Key Recommendations for Education Financing in Pakistan

Financing low-cost private schools presents a substantial, untapped opportunity for Pakistan's private banking sector, offering both economic returns and strategic value. Investment in high-potential sectors like education not only drives socio-economic impact but also enables banks to diversify portfolios, enhancing returns while reducing overall risk. With private institutions comprising 43.7% of the total 313,418 schools in Pakistan and educating 46.5% of the student population, the sector's expansion is evident. Private primary schools enroll 44% of primary students, despite making up only a minority of total schools, underscoring their role in meeting the demand for affordable, quality education. This sector is expanding rapidly in urban areas and is notably bolstered by female educators, who represent a substantial portion of the workforce — particularly at the primary (46%) and middle school (72%) levels. (PES Report 2021-22)

By extending credit to the education sector, banks can address Pakistan's over-reliance on government debt financing, which currently limits private sector credit availability, a phenomenon known as crowding out (Hyder & Qayyum, 2002). Expanding financing into education supports the development of a better-prepared, knowledge-enabled workforce, ultimately contributing to sustainable economic growth and a more robust, resilient economy while also diversifying the private banks' portfolio and enhancing financial and social returns.

Regulatory support from the **State Bank of Pakistan (SBP)** further enhances the attractiveness of SME lending in sectors like education. Key initiatives include the **Risk Coverage Scheme**, which provides first-loss protection by absorbing 30-50% of the principal on SME loans in case of default, thus reducing the financial risks for banks. Additionally, the SBP has increased the **clean lending limit to Rs. 10 million**, allowing banks to extend loans without the need for traditional collateral. Further flexibility is provided by revised **exposure limits**, enabling banks to lend larger amounts to SMEs while mitigating risk.

By leveraging these regulatory de-risking tools, private banks can confidently step into high-demand sectors like education, tapping into a growing and profitable market while supporting Pakistan's broader development goals. This note presents research conducted by the Centre for Economic Research Pakistan **(CERP)** and partners on private lending in the education sector, particularly for low-cost schools. The study offers key insights, outcomes, and lessons for the banking sector, focusing on how private banks can leverage opportunities in this high-growth area while managing risks. These findings aim to guide banks in developing effective lending strategies for the education sector.

CASE STUDY: GRANTS TO PRIVATE SCHOOLS

Private schools in Pakistan face significant challenges in accessing capital for essential investments, which limits their ability to improve infrastructure, teacher salaries, and the quality of education. To test this hypothesis, the study offered **unconditional cash grants to private schools**, exploring how financial interventions could enhance educational outcomes and sustainability. This research experiment is part of a broader effort to improve educational quality in low-cost private schools, based on years of systemic research by LEAPS.

DESIGN AND METHODOLOGY

The study implemented a **Randomized Controlled Trial (RCT)** across **266 villages**, testing two intervention levels:

- **Low saturation:** Only one private school in a village received the grant.
- **High saturation:** All private schools in a village received the grant.

The study provided an unconditional cash grant of **$500** per school to assess how schools would allocate the funds to improve their performance.

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This initiative covered **855** schools, with data collected over **7** survey rounds across **2 years and 4 months**, focusing on key metrics such as enrollment, revenues, and quality improvements.

To evaluate the impact under different conditions, two intervention levels were tested across **266** villages: in the low-saturation group, only one private school per village received the grant, whereas in the high-saturation group, all private schools in a village received the grant.

A rigorous **Randomized Controlled Trial (RCT)** method ensured the reliability of the findings, providing clear insights into the effects of targeted financial support on school outcomes.

FINDINGS AND IMPACT

- **IRR (Internal Rate of Return):** The study found that the IRR was high in low saturation contexts, ranging from **61-83%**, while in high saturation contexts, it ranged between **12-32%**. The pay-back period for low saturation grants was around **1.5 years**, compared to **4 years** for high saturation.
- **Low Saturation:** In villages where only one school received the grant, there was a noticeable increase in **enrollment and revenue**, though no significant changes in **fees** or **educational quality**. The grant money was largely spent on **infrastructure improvements.**
- **High Saturation:** In villages where all private schools received the grants, schools focused more on enhancing **teacher salaries** and additional **infrastructure** investments. This led to a moderate increase in **school quality** and **fees**, along with a modest increase in **enrollment**.
- **Social Return:** The intervention yielded substantial social benefits, particularly in high saturation areas, where students achieved better learning outcomes, and teachers received higher pay. The study noted that the intervention was **cost-effective**, with better learning outcomes per dollar invested than many other global educational initiatives.
- **Cost-effectiveness:** The grants led to a significant improvement in educational outcomes, with a **117%** increase in performance per school for a **$500** investment. This translates to about a **23%** improvement in outcomes for every **$100** invested, making this one of the most cost-effective educational interventions compared to similar programs worldwide.

