different sampling strategies in order to make sure that basic requirements of effective sampling are duly met. This will in turn enhance the validity of data gathered, ensure the collection of the most relevant and adequate information for the case study (Kuzel, 1992; Patton, 2002), and add to the reliability of its final outcome (Black, 2002).

A ‘purposive sampling’ strategy is one of the alternatives we come across in the literature. The strategy is adopted in order to make sure that people with rich information on different aspects of the research issue are carefully selected for interviews (Rice and Ezzy, 1999). Under the strategy, prospective participants are short-listed from different official positions in an organization over a period of time in order to ensure participation of only those people who have the most relevant information but difficult to identify at the first instance because of different factors (Kuzel, 1992). ‘Snowball sampling’ is another strategy resorted to by researchers. If researchers are unable to identify or access people with the most relevant information concerning the research issue, they rely on other organizational members to help them identify such people (Rice and Ezzy, 1999). Other sampling strategies include ‘Extreme Case Sampling’, which is resorted to by researchers when they need to choose interviewees on the basis of their specific expertise and knowledge relevant to the research issue, and ‘negative case sampling’, which is used for selecting interviewees who can divulge such type of information that could allow the researcher to refute an existing evidence (Kuzel, 1992).

The literature does not hint towards any of these strategies to be more capable of producing good and reliable results compared to the rest of the strategies. The quality of any of the strategies is dependent on the choice of researchers keeping in view their research aims (Fossey *et al*, 2002). Researchers must ensure they select an appropriate sampling strategy for short-listing the prospective interviewees in an organization. Their purpose should be to identify people with the most relevant information and knowledge about their research issue. They must make sure to conglomerate enough information in both quality and quantity, and, thus, increase their research findings in credibility (Lincoln and Guba, 1985; Kuzel, 1992). In addition a sample should be large enough to provide researchers with enough information, both in quantity and quality, to satisfy the needs of the research endeavour in terms of analysing the data and arriving at a conclusion (Rice and Ezzy, 1999).

This case study used a ‘purposive’ sampling strategy, one of the branches of ‘qualitative sampling’ suggested by Kuzel (1992) and Rice and Ezzy (1999), among others, to first short-list prospective interviewees before instigating interviews, as it was appropriate in the light of the research objectives of this study. As this case study explored the internal adaptation, reorientation, and transformation of the Aga Khan Rural Support Programme in response to the unavoidable external environmental disturbances, the participants in this study were only those who were associated with the microfinance institution (MFI) during both phases: before and after the environmental disturbances affected the tangible and intangible organizational elements.

As the job of adapting and reorienting organizational elements in response to external pressures is carried out by a senior management team, these participants were also part of the top- and middle-level management team. Thus, to have the right ‘sample’ of

interviewees, this study pinpointed the prospective participants using an ‘extreme case sampling’ strategy. Furthermore, in selecting the interviewees for this case study, the selection criteria for interviewees proposed by Gorden (1980) were fully addressed, as the interviewees selected possessed the relevant information. Moreover, they were physically and socially accessible, willing to give the information, able and allowed to give the desired information.

5.4.2.ii. Selecting Interview Type.

In selecting the type of interview, the researcher needs to consider the advantages and disadvantages of the different types available keeping in view their research aims. Different interview types, as far as their flexibility is concerned, can be spread along a continuum (Rice and Ezzy, 1999). Breakwell (1995) and Minichiello *et al* (1995) pointed out a variety of interview formats that can be adopted by researchers according to their research needs. They classified interview formats on the basis of their flexibility. Their division ranges from interviews that are totally structured allowing researchers no room to change any aspect of the interview to interviews that are completely unstructured allowing researchers a complete liberty to lead the interview process according to their will and need. However, few interviews, if any, could be categorized as those lying at each end of the continuum. As Breakwell (1995) puts it:

structured interviews involve a fixed set of questions which the researcher asks in a fixed order.....In unstructured interviews, the researcher has a number of topics to cover but the precise questions and their order not fixed, they are allowed to develop as a result of exchange with the respondent (Breakwell, 1995, p.231).

In a fully structured interview, both the interviewer and the interviewees are limited to a few response choices. They are not allowed to subsequently change or alter any aspect

of the interview process, as the interview continues. The response of the interviewee in such types of interviews is usually limited to choosing one answer from a list of few possible responses (Rice and Ezzy, 1999). Possible responses to interview questions are usually arranged by researchers in the form of a rating scale (Breakwell, 1995). Previous research proved this type of interviews to be of little use for gathering the most relevant information for a case study, as it limits interviewees' responses to only few available answers. Thus, some of the most vital information pertaining to the research issue may not be gleaned at all, which will have a negative bearing on the outcome of the research effort (Rice and Ezzy, 1999; Breakwell, 1995).

At the other end of the continuum, in an 'unstructured interview', the researcher tries to gather information on a variety of aspects of a single case study. The researcher leads the interview process and adapts it frequently not only to cover all important issues but also to make it comfortable to the interviewee as well. The interview questions are not fixed both in format and contents (Rice and Ezzy, 1999; Breakwell, 1995). Mason (2002) argues that the idea behind an unstructured interview is to leave both the interviewer and the interviewee at ease and conglomerate as much information as possible through an informal dialogue between them. Transcribing an unstructured interview for the purpose of extracting the most relevant information can prove to be a big job for the researcher in terms of time and physical effort (Rice and Ezzy, 1999; Breakwell, 1995).

There is always a best option, somewhere along the interview-format continuum, which prudent researchers should pinpoint in order to design and formulate the interview questions and the format to conduct the interview that best suits their research objectives. A semi-structured interview format does not refer to a single option. It

represents a number of alternative choices along the continuum between the two extremes. Researchers should select one of them according to the particular needs of their research endeavour. In such types of interviews, interview questions are not fixed in wording or ordering; rather they can be tailored by researchers according to their own need and the mood of participants during the interview (Minichiello *et al*, 1995). Yin (2003, p.91) regarded semi-structured interviews as the most appropriate to glean the most relevant empirical data for a research study. Researchers using this data collection technique can ascertain interviewees' ideas and perceptions about a particular issue.

To avoid the disadvantages associated with the two forms of interview techniques lying at the two extreme ends of the continuum, and reap maximum advantages of using the interview technique, this study used 'semi-structured' interviews format for collecting primary data for informing the research questions in the best possible manner. Using this technique the researcher was able to tailor the mode of the interview according to need and, thus, collect maximum amount of information on all aspects of the case study.

5.4.2.iii. Conducting an Interview.

Interviews, if conducted by prudent researchers and in accordance with established principles can yield a bulk of valuable information for a research issue. Gorden (1980) suggests some prerequisites for conducting a fruitful interview. In conducting the interviews, this case study adopted Gorden's (1980) approach, which suggests that, for reaping maximum benefits, researchers should divide their interview task into two basic themes: *first*, researchers' may discuss many things but their main focus should not deviate from extracting the most relevant information from the interview process, and,

second, researchers' emphasis should be on getting valid information that can be verified from other sources.

Semi-structured interviews are a special tool to extract relevant and valid information only if researchers follow the relevant principles. Gorden (1980) suggest that interviewers should facilitate the smooth flow of the interview process instead of trying to tailor the interviewees' perceptions to make them divulge information that is adjusted to the interviewers' demand. This facilitation will result in extracting the most relevant information for the research issue, and will reflect the interviewees' own particular knowledge and expertise. A prudent interviewer is skilful in keeping quiet and listening effectively, as interrupting the interviewee can largely jeopardize interviews (Rice and Ezzy, 1999). Black (2002) and Gorden (1980) suggest that, in order to enhance the validity and reliability of the extracted information, the data should be capable of being cross-examined. Any differences among responses should reflect different interviewees' individual perceptions and knowledge rather than caused by the interview questions asked by the researcher. In addition, the researcher should try to keep the interviewees' interest and moral high by using different tactics, such as giving value to interviewees through careful listening and paying attention to what they say, and making them feel that they have expertise in the area and that their participation is of utmost significance to the success of the research. Interview questions should be carefully worded in order to achieve these aims of good interviewing. Questions that somehow challenge the knowledge of the interviewee should be avoided (Rice and Ezzy, 1999).

Researchers' prudence in keeping interviewees' interest high, and monitoring their level of interest throughout the interview process will prove highly beneficial for their research endeavour. Paying due attention to the mood of interviewees and the effects of

different questions on their temper is bound to add to the validity of the research findings. Moreover, researchers are advised not to deviate from the predetermined interview schedule already conveyed to and agreed upon by interviewees. The last but not the least factor in making interviews a good source of primary data is to make sure that the confidentiality of interviewees is maintained. Researchers can achieve this by disguising their names in the final transcripts. In addition, interviews should be well-managed in terms of time, location, and duration (Rice and Ezzy, 1999; Gorden, 1980; Kvale, 1996). Hussey and Hussey (1997) also emphasize maintaining the confidentiality of interviewees for extracting quality information.

Meeting all these prerequisites for conducting good and highly beneficial interviews will help researchers in two ways: *first*, it will result in an enhanced quality of their current research effort, and *second*, it will also benefit any future research which will involve these interviewees again at some later stage.

5.4.2.iv. Recording and Transcribing Interviews.

Rice and Ezzy (1999) and Gorden (1980) argue that, before instigating the interview process, interviewers should seek interviewees' permission to allow them to record the interview on a tape. This highly relieves researchers as, instead of writing all the details, they can focus attention on their interview questions and the issues, as discussed in the preceding section, which may otherwise negatively impact upon the quality of the interviews. If it is not possible to tape record the interviews, researchers in that case should put only the important details into black and white while simultaneously trying to maintain a smooth flow of the interview (Gorden, 1980). However, tape-recording interviews may prove quite costly in terms of researchers' time in transcribing them

(Rice and Ezzy, 1999). Breakwell (1995) endorses the fact that transcribing interviews is a tedious job. Breakwell (1995) and Kvale (1996) suggest some valuable tips for qualitative researchers' guidance that may prove helpful when transcribing interviews recorded on tape into a written text. Breakwell (1995) argues that researchers may make the step easy for them. He comments in this connection that:

transcription is sadly a slow and expensive business and it may be necessary to be selective about which elements of the interviews the researcher chooses to get transcribed fully (Breakwell, 1995, p.241).

Kvale (1996) even goes further to help researchers ease their job of transcribing interviews. He argues that:

transcripts are not copies or representation of some original reality; instead, they are interpretative conclusions that are useful tools for given purposes (Kvale, 1996, p.165).

Kvale (1996) suggests that researchers can make their job of transcribing the taped interviews even more easy, and endorses Breakwell's (1995) approach in this context. He leaves researchers with a complete liberty to decide about which portions of the recorded interview they think will fulfill their object, and thus, transcribe only those portions. Thus, interviewers, depending on their research objectives, may decide to transcribe the whole interview into a written text or some portions thereof. Thus, the intended use of the final transcripts is the major deciding factor in this connection. For instance, for researchers in the field of psychology, it may be important to transcribe all or a major part of an interview. They may even have to include the tone and pitch of an interviewee's voice and other body language in their final transcripts.

In this case study, the consent of all the participants was obtained⁴⁶ in writing before recording them on an audio tape. Before starting the interview, each interviewee was served a ‘participant information sheet’⁴⁷ to indicate the intended outcome of the interview and the use of the information shared by him. Only one participant did not give his consent for tape-recording his interview in which case short notes were taken in writing. All the interviews were not transcribed verbatim. Instead, relevant information was condensed and summarized, as suggested by Kvale (1996) and Breakwell (1995). The transcription focused only on answers that were particularly relevant to the research questions.

5.5. The Research Design.

Determination of a sound research design helps researchers to finalise their research plan which serves as a guide for the whole research process. Yin (1994, p. 19) defines research design as,

“an action plan for getting from here to there, where ‘here’ may be defined as the initial set of questions to be answered, and ‘there’ is some set of conclusions...between ‘here’ and ‘there’ may be found a number of major steps, including the collection and analysis of relevant data”.

Determining a research paradigm to be followed in a research and choosing a research problem/issue precede construction of a research design (Hussey and Hussey, 1997). Developing a sound research design and its prudent utilization in a research study is of vital significance to the success of research in terms of validity of final research findings (Fossey *et al*, 2002). The research problem and the relevant research questions, together with the theoretical base for analysing empirical data and interpreting research findings,

⁴⁶ The participants’ consent was obtained in writing on a ‘Consent Form’. Each interviewee signed a separate consent form. A sample ‘Consent Form’ is attached to the thesis as Appendix D.

⁴⁷ A sample ‘Participant Information Sheet’ is attached to the thesis as Appendix C.

the methodology resorted to in collecting empirical data, and the data analysis techniques, constitute research design for a study. All these must make a coherent whole in order to conduct a sound research and reach high quality conclusions (Yin, 1998). Yin (1998) argues that, since researchers have to make use of their own judgement in the process of data collection, it is of high significance for them to have a good understanding of the theoretical base they wish to look at and analyse their empirical data on. Researchers' perseverance in an extensive literature review can prove fruitful in building a sound research base to build other components of the research design on. It is also beneficial for researchers to decide about the boundaries and scope of their research effort before embarking on data collection stage, and pinpoint and make a list of all potential actors that will form part of their study (Yin, 1998).

This section explains the type of case study employed in this study, the selection of a case, the collection of empirical data, and the method resorted to in analysing the empirical data.

5.5.1. The Type of Case Study.

A case study can be categorized as exploratory, descriptive, and/or explanatory. An 'exploratory study' is basically conducted to explore reasons for particular practices observed in a real life setting. It is resorted to when the research issue is new and very few studies, if any, have covered it. A 'descriptive study' is often used to describe contemporary practices, may be to develop a new practice or polish an existing one. It describes a real life phenomenon in its existing setting. An 'explanatory study' is conducted mainly to explain the reasons for observed practices. Thus, it goes beyond

simple description of the research issue to analysing the reasons for its existence or happening. Any one study can also be categorized as having all, exploratory, descriptive, and explanatory, aspects (Hussey and Hussey, 1997; Yin, 1994 and 2003).

This study can be grouped with ‘exploratory’ case studies, because it tries to ‘explore’ how an organization, faced with unavoidable environmental turbulence, can best adapt, reorient, and/or transform to cope with the changed environmental conditions, and, thus, ensure its long-term survival and sustainability. In addition, two established theories — Laughlin’s (1991) Model of Organizational Change and Institutional Theory (DiMaggio and Powell, 1983) — have been used to understand and explain the underlying phenomenon, and look at and analyse the empirical data. In particular, this study can be referred to as ‘a field-based’ case study — a relatively recent sub-category introduced by Fuller and Parker (2002). They, while analysing the background and the current operations of an Australian organization in conjunction with its different internal and external circumstances, used the term ‘field-based’ case study.

In the light of Yin’s (2003) and Scapens’ (1990) arguments that one case study may have more than one analytical dimensions — exploratory, descriptive, and explanatory, this case study can be grouped as having all, exploratory, descriptive and explanatory, dimensions. Based on the empirical data, it explores the changes in the Aga Khan Rural Support Programme’s⁴⁸ tangible and intangible organizational elements in the wake of its adaptation, reorientation, and subsequent transformation in response to the changed external conditions. In its outline it also describes the AKRSP’s circumstances and background prior to the change particularly with reference to its unique location in the

⁴⁸ This refers to the changes in the Aga Khan Rural Support Programme’s Microfinance Division.

northern areas of Pakistan. It then attempts to explain why the AKRSP passively submitted to the changed environmental circumstances and did not opt a way out.

In adopting a field-based exploratory case study methodology, researchers try to interact frequently with organizational participants to extract information about the organization's policies, rules, procedures, and other tangible and intangible organizational elements (Fuller and Parker, 2002, p. 78). They further argue that the methodology employs a combination of data collection methods including observations, interviews, and document analysis. As opposed to the approach adopted by a positivistic study, the methodology resorts to a flexible approach to employing these data collection tools to extract relevant information for the research issue.

The methodology advocated by Fuller and Parker (2002) seems to be more suited to this case study, especially because of its qualitative nature. Contrary to the approach adopted by a positivist where an artificial research setting is used, this study involved a real organizational setting as suggested by Fuller and Parker (2002). Moreover, this study resorted to a flexible approach in analysing an organization in its real life context. Fuller and Parker (2002) argue that researchers can reap optimal benefits of employing a flexible approach to data collection by remaining open to the inflow of information from any source. Researchers, under the approach, adopt opportunistic behaviour and may learn a good deal of new insights into the research issue with each step they take along their research effort. The approach best suits research on those organizations that are somehow unique with respect to their cultural environment and geographical location.

5.5.2. Choosing a Case.

One of the crucial components of an effective research design is the selection of a case. Using Scapens' (1990, p. 273) approach, the rationales that guided this study to choose the case of Aga Khan Rural Support Programme for research were: *first*, the case chosen was unique as it represented the research issue of an organization under completely different set of circumstances; *second*, in Yin's (2003, p. 43) terminology, it was representative, as it represented all other microfinance institutions in the country in a similar cadre with respect to size and operations; and, *third*, it examined an area in the vast field of microfinance on which little prior research had been conducted.

The Aga Khan Rural Support Programme has been selected for the purpose of this study. The AKRSP⁴⁹ has been in operation in the microfinance sector since its inception in 1982. The reasons for selecting this MFI are based on the microfinance literature in Pakistan. These are: *first*, the AKRSP is pioneer in the field of microfinance in Pakistan (Hussein and Plateau, 2003; Gloekler and Seeley, 2003); *second*, after experiencing the external environmental 'disturbances' during the 1990s, such as the changed approach on the part of donors as to the sustainability of microfinance institutions, the resulting competition among microfinance institutions, and changed government regulations, the AKRSP has successfully transformed itself to the new environment (Hussein and Plateau, 2003); and, *third*, the AKRSP's adaptation, reorientation, and subsequent transformation to a commercial setup in response to the environmental disturbances has not been studied so far. The peculiarity of the case will be discussed in detail in the next chapter.

⁴⁹ Aga Khan Rural Support Programme (AKRSP), a private-sector microfinance institution, was established in 1982 as part of the Government of the Islamic Republic of Pakistan's Poverty Reduction Strategy.

5.5.3. The Collection of Empirical Data.

Hussey and Hussey (1997, p. 118) highly emphasize the availability of suitable data for a successful and reliable outcome of a research study. Since this study covers the Aga Khan Rural Support Programme's (its Microfinance Division) adaptation, reorientation and subsequent transformation to an independent commercial setup — The First Microfinance Bank Limited, the empirical data was collected from two institutions: the AKRSP and The First Microfinance Bank Limited. As discussed in Chapter 8, after the microfinance institution transformed to the changed setup, most of its staff members were transferred to the newly established commercial bank. That was why the author had to look for prospective interviewees, who were well equipped with knowledge and experience most relevant to the case study, in both these organizations.

Yin (1994, p. 8) argues that the real strength of the case study approach to research is that it builds its conclusions on data obtained from a variety of sources, such as documents, interviews, observation, etc. As suggested by Yin (1994) and other scholars in case study methodology, this study, in addition to semi-structured interviews with the members of the top- and middle-level management⁵⁰, relied on other sources for gleaning empirical data for the study, including print media (news papers and magazines), Annual Reports, minutes of meetings of the board of directors, and the archival documents. The literature suggests that resorting to multiple sources of evidence adds to the validity and reliability of a case study in addition to allowing

⁵⁰ Keeping in view the objectives of the study, only the organizational members at the top- and middle-level management were interviewed. The study explores the changes in the AKRSP's tangible and intangible organizational elements in response to the changed environmental conditions, and only top- and middle-level management is involved in such types of changes.

researchers to gather all the necessary data relevant to their research issue including any obscure information (Fuller and Parker, 2002).

The empirical data was collected in Pakistan. The field work for this study comprised of two parts and was conducted over a period of three months. The survey of print media and the analysis of archival documents were conducted during the months of July and September, 2006, while interviews with the organizational members at both the Aga Khan Rural Support Programme and The First Microfinance Bank Limited were conducted during the month of August, 2006. During this field work, offices of the AKRSP, and the main offices of The First Microfinance Bank Limited in Islamabad were visited a number of times. The Central Directorate of the State Bank of Pakistan located in Karachi was also visited during the field work. In addition to collecting some printed material pertaining to both the institutions from the Microfinance Wing of the State Bank of Pakistan, one of its inspectors was also interviewed. A total of sixteen⁵¹ interviews were conducted. As argued by Layder (1993), researchers attempting to utilize a case study approach, must ensure access to all the relevant information within and outside the organization, and also not to bias research findings. This study enjoyed extensive data access and tried, at its best, to keep the researcher's bias at a minimal level to enhance the validity and reliability of the findings.

As argued by Strauss and Corbin (1990) the selection of interviewees was done through a 'purposive sampling' strategy, which involved the targeting of individuals on the grounds of their strategic importance to the AKRSP's change process. Under the

⁵¹ Sixteen interviews gave the researcher enough data to rely on when complemented by the empirical data gathered from other sources. According to Kuzel (1992) and Fossey *et al* (2002) there is no minimum or maximum limit on the number of interviews under qualitative research. However, interviews with organizational members should continue until a saturation point is reached. A saturation point in case of qualitative research is one where same facts start emerging time and again, and the researcher does not get any new information from subsequent interviews (Kuzel, 1992; Fossey *et al*, 2002).

‘purpose sampling’ strategy, researchers, depending on the nature of research they are undertaking, decide on how many organizational members they want to interview to collect adequate data required for analysis, explanation, and concluding their research endeavour. Under the sampling strategy, researchers have the liberty to decide to exclude some of the organizational members, already interviewed, if they think their attitude to the research issue did not satisfy them, or the information they divulged did not help their research (Mason, 2002; Yin, 1994).

Keeping the objectives of the study in sight, interviewees were selected for the study on the bases of their long-term association with both the Aga Khan Rural Support Programme and The First Microfinance Bank Limited at the top- and middle-management levels⁵². A total of sixteen⁵³ interviews were conducted including interviews with the president of The First Microfinance Bank Limited, the Chief Operating Officer at the Pakistan Microfinance Network, Regional Manager at the Rural Support Programme Network, and General Manager at the Aga Khan Development Network. The semi-structured interviews questionnaire and the list of interviewees are attached as Appendix E and F respectively.

5.5.4. The Method of Analysis of the Data.

The task of analysis of the empirical data under a case study research methodology is accomplished by finding organized sets of observed patterns in the data. This procedure

⁵² After the AKRPS’s transformation to the bank, the services of all its microfinance staff were either transferred to The First Microfinance Bank or they joined other institutions in the same field at the AKRSP’s request or on their own; therefore, most of the interviewees were from The First Microfinance Bank Limited and other umbrella institutions in the microfinance field. The change is discussed in detail in Chapter 7.

⁵³ Keeping in sight the objectives of the study, only those employees were interviewed who have had long-term association with the AKRSP.

was observed in this case study, where different sets of observed patterns were developed about important aspects of the adaptation, reorientation and subsequent transformation of the Microfinance Division of the Aga Khan Rural Support Programme to a commercial setup in response to the changed external conditions. The next step followed was to formulate match these sets of ‘observed patterns’ with their corresponding sets of ‘theoretical patterns’ that were derived from the two theoretical frameworks (Mayer *et al*, 1995), which in this case study are Laughlin’s (1991) Model of Organizational Change and Institutional Theory (DiMaggio and Powel, 1983), already discussed in detail in Chapter 4.

5.5.4.i. Different Alternatives Available.

Yin (1998) identifies three dominant modes of analysis for a case study data: pattern matching, explanation building, and time series analysis. Pattern matching, among these, developed by Trochim (1989), is regarded as the most desirable method of analysing case study data (Yin, 1994 and 1998), because it allows researchers to match the observed patterns found in the empirical data with their corresponding theoretical patterns, and provide necessary explanations of the results (Trochim, 1989). If the patterns observed in the empirical data coincide with those predicted under the case study’s theoretical framework, it will ensure strengthening the ‘internal validity’ of the study (Yin, 1994, p. 106).

This case study used ‘pattern matching’ as a method of analysis of empirical data.

5.5.4.ii. Pattern Matching Model.

This case study adopted Trochim's (1989) pattern matching model which is shown in Figure 5.1.

Process of Pattern Matching:

A. Theoretical Realm

(Laughlin Model)
(Institutional Theory)

B. Theoretical Patterns:

1. Laughlin (1991) Model: Organizations adapt, reorient, and/or transform in response to unavoidable external environmental disturbances;
2. The 'coercive' pillar of Institutional Theory (DiMaggio and Powel, 1983): organizations passively accept or submit to the terms and conditions dictated by an outside entity on which they are dependent for resources, like capital, customers, expertise, legitimacy, advice, etc.

C. Observed Patterns

1. The actual/observable changes introduced by the AKRSP's management in its structure, communications systems, policies, practices, rules, missions, cultures, and other tangible and intangible elements in response to the external environmental disturbances.
2. The actual/observable changes introduced by the microfinance institution's management serve as evidence of the organization's passive acceptance or submission to the terms and conditions dictated by outside entities on which it is dependent for resources.

D. Case Study primary and secondary data.

E. Analysing Case Study Data:

Patterns Coding
Matching the 'observed patterns' with the 'theoretical patterns'

F. observations / conclusions.

Figure 5.1: Patterns Matching Model for a Case Study Data Analysis.

Source: Trochim (1989, p. 356).

The top section of the pattern matching model shows the theoretical realm. Researchers may derive different sets of theoretical realms from the underpinnings of a theoretical

framework(s), their own ideas and/or experience, or a combination of both (Trochim, 1989). The lower section of the pattern matching model indicates the realm of observations that are derived from the primary and secondary data.

According to Trochim (1989, p.356) a pattern is:

any arrangement of objects or entities...the term 'arrangement' is used...to indicate that a pattern is by definition non-random and at least potentially describable.

Pattern matching is carried out with a view to establish a describable relationship between 'theoretical' patterns, which are suggested by and extracted from established theoretical framework(s), and 'observed' patterns that are developed using the empirical data collected for a case study. The two sets of patterns are then compared and conclusions reached (Trochim, 1989).

As the main aim of the study was to explore the changes in the tangible and intangible organizational elements the Microfinance Division of the Aga Khan Rural Support Programme in response to the external environmental disturbances, the empirical data allowed sufficient room to build different sets of 'observed patterns' about the different aspects of the organizational change. These 'observed patterns' were then compared with the 'theoretical patterns' suggested by Institutional Theory (DiMaggio and Powell, 1983) and Laughlin's (1991) Model of Organizational Change and conclusions drawn. In this case study, observed patterns are: first, the changes introduced by the management in the Aga Khan Rural Support Programme's tangible and intangible organizational elements in response to external environmental disturbances; second, the actual/observable changes introduced by the organization's management which depicts

the MFI's passive acceptance or submission to the terms and conditions dictated by outside entities on which it is dependent for resources.

5.5.4.iii. Matching the 'Observed' and the 'Theoretical' Patterns.

In the case of an exploratory case study, if comparison between the observed patterns and the theoretical patterns coincide, it depicts that the results will assist to strengthen the case study's internal validity (Yin, 1994). A 'theoretical pattern' represents different scholars' suppositions, expressed in the form a theory and established over time, about what is expected in the data, and an 'observed pattern' is one which is derived from the empirical data of a real life case study (Trochim, 1989). The advancement of knowledge occurs when observed patterns, developed through the empirical data in a particular case study, continuously yield the same trends as predicted by an established theoretical framework and expressed in the form of theoretical patterns (Yin, 1994).

The pattern matching technique is not without limitations (Trochim, 1989). Trochim (1989) advised researchers to be cautious about two prominent limitations of the technique: *first*, there is no one correct way in which a theoretical pattern must be used, because the patterns may be verbal in some cases and a collection of figures in others; and *second*, there is no specific procedure that can be employed to provide evidence for a match. Thus, the researcher who developed the patterns and the reader should agree to their matching, before the validity of a case study could be confirmed.

5.6. Summing Up.

The chapter starts with discussion on the two prominent research paradigms — the positivist and the qualitative, their underlying assumptions, their comparison to each other and the suitability of the later to this case study. Then the case study methodology was discussed in detail followed by discussion on different interview techniques for collecting empirical data. Finally the chapter discussed the research design of the case study and concluded with the discussion on the method of analysis resorted to for analysing the case study data.

This chapter together with Chapter 4 provide a sound platform for the collection, organization, and interpretation of the empirical data collected for the study. The next chapter changes the tone of the thesis and shifts the discussion to the case — The Aga Khan Rural Support Programme. The microfinance institution's history and the life before the external environmental disturbances impacted upon its organizational elements are briefly discussed in the chapter.

Chapter 6: The Aga Khan Rural Support Programme (AKRSP) — the Pre-Transition Era (1982-1995)

This chapter will highlight the significance of the Aga Khan Rural Support Programme (AKRSP) in the microfinance sector. Details of the areas of the microfinance institution's operations and the unique approach it followed to overcome the specific difficulties associated with those areas will be given. This chapter will also discuss the successful achievement of its core objective of improving the livelihood of the poor households within the areas of its operations.

The AKRSP was selected as a case study for this thesis because of its immense importance, success, and worldwide reputation in the microfinance sector, especially in rural development. The AKRSP was established by the Aga Khan Foundation (AKF)⁵⁴ and later on supported by many donor agencies (World Bank, 1995). The World Bank's Operations Evaluation Department, after conducting a fourth independent evaluation of the AKRSP's performance covering a period of 18 years of the programme's life, awarded it a "highly satisfactory" rating, the Bank's highest technical rating (World Bank, 2002).

For the purpose of this study and the analysis of the empirical data, I have divided the life of the Aga Khan Rural Support Programme into three phases. Figure 6.1 depicts these three phases. Phase I (1982-1995) refers to the time period before the external environmental 'turbulences' affected the AKRSP. Phase II (1996-2001) refers to the

⁵⁴ The Aga Khan Foundation (AKF) is a private-sector philanthropic network established by His Highness the Aga Khan. It seeks to promote social development, primarily in low-income countries of Asia and Africa, through funding programs in health, education and rural development. The Foundation is registered in Switzerland (1967) and has its Head Office in Geneva. Its branch offices are in many countries all over the world. The Foundation selects beneficiaries without any regard to religion, race, or political preferences (World Bank, 1995, p.ii).

timeframe during which the AKRSP adapted or reoriented itself to the new environmental condition. Phase III (2001 onwards) relates to the time period after the radical transformation of the AKRSP to The First Microfinance Bank in response to these environmental ‘turbulences’.

