Of interest rates, margin caps & poverty lending

How the RBI policy will affect access to microcredit by low income clients

July 2011

EDA Rural Systems Private Limited

Micro-Credit Ratings International Limited

Of interest rates, margin caps & poverty lending

How the RBI policy will affect access to microcredit by low income clients

July 2011

EDA Rural Systems Private Limited

Micro-Credit Ratings International Ltd
602 Pacific Square, 32nd Milestone NH8, Gurgaon 122 001, INDIA
Tel: +91 124 405 0739, 426 8707, 230 9497; Fax: +91 124 230 9520
e-mail : ***contact@m-cril.com*** website : ***www.m-cril.com***

Executive Summary

The current crisis in Indian microfinance has brought down the portfolios of Indian MFIs by 50% from their peak in October 2010. While some may see this as a cause for celebration, it **has caused collateral damage to the lives of low income families**, both recent and potential customers, which is a far more important issue. The RBI has attempted to resolve the issue by defining limits on interest rates, margins, incomes of microcredit borrowers, the size of loans to be provided to such borrowers and on various other business conduct issues such as tenure, repayment frequency and collateral. This has generated hot debate but not much real light in terms of a close examination of the actual impact of the measures announced on the availability of microcredit to those who need it. The purpose of this paper is to undertake such an examination.

The content of this paper is particularly important in the context of the draft Microfinance Bill (now in the public domain) that seeks to formalize some of the measures that the RBI has announced as part of its definition of qualifying assets for priority sector lending by commercial banks.

The paper undertakes a time series analysis of the yields on loan portfolio of the 16 largest MFIs in India that account for over 80% of all the MFI services provided in the country. Historical yield data is compared with the pricing and margin caps announced by the RBI to determine the feasibility of MFI operations within the new regulatory regime. It also looks at the income limit and maximum loan size criteria to determine their relevance for the availability of microcredit to various income segments of the population.

On the matter of interest and margin caps, the **key findings of this paper** are

1 The **combined yield on loan portfolio of the 16 largest MFIs has been well within the RBI's specified interest cap** of 28% (26% + 2% yield resulting from the 1% loan processing fee) for the 6 years, 2004-05 to 2009-10.
2 The **combined performance of the largest 16 has been comfortably within the margin cap** of 12% +2% for 5 years (2005-06 to 2009-10)
3 With **the highest yield of any individual MFI in this group being less than 34%** (and that is one of the smallest MFIs in this group) this debunks the allegations in the media that MFIs have generally been charging interest rates of 50% and above.

However, there remain parts of the country where microcredit is not adequately available, **so there is a case for the regulator to allow relaxations of the pricing caps in two situations**

- a When a small MFI operates in infrastructure challenged areas and in under-served parts of the country, and
- b When an MFI is new and small – within three years of start-up and with less than 50,000 clients.

and to introduce other measures such as a weighted calculation of the capital adequacy ratio that incentivizes MFIs to work in under-served areas**.**

On the poverty lending issue,

It is commonly acknowledged that over 60% of the population is financially excluded. Inevitably these are families with relatively low incomes. It is clearly inappropriate to regard all of these as belonging to a single category of microcredit user. Based on the available data, this paper uses four income thresholds – below the national poverty line (NPL, equivalent to $0.85 per person per day) and the international thresholds of $1.25 per person per day, $1.50 per person per day and $2 per person per day – to categorise microcredit clients. Using NSSO (2005-06) data, the proportion of population with incomes below each threshold is as follows

	National poverty line and international income thresholds in $ per person per day*			
Income threshold	**National, $0.85/day**	**$1.25/day**	**$1.5/day**	**$2/day**
% of population (2005-6) with income less than...	18	51	66	84

* The equivalents in rupees of family income per annum are provided in Table 2 (page 9) of the main text

Various income categories have been used based on the understanding that for people in the different categories, there will be differences in the appropriate loan sizes and lending conditions (products). This analysis makes a preliminary attempt at addressing this issue in the context of the RBI circular.

1 **The proportion of population in 2009-10 that qualifies within the family income limit for micro- loans set by the RBI amounts to a little under 50% in rural and urban areas respectively.** In theory, this seems to be a large enough segment of the population for microfinance to be provided viably. In practice it includes all those in urban areas with incomes below the international $2 a day threshold but <u>in rural areas excludes those with incomes above $1.5 a day</u>. This creates an anomaly that needs to be addressed.

2 **The loan size limit of Rs35,000 in the first cycle enables everyone in all areas with incomes less than $2 a day to borrow, however, critically, it leaves all those with less than $1.5 per day open to over-indebtedness** (because the loan size limit may be too high) **and it may not be high enough for those close to the $2 a day threshold** (who can repay more and probably need more for productive investment). Not catering to the needs of the upper income segments amongst microcredit clients creates an incentive for multiple borrowing.

The implications of these findings are that <u>the criteria need to be nuanced</u> using the available data for different (national and state) poverty levels and for different income categories. There should be consistency between income thresholds and loan size limits based on estimates of capacity to repay loan instalments of a reasonable size.

The need for the regulator to develop a specialist knowledge of microfinance is paramount. It could also use the services of specialist agencies – such as M-CRIL – to both monitor and enhance its understanding of the implications of the regulations proposed and introduced.

1 Introduction

Much has been said about the crisis in Indian microfinance: that it was caused by the exponential growth of the largest MFIs leading to widespread over-indebtedness of clients, client coercion by MFIs which eventually possibly contributed to some of the suicides reported in the media. An alternative view is that bureaucrats in the AP government were not only envious of the success of MFIs vis-à-vis SHGs and the Velugu programme but also of the success of the SKS IPO and reports of fabulous returns to promoters and investors. This led to the hurry with which the AP ordinance was promulgated without much warning to the MFIs. Whatever the truth, the situation affected the banking sector across the country, and led to their unwillingness to lend to MFIs with the result that even those operating in Bengal and the eastern states now report a decline in portfolio of 50% since the peak in early-October 2010.

In attempting to resolve the crisis, the Reserve Bank of India (RBI) first appointed a committee to report on and suggest solutions to the problems attributed to the sector; then, using the recommendations of the Malegam Committee and after some deliberation the RBI announced, in early May 2011, the following measures that took **a more liberal approach** on many of the pricing and market conduct rules recommended by the commitee:

Conditions	**RBI policy announcement – from the perspective of priority sector lending by banks to MFIs**
Income limit for eligible borrowers from MFIs	Rural: Rs60,000 Urban: Rs1,20,000
Loan size (maximum)	First cycle: Rs35,000 Subsequently: Rs50,000
Indebtedness of borrower	Limited to Rs50,000
Tenure	24 months for amounts in excess of Rs15,000
Loan use criterion	Minimum 75% of MFI portfolio for income generation
Repayment frequency	Weekly, fortnightly or monthly at the choice of the borrower
Pricing cap	Interest rate, 26% Margin, 12% above borrowing cost + processing fee, 1% (not included in interest cap or margin cap)
Collateral & group mechanisms	No collateral, individuals as well as SHGs and joint liability groups (JLGs)

As M-CRIL wrote (at the time) in its comment on the RBI policy, "**The central bank's policy is *restrictive* in placing pricing caps and accepting income criteria that may not be practical to apply**, **but it is nevertheless welcome in the framework of the prevailing political economy of the country**. Given the concerns of various state governments about the functioning of the microfinance sector, they would expect the RBI to do no less. While **the role of a central bank should be to create a facilitating environment for the financial system and not to micro-manage the provision of financial services**, at least the RBI's more liberal approach than the Malegam Committee will facilitate the achievement of sustainable operations by many (but not all) MFIs."

The purpose of this paper is to examine the impact of the RBI's microfinance criteria on the supply of microcredit to low income clients and the ability of MFIs to operate viably within the bounds of the pricing caps and income limits announced. It examines the likely effect of the pricing caps on 16 of the largest MFIs in India in the context of their performance over the past few years with respect to yields on loan portfolio (referred to henceforth as portfolio yields which represents the actual financial cost of borrowing to microfinance clients) and the margins earned after accounting for financial expenses. It also looks at the income limit and maximum loan size criteria to determine their reasonableness for the availability of microcredit to various income segments of the population. Thus, the analysis is aimed at determining the feasibility of microcredit availability and of the microfinance sector vis-à-vis the policy – albeit initially only for qualifying microfinance assets under the priority sector guidelines for commercial banks. This is important in a wider context; since the draft microfinance bill designates the RBI as the regulator of all microfinance in India the "qualifying assets" criteria set out above are likely to become the centerpiece of the formal regulation to be introduced after the bill is enacted by Parliament.

Data for the cost and pricing comparison in the first part of this paper has been taken from the database of the MIX (the Microfinance Information Exchange – the microfinance database established by CGAP, the World Bank-affiliated technical support agency for microfinance). Data for household income levels and poverty bands in the second part of the paper derives from the 62nd round of the National Sample Survey (2005-06).

2 The implied cost of the pricing caps for clients

As indicated in the table above, the pricing caps (on a per annum basis) are

Interest rate, on a reducing balance basis	**26%**
Margin cap, above borrowing cost	**12%**
Processing fee, not included in the margin cap or interest cap	**1%**

The actual cost to clients implied by this is determined by the repayment frequency – weekly, fortnightly or monthly (to be chosen by the client) and the loan tenure. However, by any method, for a one-year loan tenure (standard in microfinance) the resulting **net cost to the client amounts to** approximately **28%** (26% interest cost plus the 1% loan processing fee spread over the average outstanding principal – broadly half the loan principal at disbursement – resulting in an average cost of 2%).

3 MFIs covered by the study

The 16 large MFIs covered by this analysis are listed in **Table 1** along with their number of active borrower accounts and outstanding portfolio on 31 March 2010. These constitute over 81% of the 26.7 million active borrower accounts of 266 MFIs (according to data collected by Sa-Dhan) and nearly 82% of the Rs20.400 crore portfolio of all Indian MFIs on that date. Thus, comparing the caps in the RBI circular to available evidence on yields obtained by these MFIs would provide a good indication of the effect the caps could have on the outreach of microfinance to low income clients in the country. M-CRIL's data shows that these MFIs grew by 62% in terms of borrowers and 88% in terms of portfolio during the financial year 2009-10.[1]

