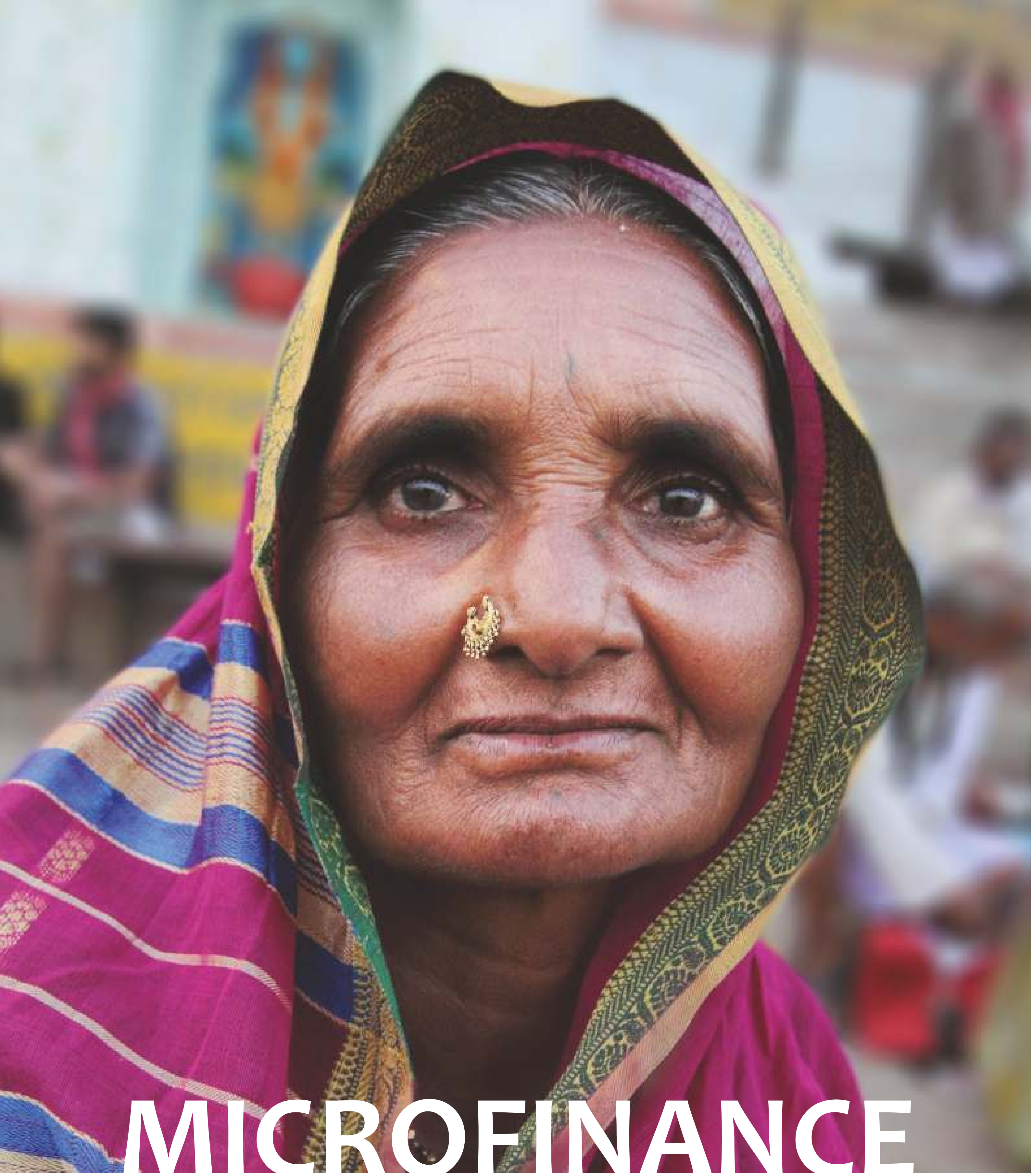


MICROFINANCE

"A POVERTY LENS ON FINANCIAL INCLUSION"

Based on A Representative State-wide Study of Microfinance in Karnataka

GRAMEEN FOUNDATION INDIA

EDA

CONTRIBUTIONS AND ACKNOWLEDGEMENTS

We acknowledge that the microfinance practitioners in Karnataka have had the foresight to look at poverty measurement as an important factor. More importantly, their willingness to work together has been more than commendable. To the credit of all the stakeholders we worked with, and in particular, the participating MFIs, we are indeed grateful for engaging in very forthright discussions with us throughout the year long effort behind the study.

Names of Participating MFIs

1. Chaitanya
2. Grameen Koota
3. IDF
4. Navachetna
5. Nirantara
6. Sanghmitra
7. SKS Microfinance
8. SKDRDP
9. Ujjivan

Members of Advisory Committee

1. Mr. Suresh Krishna (Grameen Koota & AKMI)
2. Mr. VivekanandSalimath (IDF Financial Services Pvt. Ltd. & AKMI)
3. Mr. Brij Mohan (Access Development Services & M-CRIL)
4. Ms. Achla Savyasachi (Sa-Dhan)
5. Mr. Nikhil Chandra (Micro Finance Institutions Network, MFIN)
6. Mr. Rahil Rangwala (Michael and Susan Dell Foundation, MSDF)
7. Ms. Radhika Agashe (ACCESS-ASSIST)

We would also like to acknowledge and thank Kushagra Merchant for his contribution towards the development of this report.

EXECUTIVE SUMMARY

This report demonstrates that it is possible (and necessary) for the microfinance sector to measure and understand itself through a strongly pro-poor lens and make decisions based on this. But why make this a central point of a report when there seem to be even more urgent issues at stake today in the sector?

PUTTING THE REPORT IN ITS CONTEXT

It is because microfinance was started with a mission and an ideal of serving the poor. No doubt, any ideal has to be constantly balanced against the possible and the practical over time. But in microfinance this balancing act has led the sector to the question **"What do the poor really mean in the context of microfinance and financial inclusion?"** In essence this question is a mirror to the sector.

No stakeholder within the sector doubts the importance of serving the poor. But when we ask ourselves **if decisions in microfinance are consistently approached in terms of serving the poor** the answer, at best, is uncertain. This report outlines an empirical and data-driven method to do so.

And in the process of answering this question **the report** *touches* **upon a few of the important debates of the day**. The practitioner and the regulator at whom the report is primarily directed will find it of interest that the data from the study can also inform discussions on margin caps, RBI income ceiling as well as the need for stronger poverty targeting by the practitioners.

But the report is not about "pushing" or "advocating" specific recommendations. It is part of a series of efforts to open a dialogue with the regulator and the practitioner and other stakeholders about a way to understand microfinance portfolios and the end clients in a different light. More importantly, how this understanding can **qualitatively as well as quantitatively help to define the contribution of microfinance to financial inclusion**.

CHOICE OF KARNATAKA

The report is based on the results of poverty measurement of **5,800 microfinance clients across 9 MFIs[1] in the state of Karnataka conducted from October to November 2012, using the Progress out of Poverty Index[2] (PPI)**. It is, in effect, a first-of-its kind attempt at poverty profiling of portfolios of MFIs at a state level in India.

Karnataka was chosen because it has a large and diverse microfinance presence as well as a strong and active association, AKMI, that was keen to undertake this exercise on behalf of its members. In particular, AKMI's position as the nodal body of microfinance institutions in Karnataka guaranteed access to a **statistically representative sample of microfinance clients at a state level**. The 9 MFIs that participated in the study have a combined share of 64% of the microfinance market

1. The participating MFIs follow either the JLG or the SHG group model.
2. Please refer to Annexure 7 for further information on PPI.

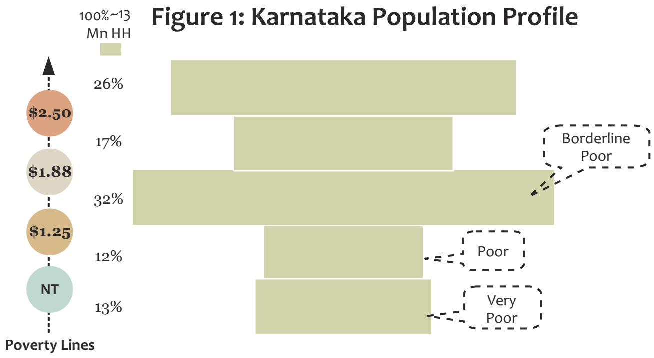
in Karnataka and include institutions following the SHG Model. Because of the statistical significance of this sample, the report can interest and engage stakeholders outside Karnataka.

The findings from the study are proportionately extended to the total client base of the participating MFIs (*and not to all the MFIs in Karnataka*). The findings presented here are indicative of the performance of all the nine participating MFIs *as a group* and not of any one of the participating MFI. However, separate reports highlighting organisational data and comparisons have been prepared and shared with each of the participating MFIs.

WHAT DO WE MEAN BY A POVERTY LENS ON FINANCIAL INCLUSION?

At the very outset, before the report can link microfinance with financial inclusion, it has to confront the question: Is microfinance for the poor or financially excluded? This is a point of constant debate within the sector. The report asserts that poverty is closely linked to financial exclusion and that the **current distinction between financially excluded and the poor is a largely artificial one**. Several studies show that the poorer you are the more likely are you to be financially excluded. Thus if microfinance can improve its outreach to the poor then it is directly contributing to financial inclusion. How does the report define the term poor in the context of microfinance?

Figure 1: Karnataka Population Profile



In a way, there are as many definitions of poor as there are stakeholders in microfinance. As the report emphasizes this often confuses and discourages the use of poverty measurement as a practice. **This report adopts a "kaleidoscopic" segmentation of the microfinance portfolios. It uses the Progress out of Poverty Index (PPI) to measure microfinance outreach to different economic levels of households**. The population and the portfolio are divided into five economic segments by means of the international 'poverty' lines ($1.25, $2.5, and $1.88 in between) as well as the National Tendulkar line to bring in the national perspective as figure 1 shows.

For the purpose of this report, we define those households below $1.25 as poor and those below the National Tendulkar line as very poor. But there is also a large fraction of the households that fall between $1.25 and $1.88. This segment can be deemed as borderline poor. Thus, while the report focuses on the households below

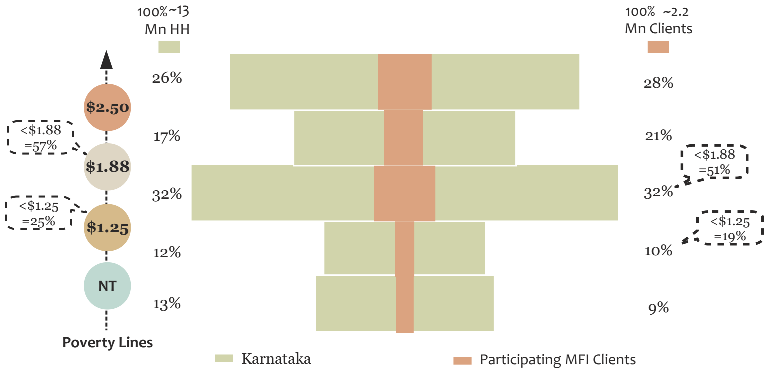
$1.25 it would be important to keep the entire picture in mind at all times. Accordingly, in all our illustrations we display data across all economic segments.

This should also benefit all readers to some extent. **Different stakeholders will also want to interpret the data within their own definitions and analytical frameworks**. This type of kaleidoscopic segmentation is also in line with our objective that the aim of this report is to create a dialogue, to deepen understanding of the microfinance target market, and not impose a specific line of defining the poor.

THE POOR AND MICROFINANCE IN KARNATAKA

As far as Karnataka is concerned, as figure 2 (below) shows, the portfolio of the participating MFIs in our study is reflective of the make-up of the underlying population. That is, 25% of the households in Karnataka were poor and very poor and they formed 19% of the portfolio of the MFIs. Significantly, the poor and the borderline poor combined, constituted 57% of the Karnataka population and over half of the portfolio of the MFIs participating in the study.

Figure 2: Client Outreach Profile of Participating MFIs in Karnataka



In our opinion these results are a reasonable accomplishment which compares well to available information for microfinance outreach in other states. More importantly the results do signify that MFIs are already playing a measurable role in reaching the poor to enable their financial inclusion. The question is one of how to make this linkage between microfinance and the poor *as strong as is feasible*.

We add a cautionary *"as strong as is feasible"* because information on microfinance portfolios like above can easily lead to over-interpretations and far-reaching conclusions. To avoid this we strongly encourage stakeholders to bear in mind that **what is observed with regard to poverty segmentation of microfinance portfolios can be attributed to several factors** including conscious choices made by MFIs, specific geography of operation, regulatory environment, characteristics of the client base and the MFI model itself among others.