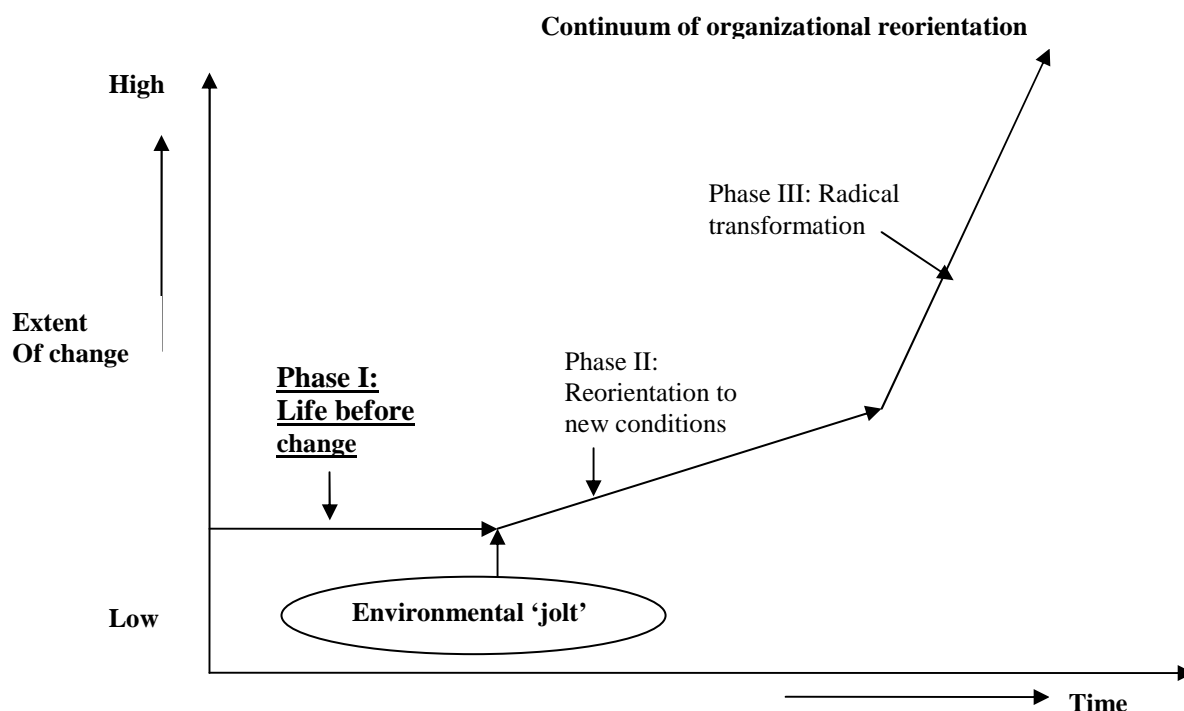


Figure 6.1: An organization’s ‘balanced’ functioning before change.
Source: Idea for the figure’s layout only is taken from Hill and Collins (2000).

This chapter will concentrate discussion on Phase I (1982-1995) of the AKRSP’s life — the period before the external environmental ‘disturbances’ impacted on the microfinance institution (MFI).

6.1. The Emergence of the Aga Khan Rural Support Programme. (AKRSP).

A number of projects have been launched by the Government of Pakistan from time to time with the objective of improving agricultural growth and conserving natural resources in different parts of Pakistan, but the country's Northern Areas and Chitral (NAC⁵⁵) region has been mostly ignored in this respect (Nyborg and Ali, 2005). The literature suggests that when a government fails to adopt suitable policies for the uplift of a particular region, some institutions emerge in the private sector to combat the effects of such policy failure on the part of the government. The Aga Khan Rural Support Programme was one such institution that came into being to fill the development gap between the NAC region and other parts of the country, and ameliorate the already deteriorated situation for the local population (Campos, Khan, and Tessendorf, 2004).

The Northern Areas and Chitral (NAC) region is unique in its climate and geographic conditions. The region's poverty⁵⁶ and deteriorated economic condition inspired the Aga Khan⁵⁷ to establish an institution that can help uplift the regions economy and improve the lives of the local population. He, with the help of various international donor agencies⁵⁸, formed the Aga Khan Rural Support Programme in 1982 (Campos *et*

⁵⁵ The Federal Government, Islamabad is responsible for the administration of the region. In terms of governance the region does not carry equal status to that of the nation's other four provinces (GoP and IUCN, 2003). The local population is not eligible to cast votes for the parliament. The AKRSP operates in the Northern Areas (Gilgit, Baltistan, and Astore districts) and the Chitral district of the North West Frontier Province (NWFP) of Pakistan (Nyborg and Ali, 2005).

⁵⁶ The region's poverty estimates show that about 23 to 32 percent of the population subsist under the national poverty line. 9 percent of the region's population can be categorised as extremely poor (GoP and IUCN, 2003).

⁵⁷ The Aga Khan is the spiritual leader of about 15 million 'Ismailis' all over the world, a separate sect of Muslims (Campos *et al*, 2004). He is the head of the Aga Khan Foundation.

⁵⁸ Major external donors of the AKRSP for the period 1982 to 2000 were the British Government's Overseas Development Agency (34 percent of the total funding), the Canadian International Development Agency (20 percent), the Netherlands Government (16 percent), the Norwegian Agency for Development

al, 2004). Shoaib Sultan Khan became the first General Manager of the programme (Nyborg and Ali, 2005).

The main underlying theme behind the AKRSP emergence in the region was to meet the financial needs of the poorer rural population and help them create a means of livelihood for themselves. The programme has had the support of many national and international donor agencies. In the literature, the programme is regarded as one of the most successful microfinance institutions in the rural development sector around the world. The World Bank has evaluated the performance of the programme several times over the past two decades and is considered to be highly successful with regard to outreach and efficiency (Nyborg and Ali, 2005; World Bank, 2002). The AKRSP made a noticeable impact in the area of poverty reduction and demonstrated the success of its model at an international level during the late 1980s and the 1990s. Before that, from 1982 to 1984, the major portion of its funding⁵⁹ came from the Aga Khan Foundation (Campos *et al*, 2004).

The Aga Khan Rural Support Programme first instigated microfinance efforts in Pakistan and is, thus, considered a pioneer in this sector. In addition, the success of its approach to microfinance is established in the literature and proved by the various World Bank evaluations of its performance over the years (Hussein and Plateau, 2003).

(8 percent), the European Union (8 percent), and the Aga Khan Foundation (7 percent); the World Bank's funding constituted only 0.13 percent of the total (Campos, Khan, and Tessendorf, 2004).

⁵⁹ During the period from 1982 to 1984, the AKRSP had a total funding of US\$ 3.3 million; 55 percent of this amount was contributed by the Aga Khan Foundation (World Bank, 2002).

6.2. Introduction to the Northern Areas and Chitral (NAC).

The northernmost districts of Pakistan — Gilgit, Ghazar, Skardu, Diamer, Ghancha, and Chitral, constitute the Northern Area and Chitral (NAC) region, shown in Figure 6.2. The region is among the world's most rugged landscapes (GoP and IUCN, 2003). The region's world famous highest mountains and large glaciers give it immense significance for research in the areas of geology and biology both at a national and an international level. The region is also home to the K2 Mountain which has the second highest peak in the world (Nyborg and Ali, 2005; GoP and IUCN, 2003). It is the convergence point for the Himalayas, Karakoram, and the Hindukush — the world renowned mountain ranges (GoP and IUCN, 2003).

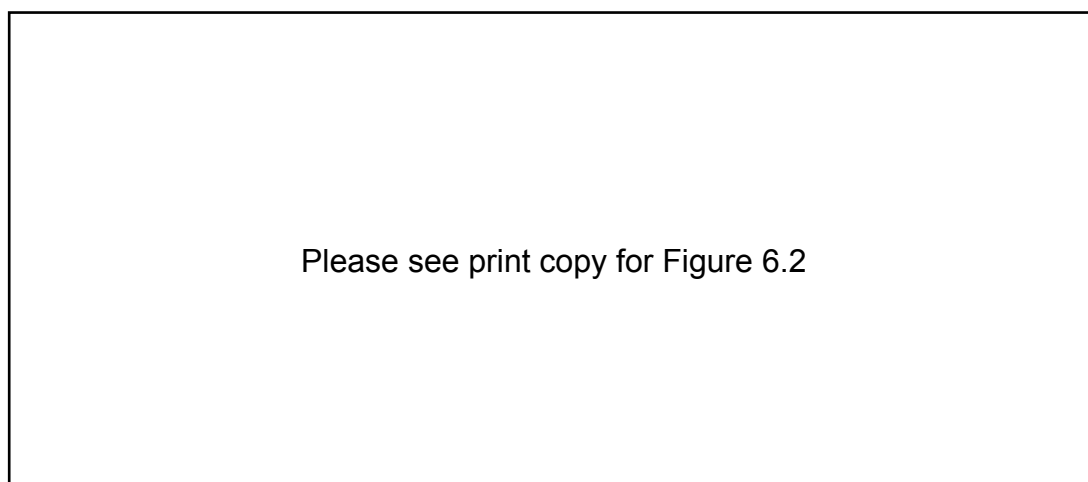


Figure 6.2: The map of the Northern Areas⁶⁰ in Pakistan.

Source: Sustainable Development Policy Institute (2002).

The region has shared boundaries with India, China, and Afghanistan. Its total covered area is 72,496 square Kilometres (Khan, 2003) with 1.2 million of total population⁶¹ (AKRSP, 2004). The economy is predominantly agriculture based with an average farm

⁶⁰ The map gives a layout of only the Northern Areas. The Chitral district does not share boundary with these areas/districts and, thus, is not appearing on the map.

⁶¹ According to the official 1998 population census, the region's population was about 870,000 (GoP and IUCN, 2003).

size of 2.5 hectares. Although about 80 percent of the region's population earn their living through engaging in agriculture activities, production is unable to cope with the local demand⁶². However, the sector is the region's main source of income (GoP and IUCN, 2003; World Bank, 1995; AKRSP, 1995). Table 6.1 gives a sketch of the region.

Table 6.1: The Northern Area and Chitral region's Statistics.

Source: Hussein and Hussain (2003, p. 3).

Please see print copy for Table 6.1

* Several estimates have been made from time to time about the area of the region.

** The change in the number of villages is due to the AKRSP's own changing definition of a village.

Transport, general trade, agriculture, infrastructure, tourism, mining, forestry, livestock, power generation, and cottage industries are among the major profit earning activities in the region's private sector, with transport being the biggest of all in terms of asset holding⁶³. Private sector capital is mostly attracted to these businesses, where it finds relatively low risk and high returns (Khan, 2003; GoP and IUCN, 2003).

The melting of snow in the mountains provides the only source of irrigation water for the agricultural activity in the region as its average rain fall is quite low. Wheat, maize, barley, potato, and barley are some of the major crops of the region. Farm income is the major contributor to the region's household income (World Bank, 1995), which stands at 50 percent of the total. The remaining 50 percent comes from remittances by members of the household working in urban areas, small scale trading such as shops,

⁶² In 2002, the concerned government officials had to import about 70,000 metric tons of food from other parts of the country. The food stuff was sold locally at a subsidized rate (GoP and IUCN, 2003).

⁶³ Total asset holding in the transport activity is about Pak rupees 316.06 million. Public sector accounts for about 60 percent of the asset ownership and public sector about 40 percent (Khan, 2003).

serving in government departments, and service (World Bank, 1995; Nyborg and Ali, 2005). The weather is extremely harsh both in winter and summer (Khan, 2003) with average temperatures ranging from 35 °C in the summer season to -20 °C in winters (AKRSP, 1995; Nyborg and Ali, 2005).

The region's long and harsh winters put timber and firewood in high demand with each person consuming an average of 4 kilograms of firewood on a daily basis during the winter season. With the opening of the Karakoram Highway⁶⁴ and the linking of valleys through roads, the demand for the local wood in other parts of the country put an additional burden on the region's precious resource. The smuggling of wood from the region is several times more in quantity than is extracted lawfully (AKRSP, 1995). This has proved very detrimental to the region's scarce natural resources. The Aga Khan Rural Support Programme, being concerned about the state of depleting resources and their significance to the region's economic wellbeing, joined hands with local communities and embarked upon different programmes to plant trees in the region on a large scale (Nyborg and Ali, 2005).

6.3. The Development Challenges for the AKRSP in the Region.

Government of Pakistan, in an attempt to bring the region under its effective control and provide better management to its affairs, abolished all the princely states⁶⁵ and established the Northern Areas Federal Administrative Zone (NAFAZ). In the process,

⁶⁴ The Karakoram Highway took 11 years (1968-1978) to complete (GoP and IUCN, 2003). It covers the route from Islamabad to the Northern Areas and, stretching about 840 kilometres, reaches the Chinese border (Nyborg and Ali, 2005; GoP and IUCN, 2003).

⁶⁵ The Northern Areas and Chitral (NAC) region consisted of many princely states and was governed by local princes; these princely states were abolished by the federal government, Pakistan, in 1972 (Nyborg and Ali, 2005).

all the local political institutions were also abolished. These institutions largely contributed to sustaining life in the region for centuries (Campos *et al*, (2004).

The princes and their officials managed the region for the overall wellbeing of the local population. After the abolishment of these princely states, the region was left with virtually no body to govern its affairs (Campos *et al*, 2004; Rasmussen *et al*, 2004). The policies of the Northern Areas Federal Administrative Zone (NAFAZ) did not take this lack of governance into consideration nor did the Federal Government in its policies. The situation was leading the region to a potential disaster. Moreover, lack of policies on the part of government to effectively tackle the region's poverty issues resulted in widespread poverty in the region (Campos *et al*, 2004; GoP and IUCN, 2003).

Lack of basic infrastructure, high risk and low returns on new investments, lack of financial services particularly for the region's poor population which lacked collateral to access credit, lack of manufacturing industry, poverty, pollution, and gender imbalances were a few of the major consequences of this inaction on the part of the government (Khan, 2003). The region's communication, power generation, sewerage, telecommunication, and drinking water sectors lacked essential infrastructure. Unemployment and women's low participation⁶⁶ in economic activities were among the main development challenges in the region (Khan, 2003; GoP and IUCN, 2003). The high level of transport activity in the region has given rise to environmental issues such as air, soil, and water pollution (Khan, 2003), which, in turn, resulted in diseases such as typhoid, cholera, and asthma in the region (GoP and IUCN, 2003).

⁶⁶ Women make up about 48 percent of the region's total population. Thus, if properly utilized in the process of the region's economic development, women's contribution could be of substantial value to the region (GoP and IUCN, 2003).

All this is evident from the household profile for the Gilgit district in Table 6.2 below.

Table 6.2: Household Profile for the Gilgit District in 1988-89.

Sources: Campos *et al*, 2004.

Please see print copy for Table 6.2

⁶⁷ After almost 17 years of the AKRSP's operations in the region, per capita income rose to Pak Rupees 10,312 for Northern Areas, compared with Rs. 18,414 for Pakistan (AKRSP, 2000).

The establishment of the Aga Khan Rural Support Programme proved fortunate for the region. It changed the situation for the overall good of the region and instigated the much needed developmental work. In only a few years after its establishment in 1982, the AKRSP had penetrated deeply into the Gilgit district with its poverty-eradication programmes, through its Village Organizations (World Bank, 1995).

Serving the most underdeveloped region of the country was a challenge for the Aga Khan Rural Support Programme (AKRSP) where most of the population survived on small-scale agricultural activities (Nyborg and Ali, 2005). The region's population growth was rapid, available resources were not enough to cope with population growth, and employment opportunities and banking facilities were meagre. In addition the lack of basic infrastructure and high transportation costs posed another challenge to the AKRSP in the region (Hussein and Hussain, 2004; Khan, 2003). After coming into being projects on the AKRSP's priority list included infrastructure development, enterprise development, creating opportunities for the economic wellbeing of the local poor population, and designing and implementing policies for a sustained development of the region (Khan, 2003).

If the scope of the AKRSP's endeavour is considered, the extent of its accomplishments becomes more impressive. The Aga Khan Rural Support Programme's area of operations covered 1.0659 million⁶⁸ people in about one thousand villages, spread over a geographical area of 74200 square kilometres. The region is also considered to be one of the most difficult to access. Not letting these difficulties come in its way, the AKRSP managed to reach about 85 percent of the region's population (World Bank, 2002; Nyborg and Ali, 2005; Campos, Khan, and Tessendorf, 2004).

⁶⁸ As of 1994. 85 percent of this is rural population (World Bank, 2002, p. 77).

Even the largest district in the Northern Areas — the Gilgit district, was largely behind the rest of the country in terms of per capita income. The district's per capita income in 1982-83 was US\$145⁶⁹, while Pakistan's average stood at US\$315⁷⁰. In terms of literacy rate, the districts' achievements were not encouraging either, which stood at just 17 percent. Moreover, agricultural production was based on old and unscientific methods and only few varieties of vegetables were grown (Nyborg and Ali, 2005; Hussein and Plateau, 2003).

Live stock was one of the major sources of income for the region's poor, which generated about 20 percent of the region's total income (World Bank, 1995). Since the slaughtering of animals was among the region's customary and religious activity, livestock was in high demand in the region and the demand often surpassed supply (Khan, 2003). Livestock, being the source of milk and meat, were in high demand both for consumption and trading purposes. The income from trading in the sector accounted for about 40 percent of the farm income of the poor households (GoP and IUCN, 2003).

Since the livestock mortality rate stood at about 10 to 15 percent per annum (Nyborg and Ali, 2005; Hussein and Plateau, 2003), the sector was not optimally exploited by the region's poor households for income generation (GoP and IUCN, 2003). Keeping in view the contribution of the sector to the region's economic wellbeing, the AKRSP implemented a strategy to preserve the region's animals stock, train local livestock specialists, and improve animal nutrition. Through adopting prudent strategies, the AKRSP was able to implement the plan with the lowest possible costs (World Bank, 1995).

⁶⁹ Hussein and Hussain (2003) and Hussein and Plateau (2003) reported it to be US\$ 150.

⁷⁰ This achievement of the district represented only 46 percent of the country's average (Hussein and Hussain, 2004).

Since the early 1990s, a period that coincides with the AKRSP's initial operations in the region, the average incomes of the region's poor households showed a positive trend (World Bank, 1995). The AKRSP's achievements can be well ascertained by the fact that during 1990-91, after almost a decade of its operations, the Gilgit district had achieved a per capita income level of US\$236 as against the country's average of US\$385⁷¹. Average income per capita of the region's poor households almost doubled from 1982 to 1991 (Campos *et al*, 2004; World Bank, 1995).

The region's growth remained stable reaching a staggering 33 percent in 2002 (World Bank, 2002). The World Bank's last evaluation of the AKRSP concluded that by 1995, the AKRSP's efforts directly or indirectly accounted for 28 percent of all cultivated land in the Northern Areas; by 2002, this proportion had risen to 33 percent (World Bank, 2002), which clearly indicates an ever increasing AKRSP contribution to the overall economic advancement of the region.

The AKRSP's contribution to boost local agricultural production was extraordinary (GoP and IUCN, 2003). Small loans to poor farmers in the agriculture sector are considered to be of vital significance to boost agricultural production, particularly in rural areas. They serve as fertilizers do to improve local agricultural produce. The lack of such types of loans in the NAC region inspired the Aga Khan Rural Support Programme to instigate rural agricultural credit programmes to help improve local agricultural production. Keeping in view the vital importance of the local agricultural activities for the wellbeing of the local poor, the AKRSP's management realized soon after its establishment that these programmes should be initiated on a priority basis (World Bank, 1995; Campos *et al*, 2004).

⁷¹ The district's achievement represented 62 percent of the country's average.

Before the inception of the AKRSP's operation, formal agricultural credit programmes were not reaching the deserving poor. Large farmers, about 16 percent of all farmers, were the main hurdle in the way of the program's success. Because of their extensive contacts with officials in the relevant government agencies, they were able to get their hands on up to 47 percent of the credit under the scheme. Campos *et al*, (2004, p. 55) explained the situation through comparing the figures of the government's subsidized agricultural loans with that of the AKRSP's subsidized financial assistance to the region's poor farmers. They argued that in 1983, the AKRSP sanctioned about US\$54,000 to 4,050 poor farmers in Gilgit alone, while the government's subsidized program failed to provide financial assistance to any of the 28,000 deserving poor farmers in the same region. Even a decade later, in 1991, the concerned government agencies sanctioned more than US\$ 5 million to only about 2,600 farmers, while the AKRSP's disbursements of only about US\$ 1 million were spread among 30,000 poor farmers.

The AKRSP proved its worth and, since its inception in 1982 to 1989, brought down the region's economic gap from that of the country as a whole by about a one-third (Campos *et al*, 2004). Although the AKRSP does not claim credit for all of the development in the region, credit for the major portion of it goes to its efforts in the region (World Bank, 1995, pp. 21-27).

6.4. The AKRSP's Distinctive Approach.

Since its initiation the overall objective of the Aga Khan Rural Support Programme has been to help the local people build and maintain both individual and institutional capacity (Ismail and Hussain, 2003). The AKRSP has been successful in the

achievement of its main objectives by adopting a policy of involving local people in all development activities. This approach resulted in not only increasing the income levels and overall welfare of the local community but also in keeping the AKRSP's operational costs low.

In order to improve local agricultural production, the AKRSP designed the unique approach of carrying out its activities through the local Village Organizations (VOs) and Women's Organizations (WOs). These organizations were formed by the AKRSP itself under its unique integrated participatory approach, and were a key to the success of its poverty reduction strategy (World Bank, 1995). The success of the Aga Khan Rural Support Programme in the fruitful implementation of its different policies and schemes through its VOs and WOs was remarkable (GoP and IUCN, 2003).

An analytical study of the Aga Khan Rural Support Programme's 35 agricultural and drinking water supply schemes in rural parts of the Northern Areas and Chitral (NAC) region concluded that these schemes, compared to such types of schemes implemented by different government agencies, were more successful in terms of sustainability and the region's economic growth (Rasmussen *et al*, 2004). Thus, the ultimate achievement was a sustainable development in the region (World Bank, 1990b). The Aga Khan Rural Support Programme (AKRSP) was faced with the extremely difficult social and environmental conditions in the NAC region. The success of the AKRSP in terms of achieving its main objective of improving the means of livelihood for the local poor can be attributed to the following factors.

6.4.1. The Low Cost Operations.

Although the region was the most difficult to access in terms of both scale and outreach for a microfinance institution, the AKRSP managed to keep its costs low while carrying out its fully fledged operations. Until 1994, it was able to serve the local poor population at a cost of about US\$ 500 per poor household (Campos *et al*, 2004). According to the World Bank's estimates, this figure represented about fifty percent of cost of a typical microfinance institution with similar characteristics (World Bank, 1988, p. 47). The World Bank applauded the AKRSP's operational efficiency in terms of its cost efficient operations in recent years as well while evaluating its performance for the period from 1994 to 2000 (World Bank, 2002).

6.4.2. The Agricultural Activities.

Participation in these community organization resulted in approximately 7.5 percent annual increase in incomes for the poor households. Moreover, the poverty level of those households who were members of these organizations was lower than those who opted out (Rasmussen *et al*, 2004). The AKRSP designed and implemented a highly successful Agricultural Input Supplies (AIS) system for the purpose. The system emphasized on bringing new land under cultivation, and providing necessary training to the poor farmers, in addition to conducting research in an attempt to introduce new varieties of crop (Nyborg and Ali, 2005).

The cultivation of vegetables, fruits, and potato dominated the region's agriculture sector. Wheat, maize, millets, and barley were among the major crops (Khan, 2003). The AKRSP's role was to act as an intermediary between the VOs, WOs, and

beneficiary households. It supplied these organizations with different inputs, either free of cost or at a subsidized rate, to improve agricultural production. It also provided the local poor farmers with training in effectively using these inputs (Nyborg and Ali, 2005). The success of these organizations depended on how close their members were living to each other and the level of their mutual relationship (World Bank, 1995).

Under the approach, the AKRSP used to sanction a loan to these Village Organizations (VOs) at a subsidized interest rate. It was then the VOs' responsibility to manage those funds, make small loans to their poor household members and recover the same, and eventually reimburse the loan, with interest, to the AKRSP. The VOs were managed by a literate male member of the village-based community, whose responsibilities included recording of the concerned VO's financial transactions and minutes of any meetings between the VOs and the AKRSP (World Bank, 1995).

The VOs, in order to remain in the AKRSP's good books, struggled hard to ensure recovery from its members and repay its original loan to the AKRSP without any default. In the process the VOs had to keep their operational costs as low as possible to avoid default of any portion of their loan from the main body. The approach was implemented in such a rigorous manner that in the case of some defaults on the part of individual borrowers, other VOs' members reimbursed the loss from their own sources. This, in turn, kept the AKRSP's own costs at a minimum level (Campos *et al*, 2004). The crucial element in explaining their success is the inculcation of a 'sense of ownership' among the villagers. This sense of ownership informed the villagers that this was indeed their own Village Organization. This was supported by the frequency of village meetings and the existence of a written set of rules and regulations (Campos *et al*, 2004).

Thus, this unique idea of the Village Organizations (VOs) and the Women's Organizations (WOs), introduced by the AKSRP, served to achieve a three-fold purpose; *first*, to reach the maximum number of poor households, *second*, to ensure the efficient utilization of the loan amount, and *third*, to achieve its core objective of eradicating poverty with the scarce available subsidized financial resources.

6.4.3. The Forestry Activities.

Forests spreading over 1100 square miles cover an area about 4.32 percent of the total region (Khan, 2003). As discussed earlier, forestry was one of the region's important farm activities that contributed about 10 to 20 percent of the Northern Areas and Chitral (NAC) region's total income from farm related activities (World Bank, 1995). Despite the immense significance of the resource, the government, because of various avoidable factors, could not manage it in a way to ensure its sustainability over the long run (GoP and IUCN, 2003). Forest wood was in huge demand both locally and in the rest of the country. To cope with this demand and replace the fast depleting natural resource, a tree-plantation program was implemented on a large scale during the late 1980s, which was warmly participated in by the local population (Nyborg and Ali, 2005).

The overall trend in the planting activity was maintained by the AKRSP and during the early 1990s the quality of the plants and other planting materials supplied by the AKRSP had improved significantly (World Bank, 1995). The number of trees planted since the AKRSP's inception reached about 40 million. In addition, about 1500 nurseries were established in the private sector in the region to keep alive the region's planting activities (World Bank, 2002). VO/WO nurseries were also encouraged to

further boost up the regions planting activities. By the end of 1994, the number of VO/WO nurseries reached 138 (World Bank, 1995).

After the success of the program, forestry activities for the promotion and conservation of the most important natural resource were given a more prominent space in the AKRSP's portfolio of activities. Limiting the legal use of the forest wood and putting a halt on its illegal use were among the successes of the program. In addition, the local population was successfully led to form new mutually beneficial relationships with other local organizations, such as the Worldwide Fund for Nature (WWF), the International Union for Conservation of Nature and Natural Resources (IUCN), and the Government (Nyborg and Ali, 2005).

6.4.4. The Integrated Participatory Approach.

The unique approach — namely, integrated, participatory approach, led the Aga Khan Rural Support Programme to the path of success. Under this new approach to foster the development of the rural poor (World Bank, 1995), integrated planning was highly emphasized, and all local communities at village level were involved in the planning process. The participation of women in the planning and implementation of various projects was encouraged through their involvement in the Village Organizations and Women's Organizations (Nyborg and Ali, 2005; World Bank, 2002). Women's status within their community and their participation in economic activities were dramatically improved in the Northern Areas and Chitral (NAC) region due to the AKRSP's activities and development schemes (World Bank, 1995).

Before the participatory approach was introduced and implemented by the Aga Khan Rural Support Programme (AKRSP), development projects, if any, were identified and implemented at the sole discretion of concerned government agencies. A development project was first identified. Technical experts from concerned government agencies then helped design and implement the project in accordance with the guidelines and rules of concerned government organizations. In this case the ultimate beneficiaries of these projects — the local community, had no suggestions or control whatsoever over the project (Nyborg and Ali, 2005).

Under the approach, introduced by the Aga Khan Rural Support Programme and tailored to the specific requirements of the region, local communities were given more importance. They were represented in all phases of projects and given greater control over project identification and implementation. The final decision about identification, acceptance for implementation, postponement, or rejection rested with the local community (Nyborg and Ali, 2005). The essence of the participatory approach is the procedure adopted by the Aga Khan Rural Support Programme in project identification and implementation. The AKRSP realized the fact that since development projects are for the benefit of the community, unless and until local people personally participate, it will prove to be beyond means for it to undertake many projects needed in various areas. The AKRSP was overlooking every aspect of a typical project, but all other aspects, from identification and implementation to completion, were effectively finalised by the local people.

The World Bank, in its final evaluation of the performance of the microfinance institution, threw light on the success of the approach. It gave credit for the success of the approach to the involvement of the local community in every aspect of development

projects. It argued that the unique aspect of the approach of encouraging local people's participation in projects resulted in huge benefits, both socially and economically, for the region (World Bank, 2002).

The provision of training to the local poor and upgrading their skills in undertaking different economic activities underpinned the AKRSP's underlying philosophy and one of the basic characteristics was its integrated participatory approach. The separate Human Resource Development Division of the AKRSP was dedicated to undertaking these activities (World Bank, 1995). The local villagers were trained in areas such as village administration, bookkeeping, and accounts management. The scheme was highly successful in improving the quality of work and record maintenance at the Village and Women's Organization. In addition, a new training program for creating VOs managers was introduced during 1995. Under the program, the new VOs managers were trained to assume leadership roles in implementing the AKRSP's different village-based schemes and also provide practical training to other potential managers (World Bank, 1995).

The idea behind the policy was to create a permanent support structure for the region, so that, even the discontinuance of the AKRSP's activities in the region for some reason does not negatively affect the progress of the development work, and the local people are trained enough to sustain the ongoing development work (Nyborg and Ali, 2005). In addition, The AKRSP was significantly successful in establishing a mutually beneficial relationship among the Village Organizations, Women's Organizations, Non-Governmental Organizations, and other public and sector development agencies of the region. This policy of the AKRSP resulted in the development of the region on a sustainable basis (World Bank, 1995).

Keeping in view the importance of the forests natural resource for the economic development of the region, the AKRSP introduced the Natural Resource Management (NRM) scheme for better management of the resource. In addition, the AKRSP adopted a policy of continuously analysing and improving its procedures. For this purpose it utilized all its staff members with different areas of expertise to keep close interaction with the local community and get necessary feedback on its policies and procedures and also keep the top management abreast of the outcome of different development projects and also about local needs in different areas (Nyborg and Ali, 2005).

6.4.5. Development in the Energy Sector.

The Aga Khan Rural Support Programme at the time of its inception witnessed the misuse of the region's forests natural resource at a massive scale. The illegal extraction of wood and timber was several times more than the legal (Ismail and Hussain, 2003). Inadequate laws to conserve the precious natural resource, the local timber mafia's strong lobbying to negatively influence forest conservation policies from the government⁷², and over-consumption of forest wood for energy purposes due to a lack of alternative sources were among the main causes of fast depleting of the natural resource (Khan, 2003).

About 99 percent of the local population was resorting to forest wood to meet their day to day energy requirements (GoP and IUCN, 2003). The natural resource was fast depleting and the situation was in dire need for a corrective action. The rate of increase in the demand for firewood was more than the population growth rate⁷³, because the

⁷² Business enterprises associated with forest sector earned more than 115 percent return on their investments in 1999 — the highest profits of all sectors (Khan, 2003).