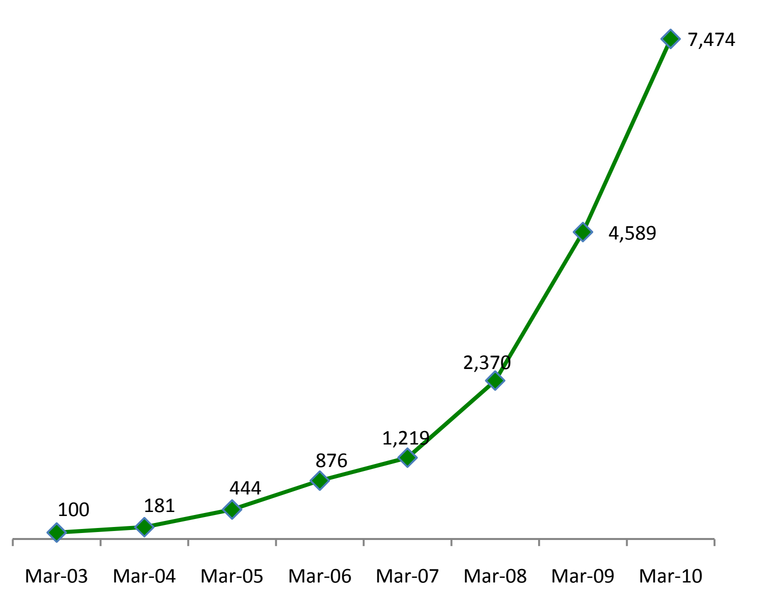
Table 1
The 16 largest MFIs covered

MFI	Portfolio, crore Rs	Active borrowers	APR*
SKS	4,320	5,795,028	32.4%
Spandana	3,540	3,662,846	28.1%
SML	1,693	2,357,456	26.9%
Bandhan	1,495	2,301,433	25.6%
AML	1,418	1,340,288	32.3%
SKDRDP	615	1,225,570	18.3%[#]
BSFL (BASIX)	776	1,114,468	25.2%
Equitas	605	888,600	26.7%
ASA GV	605	772,050	32.3%
Ujjivan	371	566,929	34.6%
Cashpor MC	267	417,039	28.0%
Grameen Koota	330	352,648	30.9%
Future Financial	244	257,991	31.8%
BSS	145	250,000	n.a.
BWDA	116	220,645	n.a.
ESAF	155	220,011	31.5%
Total	**16,695**	**21,743,002**	

* middle of range on principal product as reported by MF Transparency
\# M-CRIL information

4 Pricing caps – *not perhaps as onerous as these may appear*

Figure 1
CRILEX, 31 March 2003=100



Microfinance in India was a relatively slow growing activity until the early part of the last decade. It is only around 2003 that the advent of commercial-ization led to a significant growth impetus in the sector. This is apparent from the M-CRIL growth index for Indian microfinance (CRILEX) shown in **Figure 1**.[2] As the figure shows, by March 2010, the industry had grown to nearly 75 times the size it was in 2003. For this reason, the analysis in **Figure 2**, of the consolidated performance of the 16 large MFIs starts in March 2003.

[1] M-CRIL, 2010. **M-CRIL Microfinance Review 2010: Microfinance contributes to financial inclusion.** Gurgaon: Micro-Credit Ratings International Limited.

[2] CRILEX is a composite index incorporating both growth in portfolio and growth in numbers of clients.

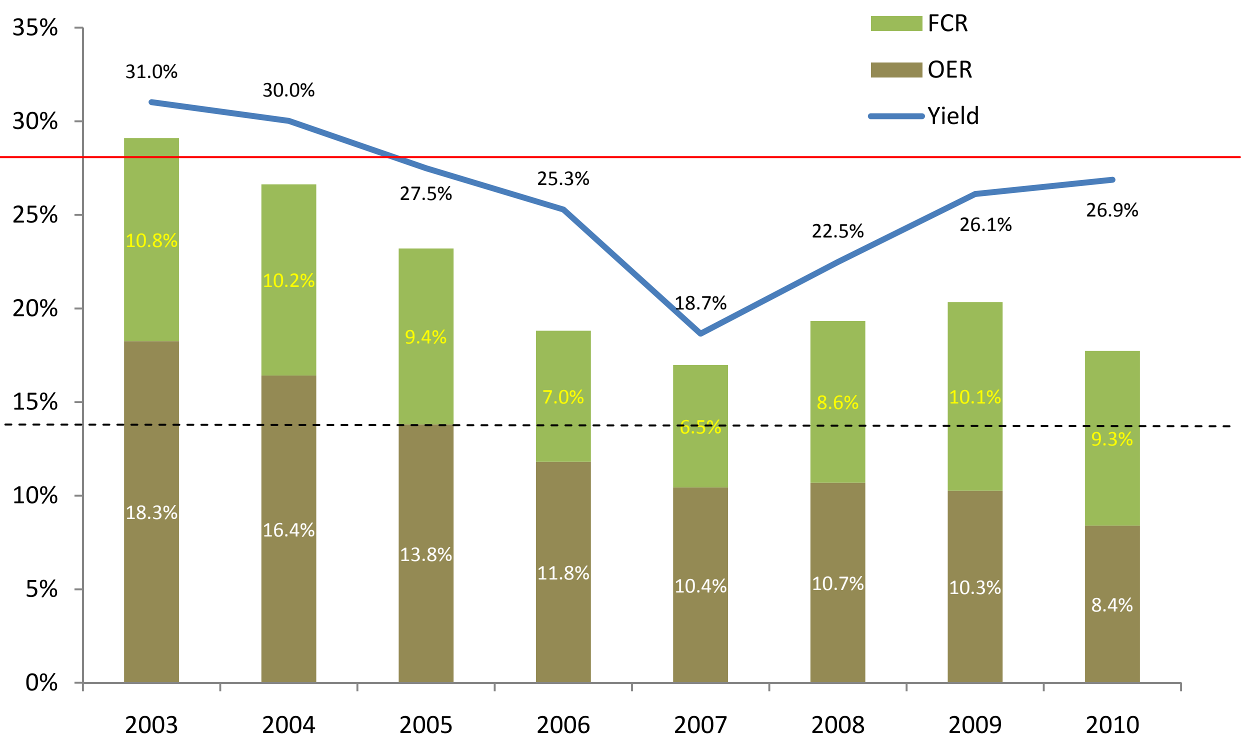
Figure 2 provides a trend analysis of the consolidated (weighted average) operating expense ratios (OER) and financial cost ratios (FCR) in comparison with the portfolio yield for the 16 MFIs over the eight years 2002-03 to 2009-10. For the purpose of this analysis and to address clearly the objectives of this paper, these indicators are defined as

a **Portfolio yield** (or simply **Yield**): Income on loan portfolio including income from interest and all types of loan processing fees as a proportion of average loan portfolio outstanding during the year. Thus the average yield amounts to the amount paid by the average client to an MFI as the cost of her loan.

b **Operating expense ratio (OER)**: All expenses incurred in lending operations including staff expenses, travel and other administrative expenses including depreciation but excluding provisioning expenses for bad debts/loan losses. Such expenses also sometimes include the cost of providing credit plus services or self-help group promotion when the MFI treats such activities as a legitimate part of its microcredit operations. The OER is calculated as the total of all such expenses incurred during the year as a proportion of the average loan portfolio outstanding during the year.

Figure 2

Consolidated – 16 largest MFIs



Clients: 21.7 million; **combined yield** *within* the interest cap;
combined operating expense *within* margin cap
red line = 28% (interest cap + loan processing fee), black line (discontinuous) = 12% (margin cap) +2% yield resulting from the 1% loan processing fee

c **Financial cost ratio (FCR)**: All financial expenses incurred by the MFI calculated as a proportion of the average loan portfolio outstanding during the year. The FCR is <u>different from the borrowing cost</u> (referred to in the RBI circular); the latter is the average cost of funds (or the weighted average cost of all loans taken by the MFI) from wholesale lenders such as commercial banks. The reason the two differ is that the amount borrowed (the denominator for borrowing cost) is not exactly the same as the amount lent (the denominator for FCR).

d **Margin**, as referred to by the RBI in setting the "margin cap", is the difference between the yield (the income earned by the MFI) and the borrowing cost (the average cost of borrowing funds). Since the borrowing cost for MFIs in general has fluctuated between 10% and 14% over the past few years, for the purpose of this paper the average is assumed to be 12%.

In theory, therefore, the **margin cap of 12%** means that MFIs must operate with

- an **OER + loan loss provisioning ratio** of 12% and the maximum portfolio yield allowed to the average MFI is, therefore, 12% (borrowing cost) + 12% margin + 2% yield on the loan processing fee leading to a total portfolio yield of **26%**.

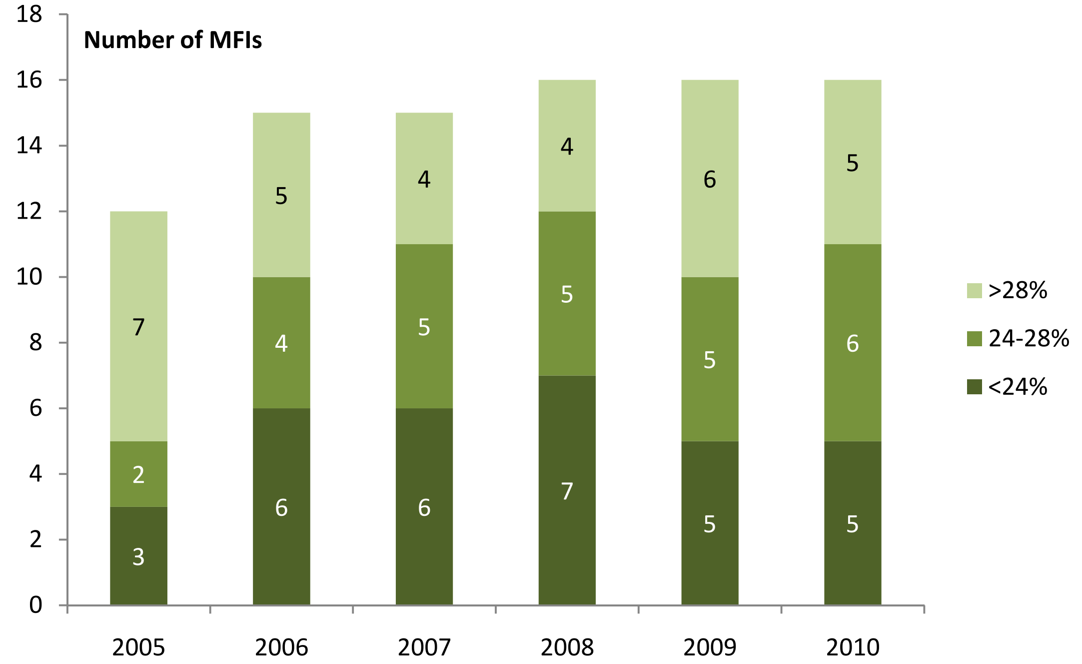
It is only if an MFI is required by banks to pay a higher borrowing cost or if the economy as a whole moves to a high interest rate regime whereby the cost of borrowing for MFIs rises to around 14% that the 28% limit on portfolio yield will become restrictive.

As the consolidated performance of the 16 largest MFIs in **Figure 2** shows, **their combined yield has been well within the RBI's specified <u>interest cap</u> of 28%** (26% + 2%) **over the 6 years**, 2004-05 to 2009-10.

Similarly, the **combined performance of the largest 16 has been comfortably within the <u>margin cap</u> of 12% + 2%** (yield resulting from the 1% loan processing fee) **for 5 years** (2005-06 to 2009-10). This would allow them to cover their operating expenses and provide a reasonable 2% for a loan loss provision as well. **What it would not provide for is a profit margin** necessary to build up their capital base to enable growth. However, with a combined OER of just over 10% over the period 2006-07 to 2008-09 a small profit margin of around 1.5% (of portfolio) would still have been available (with the current margin cap). **In 2009-10**, clearly a golden year of financial performance for Indian MFIs, **the profit margin possible even with the margin cap would have been** much larger, **of the order of 3.5%**.