KEY INSIGHTS FOR THE BANKING SECTOR BASED ON THE CASE STUDY

This case study demonstrates that diversifying financing, especially to low-cost private schools and farmers, is both a commercially viable and economically sound opportunity for banks. Here are some key recommendations for the banking sector:

- Financing SMEs in education offers a clear path to **commercial viability**, backed by strong loan repayment rates and minimal default risks. Sectors such as affordable **Education** represent a rapidly **growing market** in Pakistan, creating **substantial demand for loans and capital.** Banks that enter these spaces early can establish credibility and become the preferred choice for borrowers seeking financing. By positioning themselves as key players in these expanding sectors, banks can secure a **competitive edge** in high-demand, high-growth markets.
- Given the **higher default rates** (8% compared to the usual 2%), banks should leverage the **first-loss protection schemes** offered by the **State Bank of Pakistan (SBP).** These schemes can absorb initial losses, reducing the risk for banks and making the sector more appealing for investment. Incorporating these tools will improve the **Risk-Adjusted ROI** for banks, aligning financial returns with risk management.
- Based on the study's outcomes, banks should develop **customized financial products** that cater to the specific needs of the education sector. These products could include **long-term loans for infrastructure, working capital financing**, and even **performance-based financing**, where better educational outcomes could lead to favorable lending terms.

Key Recommendations for Agricultural Lending in Pakistan

Agriculture remains the backbone of Pakistan's economy, contributing around 23-24% of the GDP and employing nearly 37-38% of the labor force. ((Pakistan Economic Survey, 2024; World Bank, 2024; FAO, 2024) The sector is crucial for food security and exports, particularly in crops like wheat, rice, cotton, and sugarcane.

However, access to finance has been a persistent challenge for farmers, especially smallholders who form the majority of Pakistan's agricultural workforce. Private banks play a vital role in addressing this financing gap by offering agricultural loans and credit products tailored to the needs of farmers.

As of 2024, agricultural lending by private banks in Pakistan has seen notable growth, driven by increasing demand for crop financing, mechanization, and technology adoption. Key trends include:

- **Increased Lending:** Private banks have stepped up lending efforts, supported by favorable government policies and incentives such as the **State Bank of Pakistan's (SBP) Agricultural Credit Scheme.** Additionally, the SBP's Credit Guarantee Scheme and the government's **Kissan Package** aim to incentivize private banks to lend to small and medium-sized farmers.
- **Digitization of Services:** Many private banks are leveraging digital platforms to streamline loan applications and disbursements. Mobile banking apps and digital wallets are being used to reach rural farmers, reducing transaction costs and improving access to finance in underserved areas.
- **Customized Products:** Banks have introduced innovative loan products such as **crop-specific loans, weather-indexed insurance-linked loans, and value-chain financing** to meet the diverse needs of farmers. Flexible repayment schedules based on crop cycles are also becoming more common.
- **Focus on Sustainability:** A growing emphasis on sustainable farming practices and green finance is shaping agricultural lending. Banks are offering loans for water conservation technologies, renewable energy for irrigation, and organic farming, aligning with Pakistan's climate change mitigation strategy

Despite these positive trends, several challenges persist:

- **Credit Access for Smallholders:** While larger agribusinesses have benefited from increased lending, smallholder farmers—who often lack collateral—continue to face barriers in accessing formal credit. High-interest rates and stringent collateral requirements deter many from seeking bank loans.
- **Climate Risk:** Agriculture in Pakistan is vulnerable to climate change, with increasing instances of drought, floods, and heat stress affecting crop yields. Banks face heightened risks of loan defaults in regions heavily impacted by environmental factors, making risk assessment and management critical.
- **Financial Literacy:** A significant portion of Pakistan's rural population remains financially illiterate, limiting their ability to effectively access and manage bank loans. This has led to underutilization of available credit products.