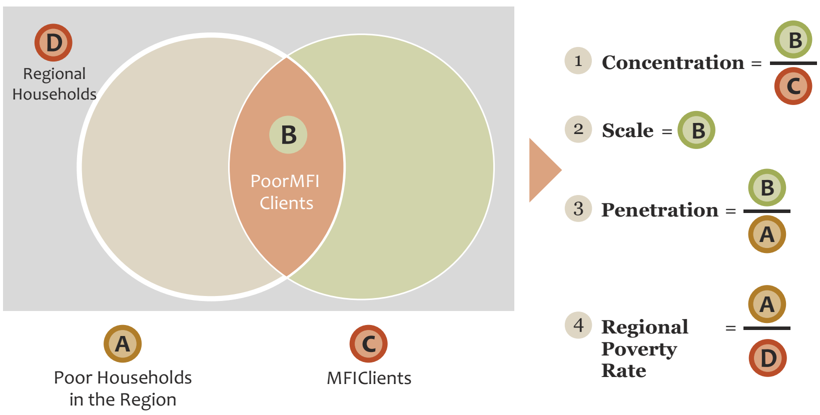
This study is not in a position to assess all of these factors and how they affect MFI portfolios. However, it is in a position to see **how microfinance portfolios may vary as the context of operation changes**.

PUTTING THE MFIS IN THEIR OPERATING CONTEXT

The sample design in the study enabled a mapping of microfinance portfolios in Karnataka in several geographic contexts: at the level of Karnataka itself; North Karnataka; South Karnataka; rural and urban parts within North and South Karnataka; and finally, the four districts of Karnataka—Bangalore and Mysore in the South; and Gulbarga (Hyderabad Karnataka) and Belgaum (Mumbai Karnataka) in the North.

And in each of these operating contexts we looked at microfinance portfolios from **four poverty related aspects** of scale, concentration, penetration and poverty incidence. These measures, defined in Figure 3, were first developed by Grameen Foundation as part of a study carried out in Philippines in 2010-11. This **gives us a simple language** to compare microfinance portfolios against their operating context and with each other. We strongly believe that a language like this is a useful permanent addition to industry vocabulary, and can help to define performance in a parallel manner to financial ratios (such as OER and PAR).

Figure 3: Four Aspects of Poverty Outreach



The report further compares the participating organizations' concentration with the poverty rates in different regions of the state for different poverty lines. Such analysis offers insight into the effectiveness of organizations in reaching out to the poor. Poverty rates at the state level therefore become an important parameter for analysis and comparison in this report.

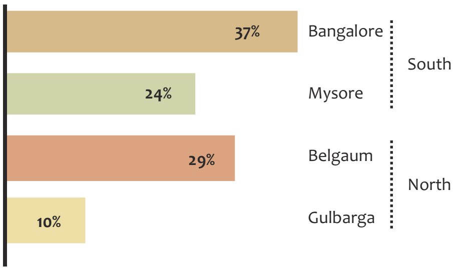
The conclusions around the 4 aspects of poverty measured in this report have been drawn from the NSSO data for 2009-10. The following table shows the total MFI data for the state of Karnataka and the Sample drawn from each area—rural and urban—for the purposes of the study.

Table 1: Sampling of the Client-Base of Participating MFIs

	TotalMFI Clients	MFI Sample Clients
All Karnataka	***22,89,100***	**5,843**
Rural	17,13,750	3,413
Urban	5,75,350	2,430

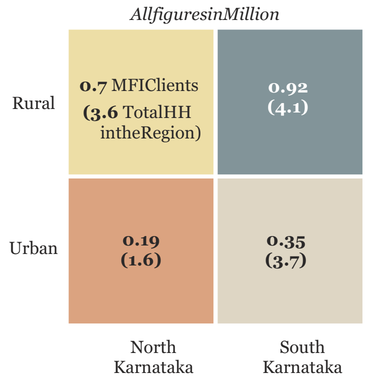
Note: Concentration here refers to poverty outreach of a total portfolio. In a dynamic framework, in which there may be changes in poverty level over time, it is relevant to measure separately the poverty level of clients at entry to a programme. The poverty level—along with other indicators—can then be tracked after a period of time to measure progress. For the current report, the sample selection did not take into account the loan cycle as a criterion for selection. Hence, a dynamic analysis is not included here.

Figure 4: Region-wise Distribution of MFIs in Karnataka



As shown in figure 4, in the Karnataka sample, as far as overall Scale and Penetration are concerned, the MFI presence was much larger in the South of Karnataka than the North; which is (maybe not unexpectedly) in line with the greater average economic development and prosperity of South. Similarly, when we compared the four different regions of Bangalore, Mysore, Belgaum and Gulbarga, it was the economically least developed Gulbarga that lagged significantly behind the other three with only 10% of the total MFI presence in Karnataka while Gulbarga has 18% of the total population of Karnataka.

Figure 5: Scale & Penetration of Outreach of Participating MFIs



Going into the study we knew that overall MFI outreach was higher in rural than in urban Karnataka. Though, in South Karnataka, we had expected overall MFI penetration in urban areas (with cities like Bangalore) to exceed that of rural South in our sample. Instead rural South had more than twice the client base and overall penetration of urban South.

A QUESTION FOR THE REGULATOR

The case of Gulbarga begs attention. Among the four regions of Karnataka it very clearly stands out in terms of its low economic development and overall levels of

outreach, mandate the microfinance model to innovate on several fronts to address issues of less favourable income generation opportunities on one hand and higher service delivery costs on the other.

But, encouragingly, our data also shows that the Gulbarga portfolio of our participating MFIs has the highest share of poor households. It could be that it is a sheer co-incidence, or MFIs indeed have stronger targeting in Gulbarga compared to other areas, or simply that it is an effect of Gulbarga having a large fraction of the poor in its population. **Nonetheless, it needs to be recognized that there are MFIs active in Gulbarga and reaching the poor in an important manner**. In our opinion, the regulator and the sector needs to take particular note of this.

Places like Gulbarga have been the focus of financial inclusion efforts for some time now. Indeed, the district (not region) of Gulbarga was singled out for RBI promoted financial inclusion drive[3] as early as 2006. But, as a working paper by Institute for Financial Management and Research (IFMR) titled *"Financial Inclusion in Gulbarga: Finding Usage in Access"* (January 2009) noted that, at best, the results were mixed. The paper focused on BPL households in particular, and in its recommendations it referred to various challenges. Financial inclusion is a continuing challenge in these areas. Against this background, **the MFIs in places like Gulbarga present an important option for the regulator to expand financial inclusion efforts**.

But this possibility raises an important question for the RBI. **Is there a need to provide greater regulatory room, in areas like Gulbarga, to those MFIs there that are already serving the poor?** For that, the regulator would need to study the challenges unique to MFIs in these areas, both on demand and delivery front, and subsequently be ready to re-visit regulatory provisions including ones such as margin caps if found necessary. In our opinion, this report strongly nudges the regulator and the sector to commence a discussion that recognises different market contexts and the challenges of reaching less developed regions and poor households.

CLOSING THE POVERTY GAP

When we come to the third of our three measurement parameters, i.e. concentration of microfinance portfolios (% of clients below different poverty lines for the portfolios of participating organizations) and when this is compared with the regional poverty rates (% total households in the region below different poverty lines), the results are intriguing and difficult to explain. As the MFI portfolio distribution in figure 6 (next page) shows, **urban South and Gulbarga have a noticeable variation in the share of the poor and the very poor in MFI portfolio**. Both Gulbarga (North region, urban and rural) and urban South (Bangalore and Mysore) represent extremes in our sample—one region lags economically far behind while the other region is much developed and sees strong MFI competition.

3. RBI announced a drive in 2006 for financial inclusion to be initiated in every state whereby the State Level Banking Committees and the Lead Banks would be responsible for promoting 100 per cent financial inclusion in at least one district in their home state . 100 per cent financial inclusion implied that all households in the district which desired a savings bank account would be provided with one. The first pilot project was conducted in Pondicherry, led by Indian Bank and completed in December 2006. Since then, several drives, typically lasting from six months to a year each time, have been completed in different parts of India, the most notable examples being Palakkad in Kerala and Gulburga in Karnataka.

Figure 6: Comparison of MFI Portfolio Concentration

	Rural South	Urban South	Rural North	Urban North	Bangalore	Mysore	Belgaum	Gulbarga
$1.25-$2.5	55%	52%	55%	54%	53%	54%	54%	55%
Poor <$1.25	20%	12%	22%	21%	18%	18%	20%	25%

As the report highlights, it requires a significant change (or discontinuity) in the operating context of MFIs to result in a change in their poverty concentration or poverty penetration in terms of outreach to the poor and very poor. Even these changes in MFI portfolios, while definitely noticeable, are not fully commensurate with the changes in the external environment. For example, a shift from Belgaum to Gulbarga produces only a 5% increase in the poverty concentration.

Further, the above contrasts with the remarkable similarity of the microfinance portfolios in the remaining contexts. It is difficult to explain why the MFI portfolio poverty concentrations should be almost identical between North Rural and South Rural where the context in terms of poverty rates are very different. It is obvious that **these poverty concentration characteristics need further research and thus, are an important point of departure emerging from this report**.

But even as unexplained observations they have immediate implications. The similarity of MFI poverty concentration across different geographic contexts shows the MFIs that they certainly have room to align their portfolios better to the underlying population characteristics. We do recognize that today in India from a practitioner's perspective it is the changes in the external regulatory environment that are a real need of the hour. But we feel it is also necessary to drive efforts in this direction *at the same time* to strengthen the poverty outreach of microfinance as part of financial inclusion.

As the report illustrates with an example, experience in the Philippines (supported by the Grameen Foundation) and elsewhere does show that **improved targeting of the poor** accompanied by investments from the MFIs into capacity building and product development can yield to higher concentration (of entry level clients) in a short period of time. For this a targeting strategy that is consciously pro-poor has to become a critical agenda of investors, funders and the practitioners.

On the other hand, the cases of urban South Karnataka and Gulbarga reveal a hint for the sector as a whole—the interaction between microfinance and the poor is not as straightforward. At the very least, the sector needs to adopt a far more **empirical mind-set when it comes to making decisions that could introduce discontinuities** in MFI's operating environment. Decisions such as margin caps, income ceiling restrictions, balancing commercial and social considerations and so on qualify in this bracket. They need to be scrutinized for their effect on the orientation of the MFIs to the **poor and very poor** and that this necessarily needs to be done on a frequent and periodic basis.

RBI INCOME CEILING AND MFI PORTFOLIOS

The report examined MFI portfolios through a more granular economic segmentation outlined earlier and did not explicitly factor in the RBI Income ceiling limits. If we were to map the RBI income ceilings to our segmentation scheme, the rural income line would lie between $1.25 and $1.88 while the urban income line would lie just above $2.5. But the income ceilings are important standard of measurement and assessment at a sectoral level today. So it was necessary to also see how the MFI portfolios in our sample fared against these income ceilings criteria.

In Karnataka overall, the RBI ceilings cover 67% of rural households, 75% of urban households. Our data showed that **the compliance to RBI income ceiling was better in urban areas than in rural areas**. In rural areas 51% of the MFI portfolio was below the RBI rural income ceiling while in urban Karnataka it was 78%. This finding reinforced that of an earlier study conducted by Grameen Foundation on the client base of Grameen Koota in 2011, and is reflected in data reported in M-CRIL's Social Ratings. Now, as was the case in 2011, a strong suggestion is that the **rural income ceiling provisions need to be revised upwards to set the level for financial inclusion**.

But, alongside, there is also a need to **enable MFIs to comply with RBI specified income ceiling** provisions, and the approach has to be more practical than the one in use today. That is, it is imperative to move from an individual client level income ceiling specification to broader compliance criteria that specify poverty concentration that a MFI portfolio as a whole should meet. And at the same time, the compliance mechanism has to ensure that MFIs uses simple but standard and objective measure of poverty to test for client eligibility.

DO DIFFERENCE IN SIZE AND MODEL PLAY A ROLE?

Do larger MFIs have better poverty outreach than smaller MFIs or it is the other way around? Does the SHG model outperform the JLG on poverty outreach? Several factors dictate preference of various stakeholders towards SHG or JLG models. This preference, in turn, is manifested in many ways including the extent of finance (governmental, institutional, philanthropic, impact investing, etc.) that is channelled to either of these models. Note, that the sample covers MFIs with Self Help Groups, it does not cover the SHG Bank linkage model.

Table 2: MFI Outreach by Size & Delivery Model

PovertyLine	Large	Small	SHG	JLG
<$2.5	72%	75%	73%	73%
<$1.25	18%	20%	19%	18%

As Table 2 shows, when we looked at our own sample we actually found no difference between large MFIs (defined as those with client base greater than 75,000 clients and 5 in number) and small MFIs (4 in number) with regard to the share of the poor and very poor in the MFI portfolios. The same "statistical indifference" was observed between poverty outreach of MFIs following the SHG model (3 in number) and those following the JLG model (6 in number). We also found no difference when disaggregating by rural and urban areas.

This report in no way claims to resolve the open questions on these issues. But the idea in presenting the above figures is to leave behind a thought that t**here is room for a nuanced position especially with regard to the JLG and SHG models of delivery, linked to MFIs**.

WHAT NEXT ?

There is a definite point of departure that future research would need to follow-up on—orientation of MFIs to the poor and very poor with a change in their operating context. More immediately, the report touches upon a few topical issues raising questions and suggestions for the regulator and practitioner alike. In the process, it also introduces a new pro-poor sensibility of re-looking at these issues.

And in our opinion, it is most important for the sector to internalize this sensibility. To reiterate the point made at the beginning, the way to do this is to understand microfinance portfolios *consistently* through a pro-poor lens. It is possible to make it an industry practice and habit; but there has to be an industry consensus on this to move it forward. This dialogue, among all stakeholders (and especially the practitioners and investors), needs to begin.