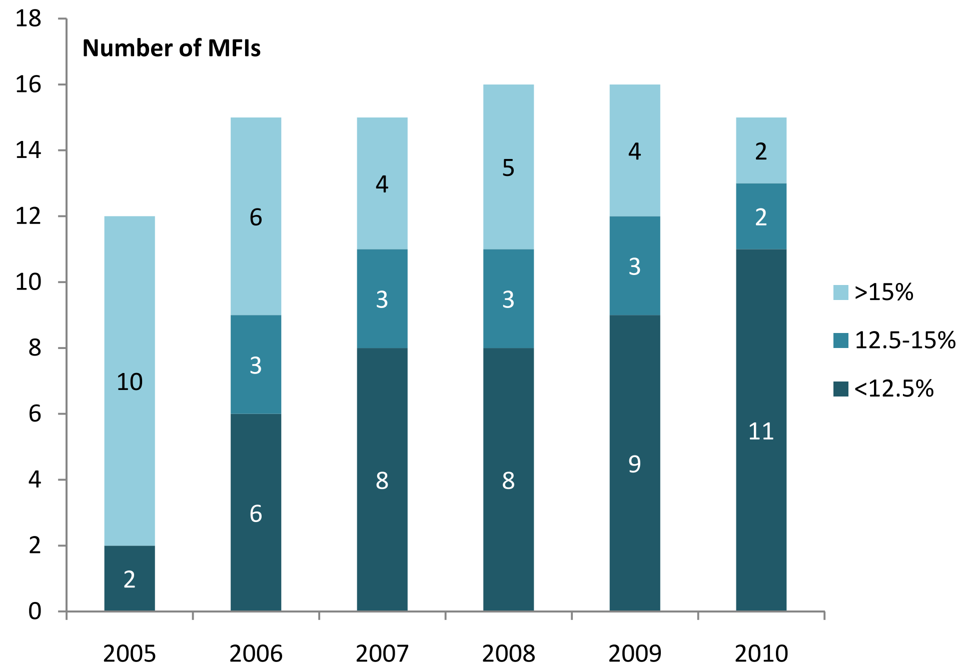
Since aggregate figures often mask issues faced by individual organizations, **Figure 3** shows the frequency of organizations whose historical performance meets the new yield criteria. It is apparent that since 2005-6, two-thirds of these MFIs have been within the criteria, with around one-third (5 of these largeMFIs) have obtained higher yields on their portfolios than will now be permitted with the pricing caps. The **annex tables** provide a presentation of the performance of individual MFIs (based on Mix Market data). *With the highest yield of any individual MFI in this group being less than 34% (and that is one of the smallest ones in this group) this debunks the allegations in the media that MFIs have been charging interest rates of 50% and above.*

Figure 3
Yield levels of large MFIs – frequency



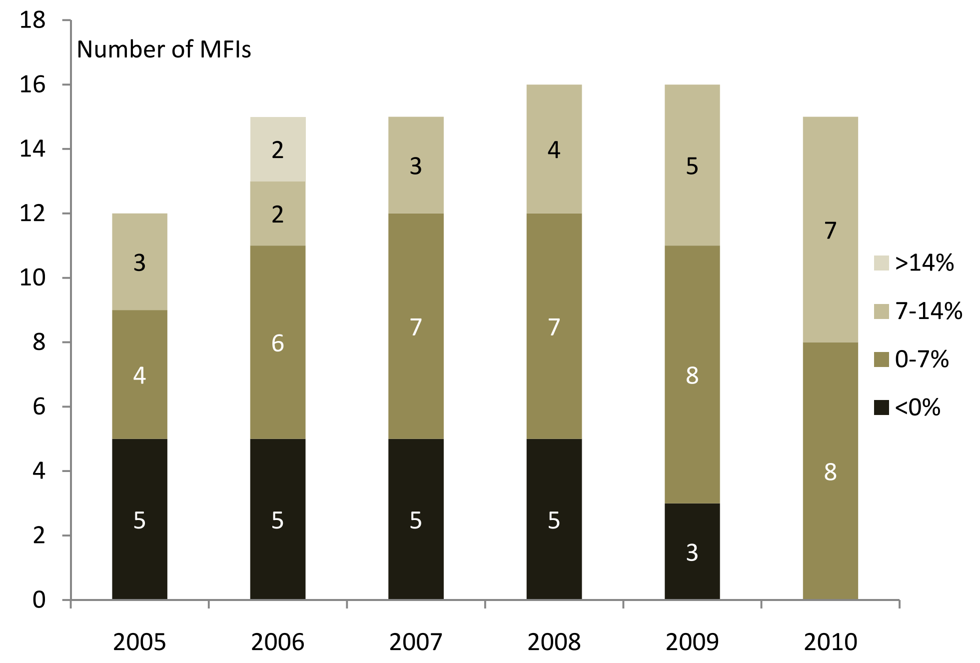
With the margin allowed being effectively 14%, but needing something of the order of 1-2% for loan loss provisioning (in normal times, rather than in the extraordinary AP crisis situation today), MFIs must restrict their operating expenses (OER) at least to 12.5% (assuming 1.5% to be the average loan loss provision required). The frequency of large MFIs operating within the OER level of 12.5% (presented in **Figure 4**) over the past few years shows how dramatically operating expense ratios have decreased over the years. Over the six years from 2004-05 to 2009-10, the number of large MFIs operating beyond the 12.5% level of OER has decreased from 10 (out of

Figure 4
OERs of large MFIs – frequency



the 12 for which usable information is available for that year) to just 4 (of 15). Of those four with higher expenses, two have less than 15% OER, so should be able to meet the margin cap with ease. Only two, BASIX and Ujjivan, are beyond this level – the latter because it is a relatively new MFI that is reducing its OER significantly from one year to the next (**Annex 1.12**) and the former because it sees itself as a "livelihood promotion institution" providing significant credit-plus services. It is likely that 'externalizing' BASIX's credit-plus activities from the calculation (if that is possible!) would bring its OER down to less than 12.5%. Thus, **it is apparent that the margin cap set by the RBI should not be a problem for any of the large MFIs.**

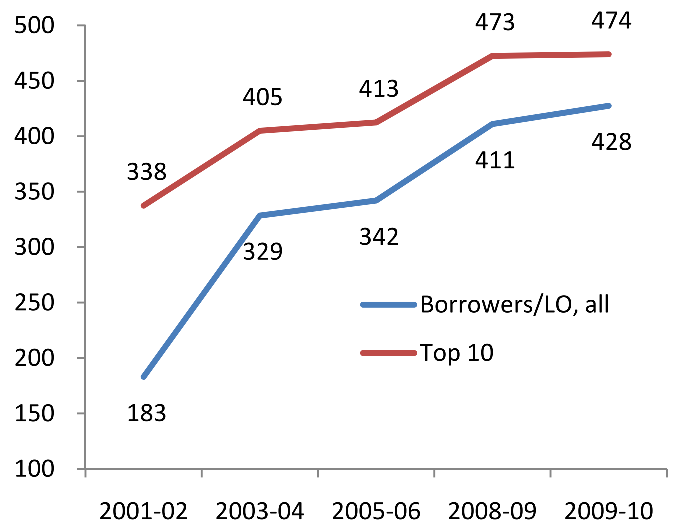
Figure 5
Margin levels – frequency



This is confirmed by **Figure 5**. While a few years ago a couple of MFIs would not have met the margin cap, in the "golden year" of 2009-10, all 15 MFIs (for which information is available) not only operated within the 14% margin now set but none made an operating loss either (unlike in earlier years). **From the perspective of providing microcredit services to increasing numbers of people through large MFIs, therefore, the margin cap does not seem to present a significant problem.**

However, there are other issues behind these numbers

Figure 6
Trend in loan officer (LO) caseloads of Indian MFIs



First, it has been argued elsewhere by M-CRIL that the large MFIs have reduced their operating expense ratios over the past few years by reducing their relationship with their clients, thereby altering the nature of the relationship from that of development supporter to that of a money lender. **Figure 6** shows the extent to which loan officer caseloads have increased over the period of this analysis. Since caseloads now average nearly 500 clients per MFI loan officer (and rise up to 800 for some MFIs), they now spend little time getting to know their clients and building a rapport with them by understanding their economic situations as well as discussing social and development issues. To this extent micro-credit has evolved from poverty-based lending to exclusively commercial lending.[3] This needs to be re-balanced to enable MFIs to understand their clients better and to focus on serving client needs (with more appropriate products) rather than merely revolving money to generate an income without caring about those needs.

Second, while large numbers of people in the heartland of the country – especially the better developed states – can be served within this capping regime, it is not clear that the same applies to those based in tribal areas, the hill and desert areas and other infrastructure challenged areas such as the north-east.

Third, despite the over-charged environment of micro-lending prevailing in some clusters of the country – much of the south and east, for instance – there remain some areas of UP, Bihar, Gujarat and elsewhere that are under-served by microfinance, indeed, lacking any inclusive finance services. Incentivising MFIs to operate in these areas rather than in the over-served clusters should be an important part of the policy. M-CRIL has already suggested a formula whereby the coverage of financially excluded families in a given area can be used to obtain a weight for calculating the prudential minimum of capital required (relative to the MFI's risk weighted assets to operate in that area) – see reference.[4]

Clearly there is a case for the regulator to allow relaxations of the pricing caps in two situations

c When a small MFI operates in infrastructure challenged areas and in under-served parts of the country, and
d When an MFI is new and small – within three years of start-up and with less than 50,000 clients.

and to introduce other measures such as a weighted calculation of the capital adequacy ratio that incentivizes MFIs to work in under-served areas**.**

Such exceptions should naturally be time-bound; the regulator's discretion here is important and having the information and understanding of microfinance necessary to take such decisions is essential. This is one of the reasons why the RBI should ideally establish a division that specializes in microfinance.

---

[3] It is easy to forget that in the late-1990s neoclassical microfinance experts actually accused Indian MFIs of indulging in "wasteful poverty lending".

[4] M-CRIL, 2010. **M-CRIL's Supplementary on the Malegam Committee Report.** Gurgaon, 10 February (www.m-cril.com)

5 The income and loan size criteria

It is commonly acknowledged that over 60% of the population is financially excluded. Inevitably these are families with relatively low incomes. It is clearly inappropriate to regard all of these as belonging to a single category of microcredit user. Based on the available data, this paper uses four income thresholds – below the national poverty line (NPL, equivalent to $0.85 per person per day) and the international thresholds of $1.25 per person per day, $1.50 per person per day and $2 per person per day – to categorise microcredit clients. This is based on the understanding that for people in different income categories, there will be differences in the appropriate loan sizes and lending conditions (products). This analysis makes a preliminary attempt at addressing this issue in the context of the RBI circular.

The income and loan size criteria incorporated in the RBI's circular of 3 May 2011, defining the qualifying MFI assets for priority lending by commercial banks are

Income limit for eligible borrowers from MFIs	Rural: Rs60,000 Urban: Rs1,20,000
Loan size (maximum)	First cycle: Rs35,000 Subsequently: Rs50,000

Using NSSO Round 62 (2005-06) data and drawing on the work of Mark Schreiner supported by the Grameen Foundation, to develop a poverty score card for India,[5] EDA Rural Systems (M-CRIL's parent company) has worked out the equivalent household poverty rates and annual household income levels (at 2009-10 prices) for the national poverty line and for various internationally recognized poverty thresholds. These are presented in columns (1) to (4) of **Table 2**, below. It shows that, using the Rs60,000 income criterion for rural areas makes any family with income above the $1.25 per day threshold ineligible for a microfinance loan. This is confirmed by the state-level information presented separately for the major states in **Annex Table 2**.