⁷³ About 2.5 to 3 percent per annum (GoP and IUCN, 2003; Ismail and Hussain, 2003).

resource is not only in demand for local use but also for commercial purposes (Ismail and Hussain, 2003). According to an estimate more than half of the region's population falls under the age bracket of 15. In addition, female population of the region in reproductive age is about 39 percent. These two factors together suggest that the region's population may increase up to 75 percent in two decades (GoP and IUCN, 2003). Thus, the situation points toward the need for prudent policies to keep a balance between the available resources and population growth.

Therefore, one of the important issues for the AKRSP to tackle at the time of its inception was to somehow conserve this precious natural resource. The AKRSP's officials asserted that the situation needed more than the simple protection of the remaining part of the resource. It, therefore, tried to find a solution for the issue through analysing the current and future demand of the forest wood for various needs both within and outside the region. It initialized annual plantation programs and, through raising awareness among the local communities about the severity of problem, convinced the local population to actively participate in the programs (Nyborg and Ali, 2005).

6.5. The AKRSP's Achievements.

Since The Aga Khan Rural Support Programme (AKRSP) first instigated operations in the Northern Areas and Chitral (NAC) region, its primary objective has been to improve the means of livelihood of the local poor on a sustainable basis. To accomplish this objective it initiated several projects and schemes and successfully managed to complete them with a measurable achievement for the region. The AKRSP's achievements can be grouped in the following two groups.

6.5.1. Qualitative Achievements.

The literature shows various instances where the qualitative achievements of the Aga Khan Rural Support Programme in terms of the efficacy of its policies and unique approach it adopted for poverty eradication in the region have been discussed (for example, World Bank, 1995 and 2002; Gloekler and Seeley, 2003; Nyborg and Ali, 2005; and Campos *et al*, 2004). The literature acknowledges contribution from various other organizations and concludes that the AKRSP was not the lone organization that worked for the betterment of the region. Different government agencies and private sector organizations have been involved in the development work in the region. Therefore, it cannot be credited with all the economic progress the region has witnessed so far. However, about 10 to 50 percent of the rise in local households' income levels over these years can be attributed to the AKRSP's efforts and activities in the region (World Bank, 2002; Rasmussen *et al*, 2004).

The microfinance institution's contribution to poverty eradication in the region can be well ascertained by the fact that average household income was more in localities with a heavy AKRSP presence compared to where it had low level of operations or where it had not yet initiated any development activity (World Bank, 1990b). Due to different infrastructure related projects successfully completed by the AKRSP, average health levels and life expectancy has improved significantly in the region (World Bank, 2002).

While the direct impact of the AKRSP's efforts in terms of the prosperity of the local population was evident, the indirect impact of these efforts cannot be ignored either. The time of the inception of the AKRSP's activities can be characterised by a high illiteracy rate, particularly in the region's female population, lack of awareness of health

issues, and high levels of poverty. Existing Non-Governmental Organizations (NGOs) and government agencies involved in the region's development work are still benefiting from the early development work undertaken by the AKRSP. The increased awareness about female education and health issues among the local population, and the overall increased interest of the local population in helping themselves and working for their region's economic growth, are among the outcomes of the AKRSP's initial efforts, which other organizations are taking advantage of (World Bank, 2002).

6.5.2. Quantitative Achievements.

The Aga Khan Rural Support Programme's success in the Northern Areas and Chitral region well lends itself to measurement in quantitative terms. The final conclusions and positive remarks of the Operations Evaluation Department of the World Bank in its different periodical evaluations of the AKRSP's successful policies and approach to tackle the region's distressed economic state and the level of poverty depict the level of its success. Since its inception in 1982, the AKRSP has spent about US\$ 50 million of subsidized financial resources in its effort to eradicate the Northern Areas and Chitral (NAC) region's poverty (Nyborg and Ali, 2005; AKRSP, 2004). However, the World Bank expressed satisfaction over its efficiency in utilization of these resources in its periodical evaluations, as highlighted in its remarks about its qualitative and quantitative achievements.

The AKRSP's investment yielded more than 25 percent return in economic terms⁷⁴. The Programme was successful not only in fighting the region's poverty but also in building

⁷⁴ Rasmussen *et al* (2004) reported 16 to 24 percent as the AKRSP's Economic Rate of Return on investment.

its social capital in terms of bringing different local communities closer to each other through Village Organizations and Women's Organizations, and combining their efforts for the region's economic development (Nyborg and Ali, 2005).

In one of its surveys of its own 13 projects in the sector of land development, the AKRSP revealed that the projects yielded return ranging from 13 to 56 percent. Only 3 projects returned less than 20 percent on their investments (AKRSP, 2000). The AKRSP's unique approach to poverty eradication and its dedicated staff were behind its popularity as an effective microfinance program, which attracted widespread interest and continued support, financial as well as non-financial, from the international donor community.

Rasmussen *et al*, (2004) documented the impact of the AKRSP's operations in the region in quantitative terms. They compared the NAC region's trend in per capita income over the years with that of the country as a whole and concluded that the AKRSP's presence in the region has contributed positively to the regions economic growth and poverty curtailment. Table 6.3 throws some light on the AKRSP's contribution to the Northern Areas and Chitral (NAC) region's economic growth in terms of gradual increase in its level of per capital income compared with that of Pakistan.

Table 6.3: Trends in Per Capita Incomes (US\$).

Source: Rasmussen *et al*, (2004).

Please see print copy for Table 6.3

In its different evaluations of the AKRSP's performance over the years, the World Bank appreciated the AKRSP's remarkable achievements in terms of eradicating poverty in the area of its operations. In its last evaluation of the AKRSP, the World Bank highlighted its operational efficiency and concluded that despite its continued dependence on the provision of subsidized financial and non-financial resources by the international donor community, unlike most of the subsidy-dependent microfinance programs around the world, it proved its sustainability over a long period of time (World Bank, 2002). Some of the quantitative achievements of the program are listed in Table 6.4 below.

Table 6.4: The AKRSP's Accomplishments in Quantifiable terms.
Source: AKRSP, 2004.

Please see print copy for Table 6.4

Since, its inception in 1982, the Programme's coverage reached about 55,000 of the region's poor households in 1,158 Village Organizations in 1989. It surpassed 75,000 poor households who were benefiting the AKRSP's 1,834 Village Organizations by the

⁷⁵ Include sheep, goats, cattle, and poultry.

end of 1994. By that time the Programme's coverage reached about two-thirds of the Northern Areas and Chitral region (World Bank, 1995).

The World Bank's last evaluation of the AKRSP's operations and performance extensively analysed its achievements over the years of its operations. The AKRSP's different projects in agriculture and land development sectors resulted in a high increase in incomes for poor farmers in the Northern Areas and Chitral (NAC) region. As the agricultural income represented more than 50 percent of the region's total income, the projects proved to be a huge success in terms of poverty eradication (World Bank, 2002), and major portion of this increase was attributable to the AKRSP (World Bank, 1990b).

Table 6.5 below shows the trends in poverty level in the NAC region and Pakistan from 1991 to 2001.

Table 6.5: Trends in Poverty.

Source: Rasmussen *et al*, 2004.

Please see print copy for Table 6.5

Since the AKRSP's inception of operations in 1983, its performance has been evaluated four times, in 1987, 1990b, 1995, and 2002, by the World Bank (Campos *et al*, 2004). The World Bank's evaluation of 1990b concluded that the AKRSP's successful approach to poverty eradication in the region proved that rural support programs are a better means to tackle poverty issues in different countries.

6.6. The Government of Pakistan's Appreciation of the AKRSP's Approach.

The Government of Pakistan's decision to implement its Social Action Program (SAP) in the northern Areas, from the beginning of the 1990s, through the Aga Khan Rural Support Programme's Village Organizations (VOs) was an important indicator of the programme's success (AKRSP, 1995, p. 4). Keeping in view the education and health level in the Northern Areas and Chitral (NAC) region⁷⁶, the region was in desperate need for such a program at the government level. VOs and concerned government agencies have their own responsibilities with regards to the program, and they interact in a prescribed manner to ensure smooth implementation of different schemes under the program. First School under the program was started in March, 1995 (AKRSP, 1995).

The Programme's integrated participatory approach had successes beyond the region's economic performance in the education and community health sectors as shown in Table 6.6.

Table 6.6: The NAC region's Social Performance Indicators.

Source: Rasmussen *et al*, 2004.

Please see print copy for Table 6.6

⁷⁶ Overall literacy rate before the inception of the government's Social Action Program (SAP) in Gilgit, the most developed part of the region, was 18.1 percent (28.6 percent in males and 5.5 percent in females). The figures for infant mortality were between 150 to 200 per 1000 live births, while comparable figures for the country were 91 deaths per 1000 live births (Campos *et al*, 2004)

The region's literacy rate was quite low with high dropout rates among both boys and girls. Moreover teaching and curriculum standards were far below the national standards (GoP and IUCN, 2003). The initial need assessment survey and then planning and implementation of village schools program under the government's Social Action Program was conducted through the AKRSP's Village Organizations, which depicts the importance of the AKRSP's approach. Moreover, the Aga Khan Rural Support Programme has provided technical support and advice in establishing different programs in Bangladesh, India, and Tajikistan using its unique approach (AKRSP, 1995; World Bank, 1995).

6.7. Is the AKRSP's Model Replicable?

The Aga Khan Rural Support Programme's achievements in the Northern Areas and Chitral region in terms of efficient use of scarce financial resources to eradicate poverty in the region endorsed the fact that Non-Governmental Organizations can play a vital role in rural development (GoP and IUCN, 2003). This encouraged the Government of Pakistan to use the unique approach in other parts of the country.

Whether, or to what extent, the experiences of the Aga Khan Rural Support Programme can be replicated in other areas of Pakistan or elsewhere in the world depends on the meaning one infers from the word 'replication' (Nyborg and Ali, 2005). The literature suggests that the AKRSP's 'blueprint' approach was not generally effective as it was tailor made to the specific social, cultural, economic, and geographical conditions (Hussein and Plateau, 2003; Nyborg and Ali, 2005). The Government's first step in this direction was the establishment of the National Rural Support Program (NRSP) in 1992. The AKRSP's approach to microfinance underpinned the basic theme of the NRSP and

was meant to replicate the AKRSP's rural development experience at a national level. Subsequently, the Government of Pakistan established more rural support programs either straight away using the AKRSP's exclusive approach or later on tailored them in light of the AKRSP's experience (World Bank, 1995).

The AKRSP's approach proved to be effective under these special circumstances of the NAC region. The success of other microfinance institutions elsewhere in the world with specific external circumstances unique to the respective areas of their operations in replicating the AKRSP's approach was in doubt. Therefore, microfinance institutions trying to resort to the AKRSP's approach in their overall endeavour without paying due attention to their respective local conditions and contexts would not achieve a lasting impact on the development of the areas of their operation (Nyborg and Ali, 2005).

Several organizations attempted to replicate the AKRSP's approach in different parts of Pakistan, as listed in Table 6.7. However, later on, they had to adjust their approach to local social, geographic, political, and economic contexts, as these institutions were not able to show an encouraging performance over the first few years of their operations (Nyborg and Ali, 2005). Thus for effective and fruitful replication of the Aga Khan Rural Support Programme in Pakistan or elsewhere, its approach and policies have to be tailored and adapted to the specific contexts of the region.

For instance, inspired by the AKRSP's success in the mountainous areas of Pakistan, the Mountain Societies Development Support Programme (MSDSP) of the Aga Khan Foundation (AKF) tried to replicate the AKRSP's approach in the mountainous areas of Tajikistan. Tajikistan was one of the poorest republics of the former Soviet Union with a predominantly agrarian economy. Since some parts of the country offered almost

similar conditions to those of the Northern Areas and Chitral region of Pakistan, the MSDSP's programmes embraced success in different sectors. Its programmes improved local economic conditions and increased agricultural production through incorporating new agricultural techniques, which resulted in an increased food security for the local poor population (Tetlay and Jonbekova, 2005).

Table 6.7: List of Rural Support Programs currently operating in Pakistan.

Source: Rasmussen *et al*, 2004.

Please see print copy for Table 6.7	
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On similar grounds, looking at the AKRSP's achievements in the NAC region, the Government of Pakistan initiated several rural support programs in the country; the list is shown in Table 6.7. The extent of success of these rural support programs largely depended on the extent of their adaptation to their specific local circumstances and the needs of the local population.

⁷⁷ Pakistan's North West Frontier Province.

⁷⁸ United States Agency for International Development.

⁷⁹ German Agency for Technical Cooperation.

⁸⁰ United Nations Development Program.

As discussed earlier in Chapter 2, Dreze and Sen (1991) gave a general rule in this regard while studying poverty issues in some developing countries. They urged policy makers not to treat all the poor alike. They suggested in their book that the poor depict different behaviour in respect of dealing with their poverty issues and managing their meagre financial resources and, as such, need different financial services to overcome their poverty. They need a variety of financial services, not just credit, adapted sufficiently to their specific circumstances, to fight poverty (Dreze and Sen, 1991).

6.8. Summing Up.

Using a unique approach which successfully accommodated the specific cultural, economic, social, and geographical condition of the Northern Areas and Chitral region, the Aga Khan Rural Support Programme (AKRSP) was able to penetrate deeply into the region only within the first few years of its operations. The microfinance institution's success in accomplishing its set objectives was due to its unique participatory approach and the management's enthusiasm and interest in helping the local poor.

The Aga Khan Rural Support Programme first began initiated its operations in 1983 with providing small credit loans to the local poor households engaged in farming activities in the region. The Programme's initial sources of capital included the Aga Khan Foundation and a line of credit from a local commercial bank. By the beginning of 1990s, 30 percent of all households throughout the Northern Areas and Chitral (NAC) were using the AKRSP's credit services. From 1983 through 2001, the AKRSP loaned out a total of Pak Rupees 1,568 million, and, during its life, wrote off only 1 percent of the loans that were not paid back (AKRSP, 2001). Table 6.8 shows a brief

account of the evolutions in the operations of the Aga Khan Rural Support Programme since its inception.

Table 6.8: Evolutions in the operations at the AKRSP over time.

Source: The AKRSP's Annual Reviews for different financial years.

Please see print copy for Table 6.8

As discussed earlier in the chapter, the Aga Khan Rural Support Programme's unique participatory approach to poverty alleviation in the Northern Areas and Chitral (NAC) region proved to be a reliable means to tackle the local poverty. The village-based Village Organizations (VOs) and the Women's Organizations (WOs) were the main elements contributing to the success of the approach. The AKRSP, through these organizations, emphasized on the development of the region's agricultural sector and a prudent management of its natural resources, which led the region to a noticeable economic growth and improved incomes for the local poor households. However, in accomplishing all this, the AKRSP remained dependent on the subsidized financial

resources from international donor agencies. There is no evidence of the AKRSP trying to pursue self-sustainability as a key aspect of its microfinance program in its first fourteen years of operation (Hussain and Plateau, 2003).

As discussed in Chapter 2, during the period from beginning to the mid-1990s, the donors changed their approach and started stressing more on self-sustainability on the part of Microfinance Institutions as it was beyond their means to keep on allocating subsidized financial resources to the sector. This, in turn, resulted in competition among the MFIs because, in the pursuit of self-sustainability, the MFIs had to compete with each other for more business. This radically changed the AKRSP's thinking about the management of microfinance operations at the AKRSP and it started adapting or reorienting to its new external environmental conditions.

The next chapter will discuss the move towards commercialization in the microfinance sector in general and the transition phase of the Aga Khan Rural Support Programme in its effort to adapt and reorient to its changed environmental conditions. The literature suggests that the AKRSP had to struggle hard to cope with its new external environmental conditions. Changing an organization's both tangible and intangible elements wherein it changes its course of action from being a social service organization to one where the emphasis is clearly on commercialism and profitability is easier to plan than to implement. After experiencing a change in the external conditions, the AKRSP was faced with a similar situation and had to struggle hard to adapt and reorient to the changed external circumstances. The international donor community provided the AKRSP with technical support and expert advice in the change process (Khan and Hussain 1995).

Chapter 7: The AKRSP's Reorientation to the Changed Environmental Conditions (1996-2001)

7.1. Commercialization of the Microfinance Sector.

7.1.1. Background.

Private capital is always attracted to a sector which promises high returns on investments and relatively low risk of a loss. For instance, sole proprietorships, partnerships, and corporations around the world operate with the main motive of safeguarding their capital and maximising returns. Microfinance appears to be in a different sector in this regard. Due to a high risk associated with extending small loans to poor households and very low, if any, return on investment, the sector has been unable to attract private investment. Since the late 1970s, the sector has sustained its mission with the financial and non-financial support of international donor agencies (Poyo and Young, 1999). Despite almost 15 years of donor support and a flow of huge sums of subsidized financial resources to the sector, the results were still not encouraging with the potential demand for microfinance services around the world still surpassing the supply (Poyo and Young, 1999).

While discussing the pre-change era of microfinance, the President of The First Microfinance Bank Limited, participant no. 13, remarked that the management at most of the MFIs used to spend exorbitantly on unnecessary things like expensive cars and sophisticated offices for executives, leaving a minimal amount for microfinance operations, which would result in the wastage of the donor-provided subsidized funds without noticeable positive outcomes. "Poor people need financial assistance whether

provided from a fancy-looking building or a small office setup”, he further added to his comments. As a result, it was realised that it was no longer within the means of the international donor agencies to continue to provide subsidized financial resources to the microfinance sector, and that in order to deepen the poor households’ access to a variety of financial services and to widen the service base of the microfinance sector, financial self-sustainability and institutional sustainability should be among the most important goals of microfinance institutions (MFIs).

By the early to mid-1990s, after almost more than 15 years of experience, it was abundantly clear that to ensure poor households’ access to a variety of financial services, not only should the mainstream financial institutions step into the sector, but the existing microfinance institutions should change their approach from a not-for-profit to a for-profit one (Baydas *et al*, 1997; Poyo and Young, 1999).

7.1.2. The Essence of Microfinance Commercialization.

The concept of commercialization of the microfinance sector is relatively a new phenomenon and carries a negative sense of exploiting the poor for some academicians. However, many professionals in the field advocate the concept and refer to it as “the application of market-based principles to microfinance” or “the expansion of profit-driven microfinance operations” (Charitonenko and Afwan, 2003, p. 2). These professionals argue that the existing limited outreach of microfinance services around the world makes it necessary to introduce the sector to commercialization principles. It is possible for microfinance institutions to meet the ever-expanding demand for

microfinance services on a sustainable basis only through adopting the commercialization approach (Charitonenko and Afwan, 2003).

7.1.3. The Commercialization Process.

The process of microfinance commercialization can be shown in the form of a continuum as shown in Figure 7.1 below.

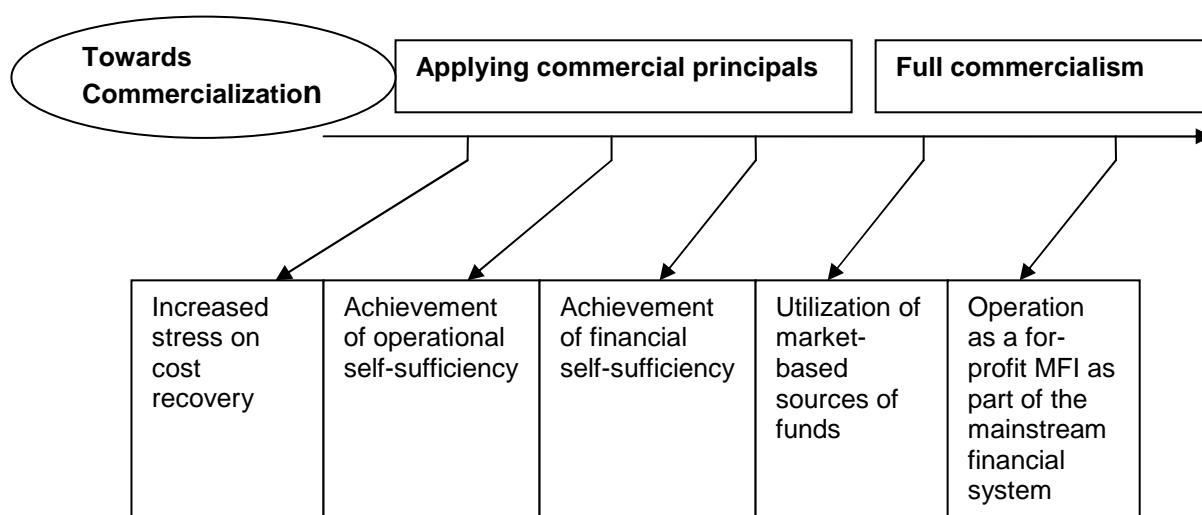


Figure 7.1: The continuum of microfinance commercialization.

Source: Adapted from Charitonenko and Afwan (2003).

Charitonenko and Afwan (2003) described the completion of microfinance commercialization as a four step process: *First*, the microfinance institution changes its course from a not-for profit to a for-profit approach in its overall administration and operation. At this stage, the institution tries to diversify its product-line, introducing new financial products according to the need and demand of its target clients. *Second*, the institution strives for operational and financial self-sufficiency. This involves clear emphasis on keeping all the costs at the lowest possible level, but without any negative impact on the level of its outreach. *Third*, the institution, instead of looking around for

subsidized financial resources, tries to generate market-based funds to meet its capital requirements. This may include seeking loans from other mainstream commercial institutions, mobilization of voluntary savings, and resorting to other non-subsidized sources. *Fourth*, the institution changes its overall approach and adopts commercialism in all its policies and operations. In other words, it tries to merge itself with other mainstream commercial institutions and attract equity investment from commercial sources. This, however, may make it subject to government regulations and supervision.

Looking at the empirical data, as discussed in the remaining sections of the chapter, the Microfinance Division of the Aga Khan Rural Support Programme (AKRSP) more or less went through the same four steps to reach the state of full commercialization. The AKRSP⁸¹, however, had to transform into a completely different organizational setup to complete the commercialization process.

7.2. The New Challenge for MFIs.

As discussed in Chapter 1, the donors' changed approach and thinking about the sustainability of the microfinance institutions and their gradual move from providing subsidized financial resources to the microfinance sector to stressing self-sustainability on the part of MFIs was initiated during the period from the beginning to the mid-1990s and posed a new challenge to the MFIs around the world (Baydas *et al*, 1997; Fernando, 2006; CGAP, 1996; Gonzalez-vega and Schreiner, 1997; Dichter, 1996; Rogaly, 1996; Hulme, 2000; Robinson 2001 and 2002).

⁸¹The name 'Aga Khan Rural Support Programme' used in the thesis refers to the Microfinance Division of the AKRSP.

However, under their changed policies, the donors did not completely stop giving subsidized funds forthwith; instead they started encouraging MFI's to tailor their operations towards 'commercialism', thereby ensuring profitability and self-sustainability. Participant no. 2, the CEO of the Pakistan Microfinance Network⁸², remarked in this context that the donors did not stop giving subsidized funds to the microfinance institutions forthwith. There were still subsidized funds flowing into these MFIs but at the same time the stress on profitability and self-sustainability was gaining momentum. Participant no. 13, the President of The First Microfinance Bank Limited, said that donors did not want the microfinance institutions to remain donor-dependent for the life of the institution, but wanted them to be self-reliant in the long-run, and look for other sources of funds, such as mobilising savings, to finance their operations.

In the microfinance literature, the term 'self-sustainability' has been defined as "to reach goals in the short-term without harming your ability to reach goals in the long-term" (Navajas *et al*, 1998, as quoted in Woller *et al*, 1999, p. 16). The objective, thus, is not only to reach large numbers of the poor, but also to do this in a sustainable manner (Gurgand *et al*, 1996). This, in turn, resulted in competition among the microfinance institutions because, in the pursuit for self-sustainability and profitability, they were forced to look for more and more business and attract more clients.

The Microfinance Division of the Aga Khan Rural Support Programme, in response to these two environmental 'disturbances', had to adapt, reorient, and ultimately transform into an entirely new commercial setup. The empirical data collected for the study

⁸² All the participants to the interviews have had long-term association with the Aga Khan Rural Support Programme (AKRSP). Upon transformation of the AKRSP to The First Microfinance Bank Limited (FMFBL) in 2002, some of the AKRSP's microfinance staff joined the FMFBL at their discretion and some joined different related organizations such as the Pakistan Microfinance Network (PMN), the Rural Support Programme Network (RSPN), and other similar organizations.

suggests that the third environmental ‘disturbance’ — government regulation — that has been discussed in Chapter 1, did not play a role in this change. Participant no. 5, the General Manager of the Pakistan Microfinance Network remarked that the microfinance sector in Pakistan is regulated by the State Bank of Pakistan; there have been changes in SBP regulations but they were not the direct result of the need for sustainability on the part of the MFI. The SBP first issued a set of rules for the microfinance sector in 2000, which it replaced by a set of new rules called the SBP prudential regulations in October 2002, which are still effective and in force. In response to a question regarding this issue, participant no. 6, the head of the Credit and Monitoring department, remarked,

no, I have not seen any regulations coming from the SBP during the 1990s, but I can say that we are following the SBP’s latest prudential regulations in our lending and other operations. These regulations were issued in 2002.

Competition among microfinance institutions was, in fact, the direct result of the donors’ changed thinking and approach. These institutions, in the pursuit of profitability and self-sustainability, had to struggle hard for more and more business and customers — the life-blood of any commercial entity. Participant no. 5, the General Manager of the Pakistan Microfinance Network, said in this connection that after the change, the microfinance sector has become ever-changing and the most dynamic. That is why product innovation and adaptation to suit customers’ needs is more and more emphasized. After the change, loan products were changed and poorly performing products gradually phased out from the AKRSP microfinance operations (AKRSP, 2000).

Table 7.1 gives an idea about the inclusion and exclusion of different loan products at different times. The changed environmental conditions jolted the AKRSP management to make certain decisions to ensure profitability and productivity for all the branches.

Clearly, products with promising return for the microfinance institution were kept and the rest were discarded.

Table 7.1: Savings and Loan Products at the AKRSP, 1982-2001.

Source: Adapted from Hussein and Plateau, 2003.

Loan Product	Year of Launch	Year of Withdrawal⁸³	Interest Rate
Short-Term Loans	1983	1999	9%
Medium-Term Loans	1984	1999	8%
Group Loans to VOs	1989		15%
Enterprise Credit Loans (ECL)	1992		16%, raised to 24% in 1998 ⁸⁴
Corporate Credit Loans	1996 ⁸⁵	1999 ⁸⁶	Varying Market Rate
Business Committee Loans	2000		Varying Market Rate

The AKRSP's credit programme, starting in 1983, was confined only to Short-term Loans (STL), used mainly for agricultural input purposes. Later on, with the passage of time, four additional loan products were introduced, namely, Medium-term Loans (MTL), the Village/Women's Organizations Credit Programme (V/WOCP), the Enterprise Credit Programme (ECP), and the Corporate Village Organization Credit (CVOC). These products remained on the 'active products' list until the end of 1998; during the AKRSP's reorientation phase all these credit products were consolidated in early 1999. All the collateralised credit products (STL, MTL, and V/WOCP) were merged together and called Group Loans (GL), while the Enterprise Credit Programme (ECP) was called Individual Loans (IL). The CVOC product was closed altogether along with STL and MTL (AKRSP's Internal Policies and Procedures manual, 2000).

⁸³ The management's push to disburse an increasing number of loans during 1997 and 1998 resulted in high levels of loan delinquency by 1999 thereby necessitating withdrawal of some non-performing loan products.

⁸⁴ During the AKRSP's reorientation phase, interest rates on some loans were raised in order to cover operational costs and provide for financial sustainability.

⁸⁵ Corporate loans were introduced after the change initiated at the AKRSP in the quest for improving profitability and ensuring self-sustainability.

⁸⁶ This loan product was withdrawn due to its large size, high level of loan delinquency, and staff's inadequate appraising expertise.

In the previous chapter Phase I (1982-1995) of the AKRSP's life — the time period before the external environmental 'disturbances' affected the AKRSP, was discussed. This chapter will focus discussions on Phase II (1996-2001) of the AKRSP's life — the timeframe during which the AKRSP adapted or reoriented itself to these new environmental conditions. Phase III (2001 onwards) — the time period after the radical transformation of the AKRSP to 'The First Microfinance Bank' in response to the said environmental 'disturbances' will be discussed in the next chapter. Figure 7.2 below demonstrates Phase II diagrammatically.

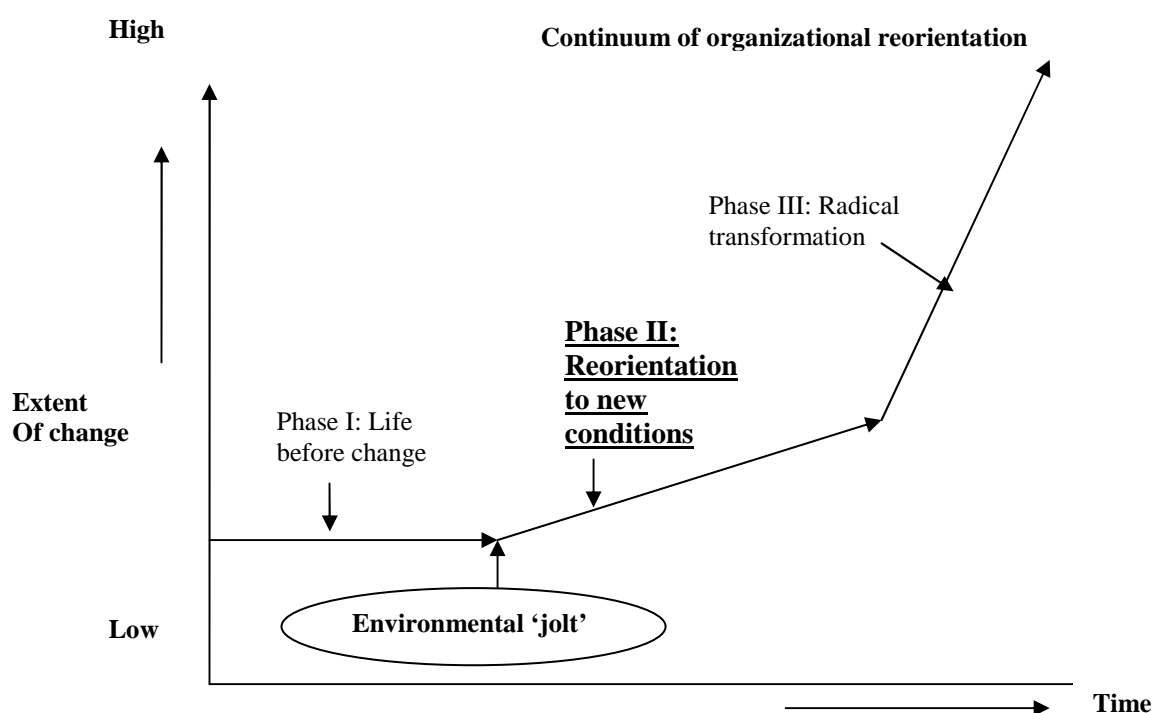


Figure 7.2: Extent of change at an organization's reorientation stage.