There are initiatives already under-way, world-wide, such as the Pro-Poor Seal of Excellence (newly branded Truelift) that are bringing a pro-poor focus back into microfinance, through development of a community of practice around issues of outreach, services and tracking progress at the client level of the MFIs. The approach that the report proposes is complementary to these. All these only go towards strengthening the linkage between microfinance and financial services for the poor, within the broader mandate of financial inclusion.

Finally, the study, in itself, is hardly an isolated and one-time effort. It is a progression of similar work done by Grameen Foundation and its partners in Philippines, as well as the experience of EDA in poverty measurement and use of the PPI, and initiatives increasingly taken up by MFIs to measure the poverty level of their clients at entry and over time. It would make sense to continue to extend this study to other geographies in India or to target specific issues. At the end of the day, what underlies these efforts is the goal to steer the spotlight in microfinance where it rightfully should rest—to those who are financially excluded from formal banking services, and within the financially excluded to include poor segments. We strongly hope the report, and similar future efforts, take the "possible" towards the "ideal" in microfinance.

"Quantitative and objective initiatives like the POR help the industry keep track of its fundamental mission to serve the poor. This data driven approach will also help the industry credibly showcase its work to its wider stakeholders and audience, including the regulatory authorities and the government."

— Brij Mohan Ji, Access Development Services

Starting a public discussion on microfinance has never been easier. We can choose from a number of ready options: the popular optimism of "*the remarkable growth and success of one of the first models to target the BoP*" TO the (equally popular) scepticism that takes a critical view "*of the sector's practices*" OR the business-like concern of "*how to deal with the post A.P. challenges facing microfinance*" AND its more academic cousin that examines "*the crisis of a concept.*" The most topical one, of course, would be "*implications of regulations on the financial viability of the sector.*"

Tempting though all these maybe how about a simpler, more basic starting point? "Microfinance is for the poor" seems to fit the bill well. That this was also the original starting point for the sector at some stage may also add to its merits. Some would be quick to point out it is a bit dated, clichéd and in need of rejuvenation. Fortunately, this old belief still continues to bind together a significant share of microfinance participants and activities. But still why talk about it so directly?

Well, for one, when it comes to the largest microfinance market in the world, the regulator, RBI, seems to echo this viewpoint more strongly than ever. "The Microfinance Institutions (Development and Regulation) Bill 2012" begins with

> "...to provide for development and regulation of the micro finance institutions for the purpose of facilitating access to credit, thrift and other micro finance services to the *rural and urban poor and certain disadvantaged sections of the people...*" *[emphasis added]*

The above statement also reflects the intent to stretch the fabric of microfinance much beyond mere credit. There has been some serious interest within microfinance to mobilize savings, shift from group to individual lending model, introduce newer products as well as expand the set of standard services offered such as insurance. The conceptual canvass is expanding. But navigating it has always been confusing, difficult and frustrating.

Meantime, expectations continue to be vocalized (and forged) in the public domain. The Finance Minister recently emphasized "Microfinance programs form an important part of the financial inclusion strategy; in fact the financial inclusion architecture will remain incomplete unless we take microfinance into this account." *["Chidambaram calls on microfinance sector to work on Inclusion"; 27-11-2012, The Hindu Business Line].* A headline in "The Microfinance Week" *(Dec 03, 2012)* quoted the Union Minister for Rural Development in a speech at The Microfinance Summit 2012: "Microfinance has promised much more than it has delivered..." Somewhere behind these public remarks lies a tacit acknowledgement of *microfinance for the poor*.

In popular perception microfinance maybe linked to MFIs. But the "burden of proof" to answer these questions is a shared one and extends to the Regulator, scheduled commercial banks, NBFCs, government institutions such as NABARD, Regional Rural Banks and more. But to talk sensibly about such questions means to first talk, **as a sector**, about the poor in a more concrete and uniform way.

A common characterization of microfinance is that it serves the financially excluded. According to a RBI report, 41% of Indian households were without access to formal financial services in 2011[4]. But within the financially excluded there are different client markets, or households living in varying conditions, at different levels of income, and poverty. In fact data on savings, bank accounts and poverty levels all show that the poorer you are the more likely you are to be financially excluded. In a way the debate on financial exclusion inevitably leads to one about the poor, although there are different ways to think about and measure poverty. One way to measure and talk more concretely about the poor is through the use of poverty lines.

Poverty lines are a means of benchmarking economic poverty and are very relevant for microfinance which seeks to match financial products to household cash flows and needs. But confusingly there are many poverty lines with differences such as below subsistence levels, above it and so forth. As a result, the poor remain hidden under passionate debates and it is very rare to see them addressed clearly, consistently and prominently.

If there are means available to measure the poor why confine them to select institutions, projects, for targeted research purpose or public policy discussions? Social performance management and reporting in microfinance is a positive step in the direction of making these measures more wide-spread. But can we move it even beyond performance management? Can we integrate it into the very fabric of decision-making of MFIs?

It is this initial idea that lay behind the study in the Philippines that Grameen undertook two years ago where it worked with a group of organizations including The Microfinance Council of Philippines, Oikocredit, Mindanao Microfinance Council to assist a few microfinance institutions to collect data on the poverty levels of their client base using the PPI[5] for Philippines. The study collected data on poverty outreach of nearly a million microfinance clients across 10 MFIs across the Philippines.

The study helped give definite shape to a "pro-poor lens" through which to segment and analyse MFI outreach. This is the same approach we bring to greater use in this study. It is possible that microfinance practitioners may find use of poverty lines disconcerting. It is a distant cry from the daily realities that a typical loan officer faces: housing conditions, demographics, nature of livelihood, past financial history. These are easy to observe, record, and more importantly *intuitively* relate to.

This is true, but it should also be remembered that poverty line simply provides a

4 http://www.rbi.org.in/scripts/BS_SpeechesView.aspx?id=810

5 PPI is a country specific, objective client poverty assessment and targeting tool, which provides client poverty level estimates and enables MFIs to manage social performance.

"viewpoint" or a benchmark. It invites (almost forces) direct questions on poverty outreach. This directness can create a jarring feeling as to how can the poor be captured in such a blunt manner? But, at some level, it is no more blunt than any other tool used to segment a population group.

At the same time, the idea is to bring a more kaleidoscopic mind-set to the understanding of microfinance outreach. Rather than focus on any one poverty line, the study accommodates more than one. Different lines for India and for Karnataka are summarized in Table 1 in terms of annual expenditure for rural and urban households.

Table 1: Annual Household Expenditure[6] (Rounded Rs./HH/Year)

	Rural		Urban	
	India	Karnataka	India	Karnataka
National Tendulkar	48,600	44,800	54,000	54,600
<$1.25	58,500	54,000	64,800	65,400
<$1.88	88,000	81,400	97,500	98,300
<$2.5	117,000	108,000	129,600	130,800

In fact, the term "poverty line" can be misleading. Because the term "poverty line" is in popular use, this report continues to use that phrase. The study, in practice, really treats different lines as proxies for economic status of a household. So when we state that a certain per cent of the population is below a "poverty line" we do not imply all those households are poor.

Instead, **this report terms households falling below $1.25 as poor and those falling below the National Tendulkar line as very poor.** This is in line with the fact that data from the National Sample Survey Organisation (Round 66, 2009-10) shows that the $1.25 line is a poverty line that covers 32% of the households in India. **It is important to note that it is in this sense that the report uses the term poverty lines, poor and the very poor.** Table 2 on the next page outlines a brief snapshot on how the various poverty lines are defined, its relevance to this report and corresponding All India poverty rates.

6. 1. *Income calibrated to various poverty lines, after being updated with inflation (indexing), was then multiplied with number of days in a month (30 days) to calculate monthly income; then by number of months in a year (12months), to calculate annual income.*
   2. *Poverty lines (Rs. / person / day) taken from Schreiner, Mark, A Simple Poverty Score Card for India, May - 2012 www.progressoutofpoverty.org*
   3. *Household Size: Rural–4.6 & Urban–4.1 (Census, 2011 data)*
   4. *Inflation Index Factor: (Based on CPI change between year 2009-10 to December, 2012)—Rural (CPI for Agricultural Labours): 1.28 & Urban (CPI for Industrial Workers): 1.29; http://labourbureau.nic.in/indnum.htm*

Table 2: Classification and Definitions of Poverty Lines

Classification of Poor	Definition	All India Poverty Rate	All India-Urban Poverty Rate	All India-Rural Poverty Rate
Very Poor	• Households that fall below the National Tendulkar line as per the PPI score	18.4%	11.6%	21.3%
Poor	• Households that fall below the $1.25 line as per the PPI score	31.8%	19.6%	36.9%
Borderline Poor	• Households that fall below the $1.88 line as per the PPI score	63.8%	42.9%	72.1%
< $2.5 poverty line	• This is an international poverty line that is popularly used to map incidence in a portfolio / region across the globe • It may not be applicable in Indian context since most of the poverty outreach of MFIs is concentrated between $1.25 and $1.88 line • However, for the sake of comparability this line has been included in the POR	79.5%	60.8%	87.4%

Accordingly, for the Karnataka study, we use the PPI (for further information on PPI refer to Annexure 7).

PPI —SCORE-CARD TO BENCHMARK HOUSEHOLD ECONOMIC LEVELS

The latest India PPI was built using the 66th round NSSO data for household expenditure. The PPI enables benchmarking to international "poverty lines" as well as the National Tendulkar poverty line and the RBI 'line'. The RBI line is discussed later in this report. Before that, we show the international lines ($1.25, $2.50 and the middle line of $1.88). Placed alongside is also the *National Tendulkar* poverty line to bring in the official national perspective for comparison[7]. Usage of dollars instead of rupees is for sake of convenience and familiarity[8].

7 Please refer to Annexure 8 for definitions of poverty lines used in the report.
8 Please refer to Annexure 9 for the INR values for the global poverty lines and how they have been derived.

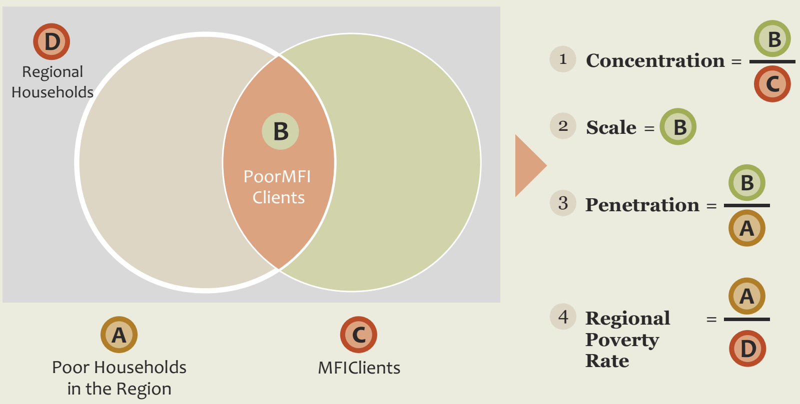
As a sector, microfinance is as large and diverse as India. Hence, there is merit in starting with one state. Many Karnataka based MFIs had been very open to the idea of learning more about their clients and portfolios; and the client base in Karnataka was large enough to ensure study results could interest a wider group of stakeholders.

In all there are 24 MFIs in Karnataka out of which 23 are AKMI members. Annexure 1 has the entire list as of March 2012. We worked with 9 of the 24 MFIs Sanghmitra which is not a AKMI member. Between them, the participating MFIs reported 2.2 million client households; which is nearly two-thirds (64%) of the total reported microfinance client base of Karnataka—a substantial per cent. The findings of the study are proportionately extended to the client base of the participating MFIs (but not for the entire client base of all the MFIs in Karnataka). Further, **the sample is designed such that the study is NOT representative of any one MFI but of the 9 participating MFIs as a group.** Annexure 2 has further details on the design of the sample.

ASPECTS OF POVERTY OUTREACH

We apply four measurements to understand the poverty profile of microfinance portfolios: (a) concentration which means *percentage* of poor microfinance clients; (b) scale which means *number* of poor microfinance client households; (c) penetration which measures the fraction of the poor households in a given population that microfinance reaches out to and (d) regional poverty rates which allows for comparison of MFI portfolio vis a vis the regional poverty incidence. The diagram below summarizes these terms and should be easy to recall.

Figure 1: Four Aspects of Poverty Outreach



The conclusions around the 4 aspects of poverty measured in this report have been drawn from the NSSO data for 2009-10. Table 3 on the next page shows the total MFI data for the state of Karnataka and the Sample drawn from each area—rural and urban—for the purposes of the study:

Table 3: Sampling of the Client-Base of Participating MFIs

	Total MFI Clients	MFI Sample Clients
All Karnataka	***22,89,100***	**5,843**
Rural	17,13,750	3,413
Urban	5,75,350	2,430

In our opinion, to understand MFI portfolios all four aspects should be considered together. For example, it is possible that MFIs may have lower share of poor clients in their portfolio but at the same time a high penetration among the poor households in a given area. In this case, if we were to focus on concentration alone we would conclude that MFI performance is not that favourable with respect to outreach to the poor. But when we include penetration too we would be forced to revise our view-point. In our analysis of MFI portfolio in Karnataka we have followed this approach of representing and looking at all these fours aspects.