Table 2

Calculation of borrowing capacity at various income levels of financially excluded households

		Income/household ₹ per year at various threshold levels				**Maximum borrowing capacity, ₹ per year**			
Region	**State**	**National***	**$1.25/day**	**$1.5/day**	**$2/day**	**National**	**$1.25/day**	**$1.5/day**	**$2/day**
% of population (2005-6) with income less than...		18	51	66	84	18	51	66	84
Rural					**Borrowing capacity**	**10%**	**20%**	**25%**	**50%**
Columns		**(1)**	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**	**(7)**	**(8)**
	India	**38,311**	**57,513**	**69,027**	**92,026**	**3,831**	**11,503**	**17,257**	**46,013**
Urban									
% with income less than...		15	20	30	49	15	20	30	49
India		**54,786**	**60,499**	**72,599**	**96,799**	**5,479**	**12,100**	**18,150**	**48,400**

[5] Schreiner, Mark, **A Simple Poverty Score Card for India**, 2008. www.progressoutofpoverty.org

In the case of urban areas, every household with income below the $2 a day threshold is eligible. Using 2005-06 data for household poverty rate, this suggests that, as a result, 51% of households in rural areas and 49% of households in urban areas would qualify for micro-credit while the remaining ~30% of the population above the $1.50 per day level in rural areas (but below $2 per day and, crucially, still mostly financially excluded) would not be eligible.

Assuming some reduction in the household poverty rate since 2005-06 (say at the rate of 1% per annum), the proportion of population that qualifies for microfinance loans in 2009-10 amounts to 47% and 45% in rural and urban areas respectively. In theory, this seems to be a large enough segment of the population for microfinance to be provided viably.[6]
In practice, the **maximum loan size** criterion also affects this assessment. One of the arguments of the critics of microfinance has been that MFIs have over-burdened low income borrowers with loans and this has led to hardship through foregone meals, sale of assets, borrowing from money lenders and other forms of distress for families struggling to keep up with the payment of regular instalments on their loans. It is important, therefore, to estimate a maximum reasonable amount of loan repayment that a family can make from its annual income. The calculations in columns (5) to (8) of **Table 2** are based on the assumptions summarized in **Table 3**.

Table 3
Assumptions on ability to set aside incomes for loan payments

Threshold income	Proportion of income that can be reasonably set aside for loan payments*
National poverty line	10%
$1.25 a day	20%
$1.5 a day	25%
$2 a day	50%

*after meeting the basic needs of the family

The figures presented in columns (5) to (8) of **Table 2** show the maximum borrowing capacity of families in various income categories using these assumptions. This suggests that the Rs35,000 income criterion for a first cycle loan is well beyond the borrowing capacity of all families below the $1.50 per day threshold but is appropriate for a significant proportion (the upper 50%) of those above this threshold but with less than $2 a day. Those with incomes close to $2 a day would easily be able to cope with payments on a first cycle loan on this basis and also with a second cycle loan (of up to Rs50,000). However, such people would not satisfy the income criteria (discussed above) in the rural areas while they would satisfy the income criteria in the urban areas. This analysis is summarized in **Table 4** below.

[6] Though disaggregated at the state level, the proportion ranges from 33% in Rajasthan to 74% in Chattisgarh – see **Annex Table 2**.

Table 4

Summary of findings on income and loan size criteria

	Categories of income below various threshold levels			
Rural	**National***	**$1.25/day**	**$1.5/day**	**$2/day**
Income criterion	OK	OK	No	No
Loan size limit	Too high			OK for most, first cycle limit may be low for others
Urban				
Income criterion	OK	OK	OK	OK
Loan size limit	Too high			OK for most, first cycle limit may be low for others

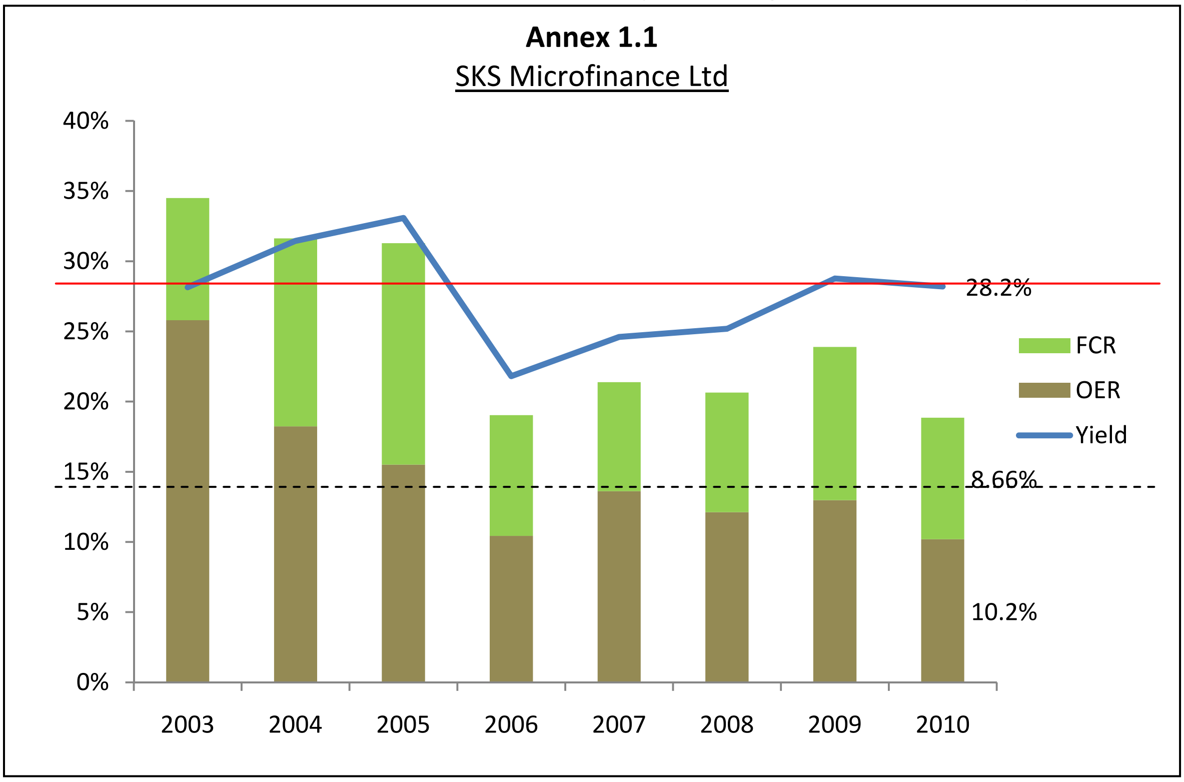
Essentially, the RBI's separate urban income criterion enables all those in urban households with income less than $2 per person per day to use microcredit services but not all those in rural areas. This means that while around 60% of the population overall is generally estimated to be financially excluded, only about 47% can get access to microcredit services. **The loan size limit of Rs35,000 in the first cycle enables everyone in all areas with incomes less than $2 a day to borrow, however, critically, it leaves all those with less than $1.5 per day open to over-indebtedness and it may not be high enough for those close to the $2 a day threshold.** The implication of this finding is that the criteria need to be nuanced using the available data on both national and state poverty levels and for different income categories. There needs to be consistency between income thresholds and loan size limits based on estimates of capacity to repay loan instalments of a reasonable size.

The Progress out of Poverty Index (PPI) is a practical tool to benchmark poverty levels. Where it has been applied by MFIs (as part of their own outreach tracking system, or as part of a social rating/audit) the results show that the market served by microfinance is very diverse. MFI clients – those excluded from formal financial services – are low income and poor, at different income levels, including those below the national poverty line. The challenge is to recognize these different market segments, to provide appropriate loans of different sizes – and to have a method that helps to identify these segments.[7]

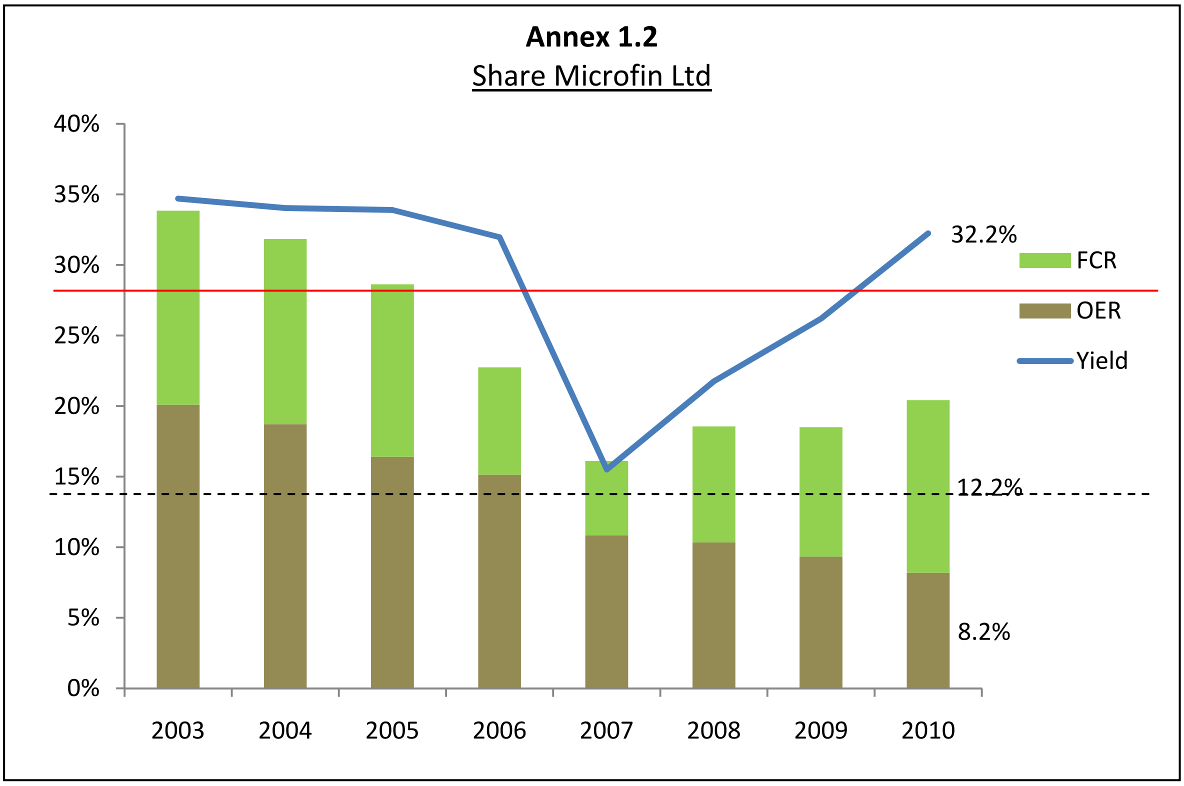
Again the need for the regulator to develop a specialist knowledge of microfinance is paramount. It could also use the services of specialist agencies – such as M-CRIL – to both monitor and enhance its understanding of the implications of the regulations proposed and introduced.

