

Do rural microcredit borrowers fare better in reducing poverty than urban borrowers?

Key findings

- Rural microcredit borrowers are on average poorer than their urban counterparts.
- By comparison with urban borrowers, rural borrowers, on average, experience a higher reduction in poverty over time.
- For mission-focused MFIs, targeting disadvantaged rural people is an effective strategy for achieving higher social returns on their investments.
- The poverty score of exit borrowers is different (could be higher or lower) when compared with those who took out one extra loan from MFIs.
- Over a period of five years, the attrition rate of borrowers among MFIs is severe at 65-95%. Further research is needed, to know whether clients don't return for more loans because they no longer need the financing, or if there are other reasons.

Background

Poverty and financial exclusion remain two significant challenges the world faces today. As per the World Bank's recent global monitoring report¹, the number of poor people remains significantly high². The same report estimates that in 2015, some 700 million people were living on less than \$1.90 a day; most of them are excluded from the formal financial sector models due to their lack of collateral, the lack of information banks have about them and higher transaction costs for banks to serve them³, further restraining their socio-economic development.

"Financial exclusion"⁴ has recently received particular attention from policy makers as it aggravates poverty. It is estimated that in 2014 more than 2 billion adults lacked access to formal financial services⁵. Financial exclusion is more severe among rural poor, representing 70% of the 1.4 billion people living in extreme poverty⁵. A region of particular concern is Asia due to its greater number of rural-poor and lack of infrastructure for formal institutions to access them.

Microfinance is a tool that actively addresses the dual curse of poverty and financial exclusion and due to its unique design, it primarily serves the rural-poor. Most MFIs follow this strategy and primarily target rural-poor on two key presumptions. First, rural borrowers are poorer than their urban counterparts. Second, social returns on investment are higher in rural areas by comparison to when similar financial services are extended to urban-poor. The empirical evidence for both of these assumptions is sparse and requires validation. As a social investor, Oikocredit does not leave social outcomes to chance; thus the social performance team at Oikocredit developed a research study to test these assumptions.

The research study analysed the differences in poverty levels of similar rural and urban borrowers and changes in their poverty over time. The results help Oikocredit's partners, investors, decision-makers and other financial service providers to determine whether targeting low income households in rural regions is an effective strategy for achieving higher social returns. Up until now, most microfinance studies have compared rural and urban poverty at single points in time, which often only provide simple snap shots of the situation. The research overcame this shortcoming by exploiting the existing data on microcredit borrowers at each loan cycle over several years. While the study was not specifically looking at client exits, it shed some light on client attrition rates. Previous studies have concluded that client exit rates cause significant financial losses to MFIs, both in terms of getting new customers aboard and the loss of future cash flow from old borrowers⁶.

Methodological approach

A crucial problem faced during the research study is that rural and urban borrowers may be fundamentally different (e.g. urban borrowers may have greater access to education, have different occupations, marital status, number of children, etc.). By simply comparing their poverty levels, it is not possible to conclude whether the differences are due to their intrinsic individual attributes or their location (rural / urban). To make a fair comparison, the researchers constructed two samples of rural and urban borrowers using the Propensity Score Matching (PSM) method, which creates a basket of rural borrowers with similar qualities as the group of urban borrowers.

¹ World Bank (2016) Development Goals in an Era of Demographic Change.

² World Bank estimated that 983 million people were living on less than \$1.9 a day in 2011.

³ Armendáriz, B., & Morduch, J. (2010). The economics of microfinance. MIT press.

⁴ Financial exclusion is lack of access to necessary financial services to individuals and households.

⁵ IFAD (2011) Rural poverty report 2011: New realities, new challenges: new opportunities for tomorrow's generation.

⁶ PPAF (2010). Client Attrition in Microfinance: Experience and Practice.

Comparing changes in poverty levels over time also presents some challenges because the individual characteristics of the borrowers, such as entrepreneurial skills or age, may also explain how a borrower develops over time and her/his probabilities of getting out of poverty. To remove this side effect out of the analysis, the study used the two way Fixed Effects regression. With this model, the research paper compares poverty changes for rural and urban borrowers over time. Furthermore, it also analysed whether borrowers who left the MFIs have a higher or lower poverty compared with those who stay with MFIs to borrow an additional loan.

Finally, a word of caution, the study is not an estimation of the impact of microcredit on the poverty of borrowers, as such research would require data on non-borrowers for comparison, which is not available. Rather, this study informs MFIs of a simple and implementable strategy in which they can study the available data to track and assess their social performance.

Three MFIs -ASKI, RSPI, and SVCL- participated in the study

To produce case studies, the research paper used data from three Asian MFIs: ASKI (2012-2014) and RSPI (2011-2015) in the Philippines and SVCL in India (2010-2014), totalling 187,988⁷ borrowers. Due to a high attrition rate^{8,9} of borrowers across MFIs, the number of long-term borrowers staying for the full time periods was 17,225¹⁰. To compare the poverty of rural and urban borrowers, and track poverty changes over time, the researchers built up the samples of similar, long-term rural and urban borrowers. The indicator used for measuring poverty at borrower level is Progress out of Poverty Index (PPI), which was developed by the Grameen Foundation. The higher the PPI score (0-100), the lower the likelihood of a borrower being below a national (or international) poverty line¹¹.