POOR ARE AN INTEGRAL PART OF MICROFINANCE PORTFOLIOS

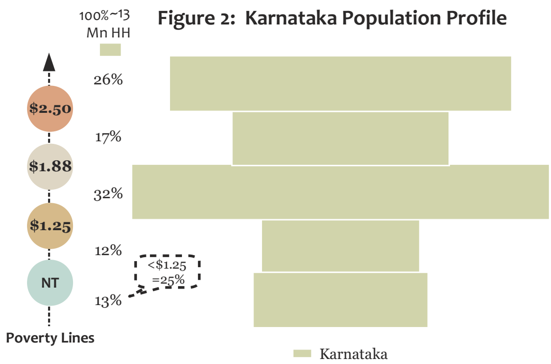


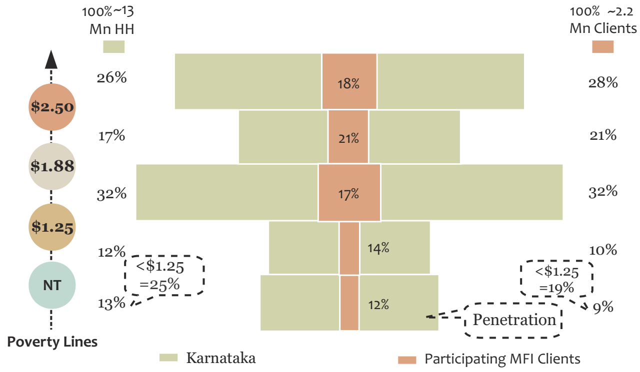
Figure 2: Karnataka Population Profile

Figure 2 represents the economic profile of households in Karnataka with reference to different expenditure or poverty lines. The data comes from the 66th round of NSSO, 2009-10. The 13 million households of Karnataka are grouped into 5 segments using four different expenditure (poverty) lines.

Against this profile, we compare the collective portfolio of the sample of clients profiled across all the participating MFIs in figure 3 (next page). The comparison broadly tracks the underlying household distribution. For example, in Figure 3, 74% of the households fall below the $2.5 line and so does 72% of the MFI portfolio. Importantly, the poor (those falling below $1.25) and the very poor (those falling below the National Tendulkar line) make-up nearly a fifth of the portfolio of the MFIs in our study. Further, those households that are between $1.25 and $1.88, that we term the "borderline poor", make up a third of the microfinance portfolios. Combined these three segments make-up over half of the MFI portfolio, compared to a similar 57% in the underlying population.

This set of findings was called to attention when we discussed the findings with the participating MFIs, AKMI and the members of our advisory committee. **The stakeholders involved (other than the practitioners) pointed out that this portfolio profile is a reasonable achievement and compares well to available information for microfinance poverty outreach in other states.**

Figure 3: Client Outreach Profile of Participating MFIs in Karnataka



A MOMENT'S REFLECTION

But the discussion also raised three sets of questions important to draw attention to at this stage. **In a way, these also set the temper for the remainder of the report.**

Concerning the target segment: What is the real target market for MFIs? More specifically, should MFIs focus only on the poor? Or can the MFI portfolio be more broad-based and have representation from multiple income groups?

Concerning absorption capacity: How should we account for the fact that most MFIs are financial intermediaries who primarily offer credit? Consequently, is credit-worthiness of households an over-riding factor in who microfinance can reach out to? If yes, then, how to determine what fraction of the poor and very poor households constitute the potential client-base for MFIs?

Concerning one size fits all: How much of microfinance outreach to the poor is really context-sensitive? What factors are under control of the MFIs and what are not? Is there one standard against which we can evaluate poverty outreach of microfinance or should much greater attention be paid to the specific operating context before drawing a conclusion?

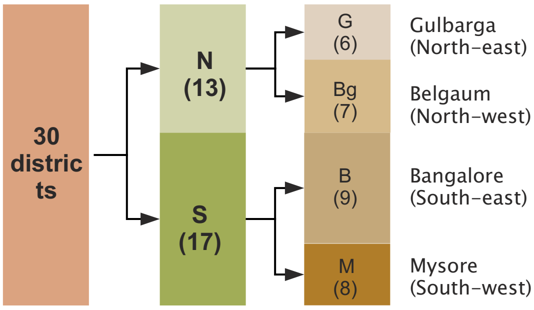
Our intent in putting across these questions is to bring home the over-arching question that we raised at the start: *if microfinance is for the poor, what does the term "poor" mean in microfinance? And what are the factors that affect poverty outreach?* This is the very reason that we have included references to different expenditure lines. It needs more than any one stakeholder and perspective to frame an answer.

Further, we have approached this study bearing in mind the limitations of a "one size fits all" consideration. As a result, when analysing the data we have consciously tried to understand microfinance against its relevant operating context and see how MFIs' poverty outreach may change in different operating environments. This also forces us, as the next step, to move beyond a simple state level picture.

DISTINCTION BETWEEN NORTH AND SOUTH KARNATAKA

If we read about Karnataka we come across a broad grouping of its 30 districts into North and South. South Karnataka further consists of the regions of Mysore and Bangalore while the North comprises Belgaum and Gulbarga. Annexure 4 has the

Figure 4: Region-wise Distribution of Karnataka Districts

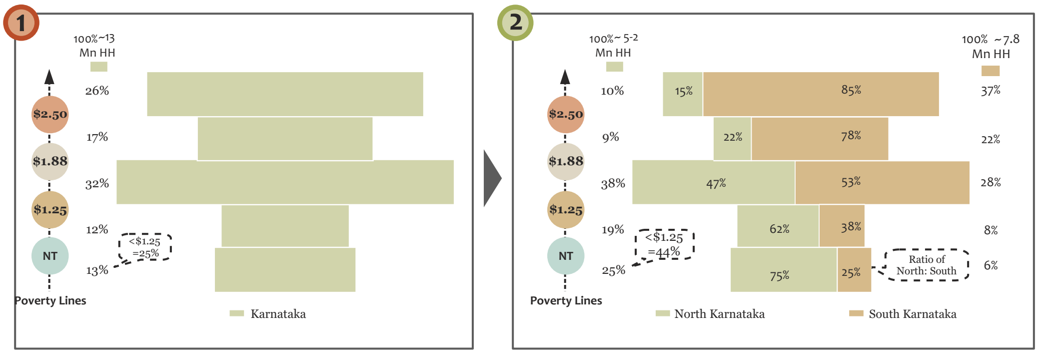


complete list of districts belonging to each of the four regions.

If we simply order all the 30 district of Karnataka by per capita income, only 3 districts from the North figure in the first 15, as shown in figure 4. Together, these 15 districts contribute 77% of State Domestic Product (SDP) of Karnataka with the 3 Northern districts contributing just under 10%. This gives a strong pointer to a North and South divide.

This fact is borne out by the profiles of North and South as shown in figure 5 below. In fact the contrast is quite striking. Not only is the South more populous (comprising 60% of households of Karnataka) and economically more developed than the North, the respective profiles are almost *inverted mirror images* of each other. In plain numbers 44% (closer to half) of the households in the North are poor compared to 15% in the South. At the top, above the "$2.5" line the ratio is almost reversed: 10% in the North compared to 37% in the South.

Figure 5: Poverty Rate of Households Compared for North and South Karnataka



Does the outreach of our participating MFIs correspond to this distinction? **In terms of absolute scale (and penetration), the distribution of MFI outreach mirrors that of the underlying population:** roughly 40% of population lies in North Karnataka and so does a similar fraction of MFI overall outreach. Annexure 6 shows the exact distribution of microfinance outreach across all MFIs between North and South.

Table 4: Poverty Concentration—Northor South?

Poverty Line	?	?
$1.88-$2.5	20%	21%
$1.25-1.88	34%	33%
NT-$1.25	11%	9%
< NT	10%	9%

But when we look at MFI portfolios in North and South, we find that the poverty **concentration in the portfolios is almost identical across North and South.** For example, from Table 4, is it possible to intuitively guess which of the column represents the portfolio of North Karnataka MFIs?

It is the column on the left. MFIs participating in our study have a 66% share of the market in the North and hence the above table is not a biased picture. We would have expected the MFI portfolios to somewhat resemble the "mirror image" profile of the underlying population. That is, in North MFIs would have a greater share of poor and very poor compared to South. **This sameness in portfolio concentration very much *hints* at a gap in behaviour of MFI.**

ACCOUNTING FOR THE POVERTY GAP

What can explain this counter-intuitive result? There could be quite a few explanations. We list those drawn from our discussions with the practitioners.

Hypothesis 1: To start with, a rupee up North is simply different from down South. This means the groups demarcated by the same "poverty lines" would have vastly different economic characteristics in the two regions with fewer employment opportunities in the under-developed Northern market compared to the South. As a result, the pool of credit-worthy households under $1.25 may be severely restricted in the North compared to the South. A real comparison of North and South would need to adjust for such differences.

Hypothesis 2: Does North being much less urban and developed than South have anything to do with the extent of difference between them? Does the higher density, especially of places like Bangalore with its high competition, make it easier for MFIs to build much deeper poverty outreach? Conversely is it the more rural nature of North with more dispersed population that makes it difficult for the MFIs to really expand presence beyond a point there?

Hypothesis 3: During our discussions, the MFIs pointed out to us that migration from the economically weaker North to the more developed South could result in a measurable number of households in the North being accounted for in the South. It is difficult to ascertain this without further study. But macro-economic factors such as these deserve closer inspection on how they may affect MFI portfolio concentrations.

Table 5: MFI Outreach by Size & Delivery Model

Poverty Line	Large	Small	SHG	JLG
<$2.5	72%	75%	73%	73%
<$1.25	18%	20%	19%	18%

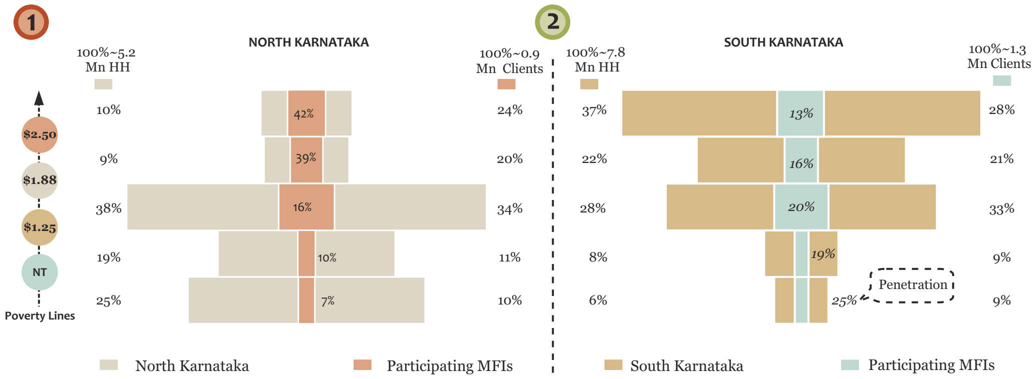
Hypothesis 4: Do JLG or SHG models have different poverty profiles? Similarly do Large and Small MFIs also differ in their outreach characteristics? If so, then, the difference in the way these groups of MFIs are distributed in Karnataka could possibly provide a partial answer. We did check for this possibility but found no statistically significant difference in poverty outreach either by size or by type of model as table 5 shows.

Each of the hypothesis posed above is a separate topic for study in itself. In this report, we are in a position to re-visit these hypotheses by comparing MFI portfolios in different geographic contexts. This comparison should crystallize why the above questions matter and also give us concrete illustrations and case studies, around which, it is then possible to have a discussion with the regulator and practitioner.

CASE OF SOUTH KARNATAKA: Greater Poverty Scale and Deeper Penetration in Rural compared to Urban South Karnataka

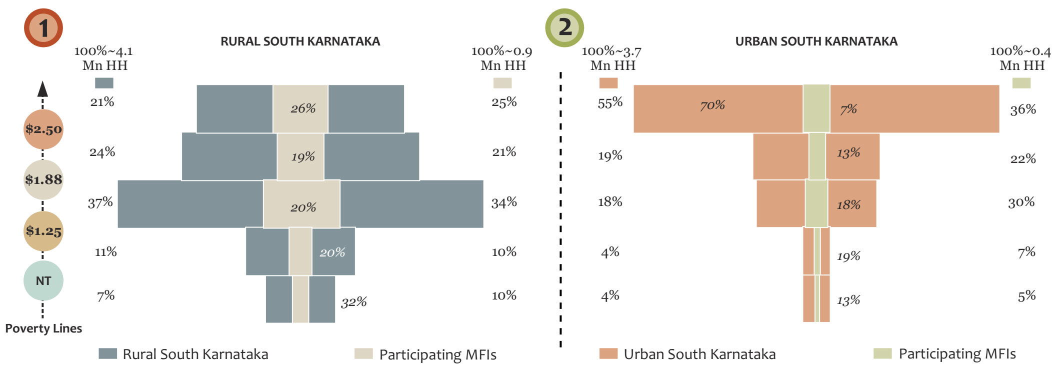
MFIs are, by default, organized as clusters of branches. And it is natural that every MFI would try to optimize the outreach of a single branch. From this perspective, urbanization has an important role to play. The number and nature of income generation opportunities vary remarkably between urban and rural areas. The high density urban neighbourhoods favour, in general, lower delivery costs. And in cities like Bangalore, the high MFI competition too can *force* the MFIs to expand their outreach to the poor. Do we see any convincing indication of this behaviour in the context of Karnataka?