[7] The PPI for India will be updated this year from the latest NSSO data that is now becoming available

All data for financial year ending on 31 March of the year shown

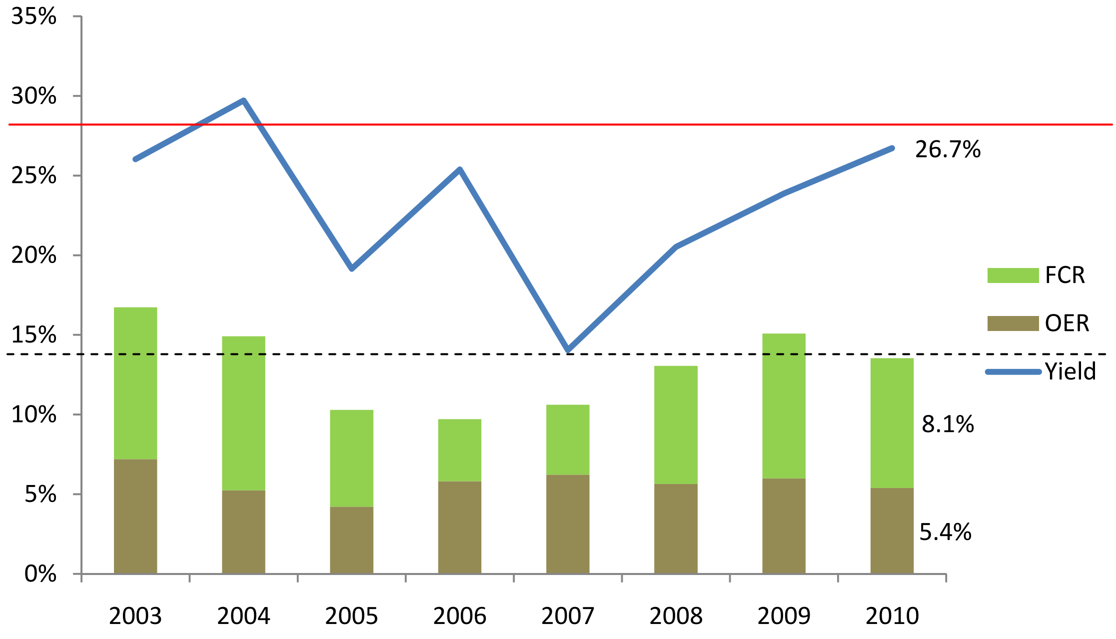


Clients: 5.8 million; **yield** *exceeds* interest cap; **operating expense** = margin cap



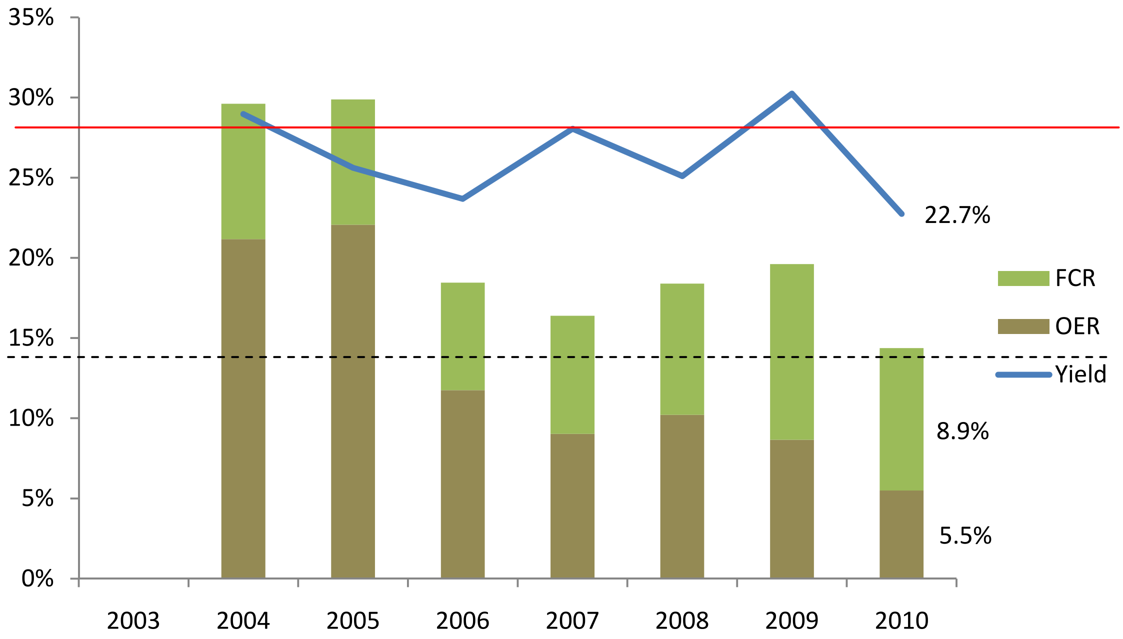
Clients: 2.8 million; **yield** *exceeds* interest cap; **operating expense** *within* margin cap

Annex 1.3
Spandana Spoorthy Financial Ltd



Clients: 3.7 million; **yield** *equals* interest cap; **operating expense** *well within* margin cap

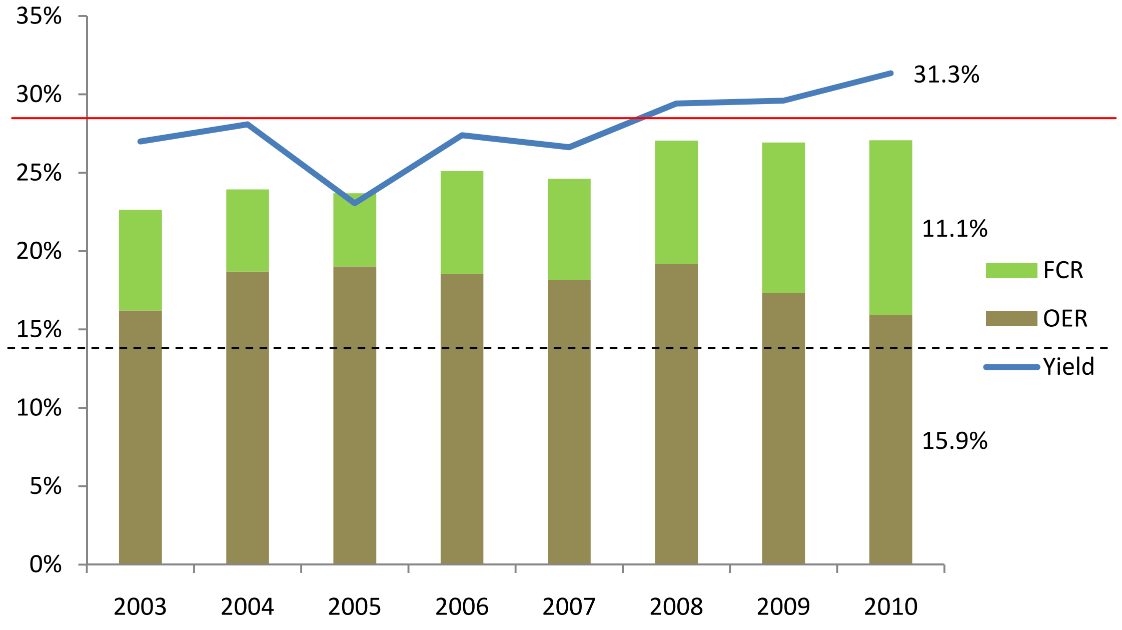
Annex 1.4
Bandhan Financial Services Pvt Ltd



Clients: 2.3 million; **yield** *within* interest cap; **operating expense** *well within* margin cap

Annex 1.5

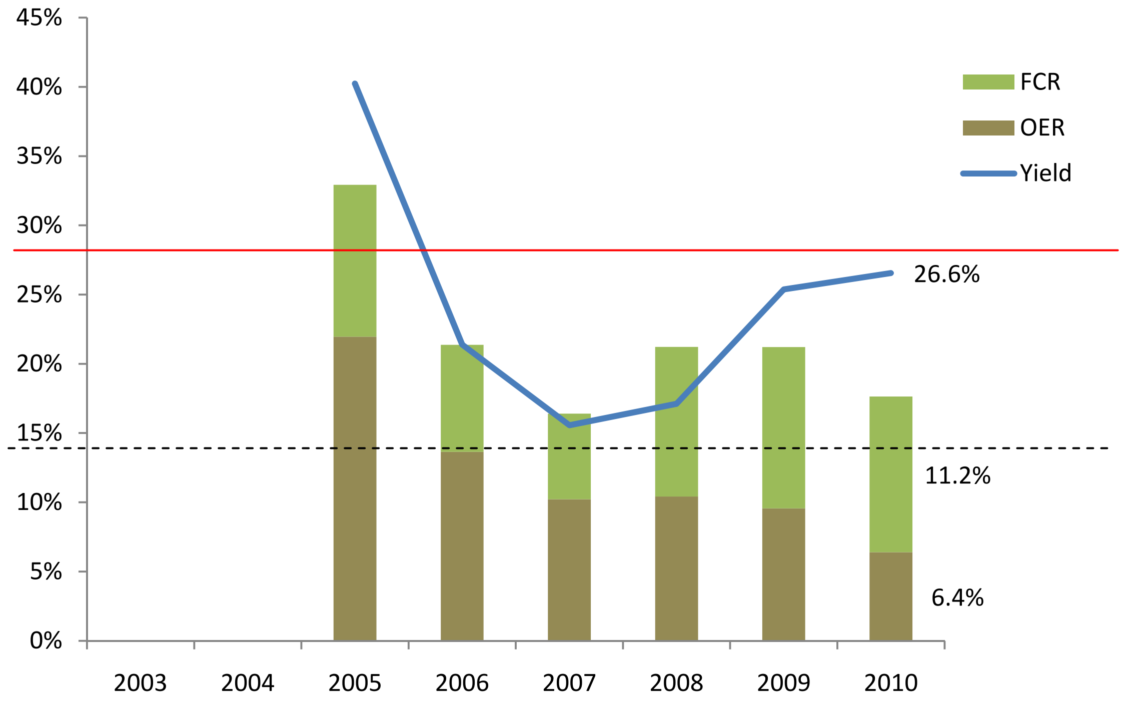
Bhartiya Samruddhi Finance Ltd [BASIX]



Clients: 1.1 million; **yield** exceeds interest cap; **operating expense** *much higher than* margin cap

Annex 1.6

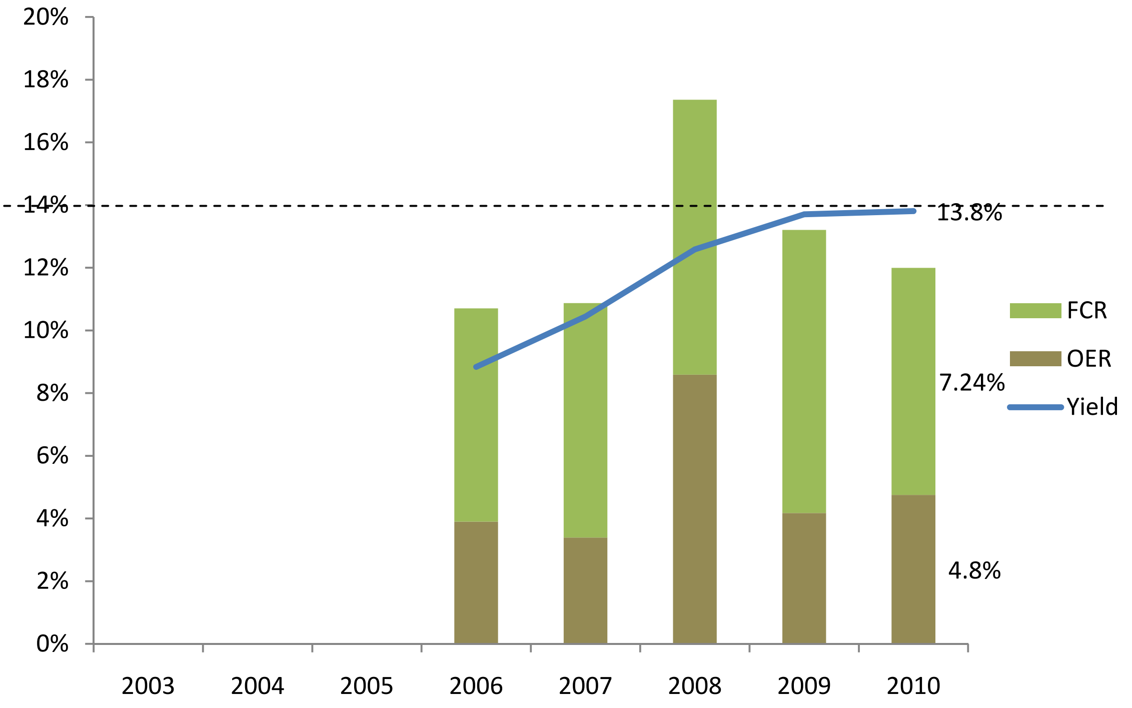
Asmitha Microfinance Ltd



Clients: 1.3 million; **yield** *equals* interest cap; **operating expense** *well within* margin cap