Source: Idea for the figure's 'layout only' is taken from Hill and Collins (2000).

7.3. Analysis of the Empirical Data.

As discussed in Chapter 4, Laughlin's Model of Organizational Change (1991), shown in figure 7.3, suggests that external environmental 'disturbances' initiate a change in the

‘Design Archetype’ (the organization structure, decision processes, and communication systems), which, in turn, leads to a change in the organization’s ‘Interpretative Schemes’ (the mission/objectives, beliefs/values/norms/culture, and the organization’s rules and policies) and ‘Sub-systems’ (tangible organizational elements, like buildings, premises, machines, finances, and locations).

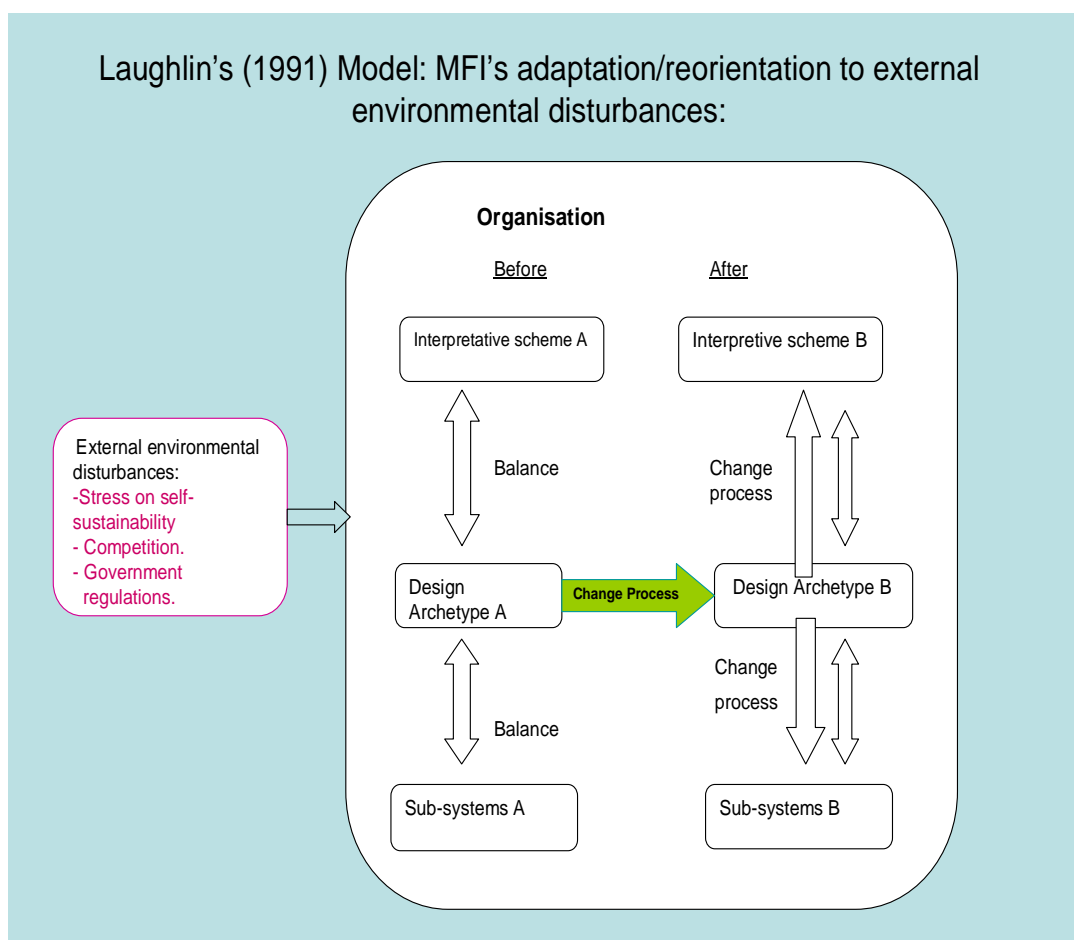


Figure 7.3: Laughlin's Model of Organization Change (1991).

Source: Adapted from Laughlin (1991), p. 219.

To explain the Aga Khan Rural Support Programme's internal adaptation, reorientation, and ultimate transformation in response to the external environmental 'disturbances', Laughlin's (1991) Model of Organizational Change will be used; and, to explain its passive submission to the 'coercive' influence exercised by the international donor

agencies, the theoretical underpinnings of Institutional Theory will be resorted to. The following sections will cover Phase II (1996-2001) of the AKRSP's life with particular reference to the gradual change in its 'Design Archetype', 'Interpretative Schemes', and 'Sub-systems' using the empirical data, thereby developing a set of 'observed patterns'; during the whole process of reorientation the AKRSP had been in fact stepping forward towards commercialization and self-sustainability.

For the analysis of the empirical data the 'Patterns Matching' technique will be used, as discussed in Chapter 5. Firstly, a set of 'observed patterns' will be developed using the empirical data; these will then be matched with the 'theoretical patterns' suggested by Laughlin (1991) and Institutional Theory (DiMaggio and Powel, 1983). The next chapter, Chapter 8, using the empirical data, will discuss Phase III (2001⁸⁷ onwards), the radical transformation of the AKRSP to a totally new independent commercial setup — The First Microfinance Bank — in response to the external environmental kick, jolt, or disturbance (Laughlin, 1991), and the subsequent achievement of a state of 'balance' by this new setup with new positions of its organizational elements, thereby developing another set of 'observed patterns'. The last chapter — Chapter 9, will look at these two sets of 'observed patterns' with the lenses of Laughlin's Model (1991) and Institutional Theory (DiMaggio and Powel, 1983), analyse the empirical data by comparing these 'observed patterns' with the 'theoretical patterns' as suggested by the two theoretical frameworks, and thereby arrive at the conclusions.

⁸⁷ The year 2001 overlaps in the two phases of the AKRSP — Phase II and Phase III as the empirical data suggest.

7.4. The AKRSP's Comprehensive Response.

Before the change process was initiated in the Aga Khan Rural Support Programme, it had reached more than 80 percent of the households in the Northern Areas and Chitral (NAC) and there were few opportunities to expand its operations geographically. But donor fatigue, which came to the surface during the early 90s, raised prospects of a leaner future, as the AKRSP, regardless of its success in achieving its objectives, was not financially self-sustainable (World Bank, 2002). Since the beginning of 1996, the programme, instead of expanding, had focussed internally on improving its financial performance and building a stronger and more efficient management system. To do this it reviewed and revised all of its internal policies and procedures (AKRSP, 2000).

At the AKRSP's Board of Directors meeting of May 26, 2001, it was resolved to ensure the wellbeing of the AKRSP during the transition period. It was resolved by the meeting that the AKRSP's microfinance program should continue to progress and be well managed during the transition period. However, some literature suggests otherwise pointing out that growth at the AKRSP practically came to a halt in real terms between 1998 and 2002 (Hussein and Plateau, 2003). Management during the transition period had to work very hard to change attitudes away from a welfare-oriented subsidized credit mentality towards a sustainable customer-oriented service delivery (AKRSP, 2000).

Table 7.2 below shows a preliminary sketch of the framework of organizational adaptation, reorientation, and subsequent transformation of the Aga Khan Rural Support Programme to a completely independent commercial setup.

Table 7.2: Organizational transformation in the AKRSP — a preliminary sketch of all the three phases of organizational change.

Description	Phase I	Phase II	Phase III
Timeframe	1982-1995	1996-2001	2001 onwards
The driving force — ‘Coercive’ element of the Institutional Theory	The donors’ community	The donors’ community	The donors’ community / The State Bank of Pakistan (SBP)
Organizational Form	Non-governmental Organization (NGO)	Adapting and reorienting	Regulated commercial bank
Laughlin’s Model	Morphostatic rebuttal	Morphostatic reorientation	Morphogenetic Evolution
Interpretive Schemes	Poverty eradication, Not-for-profit operation, local infrastructure and agricultural development, informal organizational culture, dependence on donors	Poverty eradication with stress on cost control, struggle for self-sustainability and profitability, adopting formal organizational culture, struggling to achieve independence	For-profit operation, Poverty eradication using commercial approach, business culture, customer-orientation, formally setting targets for profitability and self-sustainability, using commercial approach in all operations, strictly formal and regulated culture, complete independence.
Design Archetype including Accounting system	Poorly implemented organizational hierarchy, negligible accountability, low internal control, poorly defined decision-making powers, informal and verbal internal communication, shortcomings in accounting systems and MIS.	Restructuring the organizational hierarchy, opening and merging of departments, defining and implementing accountability, improving internal control, improving decision-making processes and internal communication, adopting formal accounting principles, orienting towards MIS	Formally implementing well-defined organizational hierarchy, professionalism, well-defined internal control, formal accountability system, assigning formal decision-making powers, full-fledge use of MIS and Accounting principles
Sub-system	Untrained and inexperienced staff, Un-standardized branch buildings, poorly designed interior and exterior of office buildings, non-commercial location of branches.	Staff training programs, internal transfers of staff, achieving standardization in branches, improving interior and exterior of branches, evaluating the branches location, considering branches attractiveness and clients’ comfort	Hiring of professional staff, complete standardization of branches, business feasibility report for branches openings, opening of branches in commercial locations, closing of extremely undesirable branches

In 1996 the Aga Khan Rural Support Programme (AKRSP) committed itself to build a financially sustainable microfinance programme; to meet this goal, the AKRSP underwent a complete reorientation phase from 1996 to 2001 (AKRSP, 2000).

The remaining part of this chapter will discuss the AKRSP's adaptation and reorientation to these external environmental 'disturbances' — the changes in the AKRSP's 'design archetypes', 'interpretative schemes', and 'sub-systems' (Laughlin, 1991) during the process of its adaptation and reorientation in response to the external environmental disturbances. The discussion below will cover only Phase II (1996-2001) of the Aga Khan Rural Support Programme's life, and thereby develop the first set of 'observed patterns'.

7.5. The Phase II of AKRSP's Life (1996-2001) — Reorientation to Changed Conditions.

At the reorientation stage, the external environment is relatively less aggressive and the extent of change it wants an organization to go through is manageable (Hill and Collins, 2000). The same situation can be observed from the reorientation phase of the Aga Khan Rural Support Programme. The microfinance operations at the AKRSP were not geared towards financial self-sustainability until the end of 1995 (AKRSP, 2000). The AKRSP management, at this juncture, decided to adapt and reorient its microfinance operations to the changed environmental conditions and, thus, tailor them to financial self-sustainability. The following sections will throw light on the changes to the AKRSP's 'interpretative schemes', 'sub-systems', and 'design archetypes' in response to the changed environmental conditions. Table 7.3 below gives a clear picture of how the AKRSP's reorientation process, initiated in the beginning of 1996, was

demonstrated by a number of key indicators. The Programme's performance during the period from 1998 to 2001 has been remarkable and its efficiency has been satisfactory in terms of the costs of achieving these results (World Bank, 2002).

Table 7.3: The AKRSP's Microfinance Operations 1998-2000.

Source: Adapted from AKRSP (2000).

AKRSP's Microfinance Operations	1998	1999	2000
1. Average Performing Assets ⁸⁸ (Rs. ⁸⁹ . Millions)	326	476	565
2. Outstanding Loan Portfolio ⁹⁰ (Rs. Millions)	253	201	142
3. Outstanding Portfolio per Borrower (Rs.)	7,423	7,523	6,522
4. Credit Portfolio at Risk ⁹¹	4.2%	7.2%	5.6%
5. Operating Cost to Avg. Performing Assets Ratio ⁹²	5.7%	4.0%	3.6%
6. Operating Cost to Avg. Loan Portfolio Ratio ⁹³	7.1%	8.5%	11.9%
7. Operational Self Sufficiency	197%	219%	353%
8. Financial Self Sufficiency	81%	107%	186%
9. Adjusted Return on Performing Assets ⁹⁴	-3.8%	0.8%	7.3%

The discussion here will focus on the AKRSP's adaptation and the reorientation in response to the two environmental 'disturbances' — first, the donors' changed approach and thinking about the sustainability of the microfinance institutions, and, second, the resulting competition among the MFIs. According to participant no. 15, Senior Operations Associate at the First Microfinance Bank Limited, senior management at the AKRSP, soon after these 'disturbances' affected the MFI during the mid-1990s, chalked out a major plan to first gradually adapt and reorient the MFI and then completely transform it to a new independent commercial setup. The AKRSP Board of Directors appointed the Strategy Development Committee in 1994 to propose a future direction

⁸⁸ It depicts the AKRSP's successful drive towards self-sustainability.

⁸⁹ Pakistani Rupees

⁹⁰ In accordance with the plan chalked out after the changes initiated in the AKRSP to first reorient and then transform it to a completely independent commercial setup, the outstanding loans portfolio was reduced gradually by recovering the existing loans and limiting sanctioning new loans.

⁹¹ This increasing trend might have been because of the borrowers' learning about the AKRSP's plans about the proposed bank (AKRSP Annual Report, 1999).

⁹² This trend depicts the effective implementation of the cost control policies incorporated after the change.

⁹³ The increasing trend in the ratio is due to the contracting outstanding loan portfolio.

⁹⁴ This trend depicts the optimal use of the performing assets and investment of idle funds after maintaining sufficient liquidity.

for the Programme (World Bank, 1995). The change was evident as noted in the AKRSP's annual review of 1995. It read:

the institutional map of the microfinance sector is changing. In response, the AKRSP is also revamping many of its support services. The year 1995 began with a bottom-up review of various programme elements in response to the emerging programmatic needs in the microfinance field. The Village/Women's Organizations (V/WOs) members, as well as field staff, were consulted during the year to streamline delivery and feedback systems, and to improve existing, or design new programmes in the light of changing needs, new trends, opportunities, and challenges in the microfinance sector (AKRSP, 1995).

During the change process, during 1997, the capacity of the Policy and Research (P&R) section was strengthened in order to develop and support important initiatives for the programme. Key functions of the P&R included the refinement and strengthening of programme planning and reporting systems, participating in and leading strategic discussions relating to issues of gender, equity, and sustainability, and the dissemination of information relating to the programme both within the AKRSP and to external organizations (AKRSP, 1997).

7.6. Changes to the AKRSP's 'Interpretative Schemes'.

Looking at the empirical data, observed patterns will be developed and then looked at with the lenses of the 'theoretical pattern' suggested by Laughlin's (1991) Model of Organizational Change.

7.6.1. 'Theoretical Pattern- Set A τ '.

According to Laughlin's (1991) Model of organizational change, an organization keeps functioning in a 'balanced' state without a noticeable change unless an external environmental 'turbulence', 'disturbance', 'kick', or a 'jolt' disturbs its existing state of

‘balance’ and compels it to adapt and reorient to its new external environment. Among other changes, the organization has to tailor its ‘interpretative schemes’ — the organization’s missions/objectives, policies/rules, internal procedures, values/cultures/philosophy, etc. — to become harmonized with its external environment.

7.6.2. ‘Observed Patterns- Set Ao’.

Using the primary and secondary data collected for this study, the following provides a discussion of the changes in the Aga Khan Rural Support Programme’s ‘interpretative schemes’ to cope with its changed circumstances.

7.6.2.i. Objectives/Missions.

During the process of adaptation and reorientation the Aga Khan Rural Support Programme went through numerous changes to its objectives/missions, values/norms/culture, and rules, procedures and policies (the ‘interpretative schemes’ in terms of Laughlin’s (1991) Model). Participant no. 2, the CEO of the Pakistan Microfinance Network, observed that during the reorientation process, for the first time ever, the AKRSP began to measure what was happening within the organization in terms of productivity, efficiency, portfolio quality, and financial sustainability. Participant no. 4, the General Manager of the Aga Khan Development Network, remarked in this context that many policies and rules, from maintaining the office kitchen to hiring staff, were all changed. Internal procedures from approval for office cars maintenance expenses to the purchase of official vehicles for executives were all changed. “...policies about the size of loans and loans approval procedures were also changed”, he further added.

Soon after the change, concrete efforts were made to improve Fund Management. Management started to prudently invest idle funds with banks to earn a profit. The purpose was to make sure that sufficient funds were available for credit operations while idle funds were at a minimal level (AKRSP, 2000). As per the Government of Pakistan, Finance Division Order dated 27th February, 1982, the primary objectives of the AKRSP were ‘rural uplift’, ‘development of land resources’, and any other ‘welfare activities’. The ‘Order’ clearly requires the company to apply its profits, whencesoever derived, and revenues towards these objectives, and prohibits the company from paying any dividend or profit to its members (Government of Pakistan Order, 1982; AKRSP’s Memorandum of Association, p. 7). This ‘Order’ clearly depicts that ‘earning profit’ was not among the primary objectives of the AKRSP. The Memorandum of Association⁹⁵ of the AKRSP lists the following among its main objectives:

- To accept grants from any governments or agencies or authorities, public bodies, corporations, companies, movable and immovable property, donations, gifts, subscriptions, and other assistance with a view to promoting the objects of the company. and,
- To take such steps by personal or written appeals or otherwise as may from time to time be deemed expedient of the purpose of procuring contributions to the funds of the company in the shape of donations or annual subscriptions.

These objectives clearly depict that the AKRSP’s inception and existence was meant to be donor-dependent. Participant no. 4, General Manager Aga Khan Development Network, said in this regard that the core objective of the AKRSP was to reach the poor people of its area of operations with micro loans to help them get out of the poverty. After the change was initiated, one more basic objective was added — to achieve the first objective but now in a sustainable manner. So the responsibility of ensuring sustainability came over the MFIs’ own shoulders. Similar views were shared about the

⁹⁵ It is a legal document submitted to the concerned government ministry in Pakistan before the incorporation of a company; it depicts and describes the objectives of the company’s existence, operations, and the permitted range of the company’s activities and powers.

change in objectives by Participant no. 5, the General Manager of the Pakistan Microfinance Network, and no. 8, the Head of the Marketing and Product Innovation department at the First Microfinance Bank.

7.6.2.ii. Policies and Rules.

After the change process was initiated at the AKRSP, sound and prudent policies were implemented in order to ensure the satisfactory accomplishment of the set objectives. Participant no. 11, the Chief Operating Officer of the Pakistan Microfinance Network, said that there were no written policies and procedures at the AKRSP before the change and no policy document was developed. He went on to say that “...every operational aspect was informally functioning without any policy document until I developed and implemented one after the change initiated in the AKRSP during 1995/1996”. The objective of financial self-sustainability was added to the existing objectives, and the requirement of cost efficiency was added to the AKRSP’s ‘principles of operations’ (AKRSP’s Internal Policies & Procedures Manual, 1996).

To achieve the much-needed profitability, an increase in business volume, and cost control are the two obvious means to resort to. Discussing a policy change about cost control, participant no. 2, the Chief Executive Officer of the Pakistan Microfinance Network, remarked that stiff policies were implemented to ensure the profitability and productivity of the microfinance operations. In addition, staff productivity was more regularly observed and evaluated after the change. After the change, the programme carefully selected new microfinance officers and efforts were made to lift their, and the existing microfinance officers’, credit appraisal and loan portfolio management skills (AKRSP, 2000).

About the new policy of cost control, participant no. 4 said,

we as staff experienced high stress for cost control after the change. Before the change, we had no such things like budgeting for costs, profits, and targets for loans, number of clients reached, etc.

The same trend in cost control prevailed till the end of the AKRSP's reorientation phase at the beginning of 2002 as depicted at the AKRSP's Board of Directors meeting dated 27th and 28th January, 2001. In the meeting it was noted that the 2001 budget projected a deficit of Pak rupees 2.4 million (excluding the investment income). The constant struggle of the AKRSP to sustain the outreach of the Programme in the face of a falling volume of loans, and therefore the service charge income, was cited at the Board meeting as the reason for the deficit.

Participant no. 9, the Head of the Operations Department, First Microfinance Bank Limited, said that policies from staff recruitment to the utilization of their services were all changed. Adding further to his comments, participant no. 9 said, "...after the change initiated in the AKRSP, most of the new staff hired were from commercial institutions with a purely commercial background; the purpose was to operate the MFI by commercial-minded staff". Participant no. 10⁹⁶, the Regional Manager of the Rural Support Programmes Network, expressed more or less same views in this regard. Participant no. 11, the Chief Operating Officer of the Pakistan Microfinance Network, remarked that since staff members were the face of an institution, after the change they introduced a lot of prerequisites for hiring new staff in the staff recruitment policies. He went on to say, "...our new policy in this respect was that if we hire good staff and pay them well, they will work hard for your good name and reputation".

⁹⁶ Ex-Head of Finance Portfolio at the AKRSP (1986-2006).

When discussing the changes in the staff advancement policies, participant no. 4, the General Manager of the Aga Khan Development Network, remarked that policies about staff promotions and rewards were changed to incorporate their individual performances in connection with the budgets. Participant no. 2, the Chief Executive Officer of the Pakistan Microfinance Network, said that after the change there was certainly more accountability on the part of the staff. They were held accountable for different issues relating to the profitability and the sustainability of the organization; for example, concerned credit staff was made accountable for the loans they sanctioned or approved, and this policy was not a policy of the AKRSP before the change. This resulted in a better loan portfolio management and eventually contributed to the MFI's profitability. Participant no. 2 further said that stringent policies about the follow-up and repayment of loans by the concerned staff were implemented.

With regard to policy changes about staff promotions and professional growth, participant no. 6, the Head of the Credit and Monitoring department, First Microfinance Bank Limited, said, "Another good thing — good for only good staff members, not for all — was that staff rewards and promotions were linked directly to individual performances in terms of their contribution to the welfare of the organization". In connection with coping with competition, a new policy, not existing at the AKRSP before the change, of keeping close and friendly contact with the borrowers through the staff members was adopted in order to retain the existing customers, keep track of their business activities, and to ensure proper utilization of the loan (AKRSP, 1997; participant no. 9).

Immediately after the change, the policy about the interest rate and service charge on loans was revised because, to ensure profitability and self-sustainability, it was logical

to charge a high interest rate and service charge on loans. At the AKRSP's Board of Directors meeting dated 27th and 28th January, 2001 it was resolved that considering the fact that service charges did not cover the full costs of the Programme, they would be reviewed in the middle of the year for possible upward revision. The Board of Directors, at the meeting, stated its commitment to the principle that service charges should be set at levels whereby full costs were recovered.

Being internationally renowned in the microfinance sector, the AKRSP could not remain isolated from the environmental 'disturbances' that were happening internationally. Participant no. 11, the Chief Operating Officer of the Pakistan Microfinance Network, said that major changes were initiated in the AKRSP during 1996, when he and the then General Manager of the AKRSP (he was pointing to the participant no. 2, the CEO of the Pakistan Microfinance Network) went to Boulder for an international course on microfinance. He further said that,

there we learnt that microfinance should not be run on the basis of subsidized funding and lending if it is to be made sustainable. So, we started to change the way our interest rates on loans were calculated. We started developing new products and processes and started to become more field oriented. We started segregating the microfinance-related staff from the other staff...From 1996 to 2000 we had made such necessary changes that we were ready to transform to an independent commercial institution.

In 2000, the microfinance programme operations were separated from the rest of the AKRSP (AKRSP, 2000).

Concerning changes in the interest rate, participant no. 5, the General Manager of the Pakistan Microfinance Network, remarked that as soon as the changes were initiated within the AKRSP, the policy about the interest rate was revised with the purpose of striking a balance between the needs of the poor borrowers and those of the institution.

“...there was a noticeable increase in the interest rate charged on loans”, he further added. Talking about the loaning policy, participant no. 13, the President of The First Microfinance Bank, observed that after the said change, the AKRSP adopted a new policy to be very flexible, and tailor its loan products according to the financial needs of different borrowers.

Staff awareness about the objectives and the internal procedures is important for an organization's success, and management was quite aware of this fact. Participant no. 11, the Chief Operating Officer of the Pakistan Microfinance Network, said in this regard that before the change process was initiated in the AKRSP, there was very little knowledge about microfinance among the staff members. It was noted that the regional office's ability to effectively manage the AKRSP's credit operations was not encouraging (AKRSP, 2000). Participant no. 5, the General Manager of the Pakistan Microfinance Network, remarked that the real strength of an organization is its manpower and they paid due attention to this fact soon after the change. “...we specifically designed new policies and rules to nurture, train, and capacitate our staff to meet and fulfill their enhanced responsibilities”, he added to his remarks. If an organization is able to secure its staff's sincerity towards the accomplishment of its objectives, the chances of the organization's success become brighter. Participant no. 5 said that they adopted a policy of inculcating in their staff members their new commercial approach and the need for their sincere commitment to help sustain the organization. In connection with the AKRSP's new struggle to cope with competition from rivals in the industry, participant no. 4, the General Manager of the Aga Khan Development Network, said that he witnessed more emphasis on product innovation and customer services soon after the changes during the 1990s.

7.6.2.iii. Internal Procedures.

At the Aga Khan Rural Support Programme (AKRSP), internal procedures were not geared towards professionalism and informality prevailed in almost all its operations. The AKRSP was functioning but there were no written manuals of policies and procedures and no accounting standards followed or observed. That time, before the change, there used to be only verbal office orders on different operational aspects. So in the field or in operations, different people were applying different methodologies for loans disbursement and recoveries, and other operations (Participant no. 11). “...I developed manuals for different operational aspects at the AKRSP. This happened during 90s and we had these different manuals ready almost in 1997”, Participant no. 11, the Chief Operating Officer of the Pakistan Microfinance Network, further remarked in this connection.

In the AKRSP’s manual for policies and procedures, developed in 1996 by participant no. 11, numerous new internal rules and policies were implemented for the efficient and cost effective operation of the microfinance operations at the AKRSP. For instance, a revised system of compensation for the Village Accountants (VAs) was introduced and implemented through the policies and procedures manual at the AKRSP in 1996⁹⁷. ‘Moving from subsidized group lending towards commercial lending’ and ‘flexible and decentralized management systems’ were named elements of self-sustainability and were followed in letter and spirit after the external disturbances impacted on the Aga Khan Rural Support Programme (AKRSP’s Internal Policies & Procedures Manual, 1996).

⁹⁷ The VAs’ job was to help the Village Organizations (VOs) and Women’s Organizations (WOs) in accounting matters and impart training to the V/WO managers. Before the change, the VAs were allowed a fixed remuneration. In 1996 the compensation system was changed and the AKRSP started compensating them on a ‘work done’ basis to improve the efficient utilization of their services (AKRSP’s Internal Policies & Procedures Manual, 1996).

Before the change there was no system of internal audit; in 2000, the main office established an Internal Loan Portfolio Audit System and appointed one of the Microfinance Officers to the post of 'Internal Auditor' (AKRSP, 2000).

Talking about procedural change participant no. 4, the General Manager of the Aga Khan Development Network, said that through his experience he could say that poor people were more honest and credible, and would honour their commitment, if the assistance was in line with their specific requirements and ability to repay. He further added to his comments that,

that is why, in our internal loan processing procedures, we incorporated another step and that was the internal assessment of the actual loan requirement of the borrower; we listed it in the responsibilities of the credit and monitoring department.

In the process of rearranging the internal procedures, the microfinance programme's costs, budget, and income were separated from the rest of the Aga Khan Rural Support Programme's activities. Excess funds held in various AKRSP accounts were allocated to the microfinance programme's credit pool and any funds from this pool in excess of the loan portfolio were invested with different banks to earn a profit. During this reorientation phase, a manual of credit policies and procedures was written and implemented to improve the management of credit operations (AKRSP, 2000).

About the change in loan processing procedures, participant no. 3, the Head of the Finance Department at the First Microfinance Bank, remarked that before the change, they used to take a lot of time in loan processing; after the change, although credit volume curtailed significantly, they made the procedure simpler eliminating a lot of paper work, and set a standard processing time of two days for a loan application. In addition, the AKRSP also started giving training and expert advice to its borrowers,

which practice was not prevalent before the change initiated in the AKRSP (participant no. 3).

In the face of competition, product innovation and adaptation to customers' needs is one of the important keys to success. The AKRSP Board of Directors noted similar concerns in its meeting dated 27th and 28th January, 2001 wherein it was resolved that in order to help make the programme more responsive to client needs and more sustainable, new products would be launched from time to time. In the meeting the members pointed to a recently innovated 'business committee' product as an example; they also pointed to another "leasing product" that was proposed to be developed in that year. Poorly performing products were gradually abandoned (AKRSP, 2000). To cope with competition among the MFIs, participant no. 5, the General Manager of the Pakistan Microfinance Network, said that they went beyond credit and gradually, with the passage of time, started a full range of financial services, like mobilizing public savings, micro-insurance, remittances, and 'training and expert advice' services in our product-line. Talking about the procedural change in entertaining a loan request from a poor borrower, participant no. 13, the President of The First Microfinance Bank, said that instead of sanctioning whatever amount requested by a poor borrower, they started doing their internal evaluation and assessment of the requirements of the borrower and accordingly an increased or decreased amount was actually sanctioned to the poor borrower. "...we have even given bigger loans than the requested amount of the borrower because our internal analysis of his financial needs showed that for the successful implementation of his particular project he needed more than he had requested", he further said.

7.6.2.iv. Organizational Philosophy and Overall Culture.

In the literature there are various proposed classifications of organizational culture (see, for instance, Chang and Wiebe, 1996, and Gould, 1996). Gould (1996) has proposed that each stage of an organizational transition, before and after the change, requires a matching culture that best describes a particular phase the organization is going through. Gould (1996) further argues that an organizational culture protects and sustains the organizational core competencies, beliefs, and codes of conduct, and it also determines the behaviours that pervade the organization.

When an organization adapts or reorients to external environmental conditions, the management tries to adjust or tailor the overall organizational culture and promulgates a specific organizational philosophy. At the Aga Khan Rural Support Programme the overall organizational culture was surrounded by the ‘social organization’ principle of rural development (AKRSP, 1997). The new environmental conditions had a profound effect on the overall organizational culture and operational philosophy. Participant no. 4, the General Manager of the Aga Khan Development Network, said in this context that after the change, overall organizational culture was about efficiency and cost control. The informality in the overall organizational culture in the AKRSP changed to a more formal and professional internal environment. Participant no. 12, an officer in the Marketing and Product Innovation department at the First Microfinance Bank, said that efforts were made during the first two to three years of change on institutional capacity building within the AKRSP. Participant no. 13, the President of The First Microfinance Bank, said that the organizational philosophy at the AKRSP was totally opposite to that of a perpetual entity. After the change was initiated, it tailored its overall organizational philosophy to make it compatible with that of a commercial and

perpetual organization. The participant further added that they built institutional capacity, and developed and implemented professional standards within the AKRSP.

Because of the donors' changed approach and the resulting competition among microfinance institutions, every MFI had to struggle for more and more clients to cope with the new environmental conditions. About the organization philosophy and culture, participant no. 7, the Head of the Human Resources department at the First Microfinance Bank, said that after the change, they became commercial and client-oriented. "...we adopted a management-by-objective style where every effort was focussed on achieving our new set of objectives — serving the poor community and ensuring profitability and self-sustainability", he further added to his remarks.