This note presents **baseline-endline research** carried by HBL in collaboration with CERP to provide an insight into the challenges and opportunities in the agricultural lending space.

CASE STUDY: HABIB BANK LIMITED (HBL) LENDING IN AGRICULTURE PROJECT

The HBL-CERP Agricultural Financing Project, launched in 2020, was an innovative initiative aimed at improving agricultural productivity for smallholder farmers in Pakistan. In partnership with researchers from Princeton University, Yale University, and the CERP, HBL developed a **comprehensive development financing model to support farmers.**

Aligned with HBL's development finance and social impact goals, the project aimed to support underserved agricultural sectors that typically lacked access to private lending. Beyond conventional loans, the project introduced a **unique financing mechanism,** where support extended beyond cash-based loans to encompass **credit** for tractor rentals, feed, materials procurement, and advisory services.

In its first year, the project provided only non-cash-based loans, prioritizing in-kind support through equipment and inputs. A small component of cash loans was later introduced, offering farmers greater flexibility. By providing unsecured loans, high-quality inputs (such as seeds, fertilizers, and pesticides), and agronomic advice, along with connections to bulk buyers like JSK Feeds Ltd., the project successfully enhanced farm productivity and profitability.

This integrated approach was tested with:

- **78** maize farmers, covering a total of **3200** acres of farmland in **Okara** during the maize growing season, expanding the original pilot. Out of these 78, **20 farmers covering 434 acres,** were given unsecured loans.
- **95** maize farmers, covering a total of **4,840** acres of farmland in **Sahiwal** during the maize growing season, expanding the original pilot.
- **104** wheat farmers, cultivating **5,800** acres of farmland in the Gujranwala region of Punjab,
- **142** rice farmers in the regions of Okara and Gujranwala.

Farmers participating in HBL's agricultural support programs across multiple crop cycles experienced **significant improvements in yields, revenues, and profitability.**

- **Maize Sector:**
  - In 2021, HBL-supported maize farmers saw a **22% increase in yield**, reaching an average of **106 maunds per acre**, significantly higher than the regional average.
  - In 2022, HBL expanded the program to **95 farmers covering 4,840 acres** in the Sahiwal region, achieving a **5% yield increase** with an average yield of **84.1 maunds per acre**.
- **Wheat Sector:**
  - In Gujranwala, HBL-contracted wheat farmers reported **15% higher profits** and a **14% increase in yield** over regional benchmarks.
  - The average yield for HBL-contracted wheat farmers reached **34.4 maunds per acre**, driven by access to quality inputs and expert agronomic guidance
- **Rice Sector:**
  - HBL-contracted rice farmers in Okara and Gujranwala achieved impressive yield gains, with a **77% increase in Basmati yields** (42.2 maunds per acre) and a **118% increase in non-Basmati yields** (84.4 maunds per acre).
  - Revenue gains were equally substantial, with **63% higher revenue** for Basmati and **116% higher revenue** for non-Basmati varieties.
- **Cost Reduction and Farmer Profitability**
  - Across these projects, HBL's bulk purchasing strategy consistently reduced input costs, with average savings ranging from **7% to 22%**.
  - This cost efficiency, combined with higher yields and better market access, enabled HBL-contracted farmers to significantly enhance their profitability and overall income.

Apart from the impact on the farmer, as mentioned above, the research also had **significant institutional benefits.** This initiative laid the groundwork for HBL's establishment of a subsidiary, **HBL Zarai Services,** to continue providing dedicated agricultural support. The project strengthened HBL's **outreach and relationships with rural farmers**, with crop advisors doubling as loan sales representatives to streamline service delivery. HBL benefited further through **commissions on crop sales, rental income from lending tractors, and invaluable research insights** that underpinned the formation of HBL Zarai Services, positioning HBL as a **comprehensive support provider** in the agricultural sector.