Figure 6: Comparison of Concentration and Penetration of Participating MFIs in North & South Karnataka



North is pre-dominantly rural with 70% of households in rural areas as per Census 2011 while in South that ratio is closer to 50%. Further, in South, as figure 7 shows below, we find that the contrast between the urban and rural is very visible: nearly 55% of households in urban South are above $2.5 line compared to 21% in rural South. Thus, South offers as good a context as any to study how the urban context may

Figure 7: Comparison of Concentration and Penetration of Participating MFIs in Urban and Rural South Karnataka



affect the MFI portfolios: in terms of scale, concentration and penetration.

We find that rural South, and not urban South, has the highest scale of microfinance outreach in Karnataka[9]. Importantly, this is line with the household distribution. As figure 7 shows, in our sample, 70% of the overall microfinance outreach in South Karnataka is concentrated in its rural areas while it has 53% of the households of South Karnataka. The same pattern is true when we focus on the poor

9. The findings from the study are proportionately extended to the total client base of the participating MFIs (and not to all MFIs in Karnataka). The findings presented here are indicative of the performance of all the nine participating MFIs as a group and not of any one of the participating MFI. However, separate reports highlighting organisational data and comparison have been prepared and shared with each of the participating MFIs.

Table 6: Rural Penetration in North & South

< $1.25 (in Mn HH)	Rural North	Rural South
Population	1.7	0.8
MFI Outreach	0.15	0.18
%	8.8%	22.5%

and very poor segments. 73% of the poor households are in rural South while 90% of the MFI poor and very poor client base is in rural South.

Rural South also displays deeper penetration characteristics compared to other regions of Karnataka. This is most evident when we compare penetration of rural South with rural North in the poor segment.

As the table 6 shows, in the South, there are approximately 0.8 million poor households and MFIs reach out to nearly a fourth of them. In Rural North, the MFIs in our sample manage to reach only a tenth of 1.7 million poor households. Thus, the outreach in rural South is built on a base half of that of rural North.

As first approximation, we can attribute this observed higher poverty scale and deeper penetration of rural South to the greater economic development of the South in general compared to North. This would confirm what most might expect. However, we were not able to see a direct effect of urbanization on poverty scale or penetration characteristics. Does it show up in the concentration profile? Yes but in an interesting way and this should attract attention of most stakeholders.

CASE OF URBAN SOUTH: Portfolio Concentration that is Deeper than Underlying Household Distribution

It is best to understand urban South through trying a comparison between the four population groups that we now have 1) rural North 2) urban North 3) rural South and 4) urban South. In some sense, all four have a distinct character of their own. But we find that in nearly three of them the MFI portfolio distribution is very similar. As table 7 shows, we only see a difference in urban South.

Table 7: Comparison of MFI Concentration in Four Regions

Poverty Line	Rural North	Urban North	Rural South	Urban South
$1.88-$2.5	20%	21%	21%	22%
$1.25-$1.88	35%	33%	34%	30%
NT-$1.25	11%	10%	10%	7%
< NT	11%	11%	10%	5%

The portfolio concentration of urban South Karnataka stands out in two segments: above $2.5 line and among the poor and very poor. But interpreting these numbers on a stand-alone basis is misleading. To understand the significance of the portfolio profile in urban South, we need to view it against the underlying household poverty rates of urban South.

We find that in urban South Karnataka, our sample MFIs concentration is consistently deeper than the underlying household distribution. But what is of interest to us is the presence among the poor and very poor. As table 8 below shows, while 8% of households in urban South are poor, MFIs have 12% of their client base in this segment. Similarly, among the very poor, MFIs have 5% of their client-base as against 4% in the underlying household distribution.

Table 8: MFI Concentration Compared to Household Poverty Rates in Urban South

Poverty Line	Population	MFI
< $2.5	45%	64%
< $1.88	26%	42%
<$1.25	8%	12%
< NT	4%	5%

Table 9: MFI Concentration Compared to Household Poverty Rates in Rural North

Poverty Line	Population	MFI
< $2.5	92%	77%
< $1.88	84%	57%
<$1.25	44%	22%
< NT	24%	11%

Comparing MFI portfolio concentration in urban South with rural North allows us to see why urban South is of interest. In case of rural North (table 9), the portfolio lags significantly behind the household distribution. In fact, even in rural South where MFIs have the largest overall outreach, the MFI portfolio, at best, mirrors the underlying population.

In case of urban South, it's much higher degree of overall economic development, favourable road and communications infrastructure, and resulting strong competition between MFIs all contribute to the poverty outreach results of MFI portfolios there. It is a confluence of factors that is not found in other parts of Karnataka.

Thus, we can conclude that MFIs do respond to the context in terms of their outreach to the poor and very poor but, seemingly, only in exceptional cases where a confluence of factors emerge as in urban South.

On the other hand, we are left with a question: in North Karnataka, why does MFI portfolio lag so far behind the household distribution?

CASE OF GULBARGA

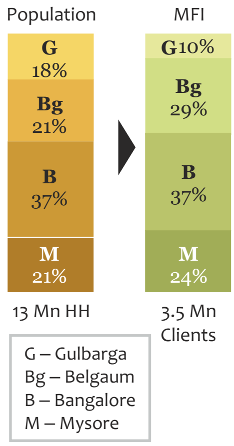
What makes the North so different? To better understand it, we compare the absolute outreach of all MFIs (not only our sample MFIs) in Karnataka in each of the four regions within Karnataka—Belgaum and Gulbarga in the North, and Bangalore and Mysore in the South.

On scale and penetration, Belgaum in the North is actually comparable to Bangalore and Mysore regions in the South. Indeed, it is really Gulbarga in the North where MFI outreach is considerably low. Gulbarga has a population comparable to Mysore and Belgaum but barely 10% of MFI client base. What contributes to this?

In *"A Note on The Backward Regions Grant Fund Programme"* prepared by the Ministry of Panchayati Raj dated 8th September, 2009, of the 5 districts in Karnataka then considered backward, 3 were from the region of Gulbarga: namely Bidar, Gulbarga and Raichur (incidentally the remaining 2 were in the Bangalore region). It is unlikely that the picture would have changed significantly in the last three years. These three districts today comprise 55% of the population of the total six districts of Gulbarga.

It is a telling indicator of the sharp contrast that Gulbarga represents economically when compared to the other 3 regions. But Gulbarga is an exception in more than one way. It has notable historical and cultural characteristics that may be playing no small role in observed microfinance response. [*See "A Bit of Bombay and Hyderabad in Karnataka" on next page*].

Figure 8: Region-wise Distribution of MFI Outreach in Karnataka



But once again when we look at the concentration parameter Gulbarga surprises like urban South Karnataka.

Table 10: Region-wise Comparison of Concentration Profile of Participating MFIs

Poverty Line	Belgaum	Gulbarga	Bangalore	Mysore
$1.25-$2.5	54%	55%	53%	54%
<$1.25	20%	25%	18%	18%

That the concentration characteristics of microfinance portfolios in three of the four regions barring Gulbarga are quite similar should not come as a surprise by now. But what does surprise is that the concentration in Gulbarga is not even deeper as may be expected given that is poorer than the rest.

How important is this observation is debatable in light of the small scale of MFI outreach in Gulbarga combined with a higher share of the poor in the underlying population. But despite our doubts, we have to acknowledge that**, MFIs respond, once again, to exceptional operating contexts, though not to the extent one would have expected;** much like urban South Karnataka.

TYING URBAN SOUTH AND GULBARGA WITH *REST OF KARNATAKA*

It is reasonable to ask why the MFI portfolios do not vary between Belgaum and Bangalore as they do between Belgaum and Gulbarga? In fact, in Bangalore, Mysore and Belgaum (or for that matter in rural North, urban North and rural South) it seems almost as if the MFI response to it's environment takes a familiar *form* independent of the operating context.

We can best summarize this behaviour of MFIs as follows: (a) individual MFIs do differ in their pattern of poverty outreach *but* (b) across many different operating contexts these individual differences are sustained (i.e. MFIs respond to the change in more or less the same way) *except* (c) where the operating context of MFIs

A BIT OF HYDERABAD AND BOMBAY IN KARNATAKA

In the report *"Regional Disparities in Karnataka: A District Level Analysis of Growth and Development"* published by Centre for Multi-Disciplinary Development (under Dr. D. M. Nanjundappa Chair) in December 2010,the authors Shiddalingaswami H and Raghavendra V K surprisingly point out that: *"History of Karnataka shows that North Karnataka was more developed politically, economically and culturally. The question is in spite of this, why North Karnataka at present remained an under developed region."*

They briefly outline the fall of the Vijaynagar empire in the North, the subsequent rise and expansion of the Mysore Empire in the South followed by the defeat by the British of Tipu Sultan. At this juncture, the erstwhile Mysore Empire got carved into three distinct parts: Hyderabad Karnataka (North-east) to the Nawab of Hyderabad, Bombay Karnataka (North-west) to the Marathas and part of Old Mysore in the South to the King of Mysore. During the subsequent period the three regions developed differently with Mysore, by far, leading the other two.

There is some practical utility to this historical account. The erstwhile Hyderabad Karnataka and Bombay Karnataka roughly map onto Gulbarga and Belgaum of today. And it is quite possible there are cultural and political differences too between Belgaum and Gulbarga and between North and South in general. For a MFI, these socio-cultural and political differences do play a role. Maybe that somewhat explains the phrase "Andhra MFIs" that we at times hear in context of MFIs in Gulbarga which implies a greater role for MFIs that originated in Andhra as opposed to those from Karnataka.

changes in an exceptional way then the impact on portfolio is most readily noticeable among the segments of the poor and very poor—though still not to the extent one would expect.

Is this behaviour then simply a sheer co-incident and an effect of the characteristics of our sample?

Do most or all MFIs in our sample have a broadly similar portfolio profile? At a Karnataka level, under the $1.25 line itself, we have a very noticeable 15% variation in poverty profiles among all our participating MFIs. These individual differences sustain to a degree even in different operating contexts.

Is it because a few large MFIs are unduly biasing the sample in certain areas? The sampling methodology was designed to address this aspect explicitly. In simple terms, our sampling was carried out in two steps: Firstly, the sample was divided into clusters at a district level and each district was assigned clusters in proportion to the population in that district. Secondly, within each district, the MFIs present there are assigned clusters in proportion to their respective poverty outreach. For those interested, Annexure 5 illustrates this with an example of the region of Belgaum.

Is it because large MFIs are tending together? As we mentioned earlier, there is no statistically significant difference between poverty profiles of large and small MFIs.

In some sense this behavioural pattern of MFIs constitutes a significant "point of departure" of the study. Not only because it needs much further research but also because it reveals a novel perspective to look at interaction of MFIs with their environment. As the next section shows, it has immediate implications for the sector, provided we accept that this perspective matters.

Client level information, including data on poverty levels, is a very critical need of the microfinance industry to help it measure its performance, and in order to better reach and serve the poor."

— Suresh Krishna, MD, Grameen Koota

From the observations highlighted, we believe that it is actually possible to draw out implications that go much beyond Karnataka and touch upon some of the more topical concerns today.

Correcting a False Distinction

Microfinance is often expected to further the financial inclusion agenda by actively targeting the financially excluded. But we know empirically that the degree of financial exclusion increases with poverty. In a way, the distinction between financial exclusion and the poor is not that clear cut and both categories overlap to a large extent. Even within the financially excluded, as we mentioned earlier, there are different client markets, or households living in varying conditions, at different levels of income, or poverty. Our study also shows that the MFI portfolio extends across multiple income segments including the poor, the very poor and the borderline poor. At a Karnataka level, over half of the MFI portfolio encompassed these three categories and, a fifth of the portfolio covered the poor and very poor.

Therefore, as far as microfinance is concerned, it may be more helpful to shift the debate from one about financially excluded to one about the poor and focus on how to improve the outreach of the MFIs among the poor and very poor to the extent possible. To that end, **we strongly recommend that poverty measurement and benchmarking become an integral part of understanding and measuring of MFI performance** for both the regulator and the practitioner themselves.

Bringing Forth A Different Sensibility

The observation in the study that prompts this suggestion is the fact that the MFI outreach to the poor was sensitive to discontinuities in it's operating environment but not to the extent expected. This was more evident when we compared **Urban South and Gulbarga versus Rest of Karnataka.** Decisions such as those on margin caps, income ceilings, funding priorities by model, balancing social versus commercial considerations as a sector all qualify as ones that have the potential to introduce such discontinuities.

For decisions of this nature we strongly encourage operating under a far more empirical and a thorough-going sensibility that tests them on their effect on MFI outreach to the poor and the very poor; and that these be subjected to frequent and regular reviews—along with other important parameters (adapted products, multiple borrowing and client retention). Simply, because, as we saw, the implications in terms of penetration *are measurable* and can make a difference to financial inclusion.

More Active Targeting by The MFIs

The observation urban South & Gulbarga vs. Rest of Karnataka prompts the following "recommendation"—in particular, the "*Rest of Karnataka*" part. Table 11 below illustrates the "Rest of Karnataka". To re-iterate the point: MFI portfolio concentration profiles overlap independent of how we are dividing Karnataka.