Talking about the change in the management's attitude after the changes affected the AKRSP, the Head of the Human Resource department said that the first thing was the gradual change in the management's attitude. All staff members were required and indirectly pressed to contribute to the welfare of the MFI in any form — whether controlling costs or bringing in or introducing new clients. "...the management placed stress on any contribution from the staff that could help the MFI cope with competition and achieve profitability", he added to his comments.

7.7. Changes to the AKRSP's 'Sub-systems'.

Using the empirical data, here again 'observed patterns' will be developed and then looked at with the lenses of the 'theoretical pattern' suggested by Laughlin's (1991) Model of Organizational Change.

7.7.1. ‘Theoretical Pattern- Set B τ ’.

Laughlin (1991) argues that after external environmental conditions affect an organization, it is compelled to adapt and reorient to its new environmental conditions. Among other changes, the organization has to tailor its ‘Sub-systems’ — the tangible organizational elements like buildings, premises, staff, locations, assets — to cope with the new circumstances.

7.7.2. ‘Observed Patterns- Set B θ ’.

Based on the primary and secondary data, discussion will be focused on the changes in the Aga Khan Rural Support Programme’s ‘sub-systems’ that it developed to cope with its changed circumstances. These changes were very prominent, as endorsed by most of the participants in the interviews. Participant no. 5, the General Manager of the Pakistan Microfinance Network, said in this context that the changes in the tangible organizational elements were primarily in response to the combined effects of the changed donors’ approach and the resulting competition. Plans for the transfer of all of the AKRSP’s microfinance related tangible assets to the proposed commercial microfinance setup were made during the reorientation phase, which were subsequently endorsed by the AKRSP’s Board of Directors in their meeting in May 2001. It was resolved that physical assets (vehicles, equipments, etc.) belonging to the AKRSP’s microfinance section would be transferred to the proposed commercial bank. However, it was left undecided in the meeting as to whether the bank would acquire these assets at a market value or book value.

7.7.2.i. Changes in Staff.

During 1995, The AKRSP sent its employees for training both within and outside Pakistan for their professional development (AKRSP, 1995). Participant no. 10, the Regional Manager of the Rural Support Programme Network, said that during 1997 and 1998, new Program Managers were designated for different business sites. They were either newly appointed or selected through the existing staff reshuffle (participant no. 10). Participant no. 14, the Program Manager of the First Microfinance Bank, was one of those new program managers who was selected in 1997 through a staff reshuffle. The year 1997 also witnessed training of all the finance and accounts staff in the use of modern accounting methods (AKRSP, 1997).

During the initial reorientation process, the AKRSP witnessed, among other changes, prominent changes in the ‘staff’ tangible element. Participant no. 11, the Chief Operating Officer of the Pakistan Microfinance Network, said in this regard that soon after the change they started segregating the microfinance staff from the other staff at the AKRSP and also made the staff more field-oriented. He further added that in 2000, the then General Manager at the AKRSP issued an Office Order defining all the organizational elements for the setup of independent microfinance operations within the AKRSP. This was approved and implemented by its Board of Directors. At the AKRSP’s Board meeting dated May 26, 2001, this issue was formally resolved to alleviate the staff’s concerns. The Board of Directors in their meeting held on 27th and 28th of January, 2001, had approved the proposal for more independent management of the microfinance programme within the context of the AKRSP for immediate implementation. Participants no. 2, the Chief Executive Officer of the Pakistan Microfinance Network, and no. 5, the General Manager of the Pakistan Microfinance

Network, shared similar views in this regard. Participant no. 3, the Head of the Finance Department at the First Microfinance Bank, remarked in this connection that frequent branch to branch, branch to main office, and vice versa staff transfers were also carried out in order to improve staff efficiency. New staff with a purely commercial background were hired from other commercial banks and development financial institutions (participant no. 5).

7.7.2.ii. Changes in ‘Branches’ Buildings’.

As a result of the donors’ changed approach and thinking the Aga Khan Rural Support Programme found itself in competition with other rivals, so it was logical to make some changes in the branches’ and main office’s buildings to make them more attractive and good-looking. Participant no. 14, the Program Manager of the First Microfinance Bank, said in this connection that at the AKRSP mostly things were done on an informal basis; the branches setup was not appealing; often branches were opened in small houses rented by the AKRSP. The external and internal appearance of the AKRSP branches and the main office were gradually improved after the change process was initiated (participant no. 14). Participants no. 9, the Head of the Operations Department, First Microfinance Bank, and no. 5, the General Manager of the Pakistan Microfinance Network, expressed similar views in this connection. Participant no. 5 further added that the internal seating arrangements for officers were also changed giving the interior of branches a more formal look. High performing branches were gradually carpeted, provided with more comfortable furniture, and the interior setting therein was adapted keeping in view clients’ comfort and needs. Participant no. 9 said that these changes were not as abrupt as the other changes, such as those in the objectives, policies, and procedures. Also, since the AKRSP became very much customer-oriented soon after the

change, the improvements to the branches' buildings were done on a priority basis before the main office's building because of clients' frequent visits to branches as compared to the main office.

7.7.2.iii. Changes in 'Premises/Location'.

The location of an organization's business offices, among other things, depends to a large extent on the organization's objectives. Since the external environmental 'disturbances' impacted on the AKRSP, changing its main objectives, it had to make necessary changes in its branches' locations. Participant no. 5, the General Manager of the Pakistan Microfinance Network, said in this context that they closed some non-performing branches which were located in cheap but remote and non-commercial areas, and also gradually opened new branches in commercial areas to attract the not-so-poor segment of the society to support the drive for profitability.

7.8. Changes in the AKRSP's 'Design Archetype'.

Here again 'observed patterns' will be developed based on the empirical data and looked at with the lenses of the 'theoretical pattern' suggested by Laughlin's (1991) Model of Organizational Change.

7.8.1. 'Theoretical Pattern- Set C τ '.

According to Laughlin's (1991) Model when an organization's existing 'balanced' state of operation is 'disturbed' by an external environmental 'turbulence', 'disturbance', 'kick', or a 'jolt', it causes a change in the organization's existing 'balanced' state; the organization, among other changes, has to adjust its 'design archetype' — the overall

organizational structure, internal communication systems, use of accounting, and decision processes — to cope with the new external conditions.

7.8.2. ‘Observed Patterns- Set Co’.

The primary and secondary data that were collected for this study suggests that the ‘design archetype’ at the Aga Khan Rural Support Programme went through numerous prominent changes during its adaptation and reorientation to the changed environmental conditions in the late 90s. These changes are discussed here thereby developing a set of ‘observed patterns’ — set C.

7.8.2.i. Changes in ‘Overall Organizational Structure’.

Before the change process was initiated, microfinance operations at the AKRSP were managed by one department. The structural reorientation was carried out through the opening of different departments in the Credit and Savings division (C&S) of the AKRSP. The C&S section made considerable efforts throughout 1997 to bring about structural and strategic shifts to its operations with the aim to strengthen its capacities to function as an independent unit within the AKRSP (AKRSP, 1997). In the process of reorienting the overall organizational structure at the AKRSP to cope with the new environmental conditions, internal departmentalisation and the organizational hierarchy were mainly ‘disturbed’ and moved towards a new ‘balanced state’.

With regards to structural changes, participant no. 4, the General Manager of the Aga Khan Development Network, remarked that compared to the other changes that the AKRSP went through in the process of its reorientation, the change in the organizational structure of the MFI was the most dominant and prominent one which

ultimately led it to the adoption of a completely new independent setup. Participant no. 11, the Chief Operating Officer of the Pakistan Microfinance Network, said in this connection that before the change, earlier at AKRSP they used to have only one main microfinance department with all staff working in it almost collectively; but after the change, they gradually started to formalize their organizational structure.

Participant no. 15, the Senior Operations Associate of The First Microfinance Bank, said that before the change the microfinance department of the AKRSP was mainly responsible for all microfinance related activities with no real formal structure; after the change process was initiated within the AKRSP, they slowly and gradually established formal departments such as the Operations department, Credit and Monitoring department, Marketing and Product Innovation department, Finance department, Human Resource department, and so on. Participant no. 5, the General Manager of the Pakistan Microfinance Network, said in this regard, "...it is still fresh in my mind, in 1998, 1999 we had opened three new departments, directly in response to the changed circumstances: the credit and monitoring department, the field operations department, and the marketing and product innovation department".

Since 1997 the marketing of the local products has also been emphasized by the Aga Khan Rural Support Programme (AKSRP, 1997). Participant no. 10, the Regional Manager of the Rural Support Program Network⁹⁸, remarked that before the change at the AKRSP, finance and credit operations were handled under one department; later on during the late 90s, these departments were separated and placed under the control of different heads.

⁹⁸ An umbrella organization for all the Rural Support Programs in Pakistan.

When talking about changes in the organizational hierarchy participant no. 3, the Head of the Finance Department said that the organizational hierarchy was properly defined after the change when microfinance operations were segregated into different departments. Participant no. 15, the Senior Operations Associate of The First Microfinance Bank, said that,

earlier at AKRSP no one knew whom to report to and even one person was reporting in official matters to two or more persons at a time. So, after the change we formalized everything and then with the organizational hierarchy properly defined everyone knew his reporting responsibilities; all staff was made to report to branch managers, branch managers to area managers, and all area managers to the head of operations.

These changes were incorporated after internal departmentalisation was finalised during the late 90s at the AKRSP. After the change the microfinance operations at the AKRSP were divided into two regions — Gilgit and Baltistan; before that all microfinance operations were under one region (Participant no. 15).

7.8.2.ii. Changes in ‘Internal Communication Systems’.

According to participant no. 3, the Head Finance Department, and no. 8, the Head of the Marketing and Product Innovation Department, internal communication, both upward and downward, was very poor at the Aga Khan Rural Support Programme before the change. Participant no. 4, the General Manager of the Aga Khan Development Network, also expressed similar views about the issue. Participant no. 15, the Senior Operations Associate of The First Microfinance Bank, said in this context that before the change at the AKRSP there was only one formally nominated region covering the whole microfinance operations; after the change, it formally divided the whole area of its operations into two regions — Gilgit and Baltistan, causing an increase in the internal flow of communication. The Head of the Credit and Monitoring department and the

Program Manager at The First Microfinance Bank, participants no. 6 and 14 respectively, said in this context that during the MFI's reorientation process internal communication had increased tremendously both in quantity and quality. All this frequency of internal communication had increased gradually with the passage of time, initiating during the late 90s. After the change, new statements and reports were incorporated into the internal communication system which included information on efficiency, loan portfolio quality, and sustainability (AKRSP, 2000). The Head of the Marketing and Product Innovation department, participant no. 8, remarked that the internal communication was not effective at all in the pre-change setup of the AKRSP, and later on, after the change, staff witnessed more and more emphasis on this aspect of the organization. "Internal circulars were more frequently issued to different departments asking for different statements and reports about different aspects of the AKRSP's operations. Later on, these one-off statements and reports were permanently incorporated into the internal communication system", participant no. 8 further added to his comments.

7.8.2.iii. Changes in 'Accounting Use'.

Accounting has been examined over the past in organizational contexts. "Accounting is not a static phenomenon...accounting has been implicated in the creation of very different patterns of organizational segmentation...different managerial functions have come to be emphasized by the changing accounting representation of them" (Hopwood, 1987, p. 207). Accounting change is seen as a 'reflective' rather than a 'constructive' organizational endeavour. Different accounting practices are seen as reflecting different organizational circumstances. Accounting changes in order to get better and there can

be a number of significant pressures on accounting to change — ‘organizational reforms and improvements’ is one of them (Hopwood, 1987, pp. 209-212).

Looking at the Aga Khan Rural Support Programme’s (AKRSP) pre-change scenario, it becomes evident that it was not making use of accounting concepts and principles; the concept of a Management Information System (MIS) was totally ignored and the role of Information Technology (IT) was literally negligible. At the AKRSP’s Village Organizations (VOs) and Women’s Organizations (WOs) no reserve funds were maintained to meet unforeseen losses and contingencies; even at some VOs/WOs, no accounts or records were maintained at all (Hussein and Plateau, 2003).

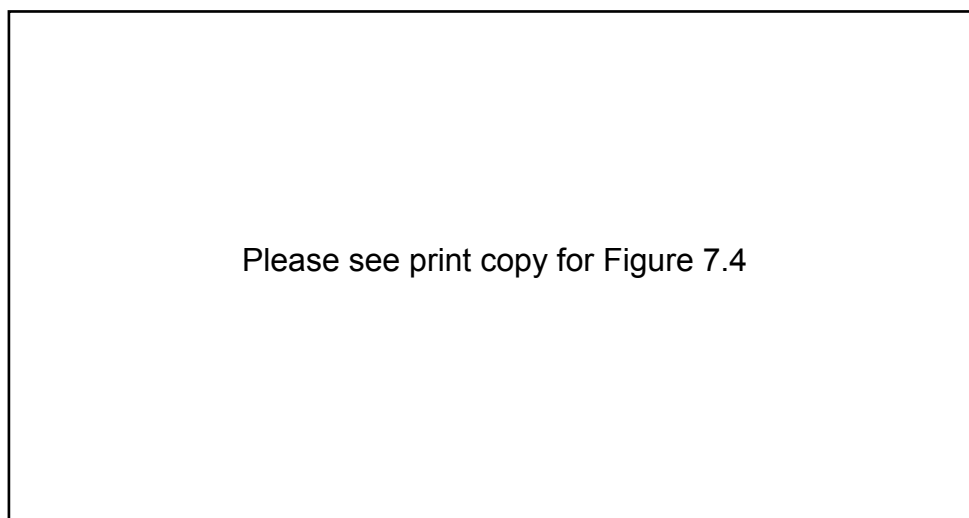
Financial reporting and internal control are critical for managing a microfinance program but the use of these concepts started at the AKRSP in the late 1990s when it was made compulsory to make a yearly detailed budget projecting costs, income, loan disbursements, and loan recoveries for the year. The management then realized that budgeting is crucial for improving internal control, setting operational targets, maintaining sufficient liquidity, and improving fund management. Moreover, the microfinance staff was made to produce a monthly Credit Operations Report (COR) that contained figures on efficiency, credit portfolio quality, and financial sustainability (AKRSP, 2000). Participant no. 9, the Head of the Operations Department, The First Microfinance Bank, said in this connection that after the change, gradually a Management Information System was developed and numerous statements and periodical reports, about almost every aspect of the AKRSP’s operations, were incorporated after the structural reorientation was completed. These reports and statements were prepared and sent by lower staff to the senior management for day-to-day decision making purposes. Before the change, the AKRSP used to have a manual system to maintain accounts and track the loan portfolio; however, since the beginning

1997 it started to develop and test a computerized Management Information System which would be utilized for management and financial reporting in future. All this clearly depicts the lack of use of accounting concepts and principles at the AKRSP before the change.

7.8.2.iv. Changes in ‘Decision Processes’.

During the late 1990s, while the AKRSP was adapting to its changed external conditions, an attempt was made to decentralize the internal decision processes, which resulted in more autonomous and strengthened regional programme offices (AKRSP, 1997). The purpose of decentralizing the programme was to provide financial services at the ‘doorstep’ (AKRSP, 2000). The first such change in the decision process occurred in 1997 during the AKRSP’s reorientation phase when the credit management responsibility was moved from the AKRSP main office to the Finance Department in each of the three Regional Offices, although not further to the Field Management Units (AKRSP, 2000). After this initial decentralization of the internal decision processes, another attempt was made a year later in 1998 to further decentralize lending operations, and microfinance officers in the field were given authority to sanction loans. The purpose of this decentralization was to increase the client base and, keeping in view the overall high loan recovery rate, to increase the profitability of the institution (AKRSP, 2000). However, as demonstrated in Figure 7.4, the AKRSP had to tighten back the lending policy and again centralize the decision making during 1999.

Figure 7.4: AKRSP's Own and VOs'/WOs' Internal Lending



Source: AKSRP (2000).

As the graph illustrates, during 1997 and 1998 there was a push to disburse an increasing number of loans, particularly in the Baltistan region. Most of these loans were larger in size and not adequately appraised, which resulted in high levels of loan delinquency by 1999. As a result, the AKRSP's management decided to centralize the lending powers and tighten the lending policy (AKRSP, 2000), which, in turn, resulted in reduced credit volumes in 1999 and 2000, as illustrated in the graph.

7.9. AKRSP's Passive Submission to the Environmental Disturbances.

This part of the chapter discusses a different aspect of the AKRSP's adaptation and reorientation to the external environmental conditions. Here I will try to answer a logical question that arises as a result of the acceptance of the externally dictated conditions by the Aga Khan Rural Support Programme (AKRSP) as to why the AKRSP

passively submitted to these external environmental ‘disturbances’? This section intends to develop ‘observed patterns’ based on the empirical data and look at them with the lenses of the ‘theoretical pattern’ suggested by Institutional Theory (DiMaggio and Powel, 1983).

7.9.1. ‘Theoretical Patterns- Set Dτ’.

7.9.1.i. AKRSP’s Passive Submission to the External Conditions.

The ‘coercive’ pillar of Institutional Theory (DiMaggio and Powel, 1983) suggests that there are ‘formal’ pressures on organizations, such as from an authoritative entity in the form of rules, systems of monitoring, or sanctions, whereby organizations are penalized in different ways for not adhering to the demands or conditions dictated by the entity. Informal pressures from the donor community to which microfinance institutions (MFIs) have to prove their legitimate existence and eligibility for financial and other support, is an example of the ‘coercive’ influence advocated by Institutional Theory. Thus, the ‘coercive’ influences represent rules, regulations, state jurisdictions, and pressures for conformity to public expectations regarding an issue (Oliver, 1997). Organizations gain legitimacy by conforming to the rules and regulations or any conditions dictated by an external entity on which they are dependent for resources (DiMaggio and Powel, 1983).

7.9.1.ii. Achieving ‘Legitimacy’.

Institutional Theory argues that being one of the recipients of the society’s scarce financial and non-financial resources, a microfinance institution must be viewed as a

‘legitimate recipient’ of these resources by the society (DiMaggio and Powel, 1983). The MFI therefore must ensure its legitimacy in the eyes of the general public in order to sustain itself in the long-run.

7.9.2. ‘Observed Patterns- Set Do’.

7.9.2.i. AKRSP’s Passive Submission to the External Conditions.

The primary and secondary data that was collected for this study revealed that the Aga Khan Rural Support Programme’s (AKRSP) passive submission to the external environmental conditions was due to its dependence on the donor community for future financial and non financial support and the donors’ legitimising power. This was depicted in one of the meetings of the AKRSP’s Board of Directors dated 26th May, 2001 wherein it was resolved that, “It would be important to communicate with donors about the microfinance bank project”. Participant no. 13, the President of The First Microfinance Bank, said in this regard that donors were stressing that microfinance institutions all over the world should achieve self-sustainability and profitability but, in fact, they are still supporting these MFIs. Donors, after changing their approach, wanted MFIs to look for avenues that could make them self-reliant, such as mobilizing savings. “...if MFIs start generating these funds through savings and profits, dependence on donors will be reduced”, participant no. 13 further added. Responding to a question about the AKRSP’s passive acceptance of the new conditions, participant no. 13 said, “...from day one, after the change, our policy was to make ourselves self-reliant by increasing our profitability. But we need the donors’ support in one form or the other, so we can’t actually resist them”. Participant no. 8, the Head of the Marketing and Product Innovation department, expressed similar views regarding this issue. Participant no. 9,

the Head of the Operations department at The First Microfinance Bank, said in this connection that MFIs need donors' support in today's commercial setup as they did in their old non-commercial setup; As an MFI we knew this fact, so there was no question of rejecting their changed approach. "...they (the donors) can bring a good or a bad name to an MFI if they want", participant no. 9 conceded.

7.9.2.ii. AKRSP's Struggle for Gaining 'Legitimacy'.

To achieve legitimacy in the eyes of the general public, the President of The First Microfinance Bank, participant no. 13, said that,

you have to keep a vigilant eye on your cause and objectives, and tailor your policies and procedures accordingly; then you can expect your organization to embrace good public perception and legitimacy.

He further added that, "...that's exactly what we did after the change; we nurtured and trained our staff to work sincerely towards achieving our new set of objectives". The Chief Operating Officer at the Pakistan Microfinance Network, participant no. 11, said in this regard that one has to be very careful in hiring new staff because they are the face of an institution. So, if good staff are hired and paid well, they will put in sincere efforts for earning a good reputation for the institution; and that was one of the steps the AKRSP took after the change and incorporated these facts in its new staff recruitment policies. The General Manager at the Aga Khan Development Network, participant no. 4, said of this aspect of the AKRSP's struggle that:

after the change, we had incorporated into our policies to publicize, in a positive way, our every single achievement. In addition, we always encouraged our staff to show acceptable social behaviour on and off the field. The purpose was to create a good image of the MFI in the eyes of general public.

The Senior Operations Associate of The First Microfinance Bank, participant no. 15, tied the AKRSP's struggle for gaining public's endorsement for its legitimate existence to the reputation of the 'Aga Khan' group, and said, "Since the name 'Aga Khan' is well-known in the development and social services areas, so we mostly make use of this reputation in our publicity".

7.10. Summing Up.

"...it is difficult to keep an organization alive based on a savings programme alone" (Hussein and Plateau, 2003, p. 4). The AKRSP, under the changed external circumstances, had to change in order to ensure its survival. As discussed in the chapter, the Aga Khan Rural Support Programme struggled hard to adapt and reorient to new environmental conditions. 'To transform the AKRSP into a financially self-reliant microfinance institution (MFI)' was the ultimate goal of the adaptation and reorientation process started in 1995. The Aga Khan Rural Support Programme (AKRSP) went through a successful reorientation phase from 1995 to 1996. The financial performance of the AKRSP persistently improved in each year since 1995 as demonstrated in its annual reports. Financial self-sufficiency of the programme stood at 186 percent by the end of 2000, which was the result of its emphasis on efficiency, improving internal operations, and segregating microfinance operations from the AKRSP's other operations (AKRSP, 2000).

The next chapter will focus discussion on Phase III (2001 onwards) of the AKRSP's life and develop more sets of 'observed patterns' pertaining to the post-transformation phase of the Aga Khan Rural Support Programme (AKRSP); the 'theoretical patterns', however, will remain unchanged for obvious reasons.

Chapter 8: The AKRSP's Transformation — Phase III

The previous two chapters threw light on Phase I (1982-1995) and Phase II (1996-2001) of the Aga Khan Rural Support Programme's life. The chapters developed different sets of 'observed patterns', and compared them with their corresponding sets of 'theoretical patterns'. This chapter⁹⁹ will focus discussion on the third Phase (2001 onwards) of the AKRSP's life. The phase is diagrammatically shown in Figure 8.1 below. This includes the time period after the radical transformation of the AKRSP to 'The First Microfinance Bank' in response to the environmental 'disturbances'. It will compare 'observed patterns' with the 'theoretical patterns' suggested by Laughlin's Model of Organizational Change (1991) and Institutional Theory (DiMaggio and Powel, 1983).

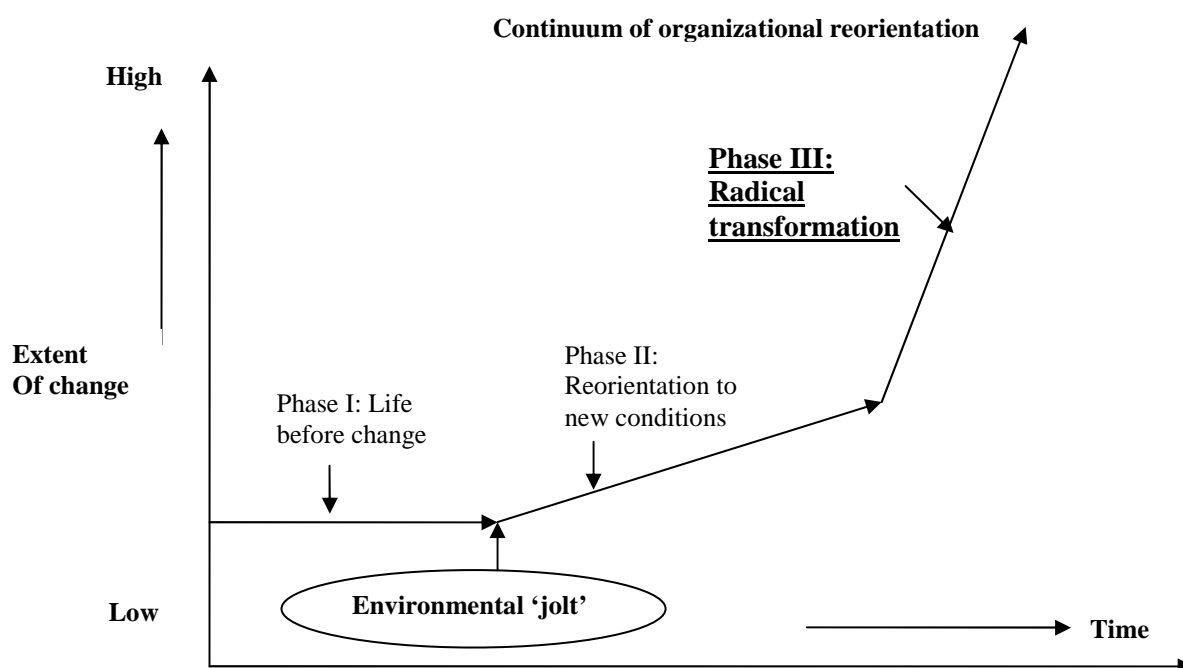


Figure 8.1: Severity of change at an Organization's transformation stage.

Source: Idea for the figure's 'layout only' is taken from Hill and Collins (2000).

⁹⁹ In this chapter, observed and theoretical patterns will be developed on the same grounds as in Chapter 7, but with discussion focusing on the changed (finally adopted) position of the AKRSP's tangible and intangible organizational elements.

8.1. Introduction.

In order to achieve long-term self-sustainability and to be able to provide a full range of financial services including the mobilization of savings, the AKRSP's microfinance program had to transform or evolve into a commercial financial institution (FMFBL Annual Report, 2003). By the end of 2000, the Aga Khan Rural Support Programme's top management had determined that in view of the prevailing circumstances its microfinance programme would work best if it was managed separately from the AKRSP's other activities (AKRSP, 2000).

Thus, it is worth-mentioning that the transformation of the Microfinance Division of the Aga Khan Rural Support Programme to The First Microfinance Bank Limited (FMFBL) was internally driven and chosen by the AKRSP's management. This was also pointed to by the Regional Manager of the Rural Support Programs Network, participant no. 10, who said that the idea of transforming the AKRSP into an independent commercial bank was internally driven and was based on the management's realization that in order to achieve the objective of long term self-sustainability the AKRSP must re-establish itself on a purely commercial footing. The President of The First Microfinance Bank, participant no. 13, expressed a similar opinion in this connection. This meant that the AKRSP's new set of 'interpretative schemes' (objectives, policies, philosophy, culture), developed after its reorientation in response to the changed environmental conditions, necessitated another change — the transformation to an independent commercial setup.

The AKRSP's Board of Directors at its meeting in September, 2001 approved the outline of the proposed bank's organizational hierarchy and initial operational targets. After a smooth and successful reorientation, the microfinance programme at the

AKRSP was transformed to a completely independent commercial setup and became The First Microfinance Bank Limited in March 2002.

The transformation of the AKRSP from a social service setup to a commercial one was not simply a change in its procedures and operations; rather the change was drastic in nature affecting all aspects of the Microfinance Division of the AKRSP. As a result it altogether divested itself of all microcredit operations (Hussein and Hussain, 2004).

8.1.1. Background and Overview.

Broadbent (1992) and Kikulis *et al*, (1995) assert that in some cases of organizational change, an organization's 'design archetypes' may not be compatible with the organization's changed 'interpretative schemes', especially when the 'interpretative schemes' are affected by external environmental disturbances to a larger extent. Tyrrall and Parker (2005) in their study of organizational change in the British Railways found that a major change in the interpretative schemes results in mutually reinforcing changes in multiple categories of the design archetypes and is supported by other changes at the sub-systems levels.

The empirical data collected for the study revealed a similar outcome in the case of the transformation of the Microfinance Division of the Aga Khan Rural Support Programme into the First Microfinance Bank Limited, because the AKRSP's highly affected 'interpretative schemes' necessitated full-fledged and mutually reinforcing changes in its 'design archetypes' and 'sub-systems'.

The groundwork for the creation of a separate independent microfinance institution was completed by 2000 (AKRSP, 2001). The establishment of the bank was formally discussed at the AKRSP's Board of Directors meeting dated May 26, 2001 when one of the members, who is now the Chief Operating Officer of the Pakistan Microfinance Network, participant no. 11, made a detailed presentation about the plans for the microfinance bank. At the beginning of 1996 the AKRSP began the process of streamlining the microfinance program separately within its existing structure, which was finalized by 2000 (FMFBL Annual Report, 2003). The Aga Khan Rural Support Programme's Board of Directors at its meeting on the 23rd of September, 2001 resolved that the AKRSP's entire microfinance programme would be absorbed in the microfinance bank. They resolved that the bank, over the first five years of its operations, would establish 30 branches representing Pakistan's all four provinces. The AKRSP and the Aga Khan Fund for Economic Development¹⁰⁰ (AKFED) agreed in the meeting to include all these issues in the Memorandum of Understanding (MOU). Also, in the same meeting it was mentioned before the Board members that the crucial discussion of transition issues had begun between the AKRSP and the microfinance bank's tentative top management team¹⁰¹.

Finally, the FMFBL was established in November 2001 as a public limited company¹⁰² under the Company's Ordinance (1984). It was licensed as a microfinance institution in January 2002 under the provisions of the Microfinance Ordinance 2001¹⁰³ (AKRSP's

¹⁰⁰ One of the major shareholders of the AKRSP (20%), and an economic arm of the Aga Khan Foundation (AKF) which is the parent body of all the Aga Khan's projects throughout the world.

¹⁰¹ Appointments of the bank's President, Chief Executive Officer, and other key position-holders in the management of the proposed bank in addition to the members of its Board of Directors had already been finalised by this time (AKRSP's Board meeting dated September 23, 2001).

¹⁰² Non-listed on the stock exchange.

¹⁰³ The Microfinance Institutions Ordinance was promulgated on 16th October, 2001. The Ordinance covers all the microfinance institutions (MFIs) in Pakistan. It was specifically issued to cover the AKRSP's transformation to The First Microfinance Bank.

BOD¹⁰⁴ meeting dated January 19, 2002). The AKRSP's Board of Directors resolved at their meeting dated October 26 and 27, 2001 that the entire responsibility to manage the microfinance operations, both the AKRSP and The First Microfinance Bank components, should rest with the bank from day one. That is, The First Microfinance Bank would manage the AKRSP's part of the programme on behalf of the AKRSP, including making and collecting loans until such time as operations are fully taken over by the Microfinance bank. It was resolved at the meeting that the AKRSP's staff should be offered positions by the First Microfinance Bank on terms and conditions to be decided by the bank. The services of the staff who did not accept these offers would be terminated by the AKRSP. The Board of Directors requested the bank's nominated members of the top management team to arrange to prepare and communicate its offers to the AKRSP's staff in order to allow the AKRSP to serve notice to staff members who did not accept the bank's offer.