Annex 1.7

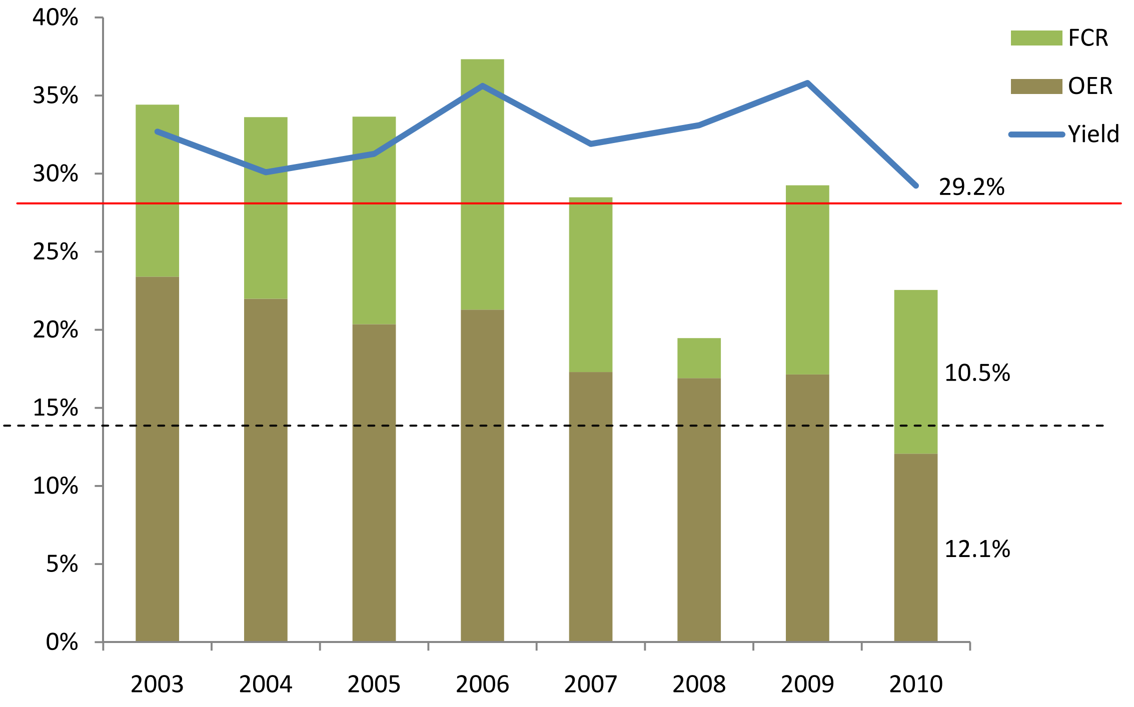
SKDRDP



Clients: 1.2 million; **yield** *well within* interest cap; **operating expense** *well within* margin cap

Annex 1.8

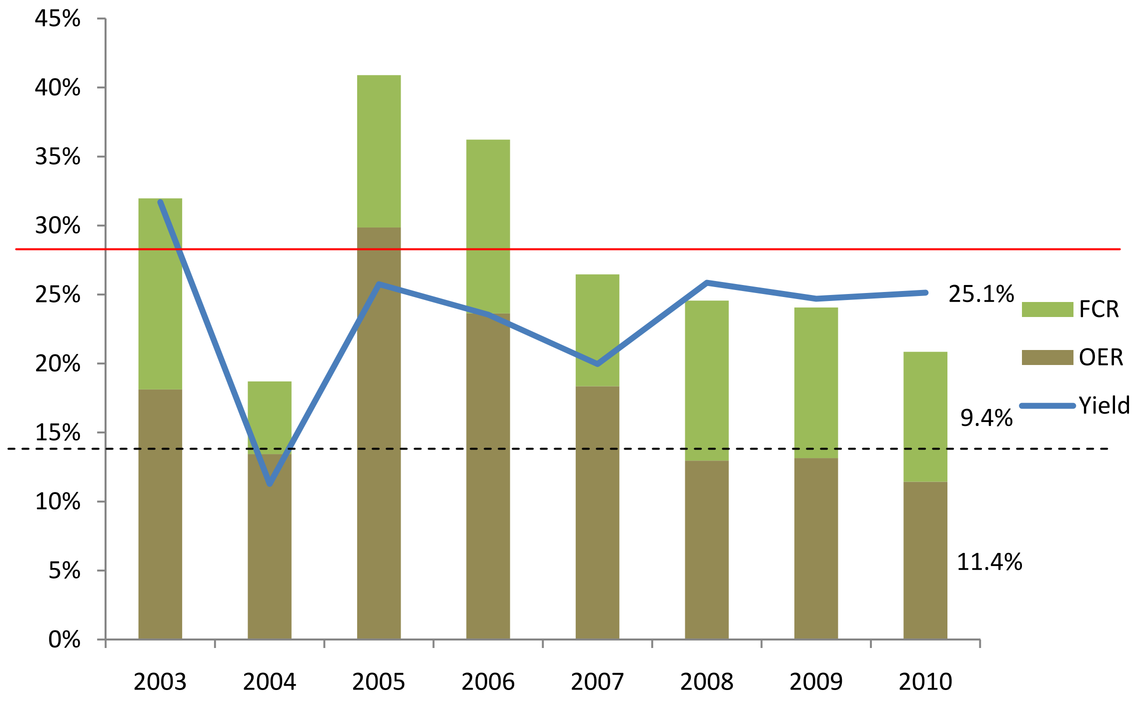
Grama Vidiyal Microfinance Ltd



Clients: 0.77 million; **yield** *exceeds* interest cap; **operating expense** *exceeds* margin cap

Annex 1.9

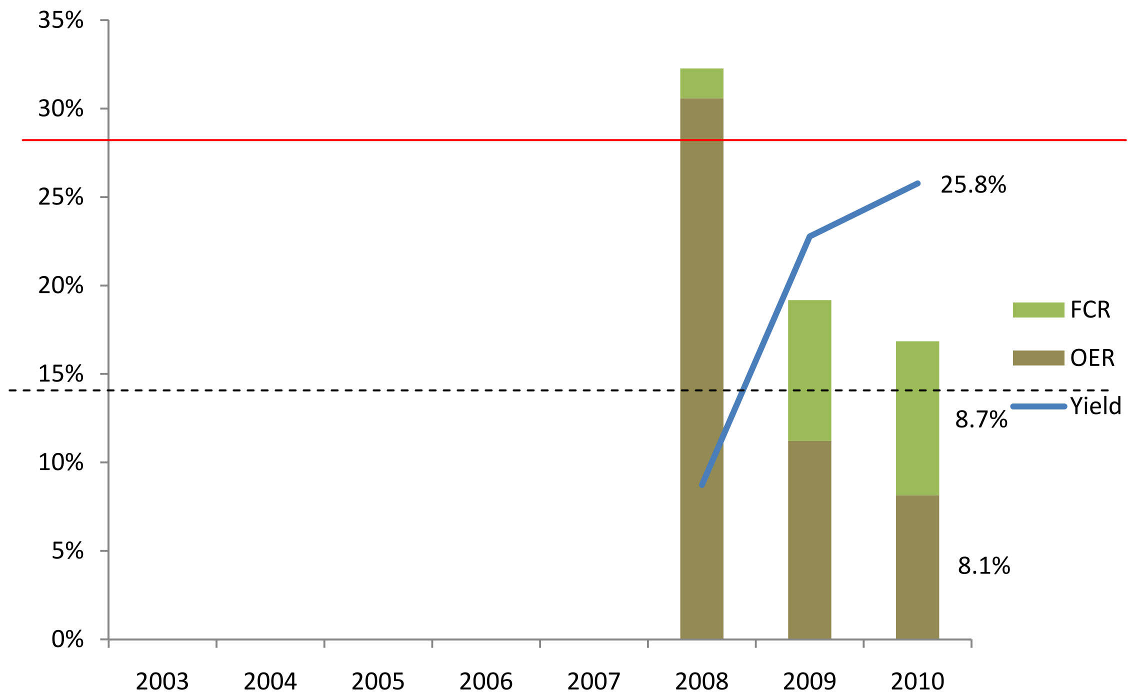
Cashpor Micro Credit



Clients: 0.42 million; **yield** *within* interest cap; **operating expense** *exceeds* margin cap

Annex 1.10

Equitas Microfinance India

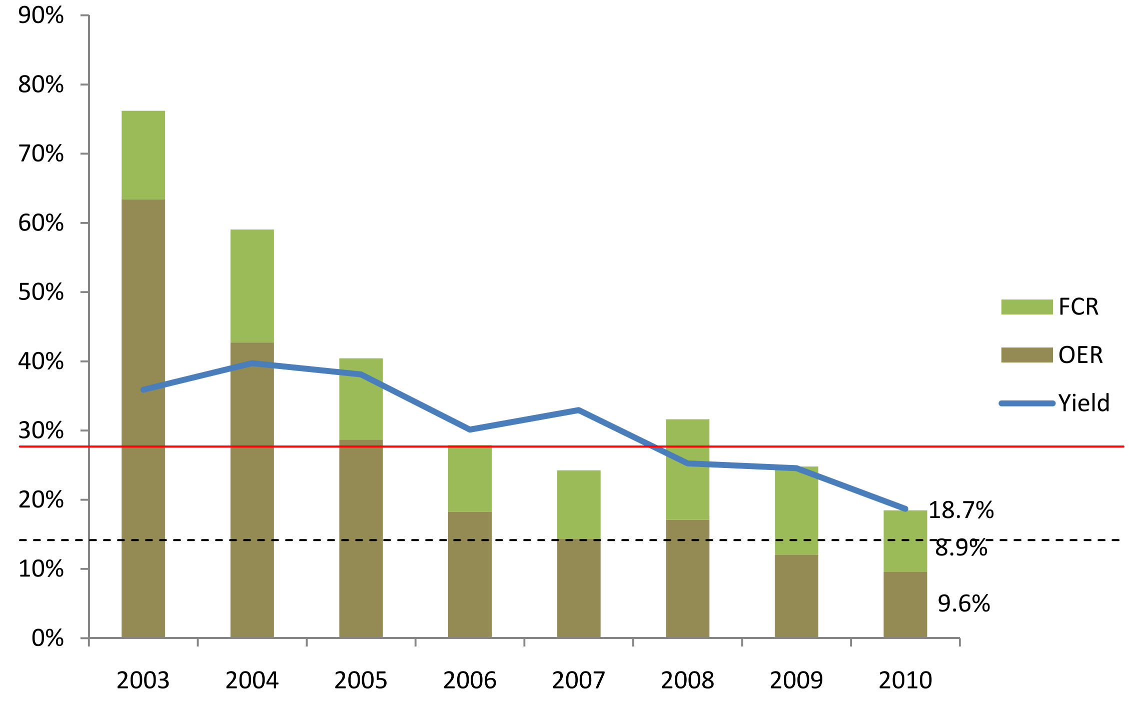


0

Clients: 0.89 million; **yield** *within* interest cap; **operating expense** *within* margin cap