Table 11: Concentration Profile of Participating MFIs ex-Urban South & Gulbarga

Poverty Line	Belgaum	Bangalore	Mysore	Rural North	Urban North	Rural South
$1.25-$2.5	54%	53%	54%	55%	54%	55%
<$1.25	20%	18%	18%	22%	21%	20%

The variation between portfolios is marginal and not what we would expect given the difference between the different geographies in these groups. For example, we know that 46% of households in rural North and 38% of households in urban North are poor. Even if the effective market for MFIs in North is assumed to be smaller than South, it is still difficult to imagine that the share of the poor in the MFI portfolios would be 22% and 21% in rural and urban parts of North respectively. There is indeed a case to improve the sensitivity of MFIs to their local operating context.

Can the MFIs better align their portfolios with their local context through more conscious and pro-active targeting of the poor?

Based on our past work, we have a firm reason to believe so. To take one comprehensive example, Grameen Foundation worked with a microfinance organization in Malawi, Africa. The organization was looking to improve its outreach to the poor—an objective it set after a social performance assessment. Grameen Foundation subsequently worked with the organization on instituting specific measures to improve the organization's targeting capability. Did such an effort result in a tangible concentration difference?

Consider the data from the organization's three branches, in table 12 below, that compares the poverty profile before the changes (Column A) and 6 months after the changes were introduced (Column B) across two income lines, $1.25 and $2.5. Below the $1.25 line, the one of interest to us, we observe a distinct and measurable difference.

Table 12: Malawi Case Study---Branch Comparison

	<$1.25		<$2.5	
Branch	A	B	A	B
Branch 1	51%	60%	86%	89%
Branch 2	53%	58%	85%	88%
Branch 3	52%	55%	86%	85%

A - After   B - Before

This data of course pertains to the Malawi context. So it does not make sense to compare absolute numbers with the Karnataka context. Or for that matter focus a lot on the extent of the change.

Table 13: Comparison of Malawi and Karnataka Poverty Rates

Poverty Line	Malawi	Karnataka
<$2.5	90%	74%
<$1.25	74%	25%

Rather, the point is that, increased poverty concentration **is indeed possible with a more conscious effort and investment by the MFIs**. And while the environments may differ in different places, MFIs in some respects are similar whether in Malawi or India. Indeed, when working in Malawi we uncovered barriers cited by the management and loan officers that should resonate strongly with the practitioners here in India, and equally importantly, their funders and investors too. The following table outlines the challenges faced—at different staff levels of the Malawi microfinance organization while targeting poor clients, as also by the poor people themselves.

Table 14: Malawi Case Study—Challenges to Deepen Client Targeting

Management-related	Loan staff related	Client behaviour related
Lack of recognition at management level that significant number of potential clients are excluded	Loan staff perceive that poor are "too difficult to reach" due to their rural location	The poorest are more risk-averse and less likely to attend introductory community meetings to set-up groups
Lack of data on profile of clients reached	Loan staff believe that poor are not able to repay reliably	The poorest lack confidence and feel unable to service a loan
Financial sustainability and poverty outreach are considered incompatible	Incentives of loan-officers based on portfolio size, making larger loans for less poor more likely	

These reasons can be considered as quite "generic" for any MFI, and, what is more, are certainly addressable as the work in Malawi and other places confirms. But that requires targeted institutional capacity building including changes in employee attitudes and incentives, improved poverty outreach measurement techniques, better targeting during group formation stages, and so on. Of course, these efforts need to be supported by parallel investment in developing more tailored products.

MFIs in India today may be going through operational and financial challenges. But we believe there is value for them to take a detailed look at some of the aspects above (and possibly more) within their own organizational context. From a practitioner's perspective, the ability to respond to change in the external environment seems a real need today; and investments, monetary and otherwise, made in this direction are sure to yield immediate dividends in form of deeper poverty outreach to include poor people, while not unduly compromising the financial viability of the microfinance organization.

A Question for the Regulator

If we talk about deepening outreach to the poor and the very poor, the observations on urban and rural South on one hand, and Gulbarga on the other, seem very relevant. The difference of the two operating contexts draws out a change in response from the MFIs: in one region poverty outreach that is better than the underlying population, and in the other region, poverty outreach that is barely 10% of the total MFI outreach in Karnataka. But in both cases the degree of response of MFIs is not as one would expect given the significant change in the operating context.

Nevertheless, there are MFIs active in Gulbarga. Further, we observe that the share of the poor in the portfolio of these MFIs is noticeably higher than in the other three regions. Both these points are encouraging, even if Gulbarga may not meet the expectations of stakeholders in terms of potential scale. A context like Gulbarga (that is, the less developed districts of the country) is a long-term challenge to the microfinance model to innovate on multiple fronts including products, processes and technologies.

These innovations will need to address the physical challenges related to transport and communications infrastructure, much lower densities due to a predominantly rural character of a place like Gulbarga as well as a potentially smaller pool of credit-worthy individuals due to the nature of economic activity—agriculture in a drier belt that is reliant primarily on rain-fed irrigation. Of course, these external conditions are not static and, hopefully, will undergo a positive change over time.

But, in the meantime, we believe there is a need for a pro-active role by the regulator. It is because Gulbarga has been the focus of financial inclusion efforts in the past and has had mixed results. A working paper by Institute of Financial Management Research (IFMR) titled *"Financial Inclusion in Gulbarga: Finding Usage in Access"* (January 2009) highlights how the district of Gulbarga was part of the drive to open "No Frills Account" in 2006 with banks as the channel. The paper **studied the financial inclusion effect of this drive primarily in outreach to BPL** households in two blocks of the district of Gulbarga.

In its conclusion the paper explicitly noted that thirty-six percent of its study sample remained excluded from any form of formal or semi-formal savings mechanism including microfinance. Most accounts were opened to receive NREGP payments but failed to induce a formal savings habit. There was a continuing need from the households for micro-credit and micro-savings that was not adequately met. Further, the paper observed that, on average, the cost of travelling to a bank branch was Rs. 20 which was twice the amount (Rs. 10) that BPL households saved on average each month with the SHG. The report, appropriately, recommended that access did not mean usage and the efforts needed further investments in marketing and training by the banks.

It is possible that the attitudes of the households have changed in the intervening period and that the financial inclusion program itself has strengthened. Nonetheless, there is no denying the fact, that today, there are MFIs active in the area already serving the poor and they provide a strong option to the regulator to further expand financial inclusion efforts in Gulbarga.

This raises an important question for the regulator. Should it look in detail at what challenges MFIs face in areas like Gulbarga—both on demand and delivery fronts—and see if it can provide greater "regulatory room" for the MFIs to operate within. Especially, to encourage and support those MFIs that have already demonstrated their intent and ability to target the poor in such areas. For example, the operating costs of MFIs may be found to be higher in these areas. Would the regulator then consider re-visiting margin cap restrictions if necessary?

These, and possibly more such issues need to be studied in their proper local context. For the regulator and the sector, the most appropriate, and even necessary, course of action is to start a focused discussion on this front.

Increase the RBI Income Ceiling Especially In Rural Areas and Enforcing Greater Compliance

The RBI Income Ceiling is an important part of the set of conditions that make an MFI loan asset qualify for priority sector lending. In this report we have focused on a segmented approach defined using four household expenditure lines. But, at a sector level, the RBI guidelines have introduced an important measure of assessing MFI portfolio performance. So it makes sense to compare how the MFI portfolios also fared against these guidelines.

The guideline, as stated by the RBI, in this regard is as follows: "The loan is to be extended to a borrower whose household income in rural areas does not exceed Rs. 60,000/- while for non-rural areas it should not exceed Rs. 120,000/-". In the Karnataka context, the RBI income limits map onto $1.5 line in rural areas and $3 line in urban areas. Based on the earlier analysis, we suggest that these represent 'financial exclusion' lines for rural and urban areas, which are higher than the lines that represent people living in poverty.

The specific requirement that MFIs have to meet is that a minimum of 85% of their portfolios, in both rural and urban areas, should individually fall below the stipulated income limits. Now, for the first time, we have data at a State level to really test this out.

We found a wide disparity in MFI performance between urban and rural areas with respect to the RBI income limit. In urban Karnataka, 78% of the MFI portfolio was under the RBI income limit while in rural Karnataka it was significantly lower at 51%. The rural performance was consistent between North and South Karnataka. The urban performance showed some difference between North and South---not surprisingly, it was in urban North Karnataka that 83% of the MF clients were under the RBI limit. This was the case that came closest to the stipulated 85% requirement.

There are two obvious conclusions that can be drawn from the above: either that the rural income ceiling needs to be seriously revisited; or, the compliance in general needs to be enforced more strongly. More likely, it is both that need to be done. In fact, similar conclusions were outlined in a concept note prepared by Grameen Foundation India in October 2011 based on a similar analysis of the client base of one MFI (GrameenKoota) and by EDA/M-CRIL recommendations for Smart Regulation in August 2012, based on country-wide NSSO data. It is clear that the State level findings align broadly with the earlier ones.

Rather than saying that MFIs are not meeting RBI income ceiling criterion in rural areas, it may be more prudent to re-examine the rural income ceiling and modify it upwards. And then, enforce the income limits more strongly through improved monitoring. For that, a practical suggestion made in the October 2011 note remains valid even today—it is imperative to move from an individual client level compliance to broader compliance criteria for the poverty concentration of an MFI's portfolio as a whole. And, at the same time, ensure that as a matter of procedure MFIs use a simple but standard and objective measure of income level at the loan pre-disbursement stage to verify client eligibility.

Differences by Size and Type of Model

During our analysis we made a remark in passing that we did not find any difference with respect to poverty outreach either by the scale of the MFI, or by the type of model of the MFI (SHG or JLG). We did not pursue it any further detail at that stage.

But the difference between SHG and JLG models is a point of passionate debate within the sector. Different stakeholders have their preferences with regard to either. And, a number of factors go towards influencing these preferences, all not necessarily related only to the performance of these models. These preferences, in turn, are visible in several ways including the extent and kind of funding channelled into either of the models by the government, institutions, philanthropic funders and impact investors.

So it may make sense to re-look at the earlier figures from this perspective. We reproduce them in table 15 below. Each figure represents the concentration of microfinance portfolio.

Table 15: MFI Outreach by Size & Delivery Model

Poverty Line	Large	Small	SHG	JLG
<$2.5	72%	75%	73%	73%
<$1.25	18%	20%	19%	18%

Evidently, differences between the two types of model are not statistically significant. There may be differences on cost efficiency and other aspects, but as far as efficacy is concerned (in terms of outreach to the poor), both models seem at par as far as our sample is concerned.

This result may be surprising to many. So how should we interpret these figures against the on-going debates? These figures, in themselves, can hardly claim to address the current debate. But they do caution the sector that **there is scope to take a much more nuanced position on either of these two models, and not necessarily favour one over the other *by default*, at least, as far as performance is concerned**.

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WHAT NEXT?

From a research perspective the report clearly emphasizes a need to study in detail what factors limit the response of MFIs to poor and very poor with a change in the operating context and why in particular, in some contexts, poverty outreach is not as high as would be expected. At the same time, the report also touched upon a few of the topical issues concerning the regulator including a possibility for re-visiting regulatory provisions in more challenging areas like Gulbarga and income ceilings. For the practitioner, there is a strong hint to make the issue of pro-poor targeting strategies an important one and drive investments and efforts in this direction even while the dialogue with the regulator continues,

But beyond specific suggestions and recommendations, the report implies that it is important to first and foremost internalize a pro-poor sensibility into decision-making through measurement of poverty outreach. This report is about demonstrating one such practically feasible approach—which can be taken up by MFIs themselves. But to move it forward, there has to be a consensus among all stakeholders to make it a practice to employ such empirical methods and outlook. The important next step, therefore, is to initiate this very dialogue among the stakeholders.

To make these discussions more productive it is necessary to extend a study like this to other states, specific regions within states or targeted issues. Only through successive iterations of an effort like this can the stakeholders in the sector (and practitioners in particular) familiarize themselves and become habituated to an approach like this. But the "burden of proof" rests squarely on the sector—t needs to continue to actively participate going forward.

Importantly, this is also an opportune time to initiate such a collaborative process. There are initiatives already under-way, world-wide, such as Pro-Poor-Seal of Excellence (newly branded Truelift) that are bringing a pro-poor focus back into microfinance, through development of a community of practice around issues of poverty outreach, services and tracking progress at the client level of the MFIs. The approach that the report proposes is complementary to these. All these only go towards strengthening the linkage between microfnance and financial services for the poor, within the broader mandate of financial inclusion. The sector has an opportunity to leverage these efforts to come ever closer to its real mandate of financial inclusion that includes the poor. We do hope it takes it up with the right interest and intent.

The study was not only about statistics on poverty outreach. If you have talked to 5,800 microfinance clients it is interesting to know something more about how they engage with microfinance. We got reasonable data to open (or re-open) a few threads, one being about the role of entrepreneur in microfinance. The word "entrepreneur" and "enterprise" captivates many stakeholders today. How does it play out in microfinance?

Microfinance is often imagined dotted with micro-enterprises either started by women's self-help groups or individuals. These micro-enterprises could be either the primary source of income for the household or play a supporting role. Slowly income will grow, savings will build up and at some point the household will be eased out of the burden of poverty. In parallel, newer financial instruments will develop including savings, insurance benefiting the poor in the long run.