Initially the Aga Khan Rural Support Programme (AKRSP) and the Aga Khan Fund for Economic Development¹⁰⁵ (AKFED) were the only shareholders of the bank. Later on, the International Finance Corporation¹⁰⁶ (IFC) also became a shareholder. At present, the AKRSP and the AKFED own 46 percent and 30 percent shares in the bank respectively, while the IFC accounts for 24 percent of the ownership. The bank's total shareholders' equity is approximately US\$ 12.31 million and the number of its Board of Directors is 10. The bank's Chief Executive Officer (CEO), also on its Board, brings with him wide range of skills in banking, accounting, legal, and economic development.

¹⁰⁴ Stands for 'Board of Directors'.

¹⁰⁵ An economic development component of the Aga Khan Development Network (AKDN).

¹⁰⁶ IFC is a private arm of the World Bank Group. In working with the Aga Khan group, the IFC's role is to ensure that the FMFBL is commercially oriented and operates using international best microfinance practices to achieve full financial sustainability, sound corporate governance, and high quality management information systems (FMFBL Annual Report, 2003).

The IFC is also represented on its Board. The First Microfinance Bank Ltd. (FMFBL), ensuring a smooth transformation of the 14 Aga Khan Rural Support Programme's (AKRSP) units to its own branches, completed the transformation process on December 31, 2003 with the AKRSP's all branches/units transforming to the bank's branches. The AKRSP no longer provides any microfinance services. The bank received the certificate of incorporation in February 2002 and commenced operations in April 2002 as an independent legal entity — a private-sector commercial microfinance institution (PMN, 2004). The bank is affiliated with the world's leading microfinance networks such as the Consultative Group to Assist the Poor (CGAP), the Banking With The Poor Network Asia (BWTP), and the Pakistan Microfinance Network (PMN).

8.1.2. Gearing towards Self-Sustainability — Coping With the New Environmental Conditions.

A bank is considered to be a trustee of its depositors. Realising its fiduciary responsibility, the bank, since its inception, has focussed on developing an operational soundness by building a solid foundation, designing and implementing an indigenous IT system as the backbone of the bank's operations, employing and training human resources, implementing prudent policies and procedures, and putting up the required infrastructure.

By December 2005, the bank has managed to successfully disburse 40,000 loans worth more than Pak rupees 1.250 billion, mobilized voluntary savings of more than Pak rupees 650 million from more than 27,000 accountholders. In addition the bank did more than 9,500 funds transfer transactions worth more than Pak rupees 610 million,

and provide insurance services to more than 30,000 customers. The bank was also able to maintain portfolio at risk greater than 30 days of 2.6 percent as against the international standard of 5 percent. The bank's non-financial services provided to its clients in terms of enterprise development and health awareness programs are considered unique to the bank in the microfinance sector in Pakistan. The bank's prudent approach to growth is reflected in Table 8.1 below.

Table 8.1: The FMFBL's Performance Indicators.

Source: The FMFBL's Annual Financial Report, 2005.

Please see print copy for Table 8.1

8.1.3. Milestones.

The domestic and international recognition conferred on the bank in its short span of just four years shows the bank's successful implementation of its strategic plan. The FMFBL is the only microfinance institution in Pakistan to have been awarded membership of the MicroFinance Network, a leading association of global microfinance institutions. Confident of its success, the bank, on its own initiative and as the first MFI in the country to do so, without any regulatory obligation from the State Bank of Pakistan, solicited JCR-VIS, an international credit rating agency, to carry out a credit rating of the bank. The company awarded the highest rating of A1+ and A+ to the bank

indicating its stable position for the third consecutive year (Business Recorder, January 12 and June 23, 2005). The bank was awarded the 2004, and 2005 ‘Financial Transparency Awards’ by the Consultative Group to Assist the Poor (CGAP), an economic development arm of the World Bank. The FMFBL was among the five microfinance institutions (MFIs) from all over the world and the only one in Pakistan to be awarded the transparency awards (Business Recorder, July 30, 2006). Also, the FMFBL was awarded the ‘5 diamond status’ (the highest category) by the CGAP¹⁰⁷ on January 20, 2005 and put on the Microfinance Information Exchange¹⁰⁸ (Business Recorder, June 23 2005). Moreover, the bank’s impressive and successful delivery structure is evident from the fact that two of the bank’s clients have won the United Nations Development Program’s (UNDP) ‘Global Microentrepreneurship Award’ (FMFBL Annual Report, 2003).

8.1.4. Future Outlook.

Long-term sustainability remains at the forefront of the institution’s objectives and the management is committed to covering all its inflation-adjusted costs with the revenue generated from its operations (FMFBL Annual Report, 2003). The stress on cost control and profitability, and the prevailing enabling environment for the microfinance sector provided by the Government of Pakistan through The Microfinance Ordinance, 2001 and the State Bank of Pakistan through its Prudential Regulations, 2002 have been the key contributors to the success of the bank. The country’s legal framework provides a unique balance between regulatory cover for depositors (savers) and facilitation for the growth of microfinance institutions. The bank’s future looks bright and the trend in the

¹⁰⁷ Only 11 microfinance institutions from all over the world enjoy a ‘5 Diamond’ status.

¹⁰⁸ A website hosting detailed information on microfinance industry players from all over the world.

bank's growth suggest that, in the next few years, it is bound to leverage its solid institutional base to reach out to the target population. This is expected to be achieved by developing a well organized, efficient, and innovative structure of 'product and distribution' supported by strong management and internal systems (FMFBL Annual Reports 2003, 2004).

The bank has set a target for the next three years to have a client base of around 100,000 spread out on 60 locations (branches) across the country and to have a cumulative loan disbursement of Pak rupees 3 billion (US\$ 50 million) with a deposit/savings base of Pak rupees 1 billion (US\$ 17 million) (FMFBL Annual Report, 2004).

8.2. The AKRSP's Transformation Stage.

The Aga Khan Rural Support Programme's (AKRSP) transformation phase¹⁰⁹ — Phase III (2001 onwards), started when the process of the segregation of the microfinance related operation, staff, assets, and liabilities from the rest of the AKRSP's operations, staff, assets, and liabilities was completed. The process was completed by the end of 2000. Since the first Policies and Procedures manual was introduced in 1996¹¹⁰, there had been extensive growth in the level of professionalism, efficiency and sustainability of the AKRSP's microfinance operations. The programme continued to improve its performance standards with a view to provide enhanced financial services to communities and individuals throughout the Northern Areas and Chitral (NAC).

¹⁰⁹ Refers to the transformation of the Microfinance Division of the AKRSP.

¹¹⁰ The authors of the AKRSP's Policies and Procedures manuals for both the issues — 1996 and 2000, were the same, and both participated in the interviews as participant no. 11 and 14.

The Chief Operating Officer of the Pakistan Microfinance Network, participant no. 11, pointing to the situation, said that at the end of 2000, the then general manager of the AKRSP¹¹¹ issued an office order clarifying the new policies, procedures, organization hierarchy, rules, and the internal reporting system for the independent setup of the microfinance operations within the AKRSP. Thus, by that time the AKRSP had completed its reorientation process and was ready for the transformation to The First Microfinance Bank Limited. The President of The First Microfinance Bank, participant no. 13 remarked in this context that the plan for transforming the Aga Khan Rural Support Programme's microfinance section into a separate commercial institution was made during the mid-90s. He also pointed to the management's realisation that to achieve long-term self-sustainability, the AKRSP should move towards formal commercialization and become a self-reliant institution rather than a Programme.

Since the introduction of the first Policies and Procedures manual in 1996, a number of policy and procedural changes had taken place during the AKRSP's reorientation phase. This necessitated updating the manual for new accounting and reporting directives, loan appraisal techniques and other policies and procedures. Over the time, the focus of the traditional credit and savings operations had changed and the quality of outreach to the AKRSP's poor clients improved through the provision of improved services on a self-sustainable basis. This demanded that the credit and savings operations at the AKRSP be managed more systematically, thereby rousing the management to revise the existing Policies and Procedures manual, which was done in 2000.

¹¹¹ Currently the Chief Executive Officer of the Pakistan Microfinance Network (participated in the interviews as participant no. 2).

Major shifts in policy and procedures that had occurred during the period from 1996 to 2000 include the following for which the AKRSP's Policies and Procedures manual was updated in 2000 (AKRSP's Policies and Procedures manual, 2000).

- Revising service changes for all the loan products,
- Rationalising loan products — merging all collateralised loans into Group Loans, and renaming the enterprise credit programme as Individual Loans,
- Phasing out the Corporate Village Organization (VO) Credit Programme,
- Re-designating the Field Accountants (FAs) as Credit Officers,
- Creation of a position of the regional credit manager in each region,
- Introduction of a new monitoring and reporting system — the Credit Operations Report and the Cumulative Performance Report,
- Introduction of a new loan write-off policy and loan loss provision policy,
- Decision to consider each Field Management Unit (FMU) as a Cost Centre, and
- Decision to prepare a separate budget and financial statements for the AKRSP's microfinance operations.

In the remaining part of this chapter the Aga Khan Rural Support Programme's radical transformation to a completely independent commercial setup — The First Microfinance Bank Limited — will be discussed. The discussion will be focussed on: firstly, the changed position of the AKRSP's 'interpretative schemes' (objectives, policies/rules, procedures, and norms/culture), 'sub-systems' (tangible organizational elements such as buildings, premises, machines, and locations), and 'design archetypes' (the organizational structure, decision processes, and internal communication systems) (Laughlin, 1991) after transforming to The First Commercial Bank; Laughlin's model is again given in Figure 8.2 below for a ready reference. Secondly, the MFI's achievement of a state of 'balance' (in terms of Laughlin's Model) in its new positions of 'design archetype', 'interpretative schemes', and 'sub-systems' will be discussed. Some 'observed patterns' will be developed in the process. The empirical data collected for the study will be analysed by comparing these 'observed patterns' with the corresponding 'theoretical patterns' suggested by Laughlin's Model of Organizational Change (1991) and Institutional Theory (DiMaggio and Powel, 1983). The discussion

about the matching of the ‘observed’ and the ‘theoretical’ patterns will be concluded in the next chapter.



Please see print copy for Figure 8.2

Figure 8.2: Laughlin’s Model of Organizational Change (1991).

8.3. Phase III of the AKRSP’s Life (2001 onwards) — Transformation to an Independent Commercial Setup.

Once a successful adaptation and reorientation process in response to the environmental ‘disturbances’ (Laughlin, 1991) was over for the AKRSP, the next stage was either ‘morphogenetic colonization’ or ‘morphogenetic evolution’. Laughlin (1991) terms the morphogenetic colonization phase as a ‘second-order change’ and argues that this type of change is promoted by a group within the organization, forcing other members to either leave or accept the change. Colonization change refers to the fear of the

consequences of the environmental disturbance that leads an organization to act defensively, and adapts and reorients itself accordingly. In colonization the organization tries to settle at a new position of the ‘design archetypes’, ‘interpretative schemes’, and ‘sub-systems’ within the same overall organizational setting (Laughlin, 1991).

If the organization opts for ‘morphogenetic evolution’, Laughlin (1991) argues that the organization will opt for changes in all the organizational components. Unlike colonization, the evolution or transformation is initiated by the new set of ‘interpretative schemes’ that was developed after the organization’s initial reorientation to the changed external circumstances. This stage is characterised by a general consensus of all the organization’s members which facilitates adoption of a new common vision of the organization (please see Figure 8.3 below).

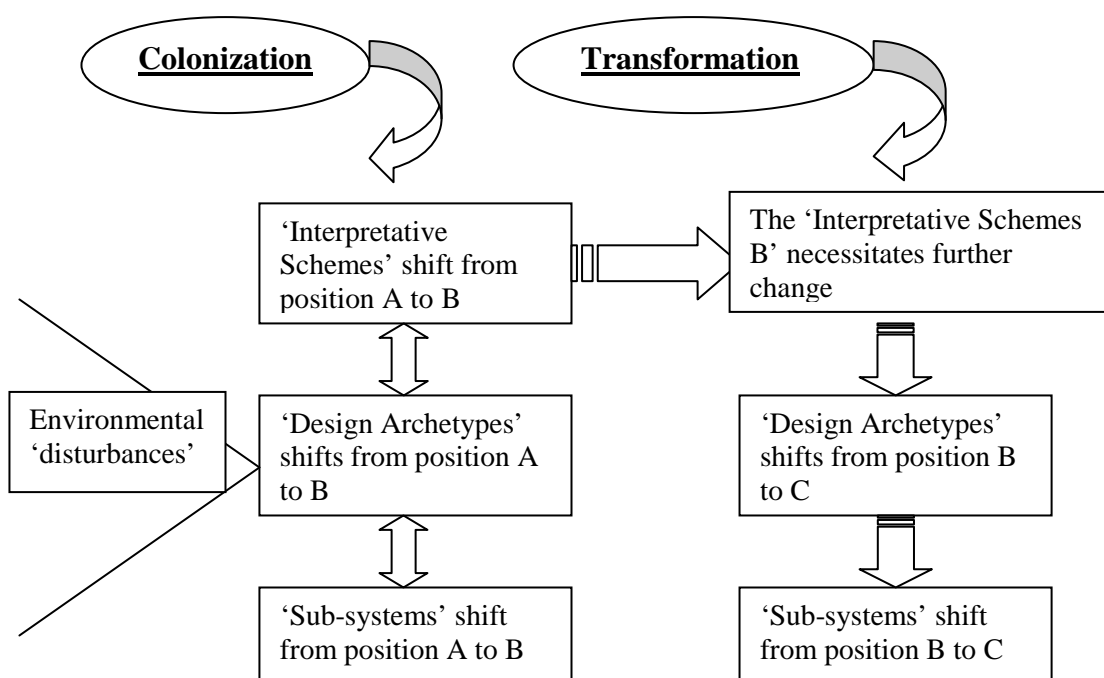


Figure 8.3: Laughlin's Model of Organizational Transformation (1991).

Source: Adapted from Laughlin's Model (1991).

In the previous chapter, the AKRSP's successful reorientation was discussed; in the following sections I will discuss: first, the new position of the AKRSP's tangible and intangible organizational elements — the 'interpretative schemes', 'sub-systems', and 'design archetypes' — after transforming to The First Microfinance Bank, and second, the state and extent of the new 'balance' of these organizational elements in the changed setup.

8.4. Changed Position of the AKRSP's 'Interpretative Schemes'.

In this section 'observed patterns' will be developed and then compared with the 'theoretical pattern' suggested by Laughlin's (1991) Model of Organizational Change. The 'theoretical patterns' should endorse the 'observed patterns' developed from using the empirical data collected for the study.

8.4.1. 'Theoretical Pattern- Set 1 τ '.

As discussed above if an organization opts for 'morphogenetic evolution', Laughlin (1991) argues that the organization will opt for changes in all the organizational components. The evolution or transformation is initiated by the new set of 'interpretative schemes' that is developed after the initial reorientation of the organization to cope with the new environmental conditions. This stage is characterised by a general consensus of all the organization's members which facilitates adoption of a new common vision of the organization. The organization then tries to achieve a state of 'balance' (Laughlin, 1991) and then keeps functioning at the new positions of 'interpretative schemes', 'design archetypes', and 'sub-systems', until again

‘disturbed/kicked’ by another new environmental ‘turbulence’ necessitating another change.

8.4.2. ‘Observed Patterns- Set 1o’.

In the case of the Aga Khan Rural Support Programme (AKRSP), after its initial adaptation and reorientation in response to the environmental ‘disturbances’, discussed in the previous chapter, it ultimately transformed into a new independent commercial setup — The First Microfinance Bank Limited (FMFBL). The new position of the AKRSP’s ‘interpretative schemes’ after its transformation to the FMFBL is discussed below.

8.4.2. i. Objectives/Missions.

The Aga Khan Rural Support Programme, after evolving from a not-for-profit Non-Governmental Organization (NGO) to a for-profit commercial microfinance bank, has now different objectives to pursue. Being a commercial microfinance institution in the private sector, the core objective at the First Microfinance Bank Limited (FMFBL) are two-fold: first, the FMFBL’s central mission is to ensure its outreach to the extreme and moderate poor populations residing in Pakistan’s urban and rural areas, particularly women, who are normally not able to access financial services from the traditional/mainstream financial institutions; second, to ensure its long-term sustainability, covering all its inflation-adjusted costs (FMFBL Annual Report, 2003). To effectively pursue the goal of achieving financial self-sustainability the bank is authorized to “implement appropriate pricing policies, which would ensure access of

affordable financial services to the poor as well as operational and financial self-sustainability” (SBP Prudential Regulations, 2002).

To achieve this two-fold objective, the FMFBL has been empowered, under the Microfinance Institutions Ordinance, 2001 and the State Bank of Pakistan’s Prudential Regulations, 2002, to mobilize public savings, and perform the majority of the functions of the traditional commercial banks (FMFBL Annual Report, 2003; FMFBL’s Memorandum of Association; AKRSP’s BOD meeting dated January 19, 2002). Participant no. 15, the Senior Operations Associate at The First Microfinance Bank, said in this connection that the basic objective at the AKRSP was to serve the poor people and help them get out of the poverty trap, but in the new setup, there were two core objectives to be accomplished: first, to alleviate poverty and second, to achieve self-sustainability and profitability. Participant no. 12, an Officer in the Marketing and Product Innovation department, said in this context, “...now we have dual objectives; not only we have to be self-sustaining but we also have our social development objective of eradicating poverty”. The Regional Manager of the Rural Support Programme Network, participant no. 10, even went further and said that the objective of ‘self-sustainability’ was more dominating than the objective of poverty eradication. He stressed that an MFI can serve the poor community only if it is financially self-sustainable. Now the bank’s struggle is to accomplish its objective of poverty eradication with a complete focus on profitability and self-sustainability.

8.4.2.ii. Policies and Rules.

Policies and rules at the First Microfinance Bank Limited reflect its shrewd professionalism and strong desire to achieve the much-needed financial self-

sustainability. The bank's policy for branch opening, for instance, reflects upon the professional staff at the top level. Participant no. 12 remarked in this context, "...we do considerable research before we establish our branch in a particular locality. We make and analyse a proper demographic profile of the locality we are moving into. In addition, considering the cost factor, our profitability and business opportunities, we analyse the tentative locations for our new branches". While discussing the bank's policy about its branches, she further added that the bank has set a standard size for its branches in different localities and ensured standardization in all its branches; every branch has blue chairs, grey tables, and almost similar furniture and interior setting. About the bank's policy regarding new product development participant no. 12 said that whenever the bank thinks of promulgating any new product policy or developing a new product, it first analyses the prospective market for the product and then finalizes and implements the policy and launches the product.

In the loaning policies, the bank has to observe another policy-cum-rule restricting the bank from extending loans exceeding Pak Rupees 100,000 to a single borrower (SBP Prudential Regulations, 2002). The bank's staff recruitment policies have also been revamped. The Chief Operating Officer of the Pakistan Microfinance Network, participant no. 11, said in this connection that the bank hires professional staff and pays them well. The bank has been able to recruit a balanced blend of microfinance practitioners and commercial bankers who build upon each other's wealth of experience and thus is able to provide a superior level of service to its clients (FMFBL Annual Report, 2003).

Regarding any financial commitment from the AKRSP, a rule was set at the AKRSP's Board of Directors meeting dated May 26, 2001 that the AKRSP would not be obliged

to keep any deposits with the bank. In addition, to prevent criminal use of its channels for the purpose of money laundering and other unlawful trade, the bank was obliged to make all reasonable efforts to determine the true identity of its clients (SBP Prudential Regulations, 2002). To ensure the privacy of its clients the bank, under the SBP Prudential Regulations, must not remove any of its records and documents either physically or electronically relating to its business from a specified area, to a place outside that specified area, without the prior permission in writing of the State Bank of Pakistan. These rules and policies were not in place at the Aga Khan Rural Support Programme.

8.4.2.iii. Internal Procedures.

The Aga Khan Rural Support Programme was not under the supervision of the central bank of the country — the State Bank of Pakistan (SBP), hence its internal procedures were adopted and tailored by its management according to its will. As soon as the AKRSP was transformed into The First Microfinance Bank, it came under the direct supervision of the State Bank. Its policies and procedures, although developed and implemented by the bank's management, became subject to the central bank's scrutiny. The bank is required under the law to develop and implement effective procedures and methods for the purpose of preventing any misuse of its channels by criminals and money launderers (SBP Prudential Regulations, 2002).

The First Microfinance Bank Limited is a formal commercial bank and operates under the direct supervision of the State Bank of Pakistan. Therefore, it is crucial for the bank to adhere to the SBP's requirements in all its operations as in case of non-compliance the SBP is authorized to impose heavy penalties on the bank (SBP Prudential

Regulations, 2002; participant no. 11). There are various procedural restrictions on the bank, for instance, the bank is not allowed to extend any financial facilities for speculative purposes, or any loan exceeding Pak rupees 100,000/- to a single borrower (SBP Prudential Regulations, 2002). The Regional Manager of the Rural Support Programs Network, participant no. 10, said in this context, "...all the SBP's regulations for all the commercial banks of the country stood applicable to the bank". The only exception was the case of regulations for foreign exchange and foreign trade transactions, as the bank is not authorized to deal in foreign exchange and foreign trade (FMFBL's Memorandum of Association; SBP Prudential Regulations, 2002).

Market research and new product development are the prominent and regular features of the First Microfinance Bank Limited's internal operations. "...we have developed new products such as small education loans, housing improvements loans, loans for working capital and fixed assets for small businesses, and loans for emergencies", participant no. 12, an Officer in the Marketing and Product Innovation department, remarked. She further added that the bank also offered some non-financial services, which were unique to the bank. For instance, the bank occasionally runs health camps for its poor borrowers with the help of the Aga Khan Development Network, offers business support services for poor entrepreneurs, and arranges special training programs for its female borrowers. One of the pioneering initiatives taken by the bank is to offer microinsurance cover to all of the borrowers to cover the amount of loan outstanding, at a nominal premium, as well as exploring the possibilities of providing some other microinsurance services to its clients (FMFBL Annual Report, 2003).

Referring to the loans approval procedures participant no. 11, the Chief Operating Officer of the Pakistan Microfinance Network, said that unlike the AKRSP where

approvals for loans used to be given on the phone and later on followed up by someone to make it in writing, the loans approval procedure at the FMFBL was very formal and everything had to be well documented before any loan was sanctioned. It was resolved in the AKRSP's Board of Directors meeting dated May 26, 2001 that the bank would take on all of the AKRSP's microfinance related responsibilities including the recovery of the AKRSP's outstanding loans.

Unlike the AKRSP, where most of the things were done on an informal basis (participant no. 11), procedure at the First Microfinance Bank Limited in respect of branch opening became very tough because of the restrictions from the bank's supervising body — the State Bank of Pakistan. The First Microfinance Bank Limited can open a branch only after getting permission from the SBP which can be obtained only after making a complete feasibility report about the potential location of the branch. The Regional Manager of the Rural Support Programs Network, participant no. 10, remarked in this context that achieving procedural consolidation of the existing branches was another requirement to be met by the bank before opening any new branch.

8.4.2.iv. Organizational Philosophy and Overall Culture.

The First Microfinance Bank Limited operates on the principles of long-term sustainability and broad outreach in terms of services and geographical coverage in order to attain maximum impact (FMFBL Annual Report, 2003). *The Banker* quoted the bank's President as saying, "You are the bank for the poor so you have to have that ingrained in your philosophy. Keep your expenses down and you would survive and also be of service to the poor" (The Banker, June 06, 2005). The bank's management

believes in professionalism in its operations and proper governance and transparency systems have been put in place to achieve its goals (participant no. 12). The FMFBL has the privilege of being the youngest institution worldwide that has been awarded the international 'Honorable Mention' 2004 Financial Transparency Award by the Consultative Group to Assist the Poor (CGAP), a subsidiary of the World Bank (FMFBL Annual Report, 2004).

As far as the management style is concerned, at present a 'consultative'/'democratic' management style is prevalent in the organizational culture under which every staff member has the liberty to communicate directly with any other staff member, whether his/her senior or junior. The president of the bank communicates directly with the heads of departments and their officers (participant no. 12). The bank is highly service-driven and customer service is emphasized by the bank's management as one of the prominent features of its organizational philosophy and culture (FMFBL Annual Report, 2004; Participant no. 13).

Poverty studies show that it is usually when the poor fall sick that they lose the majority of their savings and earnings. The First Microfinance Bank Limited, being well aware of this fact, has developed a unique culture of providing, in addition to financial services, every possible non-financial assistance to its poor clients. For instance, the FMFBL is partnering with the Aga Khan University Hospital (AKUH) on a health program wherein doctors provide health awareness to the FMFBL customers in the bank's respective branch vicinity and also at the hospital with the assistance from the Patient Welfare program at the AKUH. In addition, the FMFBL is exploring the possibility of introducing products focused on educational activities with the help of the Aga Khan Educational Services Pakistan (AKESP) and, housing improvements with the

help of Aga Khan Planning and Building Services Pakistan (AKPBSP) for its poor customers (FMFBL Annual Report, 2003).

8.5. Changed Position of the AKRSP's 'Sub-systems'.

Using the empirical data, this section will develop 'observed patterns' and look at them with the lenses of the 'theoretical pattern' suggested by Laughlin's (1991) Model of organizational change.

8.5.1. 'Theoretical Pattern- Set 2 τ '.

At the evolution or transformation stage, Laughlin (1991) argues, the organization's 'sub-systems' (the tangible organizational elements like buildings, premises, staff, locations, assets), after the initial reorientation in response to the changed environmental conditions, transform into a new state/position and the organization finally achieves 'balance' with a new set of 'sub-systems'.

8.5.2. 'Observed Patterns- Set 2 σ '.

Based on the primary and secondary data, here the discussion will focus on the changed position of the Aga Khan Rural Support Programme's (Microfinance Division) sub-systems after its transformation to The First Microfinance Bank Limited. As argued by the General Manager of the Pakistan Microfinance Network, changes in the tangible organizational elements were primarily in response to the combined effects of the

changed donors' approach and the resulting competition among the microfinance institutions.

8.5.2.i. Staff.

Referring to the changed position of the 'staff' tangible element, the Regional Manager of the Rural Support Programs Network, participant no. 10, remarked that the bank's staff was less mobile and had become mostly branch-based. Comparing this position of the bank's staff with that of the former Aga Khan Rural Support Programme's Microfinance Division, he further added that at the AKRSP the staff was mobile and they used to go from village to village, identify the poor households, and were involved in the whole process. "The outreach of the bank is less because of this factor", the participant complained. Moreover, staff at the AKRSP wore casual clothes, while at the bank the staff's clothing reflects the professional look of the organization (FMFBL Annual Report, 2003). Most of the newly hired staff at the bank have a commercial background; even the president of the bank was a commercial banker (participant no. 10).

8.5.2.ii. Branches' Buildings.

The Aga Khan Rural Support Programme (Microfinance Division), after transforming into The First Microfinance Bank Limited (FMFBL), came into direct competition with other commercial financial institutions. Therefore, logically, it had to tailor its physical infrastructure accordingly. Referring to one of the very important features of the branches at the FMFBL, the Chief Operating Officer of the Pakistan Microfinance Network, participant no. 11, said that unlike the case of the AKRSP, different SBP

Prudential Regulations apply to the FMFBL as a formal commercial bank. The bank has to design its branches in a way that will be ratified by the State Bank of Pakistan. The AKRSP was not licensed to mobilize public savings while the bank is. So according to the SBP regulations the bank had to have secure places for its branches equipped with especially built ‘strong-rooms’ to keep cash and other valuables belonging to the general public. In addition, the branches must also have an emergency alarm system and guards 24 hours a day, every day (Participant no. 11).

The bank’s branches and the head office reflect a professional and commercial outlook. Participant no. 12 said in this connection that the bank had designed its branches’ interior and exterior to look like those of a commercial financial institution. Plus, keeping in view the nature of its business, there was a provision of one big meeting area in the bank’s branches for all staff members and the branch managers to discuss business-related matters. She further remarked that the branches of the bank were attractive and clean but not excessively expensive, and all standardized in size, look, colour, and internal and external setting. The Head Human Resources department, participant no. 7, expressed similar views in this regard.

8.5.2.iii. Location/Premises.

The changed objectives at the AKRSP’s transformed setup — The First Microfinance Bank Limited — necessitated changes in the location of the bank’s branches/units and the Head Office. After the change, one of the bank’s primary objectives was to financially sustain itself. To achieve self-sustainability in the face of competition made it crucial for the organization to attract more and more clients which, in turn, needed selection of commercially attractive locations for its business units/branches.

8.6. Changed Position of the AKRSP's 'Design Archetype'.

This section will develop 'observed patterns' based on the empirical data and compare them with the 'theoretical patterns' suggested by Laughlin's (1991) Model.

8.6.1. 'Theoretical Pattern- Set 3τ'.

According to Laughlin's (1991) Model of Organizational Change, an organization, after initially adapting and reorienting to its new environmental conditions, achieves a new 'balance' with a changed set of its 'design archetype' — its overall organizational structure, internal communication systems, use of accounting, and decision processes.

8.6.2. 'Observed Patterns- Set 3ο'.

The primary and secondary data that was collected for this study suggest that the 'design archetype' at the Aga Khan Rural Support Programme (AKRSP) went through numerous prominent changes during its adaptation and reorientation in response to the changed environmental conditions, finally settling down at a new 'balanced position' after the AKRSP's transformation to The First Microfinance Bank Limited (FMFBL). I will discuss here the changed position of the AKRSP's 'design archetypes' after its transformation to FMFBL.

8.6.2.i. Overall Organizational Structure.

After the minor structural adjustments at the Aga Khan Rural Support Programme during its adaptation and reorientation in response to the external environmental

disturbances, the major structural change occurred in 2001 when the AKRSP was transformed into an entirely independent commercial setup — The First Microfinance Bank Limited (FMFBL). However, at the AKRSP's Board of Directors meeting dated May 26, 2001 it was resolved that there would be a strong AKRSP 'voice' in the management of the bank.

The FMFBL has developed a well-defined organizational structure like any other formal commercial institution. The AKRSP's Board of Directors had resolved in their meeting held on the 23rd of September, 2001 the initial organizational hierarchy at the FMFBL. The Chairperson of the bank's Board of Directors and eight new directors were nominated in the meeting in addition to the Chief Executive Officer/President, participant no. 13, and the Chief Operating Officer, participant no. 11, of the bank. The Board members mentioned at the meeting that a space for the bank's head office in Islamabad had already been leased.