The research also offers valuable insights for the other banks looking into getting in the space of agricultural lending, such as:

- Providing financial loans alongside discounted inputs, agronomic advice, and market linkages can significantly enhance farmers' productivity and profitability. Banks can increase loan effectiveness by **bundling these non-financial services** with financing, which reduces risks and strengthens farmers' repayment capacity.
- By connecting farmers to bulk buyers like banks can ensure higher prices and more reliable revenue streams. This direct link to markets could help farmers secure better returns and lower the risk of loan defaults. The buyers of the yield from this project were primarily HBL clients, such as JSK Seeds, resulting in a direct, 100% impact.
- Banks can also assist farmers in lowering input costs through **bulk purchasing of agricultural inputs.** This approach not only boosts farmers' profitability but also alleviates financial pressures, reduces side-selling, and strengthens farmers' ability to repay loans.
- Real-time crop health monitoring through satellite data enabled HBL to detect issues early, thereby **preventing crop losses and maintaining productivity.** This technology minimized non-compliance risks, such as side-selling, by providing constant oversight. Banks adopting similar technologies can reduce default risks and improve loan management.
- Banks should consider offering insurance products or risk-sharing mechanisms to protect against weather-related challenges, such as heatwaves and excessive rain, which can negatively affect **crop yields and loan repayment capacity.**
- Initial agricultural lending can thus open **long-term client relationships and cross-selling opportunities** for banks, enabling them to offer a broader suite of financial products like savings accounts and insurance.

Market Opportunity for Small Retailer Finance

Kiryana stores, or micro-retailers, are essential to Pakistan's local communities, acting as a bridge between consumers and major FMCG companies. At around **three** million across the country, these stores significantly contribute to employment generation and economic activity. According to the Pakistan Bureau of Statistics (PBS), the wholesale and retail trade sector has consistently contributed approximately **17.5%** to Pakistan's Gross Domestic Product (GDP) over the past decade.

The micro-retailers face several challenges in accessing formal finance such as:

- **Lack of Collateral:** Most micro-retailers lack tangible assets or a credit history that can be used as collateral, which makes it difficult to access loans from formal financial institutions.
- **Informal Nature of Business:** Many micro-retailers operate informally, without proper financial records or documentation, making it hard for lenders to assess their creditworthiness.
- **High Perceived Risk:** The fluctuating daily cash flows and unpredictable nature of micro-retail businesses lead to a high perceived risk for lenders, limiting access to credit.
- **High Interest Rates and Stringent Terms:** When micro-retailers do secure loans, they often face high interest rates and tough repayment terms, which can be prohibitive.
- **Limited Financial Literacy:** Many micro-retailers are unaware of available financial products and lack the financial literacy needed to navigate complex loan applications and processes.

To combat these challenges, regulatory support in Pakistan for lending to micro-retailers, such as *Kiryana* stores, is growing. The State Bank of Pakistan (SBP) has introduced several initiatives aimed at de-risking SME lending. For example, the **Credit Guarantee Scheme for Small and Rural Enterprises** provides partial guarantees to banks, encouraging them to extend credit to small businesses that typically lack collateral. Additionally, the **SME Asaan Finance (SAAF) Scheme** simplifies the lending process by reducing documentation and offering uncollateralized loans, further enabling micro-retailers to access finance. Government-backed schemes like Prime Minister's **Kamyab Jawan Youth Entrepreneurship Scheme** also offer subsidized loans to SMEs, including micro-retailers, at favorable interest rates. These programs, coupled with tax incentives for digital payment adoption, demonstrate a clear regulatory push towards increasing formal lending to micro-retailers, thus providing a robust framework for banks to capitalize on this undertapped market.

To better understand the dynamics of financial inclusion for micro-retailers, CERP examined the potential for private banks to expand lending opportunities to *kiryana stores* across Pakistan. By analyzing market dynamics, regulatory support, and the unique challenges faced by these stores, the study sheds light on the economic value and feasibility of bringing *kiryana stores* into the formal lending landscape. Through a combination of data-driven insights and strategic recommendations, the research provides a roadmap for private banks to explore lending opportunities within this segment, driving both economic growth and enhanced financial accessibility.

DEEP DIVE BY CERP: EXPLORING EXPANDING LENDING OPPORTUNITIES FOR *KIRYANA* STORES

Our research into Pakistan's retail SME market reveals that lending to *kiryana* stores could drive significant economic growth, benefiting both private banks and the wider economy. Our analysis suggests that strategic lending to this segment could generate an estimated PKR 6.07 billion in revenue over five years, offering a promising opportunity for financial institutions.