Annex 1.11

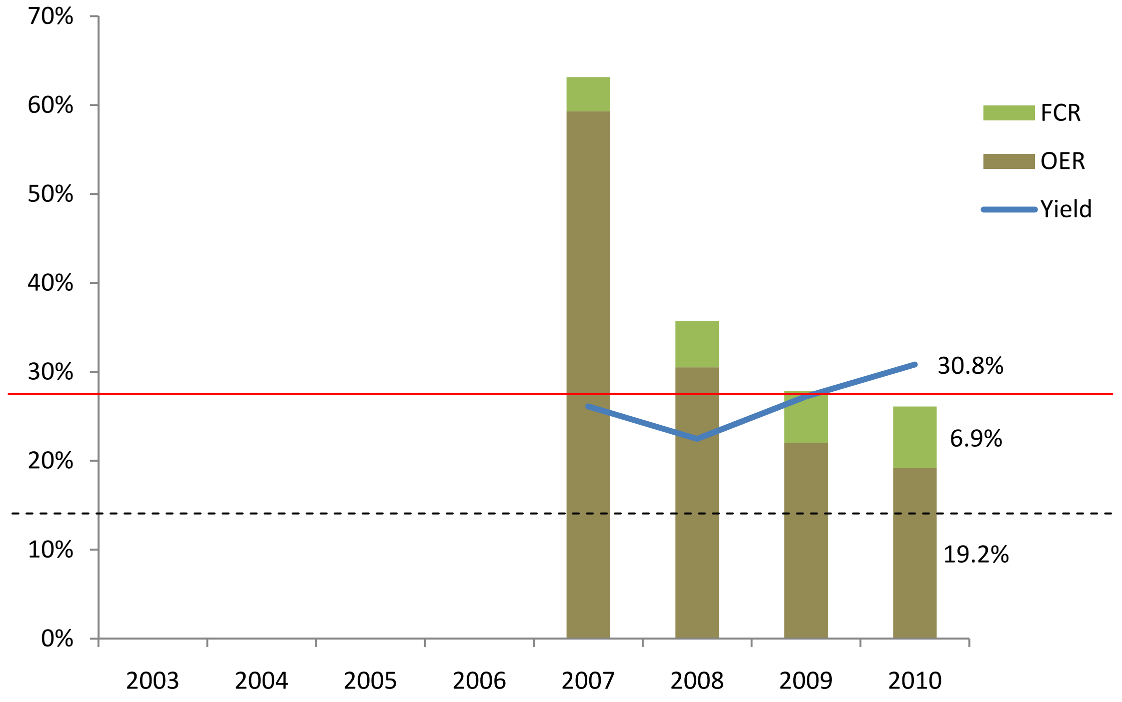
Grameen Koota/Grameen Financial Services Ltd



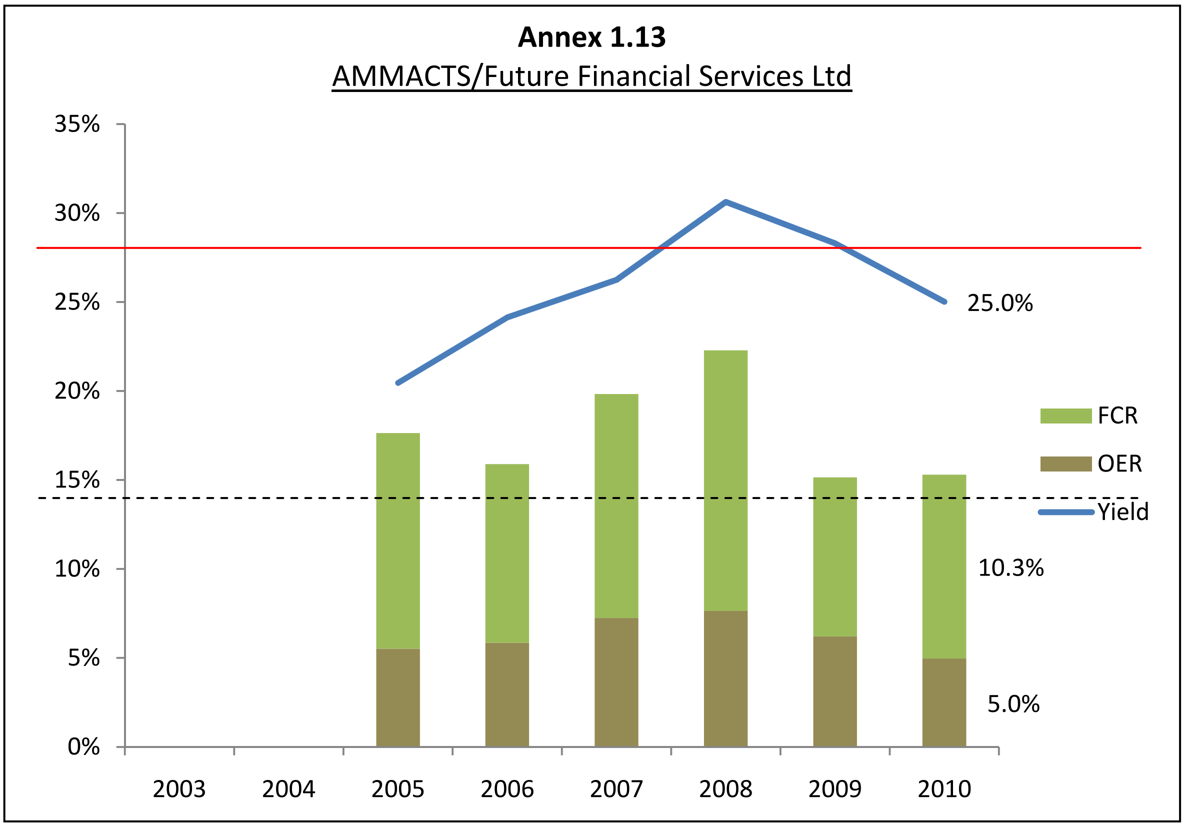
Clients: 0.35 million; **yield** *well within* interest cap; **operating expense** *within* margin cap