There is a credible basis for painting such a picture. After all, improvement in productive powers of any household over time can result in improvement in finances and ability to recycle this financial gain sets a virtuous cycle in motion. But the key word here is over time. What happens while these productive powers are being shaped?

WORKING CAPITAL OF A DOMESTIC KIND

When asked the top two areas where they put their credit to use (not only microfinance loans but credit taken across all sources) the study respondents highlighted "health and medical reasons" as equally likely as "business/farm related". "Social events" too figured noticeably but at some distance. Importantly, the poverty profile of households answering these questions was largely similar. That means a more or less same *types* of respondents highlighted similar usages of credit. Education, asset purchases, house repair / improvements were also cited; but the above reasons dominated.

"Portfolios of the Poor (How the World's Poor Live on $2 a Day)"[10] was an acclaimed diary study published in 2010 that captured financial behaviour of households living under $2 a day in Bangladesh (152 households), India (42) and South Africa (48) by tracking their financial behaviour over a period of a year. Every two weeks (at least) the field teams in the respective countries, including EDA in India, tracked cash inflows and outflows of individual households. These were then used to build cash-flow statements and balance sheets of respective households. This kind of data, if anything, is honest and humbling.

It captured an interesting statistic: "Most Frequent Events Causing a Financial Emergency with the Percentage of Sample Respondents Affected At Least Once During the Study Year." For both India and Bangladesh, "serious injury or illness"

10 Co-authored by Daryl Collins, Jonathan Morduch, Stuart Rutherford and Orlanda Ruthven ranked as the number one cause of financial emergency with 42% of diary study participants in India, and half in Bangladesh, highlighting it. [*Table 3.1, page 68, Portfolios of the Poor*]. This was followed, in India, by loss of crop or livestock (38%).

This puts in some (loose) context the "medical/health" reason cited by our Karnataka microfinance client sample. Entrepreneurial ambitions aside, being alive, eating well, avoiding sickness, protecting family against natural elements, fulfilling social obligations as well as maintaining a position in the society are all important at the same time. And for these things money is constantly needed—in big or small amounts, regularly or once in a while.

When asked how they intend to meet the expenses that worry them the most, the typical answer was: *work more than usual*. When over 4,000 out of a sample 5,800 affirm "work more" it is very difficult to see that it can mean more than the usual understanding: just work more hours, or negotiate, or get better pay for the work being done. Starting a micro-venture would also figure in there but it is unlikely to be the only, or the most dominant option.

This appears all the more likely when nearly 50% of the sample pointed out that the primary source of livelihood in their household was casual labour. In a statistically representative sample of microfinance clients this is not a co-incidence but more an indication of things as they could be on the ground. If anything, some will insist that the MFIs should target more of such client-base.

A CHOICE OF SOME MERIT

None of this, however, is a revelation. It simply confirms what all microfinance practitioners know fully well in their guts: every microfinance client is not an entrepreneur-in-waiting, whether poor or not poor. A lot of them, and especially the poor, simply want access to better sources of finance to meet a *variety* of their financial needs. Somewhere along the line, in popular imagination, microfinance clients have been turned, pre-dominantly, into a nursery of micro-entrepreneurs.

Wishing away the additional financial needs of the household is not going to help. If not institutional, or quasi-institutional sources of finance, households will continue to access highly informal sources. In our sample, friends/relatives, and moneylenders continued to figure as regular sources of credit for at least 30% of the respondents.

The authors of "Portfolios of the Poor" echo this sentiment when they ask: *"Should the credit go exclusively to small enterprises, or can other ways of fighting hardship and lack of opportunity be identified?"* and they point out a missed possibility: "When the turn toward microfinance opened up possibilities it did not entail a re-assessment of the uses of microcredit. A fundamental but easily overlooked lesson from the diaries is that the demand for microcredit extends well beyond the need for just *microenterprise* credit." *[emphasis authors, not ours]*.

In fact, it can be said that the *choice* the authors mention extends even beyond alternative uses of micro-credit and includes savings, insurance, and remittance among others. In fact in our study sample, 46% had no life insurance and over 80% no health insurance. Further, those without insurance were on average poorer than those with insurance (*a 6 to 7 percentage point difference in their poverty rates*). **Coupled with the fact that a large majority of study respondents pointed out medical expenses as a concern, it does provide strong ground to consider introduction of micro-insurance at a sectoral level, as well as providing linkages to relevant savings options—and, of course, cost-effective health services**.

The choice that was missed earlier is a one that is still very much open: something that our study sample hints at. It is a choice that can significantly determine the future direction of the sector.

ANNEXURE 1: LIST OF MICROFINANCE INSTITUTIONS IN KARNATAKA

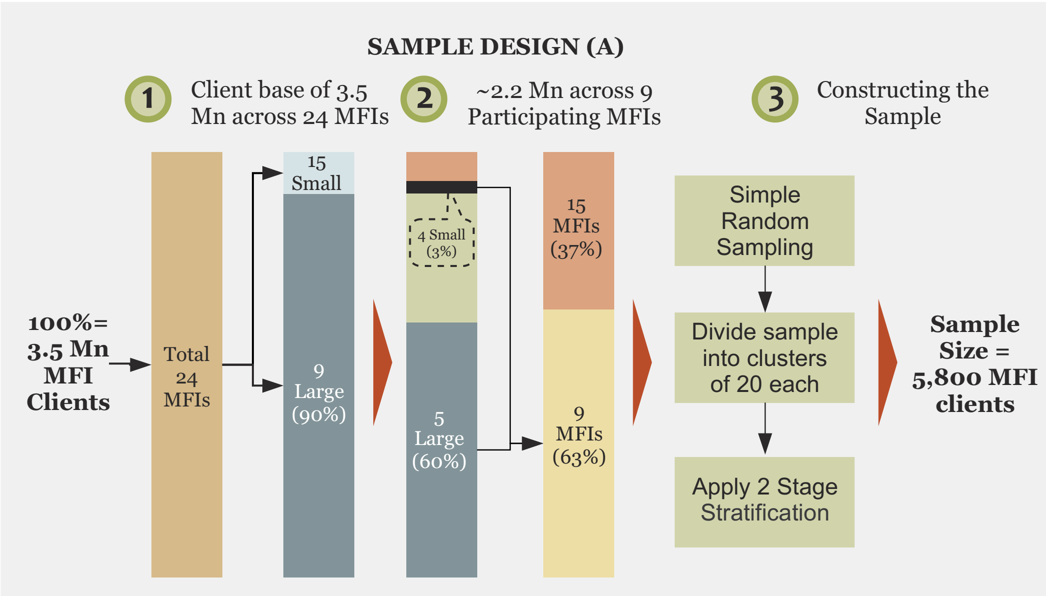
1. ASK Hulkoti
2. Asmitha
3. BASIX
4. BSS
5. Chaitanya
6. FFPL
7. GFSPL
8. GMASS PRAWARDA
9. IDF
10. Janalakshmi
11. Kaveri Credit
12. Navachetna
13. Nirantara
14. NKRDS
15. PRAK FOUND
16. Rores Micro Entrepreneur Development Trust
17. Samasta
18. Samuha
19. Sanghmitra
20. Spandana
21. SKDRDP
22. SKS
23. Ujjivan
24. UrsSeva Trust

All the institutions, except Sanghmitra, are AKMI members.

ANNEXURE 2: THE STUDY SAMPLE DESIGN

The poverty profile of Karnataka was constructed using Census and NSSO data sources and applying the poverty score-card to this data. For the microfinance client pool, a data source had to be generated in the first place. The figure below is a simplified version of how we approached the design of our sample. We partitioned our group of 24 MFIs into Large and Small. We defined the Large group to include a MFI with a client-base more than 75,000. We cross-checked the number of clients with the number of loans outstanding to ensure consistency between the two. This resulted in one large MFI being re-classified as a Small one.

As the figure on the next page shows, of the 24 MFIs, as per our classification, there are 9 large MFIs. Between them these 9 large MFIs contribute 90% of the total client base of Karnataka. On our part, we worked with **5 large and 4 small MFIs**. The larger ones we worked with made up 60% of client base of Karnataka (and 66% of client base among all large MFIs) and the smaller ones made up ~3% of client base of Karnataka (and 30% of client base among all small MFIs). In our study sample, we also have representation from both the types of MFI models: 6 MFIs followed the JLG approach while 3 followed the SHG approach.

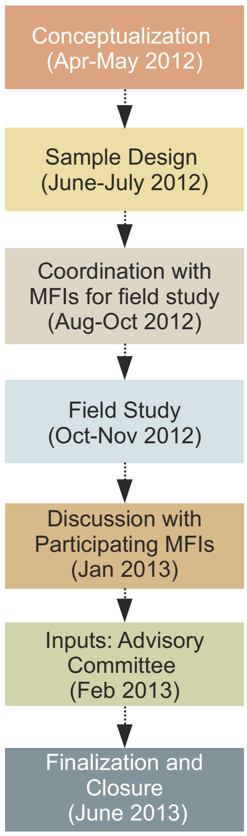


In all, we sampled 5,800 clients across 30 districts. It is important to remember that **the results of this study are not representative of any one MFI or district but of the 9 participating MFIs as a *single group***. Further, the study is based on microfinance outreach data as of March 31, 2012. This was the most complete data-set we had access to before the field-work was under-taken in November 2012. Annexure 3 lays out the time-line of the study. Those statistically curious may notice that we have used a two-stage stratified cluster sampling approach. Annexure 5 has a detailed example of it.

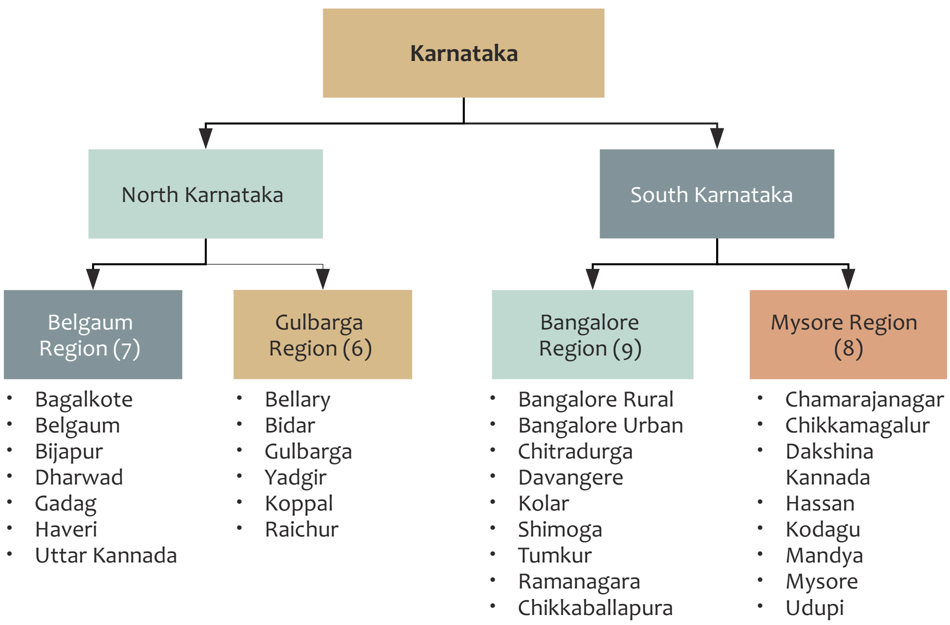
In summary, then

1. Total Number of Participating MFIs: 9
2. Total Client base of Participating MFIs: 2,159,866 clients
3. Total Number of Districts Covered: 30
4. Division by Size: 5 Large, 4 Small
5. Division by Model: 6 JLG, 3 SHG
6. Ratio of Female to Male Clients: 96% Female
7. Rural and Urban Split: 58% Rural and 42% Urban
8. % Share of Microfinance Market: 63.5%