Unlike the AKRSP, the bank was obliged to develop a formal organizational structure with a well defined organizational hierarchy under the SBP directives and regulations (participant no. 11). An Officer in the Marketing and Product Innovation department, participant no. 12, remarked in this connection that they had developed a fully functional Human Resource Department in addition to incorporating a fully operational formal training department for imparting vigorous training to the new and existing staff. ...”as far as I know, these systems were not developed at the AKRSP”, she further added to her remarks. She also said that the bank had established a separate Human Resource Department, Finance Department that looks after the accounting related matters, an IT Department, an Operations Department, and a fully fledged Internal Audit Department.

The bank also established an internal Audit Committee, comprising of two non-executive members of the Board of Directors, which operates under terms of reference approved by the Board. The Audit Committee is responsible for ascertaining the adequacy and effectiveness of the bank's system of internal controls including the accounting systems, compliance with the regulatory provisions and internal policies and a review of the independence and performance of its external and internal auditors. The head of the bank's Internal Audit department reports directly to the Audit Committee (FMFBL Annual Report, 2003).

8.6.2.ii. Internal Communication Systems.

The Aga Khan Rural Support Programme's Board of Directors resolved at their meeting on the 26th and 27th October 2001 that The First Microfinance Bank would need to establish a clear communication strategy for its internal operations as well as for the public and other stakeholders. In their meeting dated January 19, 2002, the Board members stressed the importance of constant, open, and detailed communication with internal and external stakeholders.

The General Manager of the Pakistan Microfinance Network, participant no. 5, said that the internal communication system was not much emphasized at the AKRSP. On the contrary, The First Microfinance Bank Limited, after coming into being, highly emphasized the internal communication system and the use of information technology. Participant no. 12 said that at the bank they had developed a state of the art Management Information System (MIS) for improving the internal communication system and integrating the customers' data base. "...this MIS is the only one of its kind in the microfinance sector in Pakistan; no other microfinance institution has this

advanced MIS in place”, she added in this regard. Most of the commercial banks in Pakistan are offering ‘on-line’ banking facilities to their customers. Being in competition with these commercial banks and commercial microfinance institutions for savings mobilization, remittances, and other financial services, The First Microfinance Bank Limited took the initiative and put its internal communication system on-line. Participant no. 12 said in this connection, “...we have interlinked all our branches through computer networking; so, now we have fully integrated branches”.

About the flow of internal communication, the General Manager of the Pakistan Microfinance Network, participant no. 5, said that at the bank they had gradually incorporated different periodic statements — daily, weekly, fortnightly, monthly, quarterly, half-yearly, and yearly statements and reports. “...these statements and reports are circulated within the organization for decision making purposes”, he further remarked. The bank is also bound by the law to prepare and submit periodic statements and reports to the central bank (SBP Prudential Regulations, 2002). The Head of the Marketing and Product Innovation Department, participant no. 8, expressed similar views on the issue. The Regional Manager of the Rural Support Programs Network, participant no. 10, remarked in this context that because of the increase in number of branches scattered all over Pakistan, internal communication had increased significantly. He further added that another reason for the increased volume of internal communication was the fact that the head office of the bank was in Karachi where the President sits and the main office is in Islamabad where most of the heads of departments worked. Senior Operations Associate at The First Microfinance Bank, participant no. 15, said in this regard, “...at the bank we have three regions, I mean, we have added two more regions to streamline the internal communication and reporting system. As a result internal communication had increased tremendously. We combined

the Gilgit and Baltistan regions making them one; the second is the Punjab Region, covering all the districts in the Punjab Province, and the third is the Sind Region which covers all districts in the Sind Province”.

8.6.2.iii. Accounting Use.

Different accounting practices are seen as reflecting different organizational circumstances (Hopwood, 1987, pp. 209-212). The First Microfinance Bank is making optimal use of the international accounting standards as used in Pakistan (FMFBL Annual Report, 2003). As a regulated financial institution, The First Microfinance Bank must get its books of accounts audited in line with the provisions of the Microfinance Institutions Ordinance, 2001 and submit three copies of the annual audited accounts along with the auditors’ opinion to the State Bank within three months of the close of the accounting year (SBP Prudential Regulations, 2002).

The First Microfinance Bank Limited, according to its organizational setting and the prevailing circumstances, has ensured optimal use of accounting. The bank has hired internationally reputed external auditors to ensure adherence to international accounting rules and standards, and its financial statements are fully compliant with the international accounting standards (FMFBL Annual Report 2003 and 2004; participant no. 12).

8.6.2.iv. Decision Processes.

The decision making at the bank has improved with the passage of time and reflects the professional environment prevailing at the bank. The Regional Manager, Pakistan Rural Support Programs Network, participant no. 10, said that the informal environment that

prevailed in the Aga Khan Rural Support Programme allowed the management to make and implement decisions according to the ‘need’ of the organization i.e. the decisions at the AKRSP were mostly ‘situation-driven’. However, as a regulated financial institution, the decisions taken and implemented at The First Microfinance Bank were subject to a number of laws and regulations. He further added that the State Bank of Pakistan’s Prudential Regulations, 2002 and the Microfinance Institutions Ordinance, 2001 had priority over the ‘need/situation’ of the bank and decision making at the bank were subject to the requirements of these laws and regulations.

8.7. Achieving ‘Legitimacy’.

8.7.1. ‘Theoretical Pattern — Set 4τ’.

Institutional Theory (DiMaggio and Powel, 1983) argues that being one of the recipients of the society’s scarce financial and non-financial resources, a microfinance institution (MFI) must be viewed by the society as a ‘legitimate recipient’ of these resources (DiMaggio and Powel, 1983). The MFI therefore must ensure its legitimacy in the eyes of the general public in order to sustain itself in the long-run.

8.7.2. ‘Observed Patterns- Set 4o’.

The empirical data suggest that The First Microfinance Bank Limited (FMFBL) is taking every possible step to gain legitimacy with the society and a good reputation from the general public. The Officer in the Marketing and Product Innovation department, participant no. 12, said in this context the bank was the first MFI in

Pakistan which had its credit rating evaluated without any regulatory requirements to do so. It reclined the highest short-term credit rating among the MFIs in Pakistan (participant no. 12; Business Recorder, 23rd June, 2005; FMFBL Annual Report, 2004). The bank's President, participant no. 13, had a similar opinion in this regard. The Chief Operating Officer of the Pakistan Microfinance Network, participant no. 11, remarked in this connection that the bank's affiliation with the name 'Aga Khan' had given it a good name and reputation in the eyes of the general public; in addition, strict adherence to the SBP rules and regulations had also contributed to its good name.

Relevant State Bank of Pakistan (SBP) documents¹¹² reveal that the bank's management even applied to the SBP for an alteration of the name of the bank to incorporate the group's name. The management proposed the new name of 'The AgaKhan Microfinance Bank' in the application. However, the SBP did not approve the change in the name of the bank for some reason. The Head of the Operations Department at the bank, participant no. 9, said in this context that the FMFBL complied with all the SBP regulations and whatever praises or rewards it earned, nationally or internationally, it made it public; in addition, the bank always kept good relations with the print media and the concerned government departments. "...overall the international donor agencies have a very good 'say' about us", he further remarked.

¹¹² Some of the documents are attached herewith collectively marked as Appendix H.

8.8. Achieving a State of ‘Balance’.

8.8.1. ‘Theoretical Pattern — Set 5 τ ’.

Laughlin Model (1991) asserts that an organization keeps operating in a ‘balanced’ state unless ‘disturbed/kicked/jolted’ by external environmental ‘disturbances’, initiating a change in the organization’s tangible and intangible elements. The change shifts the organization’s design Archetypes, interpretative schemes, and the sub-systems from one position to another; the organization then with the passage of time, achieves a ‘balance’ and settles at the new position. It keeps on operating at this new balanced position unless again hit by another external environmental disturbance and the process continues.

8.8.2. ‘Observed Pattern — Set 5 σ ’.

The empirical data collected for the study suggest that overall The First Microfinance Bank Limited has achieved a state of ‘balance’ and the bank’s interpretative schemes, design archetypes, and sub-systems have almost settled. However, there always is room for improvements, especially in a professionally geared commercial setup. With regard to the bank’s ongoing strategy in respect of product innovation and adaptation to customers’ needs, participant no. 12 remarked, “...some products are still in the development phase”. About the ongoing structural adjustments in the bank, participant no. 12 further added that they were in the process of establishing a Risk Management department and a Business Support department for providing training and consultation services to their small borrowers.

Talking about the increased flow of internal communication at the bank, The Senior Operations Associate at the bank, participant no. 15, said that the operations at the bank had been divided into three regions and with an increase in the number of branches over time, organizational structure would be further amended and operations would be further divided into smaller zones and areas.

This shows that the bank, although ‘balanced’ at its new positions of the organizational elements, is continuously improving its different organizational elements to better serve its customers and achieve an edge over its rivals in the industry.

8.9. Summing Up.

Since its inception The First Microfinance Bank Limited has improved its financial performance year by year ensuring achievement of its underlying objectives of alleviating poverty and achieving financial and operational self-sustainability. As the first private sector microfinance bank and a successful example of a Non-Governmental Organization (NGO) to bank transition in Pakistan, the FMFBL continues to show great promise.

The next chapter will focus discussion on the comparison of different sets of the ‘theoretical patterns’ and their corresponding ‘observed patterns’ developed in this and the previous empirical chapter, thereby arriving at the conclusions. In addition, some light will be thrown on the contribution made by the study to the literature before concluding the chapter by giving some recommendations for future research in the area.

Chapter 9: Discussion

9.1. Commentary on the Analysis of the Empirical Data.

In Chapters 7 and 8 different sets of theoretical patterns were articulated and arranged, as suggested by Laughlin's Model of Organizational Change and Institutional Theory, and 'observed patterns' derived from the empirical data collected for the study. This chapter establishes a dialogue between these theories and the revelations obtained and the themes built in the case study from the empirical data.

Yin (1994) named the process of analysing case study data 'pattern-matching' (p. 106). While analysing the empirical data of a case study, a researcher may conclude the study with outcomes predicted by an existing well established theory or may reach a totally contradictory outcome as to the predictions of the theory. In the former case, the evidence produced is seen to involve the same phenomena as described in the theory, and is termed as 'literal replication' (Yin, 1994, p. 108). In the later case where the researcher concludes the case study producing contrasting results from those predicted under a theory, it is referred to as 'theoretical replication' (Yin, 1994, p. 109).

As discussed in Chapter 5, a case is like a closely tied and interconnected system where all facts are integrated with each other. Yin (1994) argues that each individual case study is like a separate case, distinguishable from other cases, which can stand alone and independent of other cases. In other words, a case study need not be combined with other social settings in order to create a 'whole' case. Instead, every case study is complete and need to be analysed as an independent case.

The findings of a case study can be logically explained keeping in view the ‘observed patterns’ and their connectedness and similarity to the corresponding ‘theoretical patterns’. Literature suggests that in order to improve the quality of findings of a case study, the pattern matching data analysis technique can be complemented by an ‘explanation building’ (Yin, 1994, p. 110) technique. Under the explanation building approach, researchers can resort to logical explanation about the observed patterns of the case study developed from the empirical data and their similarity to or contradiction from the theoretical patterns predicted by a theory. The objective is to present the analysis of the empirical data by building an explanation about the case. The approach, if prudently used in conjunction with the patterns matching approach, can produce an intelligible conclusion about the case study (Santos *et al*, 2001).

9.1.1. Is Commercialism of the Microfinance Sector a Step in Right Direction? Evidence from the Empirical Data.

As discussed in Chapter 2, advocates of non-commercialism in the microfinance sector argue that creating stress in the microfinance institutions in relation to cost control and self-sustainability may result in drifting from the primary objectives on the part of these institutions. Microfinance institution’s management should ensure that the primary objective of eradicating poverty is not overshadowed by the stress on profitability. The empirical data collected for the study also has demonstrated evidence of low outreach after the Aga Khan Rural Support Programme (Microfinance Division) transformed to The First Microfinance Bank Limited (FMFBL) in response to the changed external circumstance. For instance, participant no. 10, a Regional Manager at the Rural Support Programme Network, talking about the post-transformation scenario, said in this regard

that, at the bank, every branch was now trying to be profitable because their performance was judged by their contribution to the profitability of the bank. So they wanted to operate with the least possible number of staff to limit their administrative costs. Branches received targets for cost control and profitability. So budgeting was vigorously observed and followed at each branch level. Therefore controlling costs and increasing profitability became the foremost objectives in the changed setup. Since work is done by a limited number of staff and cost control and profitability are the foremost priorities of the branch, it is not possible to achieve that level of outreach which was previously possible for staff at the AKRSP. The participant also said that:

...although the bank is gaining strength and sound financial footing, so what? From the poor people's point of view 'to hell with it'. There is no shortage of good commercial banks in the country; the poor want the services that are specifically for them, like the AKRSP was providing.

Participant no. 13, the President of The First Microfinance Bank Limited said in this context that the objectives had become totally different at the bank and the real mission i.e. poverty alleviation was sacrificed, because in commercial microfinance, the MFI didn't normally go to the poorest of the poor because of the high costs involved. He further added to his remarks that:

...we believe that microfinance should not be purely on commercial terms and it should not deviate from its main objective of poverty alleviation. Microfinance should fulfill the needs of the poor people as well as those of the institution.

The AKRSP's management, being aware of this aspect of change, openly expressed its concerns and raised several questions at the Board of Directors meeting prior to the AKRSP's transformation to the commercial bank. The meeting asked "...how will the bank (the First Microfinance Bank Limited) ensure the continuity of this mission given that it would be a national level bank? The bank is a commercial institution, so how will

it maintain a commitment to poor people? If the bank's objectives come in conflict with each other, how would such a conflict be resolved? For example, would unprofitable branches in the NAs/C (Northern Areas and Chitral) be closed down?" (AKRSP's BOD Meeting, 26th May, 2001).

The members of the Board also expressed their concerns at the meeting about the future of the AKRSP itself. It was resolved in the meeting that the AKRSP should not end up in a situation where it would have to start up a new microfinance programme because the bank could not serve the Northern Areas and Chitral (NAC).

9.2. Analysis of the Empirical Data.

This thesis has used the pattern-matching and explanation building approaches, as discussed above, in analysing the empirical data. Firstly, this section will look at the observed patterns with the lenses of the 'theoretical patterns', both developed in the previous two chapters using the pattern-matching method. Secondly, using the 'explanation-building' approach, discussion will be focused on the interrelationships among the empirical evidence, thereby analysing the case study data by building an explanation about the case. The explanation-building will complement the pattern matching approach for achieving a better understanding of the whole situation surrounding the case.

9.2.1. Matching the Patterns.

This section of the chapter will first compare the two sets of observed patterns, developed in the previous two chapters using the empirical data collected for the study,

with the corresponding theoretical patterns suggested by Laughlin's Model of Organizational Change (1991) and Institutional Theory (DiMaggio and Powell, 1983), and thereby arrive at a conclusion. As mentioned in Chapter 5, Trochim's (1989, p.356) pattern matching model has been used for the analysis of the empirical data in the previous three chapters, which is given in Figure 9.1 below.

Process of Pattern Matching:

A. Theoretical Realm

(Laughlin Model)
(Institutional Theory)

B. Theoretical Patterns:

1. Laughlin (1991) Model: Organizations adapt, reorient, and/or transform in response to unavoidable external environmental disturbances;
2. The 'coercive' pillar of Institutional Theory (DiMaggio and Powel, 1983): organizations passively accept or submit to the terms and conditions dictated by an outside entity on which they are dependent for resources, like capital, customers, expertise, legitimacy, advice, etc.

C. Observed Patterns

1. The actual/observable changes introduced by the AKRSP's management in its structure, communications systems, policies, practices, rules, missions, cultures, and other tangible and intangible elements in response to the external environmental disturbances.
2. The actual/observable changes introduced by the microfinance institution's management serve as evidence of the organization's passive acceptance or submission to the terms and conditions dictated by outside entities on which it is dependent for resources.

D. Case Study primary and secondary data.

E. Analysing Case Study Data:

Patterns Coding
Matching the 'observed patterns' with the 'theoretical patterns'

F. observations / conclusions.

Figure 9.1: Patterns Matching Model for a Case Study Data Analysis.
Source: Adapted from Trochim (1989, p. 356).

The top section of the Pattern Matching Model shows the theoretical realm which may be derived from a well developed theory or theories, the ideas and/or experience of the researcher, or a combination of both. The lower section of the Model indicates the realm of observations that are derived from the primary and secondary data collection (Trochim, 1989). In Chapters 7 and 8 steps A to D of the Model were completed; this chapter will cover steps E and F.

This discussion about the analysis of the empirical data, using a pattern-matching approach, builds upon the details about different observed patterns developed and their corresponding theoretical patterns given in Chapters 7 and 8. A set of four observed patterns were developed using the empirical data for the case study and were coded as observed patterns Ao, Bo, Co, and Do. These were put close to each observed pattern's corresponding theoretical pattern and coded as theoretical patterns A τ , B τ , C τ , and D τ respectively with the purpose of making it easy to match an 'observed patterns' with its corresponding 'theoretical pattern'. The same exercise was repeated again in Chapter 8 thereby developing another set of five 'observed patterns' using the empirical data and coded them as observed patterns 1o, 2o, 3o, 4o, and 5o and arranged them closer to their respective theoretical patterns coded as theoretical patterns 1 τ , 2 τ , 3 τ , 4 τ , and 5 τ respectively for the purpose of making it meaningful to compare the observed patterns with their corresponding theoretical patterns.

Looking at the observed patterns developed in Chapter 7 and 8 with the lenses of the theoretical patterns suggested by Laughlin's Model of Organizational Change (1991) and Institutional Theory (DiMaggio and Powell, 1983), as discussed in Chapter 4 in detail in conjunction with the case study, it can easily be ascertained that the theoretical patterns fully endorse the observed patterns and vice versa. This evidence, as discussed

above, could be termed as a ‘literal replication’ in Yin’s (1994, p. 108) terminology because the evidence produced by the empirical data can be seen to involve the same phenomena as predicted by the two theoretical frameworks.

9.2.2. The Building of ‘Explanation’.

As discussed above, the explanation-building approach will be used to complement the evidence obtained through the pattern matching approach. This compact discussion of the analysis of the empirical data, using the explanation-building approach, forms part of the matching ‘observed’ and ‘theoretical’ patterns developed and presented in Chapters 7 and 8.

As discussed in Chapter 4, many studies have combined more than one theoretical framework to explain different phenomena in a single case study. This case study too has two integral parts: first, the passive ‘acceptance’ of and ‘submission’ to the external environmental pressures by the AKRSP; and second, the internal adaptation, reorientation, and transformation of the AKRSP in response to these environmental pressures. Laughlin’s Model cannot answer the first part. The study explained this part from an Institutional Theory (DiMaggio and Powell, 1983) perspective. The second part of the case study cannot be explained using Institutional Theory. Laughlin (1991) Model of Organizational Change can best explain this part. Therefore, in explaining organizational change in the Microfinance Division of the Aga Khan Rural Support Programme, the study used two theoretical frameworks — Institutional Theory (DiMaggio and Powell, 1983) and Laughlin’s (1991) Model of Organizational Change.

The two perspectives offer a more logical and compelling explanation of how organizations reorient and transform in environmentally turbulent times.

9.2.2.1. From the Perspective of Institutional Theory.

A sustainable microfinance program does not necessarily mean that there will be no need for further subsidies from the donor community. That is why a microfinance institution, after attaining self-sustainability, has to prove itself as a legitimate recipient of subsidized financial resources for further expansion and outreach. Despite the changed approach and thinking on the part of the donor community as to the sustainability of microfinance institutions from providing subsidized financial resources to stress self-sustainability, The First Microfinance Bank Limited¹¹³ (FMFBL) still has to conform to the donors' terms and conditions because it has to resort to their support and the society's endorsement for their future operations and expansion programs. The FMFBL still has to adopt policies and practices that positively influence the donors' perception about its operations and to prove its legitimacy to the society. Similarly the Aga Khan Rural Support Programme (AKRSP), before its transformation, passively submitted to the changed external environmental conditions because of its current and future dependence on international donors.

Institutional Theory suggests that organizations conform to externally dictated terms and conditions primarily because of their financial and non-financial dependence on the regulative bodies that issue or change these terms and conditions. The 'regulative' institutional influence grants legitimizing authority to the organization in the field in

¹¹³Formerly the Microfinance Division of the Aga Khan Rural Support Programme (AKRSP). The AKRSP ceased to provide microfinance services after the transformation of its Microfinance Division into The FMFBL.

return for its conformity to the set rules and regulations. The ‘coercive’ pillar of Institutional Theory, which best explains such type of radical changes in organizations (DiMaggio and Powell, 1983), is usually imposed by parent organizations¹¹⁴ which, by exercising their legitimate powers to formulate, tailor, and enforce laws and regulations, are able to control dependent organizations’ behaviours and routines. These constitute ‘formal’ pressures such as rules, regulations, and sanctions, for dependent organizations. Formal interventions by a country’s central bank on formal financial institutions are an example of ‘formal’ coercive influences on these institutions’ behavioural patterns. Informal pressures, such as from donor organizations requiring microfinance institutions to prove their legitimate existence and eligibility for financial and non-financial support, constitute ‘informal’ coercive influences for these institutions.

Thus, ‘coercive’ influences compel organizations not only to follow rules, regulations from authoritative entities but also conform to what is generally expected of it as a business enterprise (Oliver, 1997). The general public will bestow legitimacy on organizations that explicitly conform to rules and regulations stipulated by an authoritative entity or any conditions dictated by an external entity on which they are dependent for resources (DiMaggio and Powel, 1983). Organizations abide by these regulative measures primarily because of their financial and non-financial dependence on the regulative bodies. The persistent conformity to these ‘regulative’ institutional influences over extended period of time on the part of an organization inturn gets it a

¹¹⁴ ‘Parent organizations’ here refer to organizations on which microfinance institutions are dependent for financial and non-financial resources. They also control legitimizing authority which they are capable of bestowing on a microfinance institution in response to its long-term compliance to their rules and regulations.

legitimizing authority in its field, which it can use on new-comers in the industry. (Scott, 1995).

Referring back to Chapters 7 and 8, it is evident that the observed patterns fully endorse the theoretical patterns. In Chapter 7, the Observed pattern, Set Do, fully endorsed the corresponding theoretical pattern, Set D τ , and vice versa. Similarly, in Chapter 8, the observed pattern, Set 4o, endorsed the corresponding theoretical pattern, Set 4 τ , and vice versa. Yin (1994) calls it ‘literal replication’ if the evidence produced by the empirical data is seen to involve the same phenomena as predicted by a well-established theory.

9.2.2.2. From the Perspective of Laughlin’s (1991) Model.

The initial adaptation and reorientation of the Microfinance Division of the Aga Khan Rural Support Programme in response to the changed environmental conditions and then subsequent transformation to a completely independent commercial setup — The First Microfinance Bank Limited — represents a case to which two categories of the changes predicted by Laughlin’s Model of Organizational Change (1991) simultaneously apply — morphostatic reorientation (first order change), and morphogenetic evolution (second order change). These are discussed below.

9.2.2.2.i. The AKRSP’s (Microfinance Division) Initial Adaptation and Reorientation.

The AKRSP (Microfinance Division) first had to adapt and reorient in response to the external environmental disturbances before transforming into an independent commercial setup. Laughlin (1991) maintains that if the organization cannot reject the

environmental disturbances it is faced with then, unlike the rebuttal change where the environmental disturbances induce limited changes that primarily affect the organization's design archetype without affecting its sub-systems and interpretative schemes, not only the organization's design archetypes but also the sub-systems will adapt and reorient to the changed environmental conditions. However, as discussed in section 9.3.3 below this case study suggests that these categories may not fully explain the situation of change in some organizations under specific contexts.

9.2.2.2.ii. The AKRSP's (Microfinance Division) Transformation or Evolution Phase.

Transformation or evolution, in terms of Laughlin's (1991) model, refers to the changes in all the organizational elements — design archetypes, interpretative schemes and sub-systems. Figure 9.2 demonstrates transformation in a diagrammatic form.

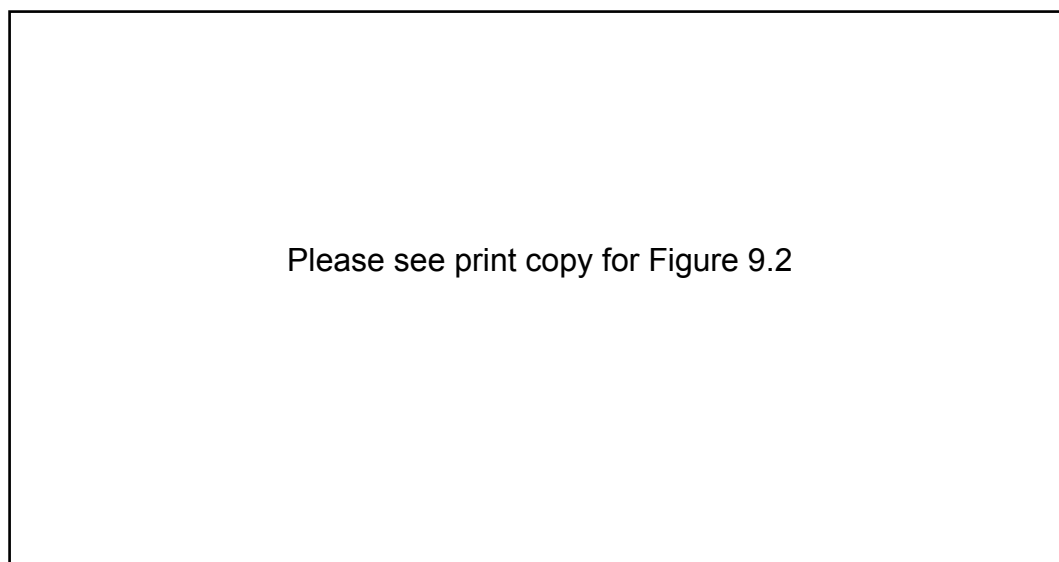


Figure 9.2: The Transformation/Evolution Part of the Laughlin's Model (1991) of Organizational Change.

Source: Laughlin's Model (1991).

Laughlin (1991) argues that, unlike colonization which is caused/forced by external environmental change, transformation or evolution is initiated by the entity's new set of 'interpretative schemes', after its initial reorientation in response to the changed environmental conditions. The distinguishing characteristic of such a change is that all organizational members endorse it, and inculcate it in the organizational setting unanimously through open discussions among all the organizational members.

Gray *et al.* (1995) in their study about the role of environmental accounting in organization change, however, could not identify the presence of such a discussion among organizational members, as proposed by Laughlin for an evolutionary change, before the incorporation of changes into the organizational setting. However, as discussed in the beginning of Chapter 8, the empirical data collected for this study shows concrete evidence of inclination towards the theoretical outcome predicted by Laughlin's (1991) model about the evolutionary change within an organization. The data suggests that after the Aga Khan Rural Support Programme's interpretative schemes were jolted/kicked/disturbed (Laughlin, 1991) by the external environmental disturbances, its management realised that under the changed circumstances the AKRSP's microfinance programme would best function under a completely independent commercial setup. Thus, they drew up a major plan for, first gradually adapting and reorienting all of the AKRSP's microfinance-related activities to the changed external circumstances, and then transforming it to a completely independent commercial setup.

Thus, as the empirical data suggest, the initial shift in the AKRSP's interpretative schemes in response to the environmental disturbances caused/forced the transformation or evolution of the AKRSP's Microfinance Division to The First Microfinance Bank

Limited — the same as is predicted by the theoretical pattern under Laughlin's (1991) model for evolutionary change. The second aspect of the AKRSP's transformation or evolution, evident from the empirical data, was that the AKRSP's evolution was decided and carried out by a consensus of its members with open dialogues among them and deliberately accepted by all the members — also an outcome predicted and endorsed by the theoretical pattern suggested by Laughlin's model for evolutionary change within an organization.

9.2.2.2.iii. The Sequence of Change.

Laughlin's Model of Organizational Change (1991) asserts that an organization keeps on operating at position 'A' in a 'balanced' state unless disturbed/kicked/jolted by an external disturbance/turbulence, necessitating a change within the organization. The sequence of the change as suggested by the empirical data is shown in figure 9.3.

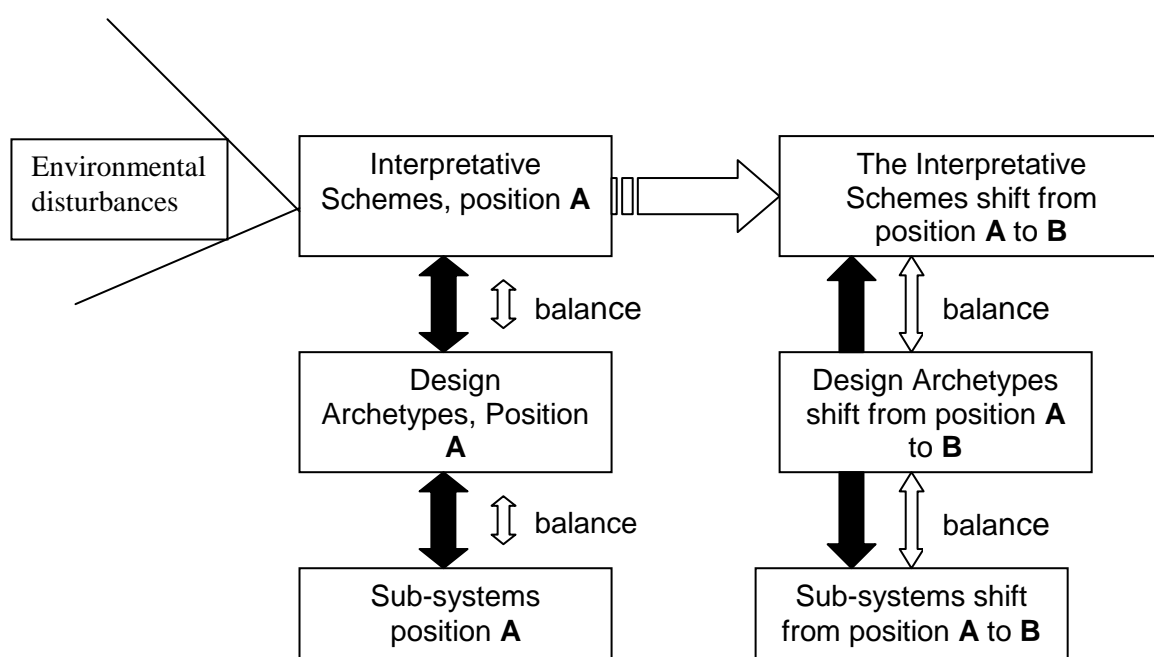


Figure 9.3: The Sequence of Change at the AKRSP depicted by the empirical data.
Source : Adapted from the Laughlin's (1991) Model, p. 219.

The Model maintains that, in case of evolution or transformation, the external environmental disturbance(s) first reverberates (p. 221) the organization's interpretative schemes which, inturn cause changes in its design archetypes and sub-systems. The organization then settles or achieves a 'balance' (Laughlin, 1991) at a new position of the design archetypes, interpretative schemes, and sub-systems (positions 'B' in the figure).