Annex 1.12

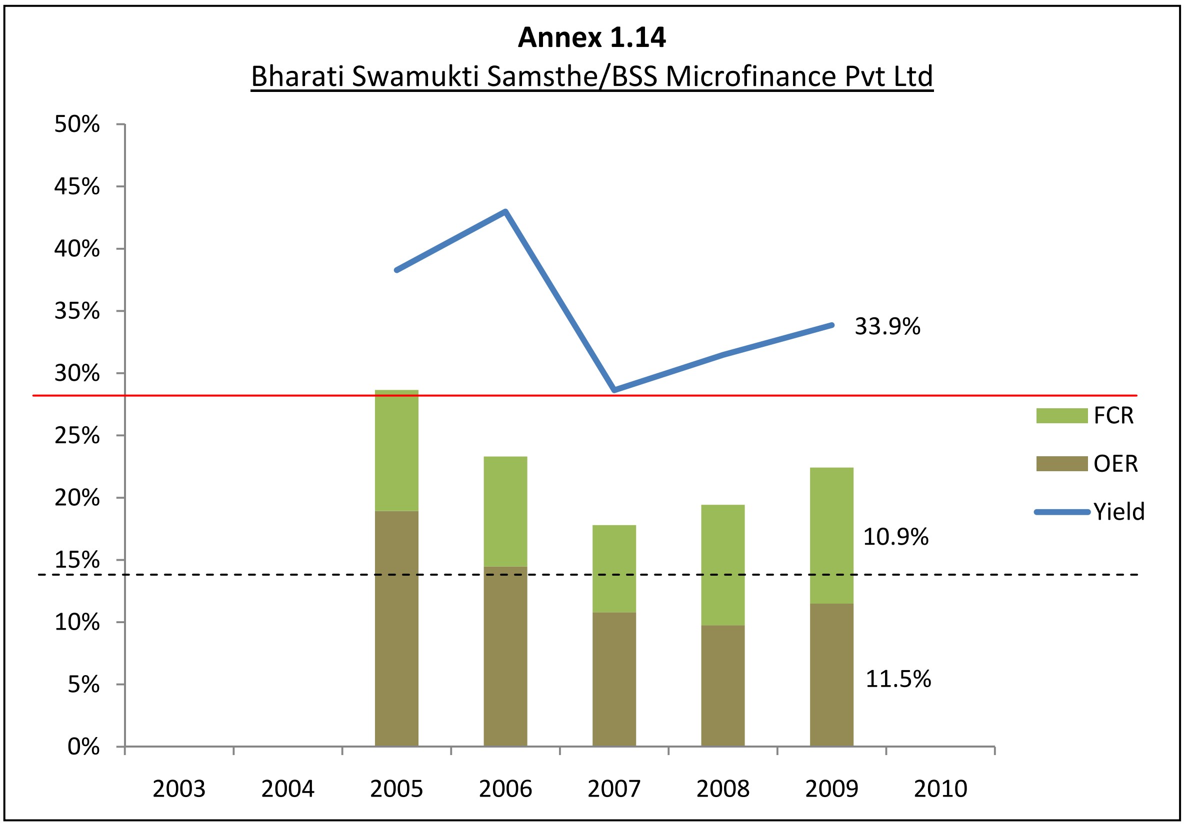
Ujjivan Financial Services Ltd



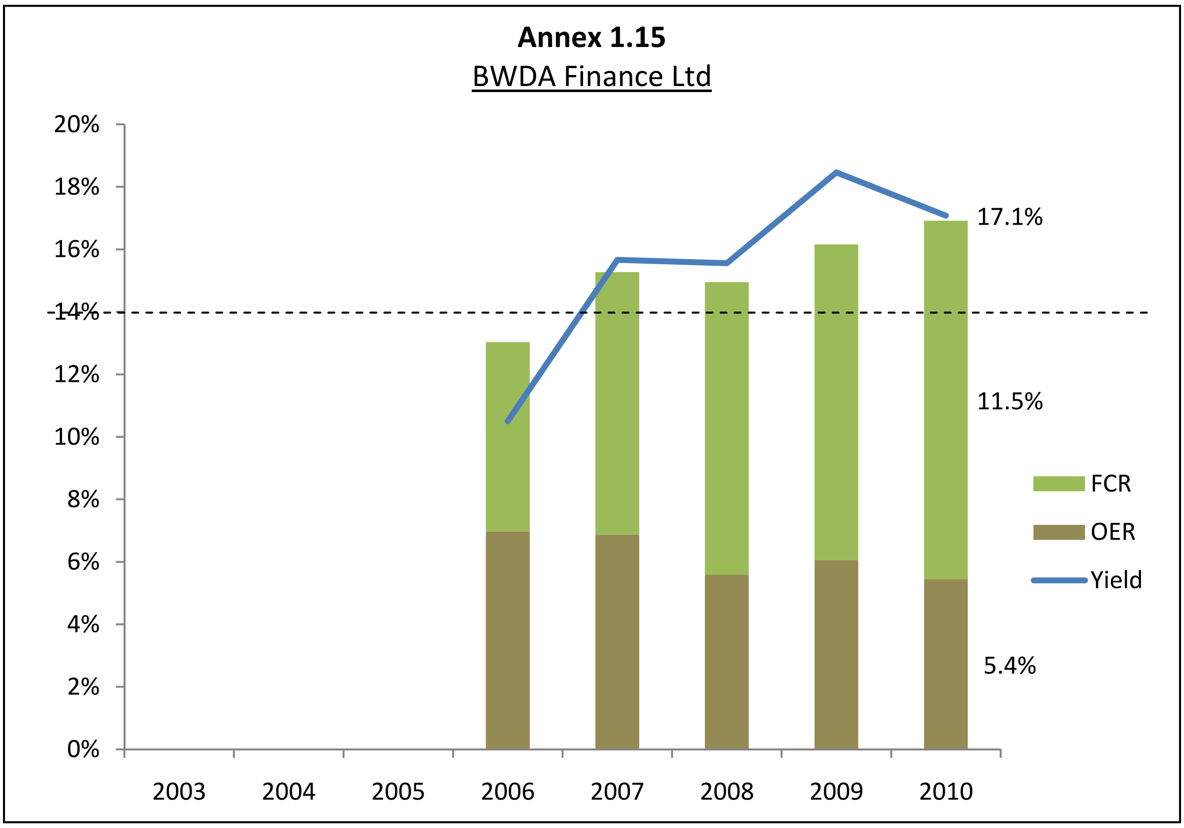
Clients: 0.57 million; **yield** *exceeds* interest cap; **operating expense** *exceeds* margin cap



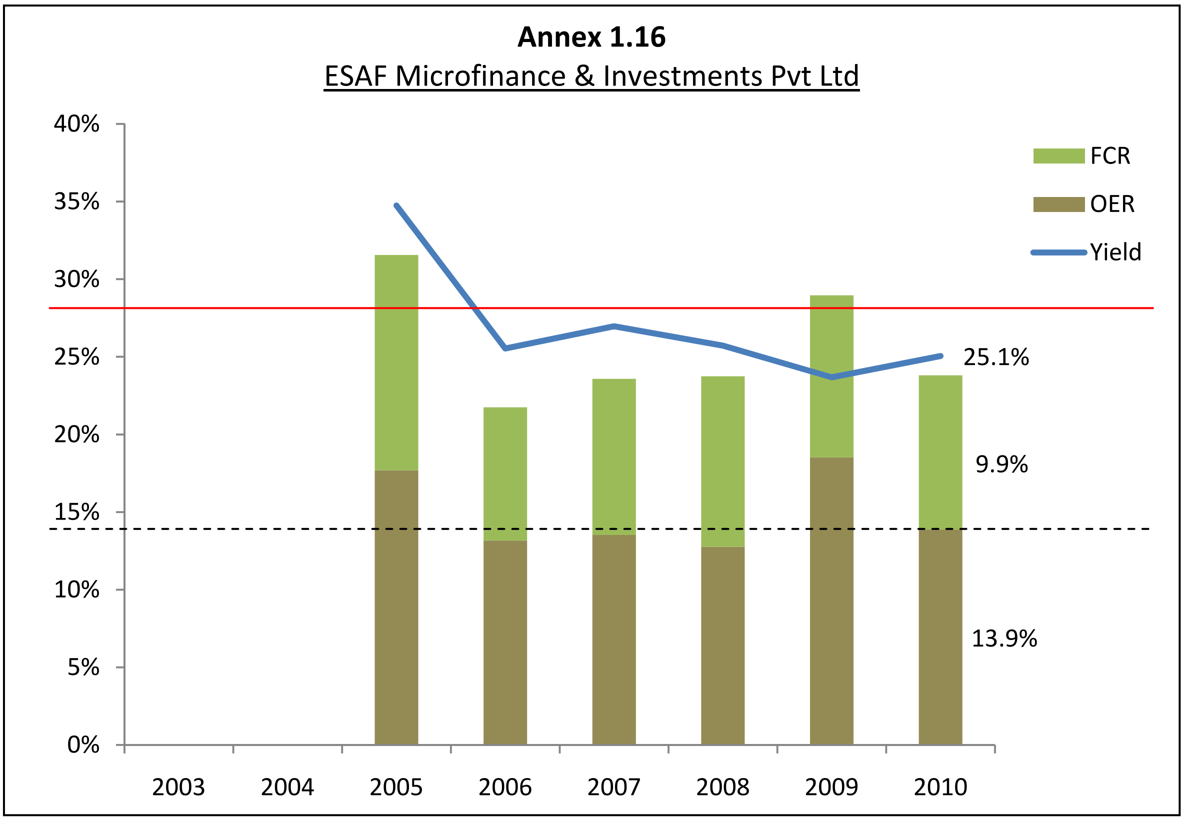
Clients: 0.26 million; **yield** *within* interest cap; **operating expense** *well within* margin cap



Clients: 0.25 million; **yield** *exceeds* interest cap; **operating expense** *exceeds* margin cap



Clients: 0.22 million; **yield** *within* interest cap; **operating expense** *well within* margin cap



Clients: 0.22 million; **yield** *within* interest cap; **operating expense** *exceeds* margin cap

Annex Table 2

Calculation of borrowing capacity at various income levels
of financially excluded households (state-wise)

		Income/household per year at various poverty levels				Maximum borrowing capacity, ₹ per year			
Region	**State**	**National***	**$1.25/day**	**$1.5/day**	**$2/day**	**National**	**$1.25/day**	**$1.5/day**	**$2/day**
% of population with lower income (2005-6)		18	51	66	84	18	51	66	84
Rural					**Borrowing capacity**	**10%**	**20%**	**25%**	**50%**
Columns		**(1)**	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**	**(7)**	**(8)**
	India	**38,311**	**57,513**	**69,027**	**92,026**	**3,831**	**11,503**	**17,257**	**46,013**
South	Andhra Pr	31,118	56,988	68,379	91,193	3,112	11,398	17,095	45,596
	Karnataka	34,452	59,396	71,281	95,021	3,445	11,879	17,820	47,510
	Kerala	45,720	68,842	82,611	110,117	4,572	13,768	20,653	55,058
	Tamil Nadu	37,385	61,958	74,337	99,127	3,738	12,392	18,584	49,563
West	Gujarat	37,601	62,082	74,492	99,312	3,760	12,416	18,623	49,656
	Maharashtra	38,496	58,902	70,664	94,218	3,850	11,780	17,666	47,109
Central/ North	Chhattisgarh	34,267	58,284	69,923	93,230	3,427	11,657	17,481	46,615
	Madhya Pr	34,822	53,191	63,810	85,111	3,482	10,638	15,953	42,556
	Uttar Pr	38,867	51,616	61,958	82,611	3,887	10,323	15,490	41,305
	Rajasthan	39,793	59,612	71,528	95,391	3,979	11,922	17,882	47,696
	Delhi	43,621	57,204	68,657	91,532	4,362	11,441	17,164	45,766
East	Bihar	37,663	54,642	65,570	87,427	3,766	10,928	16,392	43,713
	Orissa	34,606	55,321	66,373	88,507	3,461	11,064	16,593	44,254
	West Bengal	40,688	56,494	67,793	90,359	4,069	11,299	16,948	45,180
NE	Assam	41,182	62,575	75,078	100,115	4,118	12,515	18,770	50,057
	Manipur	41,182	62,575	75,078	100,115	4,118	12,515	18,770	50,057
Urban									
% with lower income		15	20	30	49	15	20	30	49
India		**54,786**	**60,499**	**72,599**	**96,799**	**5,479**	**12,100**	**18,150**	**48,400**
South	Andhra Pr	54,904	58,654	70,373	93,840	5,490	11,731	17,593	46,920
	Karnataka	60,646	62,140	74,562	99,407	6,065	12,428	18,641	49,703
	Kerala	56,574	65,128	78,166	104,211	5,657	13,026	19,541	52,106
	Tamil Nadu	55,343	62,785	75,353	100,461	5,534	12,557	18,838	50,231
West	Gujarat	54,728	64,455	77,375	103,157	5,473	12,891	19,344	51,578
	Maharashtra	67,326	65,802	78,957	105,266	6,733	13,160	19,739	52,633
Central/ North	Chhattisgarh	56,632	58,419	70,080	93,459	5,663	11,684	17,520	46,730
	Madhya Pr	57,658	55,636	66,769	89,035	5,766	11,127	16,692	44,518
	Uttar Pr	48,868	56,603	67,912	90,559	4,887	11,321	16,978	45,279
	Rajasthan	56,603	59,474	71,369	95,188	5,660	11,895	17,842	47,594
	Delhi	61,994	68,849	82,619	110,159	6,199	13,770	20,655	55,079
East	Bihar	43,976	54,874	65,832	87,775	4,398	10,975	16,458	43,888
	Orissa	53,439	53,175	63,810	85,080	5,344	10,635	15,953	42,540
	West Bengal	45,441	59,064	70,871	94,514	4,544	11,813	17,718	47,257
NE	Assam	38,321	64,777	77,726	103,625	3,832	12,955	19,432	51,813
	Manipur	38,321	64,777	77,726	103,625	3,832	12,955	19,432	51,813

Annex Table 3

Proportion of population with income below various thresholds/poverty lines (2005-06)

		Rural				Urban			
		National	$1.25/day	$1.5/day	$2/day	National	$1.25/day	$1.5/day	$2/day
	All India	18	51	66	84	15	20	30	49
South	Andhra Pradesh	9	46	66	85	16	21	29	48
	Karnataka	14	65	75	89	21	22	32	51
	Kerala	7	28	40	62	11	15	28	46
	Tamil Nadu	14	49	62	83	12	18	32	52
West	Gujarat	10	47	58	82	9	14	27	53
	Maharashtra	12	41	55	79	19	18	26	41
Central/ North	Chhattisgarh	33	80	91	98	19	20	30	50
	Madhya Pradesh	24	64	79	90	26	24	36	59
	Uttar Pradesh	20	45	66	85	20	28	39	57
	Rajasthan	11	39	61	83	17	23	35	55
	Delhi	0	2	11	53	3	6	19	33
East	Bihar	28	69	82	95	26	44	57	72
	Orissa	35	73	81	91	29	29	36	53
	West Bengal	19	54	69	87	11	19	29	47
NE	Assam	14	55	72	90	2	9	18	37
	Manipur	1	36	71	94	0	32	66	81

EDA Rural Systems Private Limited

Micro-Credit Ratings International Limited

602 Pacific Square, 32nd Milestone NH8, Gurgaon 122 001 INDIA
Tel: +91 124 230 9497, 230 9707, 405 0739, 426 8707
Fax: +91 124 230 9520
e-mail: contact@m-cril.com
website: www.m-cril.com