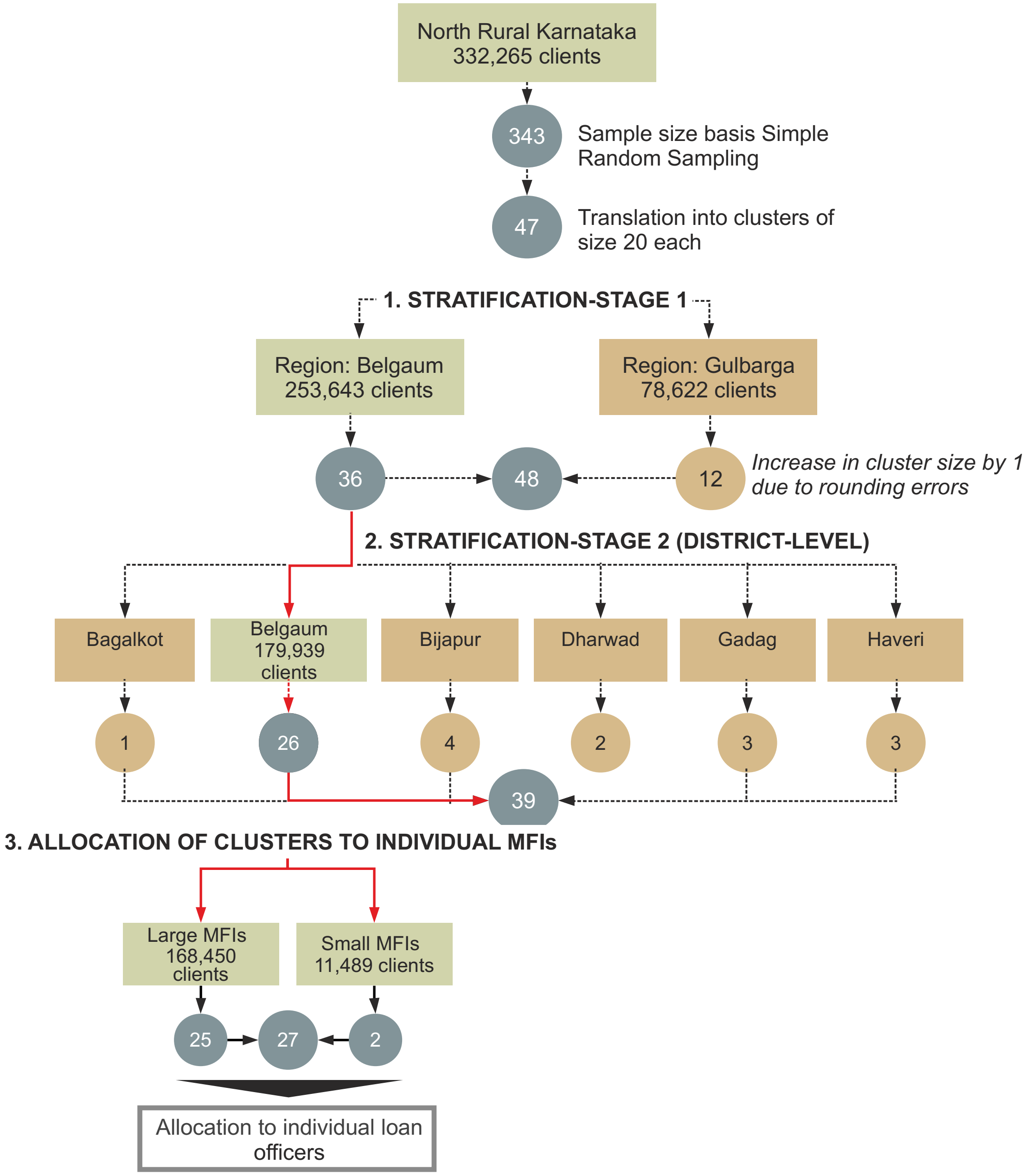
ANNEXURE 3: TIME-LINE OF THE STUDY



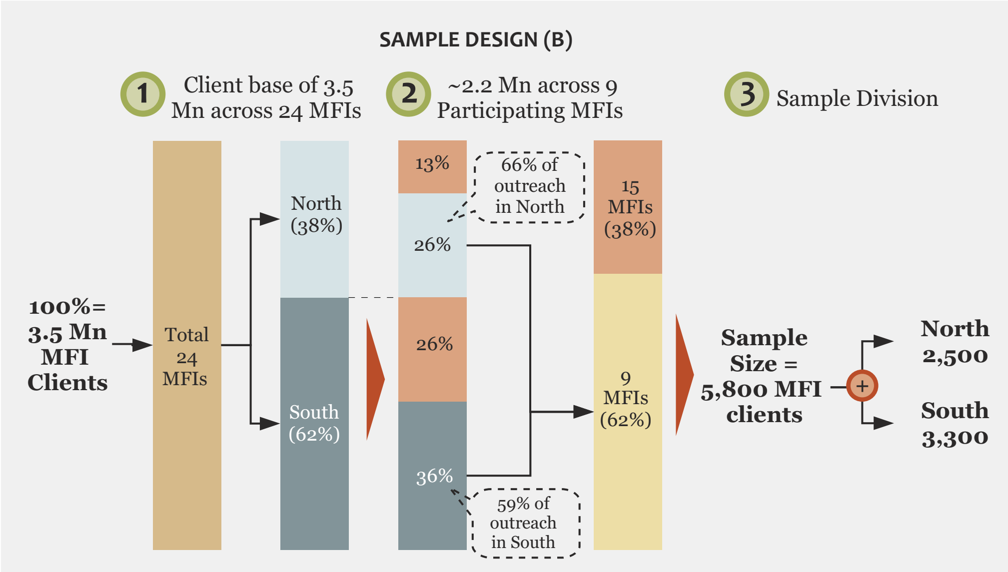
ANNEXURE 4: LIST OF DISTRICTS GROUPED REGION-WISE



ANNEXURE 5:
SAMPLE DESIGN WITH EXAMPLE OF NORTH RURAL KARNATAKA



ANNEXURE 6: SAMPLE DESIGN WITH NORTH AND SOUTH DISTINCTION



ANNEXURE 7: ABOUT PROGRESS OUT OF POVERTY INDEX (PPI)

WHAT IS THE PPI?

The Progress Out of Poverty Index® (PPI®) is a poverty measurement tool for organizations and businesses with a mission to serve the poor. With the PPI, organizations can identify the clients, customers, or employees who are most likely to be poor or vulnerable to poverty and integrate objective poverty data into their assessments and strategic decision-making.

HOW DOES THE PPI WORK?

The PPI was designed with the budgets and operations of real organizations in mind; its simplicity means that it requires fewer resources to use. The PPI is a set of 10 easy-to-answer questions that a household member can answer in 5 to 10 minutes. A scoring system provides the likelihood that the survey respondent's household is living below the national poverty line and internationally-recognized poverty lines.

The PPI is country-specific. There are PPIs for 45 countries, and a similar poverty scorecard with a different creation methodology exists for use in China. All together, Grameen Foundation has developed poverty measurement tools for the countries that are home to 90 percent of the people in the world who fall under $1.25/day 2005 PPP.

The PPI (or rather PI) serves as a poverty score to measure poverty outreach in a given population. When it is used to capture data over time, it serves to measure potential changes in poverty level-or "progress out of poverty."

MORE INFORMATION ABOUT THE PPI

Go to the website www.progressoutofpoverty.org for more information about the PPI., FAQs and resource documents.

ANNEXE 8: POVERTY LINES USED IN THE REPORT

Poverty lines are cut-off points separating the poor from the non-poor. They can be monetary (e.g. a certain level of consumption) or non-monetary (e.g. a certain level of literacy). The use of multiple lines can help in distinguishing different levels of poverty. There are two main ways of setting poverty lines—in a relative or absolute way.

1. Relative poverty lines: These are defined in relation to the overall distribution of income or consumption in a country; for example, the poverty line could be set at 50 percent of the country's mean income or consumption.

2. Absolute poverty lines: These are anchored in some absolute standard of what households should be able to count on in order to meet their basic needs. For monetary measures, these absolute poverty lines are often based on estimates of the cost of basic food needs (i.e., the cost a nutritional basket considered minimal for the healthy survival of a typical family), to which a provision is added for non-food needs.

This report examines MFI performance for the following absolute poverty lines:

1. *National Poverty Line*: The planning commission of India has accepted the Tendulkar Committee report based on which the current National Poverty Line has been estimated. This poverty line argues for setting the poverty line at just above subsistence level. The Tendulkar Committee Report has arrived at INR 26 for rural and INR 32 for all India as the minimum household spend required to access/buy a basket of goods required for a standard of living that ensures above subsistence living.

The following are dollar based global poverty lines based on the PPP based exchange rates that makes them possible to be applied to the local context of a country.

2. *$ 1.25 poverty line*: In 2008, the World Bank came out with a revised figure of $1.25 (succeeding the erstwhile $1.08 poverty line) at 2005 Purchasing-Power Parity (PPP). This is the World Bank defined extreme poverty line that defines extreme poverty as average daily consumption of $1.25 or less for a household that is living on the edge of subsistence.

3. *$2.5 line*: The International poverty line which doubles the $1.25 estimates is a low measure relative to standards of living in middle and high income countries. For these countries, the World Bank defined the $2.5 line to increase scope of poverty measurement.

4. $1.88 poverty line: This is a poverty line that has been developed as part of the PPI toolkit to enable further segmentation of the population. $1.88—the mid-point between $1.25 and $2.5—is relevant in a country such as India where there is substantial proportion of the population between the two other lines.

ANNEXURE 9:
WHAT ARE THE RUPEE VALUES FOR THE GLOBAL POVERTY LINE?

For the purpose of PPI, dollar-based poverty lines defined by the World Bank are used. Poverty measures based on an international poverty line attempt to hold the real value of the poverty line constant across countries, as is done when making comparisons over time. The internationally comparable lines are useful for producing global aggregates of poverty. In principle, they test for the ability to purchase a basket of commodities that is roughly similar across the world.

- *What is ICP?*

The international Comparison Program, which estimates PPP coordinates the collection of price data for a basket of goods and services in countries outside the jurisdiction of Eurostat (Statistical Office of the European Union) and OECD (Organization for Economic Cooperation and Development), used for comparison purposes. The data collected are combined with other economic variables to calculate **Purchasing Power Parity (PPPs).**

- *What is PPP?*

Purchasing Power Parity (PPP) is an economic theory and a technique used to determine the relative value of currencies, estimating the amount of adjustment needed on the exchange rate between countries in order for the exchange to be equivalent to each currency's purchasing power. It asks how much money would be needed to purchase the same goods and services in two countries. The PPP-based exchange rate is entirely different from market exchange rates. Market-based exchange rates should not be used while defining national currency equivalent for dollar-based poverty lines.

For India, the PPP of the Rupee to the US$ was INR 16.28 compared to the market exchange rate of INR 48.5 in 2009[11].

Rupee value estimates for poverty lines used in the POR

Annual Household Expenditure[12] (Rounded Rs./HH/Year)

	Rural		Urban	
	India	Karnataka	India	Karnataka
National Tendulkar	48,600	44,800	54,000	54,600
<$1.25	58,500	54,000	64,800	65,400
<$1.88	88,000	81,400	97,500	98,300
<$2.5	117,000	108,000	129,600	130,800

11. 2009 exchange rate mentioned for compatibility,. PPP for India was last calculated in 2009.

12. 1. Income calibrated to various poverty lines, after being updated with inflation (indexing), was then multiplied with number of days in a month (30 days) to calculate monthly income; then by number of months in a year (12months), to calculate annual income.

2. Poverty lines (Rs. / person / day) taken from Schreiner, Mark, A Simple Poverty Score Card for India, May - 2012 www.progressoutofpoverty.org

3. Household Size: Rural–4.6 & Urban–4.1 (Census, 2011 data)

4. Inflation Index Factor: (Based on CPI change between year 2009-10 to December, 2012)—Rural (CPI for Agricultural Labours): 1.28 & Urban (CPI for Industrial Workers): 1.29; http://labourbureau.nic.in/indnum.htm

ABOUT GRAMEEN FOUNDATION

Grameen Foundation helps the world's poorest, especially women, improve their lives and escape poverty by providing them with access to small loans, essential information, and viable business opportunities. Through two of the most effective tools known – small loans and the mobile phone – we work to make a real difference in the lives of those who have been left behind: poor people, especially those living on less than $1.25 per day. For more information, please visit *www.grameenfoundation.org.*

Grameen Foundation India is a social business and a wholly owned subsidiary of Grameen Foundation that catalyses double bottom line approaches to serving the poor and the poorest. Its mission is to enable the poor, especially the poorest, to move out of poverty by strengthening institutions and businesses that serve them. Grameen Foundation India aims to achieve this by enabling the growth of truly double bottom line entities that use quantitative and verifiable measures of social results and by demonstrating new business models for serving the poorest. It currently focuses on enabling the provision of financial services and information services. You can learn more at *http://grameenfoundation.in/.*

ABOUT EDA RURAL SYSTEMS

EDA is a development consultancy, active in microfinance and livelihoods. Based in India, we work throughout countries of Asia and Africa to provide technical assistance – training, capacity building – assessments, research and policy studies. A key focus area is the development and application of standards for social performance management and reporting, including issues of governance, client protection, market segmentation, poverty analysis, gender and tracking outcomes at the client level. EDA was involved in the first pilot of the PPI for India, in 2005, and since then we have included application of the PPI in our research, training and mentoring programmes. We are currently lead technical consultant for the Truelift – Pro-Poor Seal of Excellence. For more information visit www.edarural.com

ABOUT AKMI (Association of Karnataka Microfinance Institutions)

AKMI- an association of microfinance institutions in Karnataka is registered under the Societies Act of 1860. AKMI aims to build the field of community development finance in Karnataka and to help its members and associate institutions to better serve low income households, particularly women in rural and urban Karnataka in their quest for establishing stable livelihoods and quality of life. Currently, 24 microfinance institutions are members of AKMI and are supported by a secretariat that facilitates all the activities taken up by the association.

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MICROFINANCE

"A POVERTY LENS ON FINANCIAL INCLUSION"

Based on A Representative State-wide Study of Microfinance in Karnataka

GRAMEEN FOUNDATION INDIA

Grameen Foundation India
C 406, Nirvana Courtyard, Nirvana County, Sector 50,
Gurgaon 122001, India
Tel: +91 124 4100703
Email: info@grameenfoundation.in
http://grameenfoundation.in/

EDA

EDA Rural Systems Private Limited
602 Pacific Square, 32nd Milestone NH8
Gurgaon 122 001, India
Tel: + 91 124 230 9707, 230 9497, 426 8707, 405 0739
www.edarural.com