STRATEGY FOR EFFECTIVE LENDING

To effectively bring *kiryana* stores into the formal lending landscape, a phased approach can help address challenges related to informality and limited digital literacy:

- **In-depth Market Segmentation:** By identifying specific subsegments within the retail SME market, private banks can adopt targeted lending strategies that cater to the distinct financial behaviors and needs of *kiryana* store owners.
- **Customized Credit Scoring Models:** Developing credit scoring frameworks tailored to the informal financial patterns of *kiryana* stores enables a gradual expansion of lending. Starting with lower-risk borrowers, banks can incrementally include more diverse profiles as repayment data is gathered and assessed.
- **Data-driven Persona Development:** Detailed personas, created from extensive surveys and ethnographic research, can help banks understand *kiryana* store owners' digital literacy, financial habits, and product preferences, ensuring that lending solutions align well with this market.

PROPOSED SOLUTIONS

1. **Financial Literacy and Digital Adoption Programs:** Initiatives that build digital financial literacy among *kiryana* store owners will encourage greater adoption of digital banking services, making these micro-retailers more accessible and manageable for banks.
2. **Shariah-Compliant Financial Products:** Recognizing a strong preference among *kiryana* store owners for Shariah-compliant financial products can make financing options more attractive and inclusive, fostering trust in the formal banking sector.
3. **Flexible Loan Options and Digital Tools:** Offering flexible loan structures with tailored repayment terms can accommodate the unique cash flow cycles of *kiryana* stores. Additionally, introducing tools like digital ledgers can assist owners in cash flow management, supporting creditworthiness and reducing financial barriers.

RECOMMENDATIONS

- **Competitive Analysis and Partnerships:** Conducting a competitor scan allows banks to understand existing SME banking products, while partnerships with telecom providers can enhance digital lending through data-driven credit assessments and enable seamless digital adoption.
- **Customer Acquisition and Retention Plan:** A structured five-year roadmap for customer acquisition and retention, incorporating an omnichannel strategy (digital and offline), can establish and grow private banks' presence among *kiryana* stores.
- **Continuous Monitoring and Optimization:** Implementing a KPI-based monitoring framework enables real-time tracking of customer engagement and loan performance. This approach helps banks refine strategies and optimize their offerings to better serve *kiryana* stores.

By addressing the unique needs of *kiryana* stores with flexible, data-informed, and Shariah-compliant financial products, private banks can expand their reach within the retail SME market, promoting financial inclusion and supporting economic growth across Pakistan.

Private banks in Pakistan can leverage these innovative solutions and enabling environment to tap into growing segments of retail SMEs. There are several opportunities for the banks to step into this space such as:

- **Untapped Market Size:** With nearly a million *Kiryana* stores operating across Pakistan, there is a vast, underbanked segment. Most of these businesses lack formal banking relationships, offering private banks a large market for expansion in lending services.
- **Digital Lending:** With the growing digitization of micro-retailers, there is an opportunity to use transaction data to assess creditworthiness. Banks can leverage digital platforms and fintech collaborations to offer customized lending products based on real-time business performance, minimizing the need for traditional credit history.

- **Micro and SME Growth Potential:** Micro-retailers often have high growth potential, especially as they expand their product range or adopt more efficient business practices. Banks can provide working capital or asset financing to help these businesses grow, fostering long-term banking relationships.
- **Low Competition:** The micro-retailer segment has historically been underserved by formal banks, creating an opportunity for private banks to step in with tailored financial products, such as unsecured loans, inventory financing, and supply chain credit.
- **Cross-Selling Opportunities:** By offering lending solutions, banks can also introduce other financial products like business insurance, digital payment systems, and savings products to micro-retailers, increasing their overall portfolio and customer loyalty.
- **Government Support and Incentives:** Government programs that support SME financing, including credit guarantee schemes and policy incentives, reduce the risk for banks lending to micro-retailers and make this an attractive opportunity for expanding financial inclusion.

By exploring these avenues, private banks can unlock substantial growth potential within Pakistan's micro-retail sector. Tailoring financial solutions to address the unique needs of small retailers — overcoming barriers like limited collateral, informal operations, and digital literacy gaps — can facilitate meaningful financial inclusion. With regulatory incentives, innovative credit scoring models, and partnerships in digital finance, banks are well-equipped to support the expansion of these retailers. This strategic approach strengthens economic resilience at the community level, builds lasting relationships with a high-potential market segment, and contributes to a more inclusive financial landscape in Pakistan.