The empirical data collected for this study also suggests a similar sequence of change within the Aga Khan Rural Support Programme's Microfinance Division in response to the changed environmental conditions. The AKRSP's objectives, missions, culture, philosophy, etc., were the first to change in response to the changed environmental conditions. This changed or affected set of interpretative schemes necessitated changes in its structure (design archetypes) and, simultaneously, in tangible organizational elements (sub-systems). The last major structural change was witnessed when the AKRSP's Microfinance Division was finally transformed into a completely independent commercial setup. The data suggests that the external environmental disturbances — first, the donors' changed approach and thinking about the sustainability of the Microfinance Institutions i.e. their gradual movement from providing subsidized financial resources to commercialism and self-sustainability on the part of MFIs and second, the resulting competition among the MFIs — first impacted upon the AKRSP's interpretative schemes, which then, inturn, caused changes in its design archetypes and sub-systems.

Thus the empirical data collected for the study endorse the sequence of changes in an organization's tangible and intangible organizational elements also, in addition to the actual changes. The sequence of changes in the AKRSP's organizational elements in

response to external environmental disturbances was the same as predicted by Laughlin's (1991) Model.

Thus, the outcomes suggested by the observed patterns developed by using the empirical data collected for the study fully conform to endorse the theoretical patterns predicted by Laughlin's Model of Organizational Change (1991) and Institutional Theory (DiMaggio and Powell, 1983), as already discussed and ascertained in Chapters 7 and 8 in the relevant sections.

9.3. Contributions Made by the study to Existing Literature.

9.3.1. Originality.

As discussed in Chapter 4, organizational change has so far been studied with particular reference to several areas, sectors, and industries including Railways (Tyrrall and Parker, 2005; Laughlin, 1991; Erakovic and Wilson, 2005), Churches (Laughlin, 1991), Telecoms (Erakovic and Wilson, 2005), and privatization of state-owned enterprises (Dean, Carlisle and Baden-Fuller, 1999; Springdal and Mador, 2004). Similarly there are studies of organizational change with particular reference to and role of 'accounting/accountants' (Gray *et al*, 1995), 'environmental accounting' (Larrinaga-Gonzalez *et al*, 2001), and 'accounting/accountant' (Gray *et al*, 1995), among others. Organizational Change in the microfinance sector has not so far been explored in detail particularly in the context of Pakistan. This study was a modest attempt at filling this gap. The study has resorted to a unique blend of two theoretical frameworks — Laughlin's (1991) Model of Organizational Change and Institutional Theory (DiMaggio and Powell, 1983), to explain a microfinance institution's adaptation, reorientation, and

subsequent transformation to an independent commercial setup in order to cope with the turbulent external environmental conditions.

This study makes an original contribution to the existing literature on microfinance and microfinance institutions, as a microfinance institution's adaptation and reorientation in response to a change in their external circumstances has not so far been studied in detail. Moreover, it provides an insight into the actual tangible and intangible changes one organization experienced while adapting to its changed external environmental conditions.

9.3.2. Colonized Reorientation.

As discussed above the evolution or transformation process suggested by the Laughlin (1991) model fully endorse the Aga Khan Rural Support Programme's transformation process. However, the categories of change — 'morphostatic reorientation' and 'colonization' — suggested by the Laughlin (1991) Model do not seem to accommodate the process of the AKRSP's initial adaptation and reorientation in response to the changed environmental conditions. Since the external environmental disturbances caused change in not only its design archetypes but also in its sub-systems and interpretative schemes, the AKRSP's initial adaptation and reorientation to the changed external conditions, discussed in Chapter 7, should be categorized as a 'colonized reorientation', not a 'morphostatic reorientation' or 'colonization'.

Laughlin (1991) argues that in case of reorientation changes, the external disturbances will change the organization's design archetypes and sub-systems leaving the organization to keep its original interpretative schemes. The AKRSP's initial change

cannot be categorized as ‘morphostatic reorientation’ in Laughlin’s terminology because during this phase all three elements were adapted and reoriented to the changed environmental conditions. Whereas Laughlin’s (1991) Model maintains that if the change is caused by an external environmental disturbance(s) then only the organization’s design archetype and the sub-systems will reorient and the basic coherence, the interpretative schemes, will remain unaffected. According to the Model this happens in organizations during their reorientation phase. The empirical data collected for the study suggest that, during its initial reorientation phase, not only the AKRSP’s design archetypes and the sub-systems were adapted and reoriented in response to the changed environmental but also its interpretative schemes. Thus, it does not cover the findings of this case study.

In case of a morphogenetic colonization, Laughlin maintains that the external disturbances cause change in all the three organizational elements — design archetype, interpretative schemes, and sub-systems. However, the model has conditionalized morphogenetic colonization to be a non-elected organizational change caused/forced by external environmental disturbances. This change then is promoted and inculcated in all organizational settings by a specific group of organizational members. It is not accepted and promoted by a general consensus of all the members. It forces other organizational members who do not support the group in their effort to change all organizational elements either to leave the organization or accept the change, whether willingly or unwillingly. This case study, on the other hand, suggests that the AKRSP’s initial adaptation and reorientation was caused/forced by the changed environmental conditions where all the three elements — design archetype, interpretative schemes, and sub-systems were adapted (endorsed by Laughlin’s model to this extent and referred to as morphogenetic colonization), but it was then openly accepted and promoted by a

general consensus of all the organizational members (not imposed by a particular interest group on others) because all the members openly endorsed the fact that the long-term success and sustainability of the organization, under the changed environmental conditions, lies in its adaptation and gearing towards commercialism. Therefore the AKRSP's (Microfinance Division) initial adaptation and reorientation in response to external environmental disturbances could be called 'colonized reorientation' because none of the categories predicted by Laughlin's (1991) model for an organization's initial adaptation would cover such a change.

It is concluded, therefore, that an initial adaptation and reorientation in response to changed environmental conditions in all the three organizational elements — 'design archetypes', 'interpretative schemes', and 'sub-systems', openly accepted and promoted by a general consensus, not imposed by a particular interest group within the organization, may be categorized separately as 'colonized reorientation', particularly in the context of microfinance institutions and Pakistan. This should be allowed a room in the existing categories of organizational change in the Laughlin's model.

9.4. Conclusion and Recommendations for Future Research in the Area.

9.4.1. Significance.

The substantive conclusions drawn about the Aga Khan Rural Support Programme's successful adaptation, reorientation, and subsequent transformation to a commercial setup will serve as a model in Pakistan to be followed by other microfinance institutions. The study carries significance in four ways: first, it will provide an insight

into how MFIs can successfully adapt/adjust when faced with unavoidable external environmental disturbances, second, it will provide an insight into how MFIs can successfully adapt and reorient to unavoidable external environmental disturbances, third, the study will provide existing MFIs attempting such reconstruction with good lessons in their struggle for adaptation and reorientation to the changed environmental conditions, and fourth, it will provide new incoming MFIs with valuable insight into good policies and practices under the prevailing commercial approach in the sector.

9.4.2. Summing Up.

Earlier studies suggest that loose-coupling among organizational elements may enable organizations to keep all or some of their organizational elements in the face of external disturbances (Broadbent, 1992). Tyrrall and Parker (2005), however, found in their study of the British Railways the interconnectedness of all organizational elements, as opposed to loose-coupling, to be of importance in organizational change, which may help organizations to keep bound with respect to its organizational elements.

The findings of this study endorse Tyrrall and Parker's (2005) hypothesis that the more the organizational elements are interconnected the more it will be difficult for external disturbances to compel the organization to undergo changes in response to external disturbances. In other words, prominent changes in organizations may follow because of the loose coupling of their organizational elements. If external disturbances somehow cause a change in an organization's basic coherence — the interpretative schemes, this renders its design archetypes and sub-systems incompatible to its changed interpretative

schemes. In that case it may be very difficult for the organization to keep its original organizational elements.

The abrupt and noticeable changes in all three elements at the Aga Khan Rural Support Programme's Microfinance Division point to the interconnectedness, as opposed to loose-coupling, of its organizational elements. Because of the nature of the business the AKRSP was in — microfinance — its interpretative schemes (the objectives, mission, culture, philosophy, policies, practices, etc.), design archetypes (organizational structure, decision processes, internal communication system, ownership, etc.), and the sub-systems (the tangible organizational elements like buildings, machines, premises, locations, technology, etc.) were closely connected within its organizational structure. Because of this close interconnectedness among its organizational elements, the initial change in the AKRSP's interpretative schemes in response to the changed environmental conditions rendered the existing design archetypes and the sub-systems incompatible with the changed interpretative schemes, and, thus, triggered a huge wave of change in all its organizational elements.

As a result, at the Aga Khan Rural Support Programme's Microfinance Division, all three elements underwent thorough adaptation and reorientation in response to the changed external conditions. This process continued from the beginning of 1996 and was eventually completed in 2001. All these organizational elements were improved in efficiency from their previous grim state and the AKRSP's Microfinance Division was successfully reoriented according to its changed external environment which, in turn, facilitated its eventual transformation to a commercial organization. After its successful adaptation to the changed external circumstances, it was declared by the then AKRSP's management that the Microfinance Division of the institution was ready to be

transformed into the proposed commercial setup — The First Microfinance Bank Limited (FMFBL).

The basic theme of the study was to throw light on the Aga Khan Rural Support Programme's (Microfinance Division) struggle and the strategies it adopted for ensuring its long-term self-sustainability after being faced with changed external environmental conditions. It is concluded that the objectives as set for the study were successfully accomplished and, as expected of the study, a contribution made to the existing literature on microfinance.

9.4.3. Limitations.

Keeping in view the qualitative, in-depth nature, and regional focus of the study, I recognize that the findings may be viewed and interpreted accordingly.

9.4.4. Recommendations for Future Research.

The empirical data suggested that the Aga Khan Rural Support Programme's management was concerned for the welfare of the poor especially in the AKRSP's core areas of operations — the Northern Areas and Chitral — after the AKRSP's (Microfinance Division) transformation to the First Microfinance Bank Limited — an entirely commercial setup. Therefore, further studies are recommended to gauge the outreach of the AKRSP before and after its transformation with two main objectives: first, to ascertain success, in terms of outreach and impact on poverty, of the microfinance institution before and after its transformation to a purely commercial

setup, and second, to throw some light on the real essence of microfinance under the ‘welfarist’ and the ‘institutionist’ approaches.

Moreover, since this case study has focused on the AKRSP, a microfinance institution, in the special context of Pakistan, more studies in different national, social, and geographical contexts would be valuable to test the generalizability of its findings.

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APPENDIX A

Please see print copy for Appendix A

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> > To: iftikhar.ahmed@akrsp.org.pk
> > Subject: Letter of consent
> >
> > Mr. Iftikhar Ahmad,
> >
> > Assalaamo Alaikum,
> >
> > I am writing to you with reference to our today's telephonic
conversation.
> >
> > I am a PhD candidate at the University of Wollongong, Australia. I am on
> > scholarship from the Ministry of Education, Government of Pakistan,
under
> > mandate from the State Bank of Pakistan. This is the last year of my
study
> > here in Australia. For the purpose of my study, I need to collect data
on
> > Aga Khan Rural Support Programme (AKRSP) and the FirstMicrofinance Bank;
> > In
> > August this year, I intend to come to Pakistan for Field Data
Collection.
> >
> > At present, as per policy of the University of Wollongong, I need a
> > 'letter
> > of consent' from your side (I will get one from First MicroFinance Bank,
> > as
> > well) expressing your organization's consent to cooperate with me in my
> > data
> > collection process. Primarily, I will get annual reports of the AKRSP
and
> > the FMB. In addition, I will be needing information about the policies
and
> > practices of AKRSP and the First MicroFinance Bank.
> >
> > PLEASE SIMPLY WRITE TO ME THROUGH EMAIL MENTIONING MY NAME AND
EXPRESSING
> > YOUR ORGANIZATION'S CONSENT TO COOPERATE WITH ME IN MY DATA COLLECTION
> > PROCESS.
> >
> > Please note that your reply in not binding on you or your organization;
it
> > is a routine procedure that every PhD student has to follow here at
> > Australian universities.
> >
> > This the last stage of my PhD, I need this letter of consent on urgent
> > basis. Your cooperation in this regard will be highly appreciated.
> >
> > Thanking you in anticipation,
> >
> > Yours truly,
> >
> > ASHFAQ KHAN
> > Scholar-Ministry of Education, Government of Pakistan.
> >
> >
> > -----
> > ----
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Appendix D

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Thesis Title:

“Managing environmental turbulence in the microfinance sector — A case study of the Aga Khan Rural Support Programme in Pakistan”.

Student Name: Ashfaq Khan (PhD candidate)

**School of Accounting and Finance, University of Wollongong,
Australia.**

The two environmental disturbances:

- i. The changed approach on the part of donors from “**providing subsidized financial resources**” to “**stress on self-sustainability**”.
- ii. The resulting “**competition among MFIs**”.

The Interview Questions:

1. How long have you been working in AKRSP?
2. What position(s) have you served in during your time with the MFI?
3. How did these ‘disturbances’ work their way into the organizational structure of the MFI?
4. What changes did the external disturbances cause in the policies, practices, objectives, and rules at the AKRSP?
5. What changes did the external disturbances cause in the MFI’s tangible elements, like, premises, staff, locations, buildings, and interior settings?
6. How did the external disturbances impact on the overall organizational structure?
7. Were there any new regulations for the microfinance sector? How did the AKRSP respond to them?
8. What were the major changes in the internal communication systems of the MFI?
9. Why did the AKRSP accept these external disturbances? Did it try to resist the changes?
10. What extra steps did the MFI take to ensure its self-sustainability and prove legitimacy to the society?

List of Interview Participants¹

Participant No.	Designation	Organization
1	Assistant Director	State Bank of Pakistan
2	Chief Executive Officer	Pakistan Microfinance Network
3	Senior Manager/Head of Finance department	Aga Khan Rural Support Programme Network
4	General Manager	Aga Khan Development Network
5	General Manager	Pakistan Microfinance Network
6	Senior Manager/Head of Credit and Monitoring department	The First Microfinance Bank Limited
7	Senior Manager/Head of Human Resources department	The First Microfinance Bank Limited
8	Senior Manager/Head of Marketing and Product Innovation department	The First Microfinance Bank Limited
9	Senior Manager/Head of Operations department	The First Microfinance Bank Limited
10	Regional Manager	Rural Support Programs Network
11	Chief Operating Officer	Pakistan Microfinance Network
12	Officer/Marketing and Product Innovation department	The First Microfinance Bank Limited
13	President	The First Microfinance Bank Limited
14	Program Manager	The First Microfinance Bank Limited
15	Senior Operations Associate	The First Microfinance Bank Limited
16	Member Board of Directors	Rural Support Programs Network

¹ All the interviews took place in August, 2006 in Pakistan. Moreover, only those employees were selected for the interviewees who have had enough association with the AKRSP to satisfy the interview questions.

APPENDIX G

Extracts from the AKRSP Board of Directors Minutes of Meeting regarding The Microfinance Programme and The 1st Microfinance Bank

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APPENDIX I

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APPENDIX J

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APPENDIX K

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APPENDIX L (11 Pages)

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APPENDIX M (16 Pages)

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Prudential Regulations for Microfinance Banks/ Institutions

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MICROFINANCE BANK/INSTITUTION

***BI-Weekly Statement Of Affairs as At Close Of Business on ——
(Saturday)**

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MICROFINANCE BANK/INSTITUTION

**Quarterly Report Of Condition
For The Quarter Ended_____**

Please see print copy for Appendix M

MICROFINANCE BANK/INSTITUTION

Profit & Loss Account

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MICROFINANCE BANK / INSTITUTION
RISK-WEIGHTED ASSETS ON-BALANCE SHEET ITEMS

Please see print copy for Annexure A

Penalty Scale for Microfinance Banks / Institutions

Please see print copy for Annexure B

Please see print copy for Appendix N

----- Original Message -----

From: <aak24@uow.edu.au>

To: <atejany@cyber.net.pk>

Sent: Thursday, June 29, 2006 11:16 AM

Subject: PHD Student from Australia

> Dear Sir,

>

> Assalaamo Alaikum,

>

> I am a PhD candidate at the University of Wollongong, Australia. I am on
> scholarship from the Ministry of Education, Government of Pakistan, under
> mandate from the State Bank of Pakistan. This is the last year of my study
> here in Australia. For the purpose of my study, I need to collect data on
> Aga Khan Rural Support Programme (AKRSP) and the FirstMicrofinance Bank;
> In August this year, I intend to come to Pakistan for Field Data
> Collection. I need the data for my thesis.

>

> I understand that you mostly remain busy, but for the purpose of my study,
> I need to interview your goodself. I would be grateful if you could give
> me some time (approximately 60 to 80 minutes) of your valuable time in
> your Islamabad office. (Once I get your consent, I will apprise you as to
> when I am coming to Pakistan, and then accordingly we can fix the
> interview time).

>

> I would really be grateful for your cooperation in this regard.

>

> Yours truly,

>

> ASHFAQ KHAN

> PhD candidate, University of Wollongong, Australia.

Please see print copy for Appendix N

>
> ----- Original Message -----
> From: <aak24@uow.edu.au>
> To: <atejany@cyber.net.pk>
> Sent: Thursday, June 29, 2006 11:16 AM
> Subject: PHD Student from Australia
>
>
>> Dear Sir,
>>
>> Assalaamo Alaikum,
>>
>> I am a PhD candidate at the University of Wollongong, Australia. I am on
>> scholarship from the Ministry of Education, Government of Pakistan, under
>> mandate from the State Bank of Pakistan. This is the last year of my
>> study here in Australia. For the purpose of my study, I need to collect
>> data on Aga Khan Rural Support Programme (AKRSP) and the

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----- Original Message -----

From: "Iftikhar Ahmed" <iftikhar.ahmed@akrsp.org.pk>
To: "'Anwar Ali Khan'" <anwar@glt.comsats.net.pk>
Sent: Monday, July 03, 2006 12:06 PM
Subject: FW: further to my previous email

> Please respond him
> iftikhar

> -----Original Message-----

> From: aak24@uow.edu.au [mailto:aak24@uow.edu.au]
> Sent: Saturday, July 01, 2006 1:30 PM
> To: iftikhar.ahmed@akrsp.org.pk
> Cc: izhar.hunzai@akrsp.org.pk
> Subject: further to my previous email

> Dear Mr. Ahmed,
>
> Assalaamo Alaikum,

>
> In continuance of my previous email, please note that if
> microfinance-related senior level staff members have been shifted to the
> transformed First MicroFinance Bank, then, in reply you can simply mention
> this. I will then find these staff members and interview them in the
> microfinance bank.

>
> In that case, I need only information about the current G.M., Mr. Izhar
> Hunzai. I mean when did he join AKRSP and when did the previous G.M., Mr.

Appendix N

original Message -----

From: <aak24@uow.edu.au>

To: "Shakila" <shakila@rspn.org.pk>

Sent: Saturday, July 08, 2006 12:30 PM

Subject: Re: PhD student from Australia

> Ms Shakila,

>

> Thank you for your earlier response. I have sent email to Mr. Shoaib
> Sultan Khan but still I am waiting for his reply. I would be grateful if
> you could please me his office contact number and office address as well.

>

> Thanks indeed.

>

> ASHFAQ KHAN

>

>

>

[Delete](#) [Prev](#) [Next](#) [Reply/All](#) [Forward/Inline](#) [Open](#) [Inbox](#) 19 of 61

[Go to](#)

[Move](#)

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----- Original Message -----

From: <aak24@uow.edu.au>

To: <chnrsp@isd.wol.net.pk>

Sent: Thursday, July 06, 2006 4:39 AM

Subject: PhD student from Australia.

> Dear Sir,

>

> Assalaamo Alaikum,

>

> I am a PhD candidate at the University of Wollongong, Australia. I am on
> scholarship from the Ministry of Education, Government of Pakistan, under
> mandate from the State Bank of Pakistan.

>

> For the purpose of my study, I need to interview some of the senior
> management members at AKRSP and The First MicroFinance Bank. Sir, I want
> to interview your good self as the member of board of directors of AKRSP
> and as chairman board of directors of RSPN. Since, I am conducting all my
> interviews in Islamabad, I request you to please give me time in your
> Islamabad office. I am coming to Pakistan in the first or second week of
> August for a short visit for that very purpose. I have already arranged
> one interview with Mr. Hussain Tejany, CEO and President, The First
> MicroFinance Bank. I will send you the exact details of my arrival in
> Pakistan once I get your consent about the interview.

>

> The purpose of my interview is to seek information on the AKRSP and its
> subsequent transformation to the First Microfinance Bank. I need to
> collect some printed material too on the issue. I will use the interview
> and printed data in my thesis and subsequent publications in academic
> journals.

>

> This the last year of my study, and I am under obligation from the
> Ministry of Education and the State Bank of Pakistan to finish in time, so
> I request your good self to kindly respond to my email at your earliest
> convenience.

>

> Thanks and regards.

>

> ASHFAQ KHAN

> PhD candidate, University of Wollongong, Australia.

>

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----- Original Message -----

From: <aak24@uow.edu.au>

To: "Uzma Patel" <uzma.patel@mfib.com.pk>

Cc: <atejany@cyber.net.pk>

Sent: Tuesday, July 11, 2006 12:36 PM

Subject: Re: ASHFAQ-interview

> Dear Ms Uzma,

>

> My flight is direct to Islamabad and it is not affordable for me "in
> monetary terms" to arrange a return trip to Karachi. I am not from an
> affluent family.

>

> However, if there is no other choice with me then, "somehow", I will
> arrange to see the honorable president at his Karachi Office.

>

> Thanking you.

>

> Yours truly,

>

> ASHFAQ KHAN

Please see print copy for Appendix N

----- Original Message -----

From: <aak24@uow.edu.au>

To: "Shoaib Sultan Khan" <chnrsp@isd.wol.net.pk>

Sent: Monday, July 10, 2006 11:57 AM

Subject: Re: PhD student from Australia.

> Dear Sir,

>

> My scholarship deadline is February 2007; I have already booked tickets
> for me and my family to Pakistan on the 1st of August; so, if you could
> give me an hour or so of your precious time on the 3rd, 4th, 5th or any
> other day, at any time, I would be really grateful for that.

>

> Sir, as I have explained earlier, I have to interview the few top
> personalities in microfinance field who have been associated with AKRSP
> for long period of time; and, you can understand, only few people qualify
> for this as per the university's requirements. I am sure, the university
> here will not accept my data without interviewing you, among others.

>

> I have taken your contact number and address in Islamabad from RSPN.
> Please, I request you to kindly give me an hour on any of the above days
> at any time.

>

> Looking forward to a positive and encouraging response from your end.

>

> Thanks and regards.

>

> ASHFAQ KHAN

>

>

[Delete](#) [Prev](#) [Next](#) [Reply/All](#) [Forward/Inline](#) [Open](#) [Inbox](#) 23 of 61

[Go to](#)

[Move](#)

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-----Original Message-----

From: aak24@uow.edu.au [mailto:aak24@uow.edu.au]
Sent: Tuesday, August 08, 2006 5:16 PM
To: iftikhar.ahmed@akrsp.org.pk
Cc: izhar.hunzai@akrsp.org.pk
Subject: Ashfaq-data collection

Dear Iftikhar, Assalaamo Alaikum,

I came to your office in Islamabad a couple of times but unfortunately could not find you. I was told that you are on visit to the northern areas.

I need print materials about the AKRSP and its transformation to the First Microfinance bank. I need also to see Mr. Izhar Hunzai for about 15 to 20 minutes. I am on a very short visit to Pakistan specifically for this purpose.

Mr. Altaf, G.M's secretary told me that the internal documents, print material, and data about the above change are available from our library at our main office in Gilgit. And I will be grateful if you, using your position and authority, could arrange the material for me.

Kindly advise me as to when you and Mr. Izhar Hunzai are coming back to your offices, so we can have a short meeting of not more than 20 to 30 minutes.

Waiting for a prompt response from your end.

Thanking you.

Yours truly,

ASHFAQ KHAN
PhD candidate, University of Wollongong.

[Delete](#) [Prev](#) [Next](#) [Reply/All](#) [Forward/Inline](#) [Open](#) [Inbox](#) 37 of 61

[Go to](#) [Move](#) [Copy](#)

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> -----Original Message-----

> From: aak24@uow.edu.au [mailto:aak24@uow.edu.au]

> Sent: Tuesday, August 08, 2006 5:16 PM

> To: iftikhar.ahmed@akrsp.org.pk

> Cc: izhar.hunzai@akrsp.org.pk

> Subject: Ashfaq-data collection

>

> Dear Iftikhar, Assalaamo Alaikum,

>

> I came to your office in Islamabad a couple of times but unfortunately
> could

> not find you. I was told that you are on visit to the northern areas.

>

> I need print materials about the AKRSP and its transformation to the First
> Microfinance bank. I need also to see Mr. Izhar Hunzai for about 15 to 20

> minutes. I am on a very short visit to Pakistan specifically for this
> purpose.
>
> Mr. Altaf, G.M's secretary told me that the internal documents, print
> material, and data about the above change are available from our library at
> our main office in Gilgit. And I will be grateful if you, using your
> position and authority, could arrange the material for me.
>
> Kindly advise me as to when you and Mr. Izhar Hunzai are coming back to
> your
> offices, so we can have a short meeting of not more than 20 to 30 minutes.
>
> Waiting for a prompt response from your end.
>
> Thanking you.
>
> Yours truly,
>
> ASHFAQ KHAN
> PhD candidate, University of Wollongong.
>

[Delete](#) [Prev](#) [Next](#) [Reply/All](#) [Forward/Inline](#) [Open](#) [Inbox](#) 39 of 61

[Go to](#) [Move](#) [Copy](#) [

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> -----Original Message-----
> From: aak24@uow.edu.au [mailto:aak24@uow.edu.au]
> Sent: Tuesday, August 08, 2006 5:16 PM
> To: iftikhar.ahmed@akrsp.org.pk
> Cc: izhar.hunzai@akrsp.org.pk
> Subject: Ashfaq-data collection
>
> Dear Iftikhar, Assalaamo Alaikum,
>
> I came to your office in Islamabad a couple of times but unfortunately
> could
> not find you. I was told that you are on visit to the northern areas.
>
> I need print materials about the AKRSP and its transformation to the First
> Microfinance bank. I need also to see Mr. Izhar Hunzai for about 15 to 20
> minutes. I am on a very short visit to Pakistan specifically for this
> purpose.
>
> Mr. Altaf, G.M's secretary told me that the internal documents, print
> material, and data about the above change are available from our library at
> our main office in Gilgit. And I will be grateful if you, using your
> position and authority, could arrange the material for me.
>
> Kindly advise me as to when you and Mr. Izhar Hunzai are coming back to
> your
> offices, so we can have a short meeting of not more than 20 to 30 minutes.
>
> Waiting for a prompt response from your end.
>
> Thanking you.
>
> Yours truly,

[Delete](#) [Prev](#) [Next](#) [Reply/All](#) [Forward/Inline](#) [Open](#) [Inbox](#) 44 of 61

[Go to](#)[Move](#)[Copy](#)

Date: Thu 24 Aug 17:43:07 EST 2006

From: "Iftikhar Ahmed" <iftikhar.ahmed@akrsp.org.pk> [Add To Address Book](#) | [This is Spam](#)

Subject: RE: FW: Ashfaq-data collection

To: <aak24@uow.edu.au>

Ya sure

-----Original Message-----

From: aak24@uow.edu.au [mailto:aak24@uow.edu.au]

Sent: Thursday, August 24, 2006 5:38 AM

To: Iftikhar Ahmed

Subject: Re: FW: Ashfaq-data collection

Dear Iftikhar Ahmad,

Thanks for the attached file, and I will be waiting for your next email (especially if you could get that vision paper prepared for the transformation of AKRSP).

Thanking you.

Yours truly,

ASHFAQ KHAN

[Delete](#) [Prev](#) [Next](#) [Reply/All](#) [Forward/Inline](#) [Open](#) [Inbox](#) 44 of 61

[Go to](#)[Move](#)[Copy](#)

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-----Original Message-----

From: aak24@uow.edu.au [mailto:aak24@uow.edu.au]
Sent: Thursday, September 21, 2006 6:22 AM
To: Iftikhar Ahmed
Subject: Re: FW: Ashfaq-data collection

Dear Iftikhar,

A A

I hope things are going good there at your end. I had sent you my mailing address in my last email. Did you send something to me?

Dear Iftikhar, I really need those things that I mentioned to you, like the annual reports of the AKRSP (98, 99, 2000, 2001, and 2002) AND especially the "VISION PAPER" that was prepared for the transformation of the AKRSP.

Iftikhar, please cooperate with me in this regard as these are the last things I need. I am coming back soon to Pakistan and I will personally come to your office to thank you for your cooperation and we will be friends for ever.

Please don't turn down my request; I need these things desperately and I can't come to Pakistan again for these things, you can understand my situation. My address is:

ASHFAQ A. KHAN
PHD CANDIDATE, FACULTY OF COMMERCE,
SCHOOL OF ACCOUNTING AND FINANCE, BUILDING 40,
UNIVERSITY OF WOLLONGONG,
NORTHFIELDS, NSW 2522,
AUSTRALIA. +61 2 4221 3218

Looking forward to a really good response from your end.

Thanks.

Yours truly,

ASHFAQ KHAN

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[Go to](#) [Move](#) [Copy](#)

[Delete](#) [Prev](#) [Next](#) [Reply/All](#) [Forward/Inline](#) [Open](#) [Inbox](#) 54 of 61[Go to](#)[Move](#)[Copy](#)

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-----Original Message-----

From: aak24@uow.edu.au [mailto:aak24@uow.edu.au]

Sent: Thursday, October 12, 2006 5:51 AM

To: Syed Altaf Hussain Shah

Cc: iftikhar.ahmed@akrsp.org.pk

Subject: Re: FW: Ashfaq-data collection

Dear Altaf,

If I had someone there, I would have first of all sent them to pursue my request for these things; but did you notice I had been sending emails to follow-up.

The most I can do is to reimburse you for the despatch of the items when I will come back and that's a gentleman promise.

Please consult Mr. Iftikhar Ahmed and arrange to despatch them to me at the earliest.

Thanks and regards.

ASHFAQ A. KHAN

UNIVERSITY OF WOLLONGONG, AUSTRALIA.

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[Go to](#)[Move](#)[Copy](#)

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[Go to](#)

[Move](#)

[Copy](#)

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-----Original Message-----

From: aak24@uow.edu.au [mailto:aak24@uow.edu.au]

Sent: Thursday, November 09, 2006 6:11 AM

To: iftikhar.ahmed@akrsp.org.pk

Cc: altaf.hussain@akrsp.org.pk

Subject: Receipt of Documents

Dear Iftikhar and colleagues,

Assalaamo Alaikum,

I have received the documents sent to me by your good self. I appreciate the cooperation that you and your staff have extended to me.

Thank you again.

Yours truly,

ASHFAQ KHAN

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[Go to](#)

[Move](#)

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