Results

The results show that rural borrowers of all three MFIs are poorer than similar urban borrowers (see Table 1). The quantum of the poverty gap between rural and urban borrowers varies with each MFI. Among three MFIs, the urban-rural poverty gap is lowest for ASKI borrowers and highest for RSPI borrowers. The decline in the poverty gap has been greatest for SVCL borrowers (6.57 points), followed by RSPI (3 points) and ASKI (0.29 points).

Table 1: Average PPI scores for matched samples of rural and urban borrowers.

Year	ASKI		RSPI		SVCL	
	2012	2014	2011	2015	2010	2014
Urban	62.72	64.38	58.38	65.21	46.16	44.21
Rural	60.30	62.25	50.02	59.86	38.46	43.09
Poverty Gap	2.42*** (0.53)	2.13*** (0.53)	8.35*** (1.14)	5.34*** (0.85)	7.69*** (0.53)	1.12** (0.50)

Robust standard errors in parenthesis *** p<0.001, ** p<0.01, * p<0.05, + p<0.10

⁷ ASKI =41,514, RSPI = 56,474, SVCL=90,000

⁸ Attrition rate is the ratio of 'number of base-year borrowers dropping-out during a specific period' to 'the number of borrowers at the base year'. For e.g. If in 2011 a MFI has 100 borrowers, and if 90 borrowers leave MFI by 2015, attrition rate during 2011-2015 is 90%.

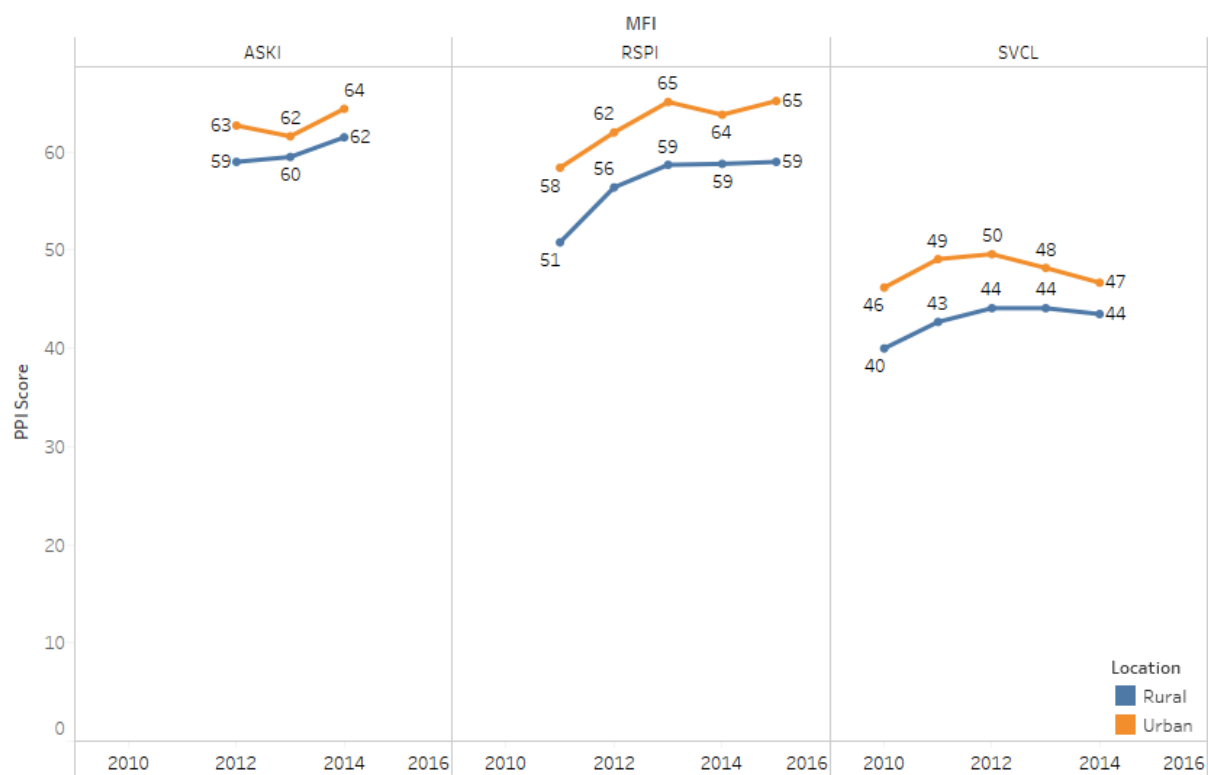
⁹ On average, borrowers stayed for a period of 2-2.6 years at MFIs.

¹⁰ ASKI=6,431, RSPI=5,842, SVCL=4,952

¹¹ PPI scores across MFIs cannot be compared as the PPI scorecard is country specific. MFIs have also used different versions of PPI scorecard. Due to this reason, data from all 3 MFIs is analysed separately.

The research study also showed that rural borrowers experienced a higher reduction in poverty when compared with urban borrowers. In general, over the complete duration of the study¹², the poverty of rural borrowers decreased by 2 PPI score points more than that of similar urban borrowers. To illustrate this (see Figure 1), the **urban** borrowers from SVCL **increased their score by 2 points**, from an average of 46 points in 2010 to 48 points in 2013; over the same time period, similar **rural borrowers increased their score by 4 points**, from 40 to 44. Thus, the difference in the rate of change of urban-rural poverty is 2 points, implying that over the long term, rural borrowers have a higher reduction in poverty. Considering that 70% of the 1.4 million people in extreme poverty live in a rural area¹³, a higher poverty reduction in these regions translates into higher social returns for MFIs.

Figure 1: Poverty scores of rural and urban borrowers, matched samples



Other results

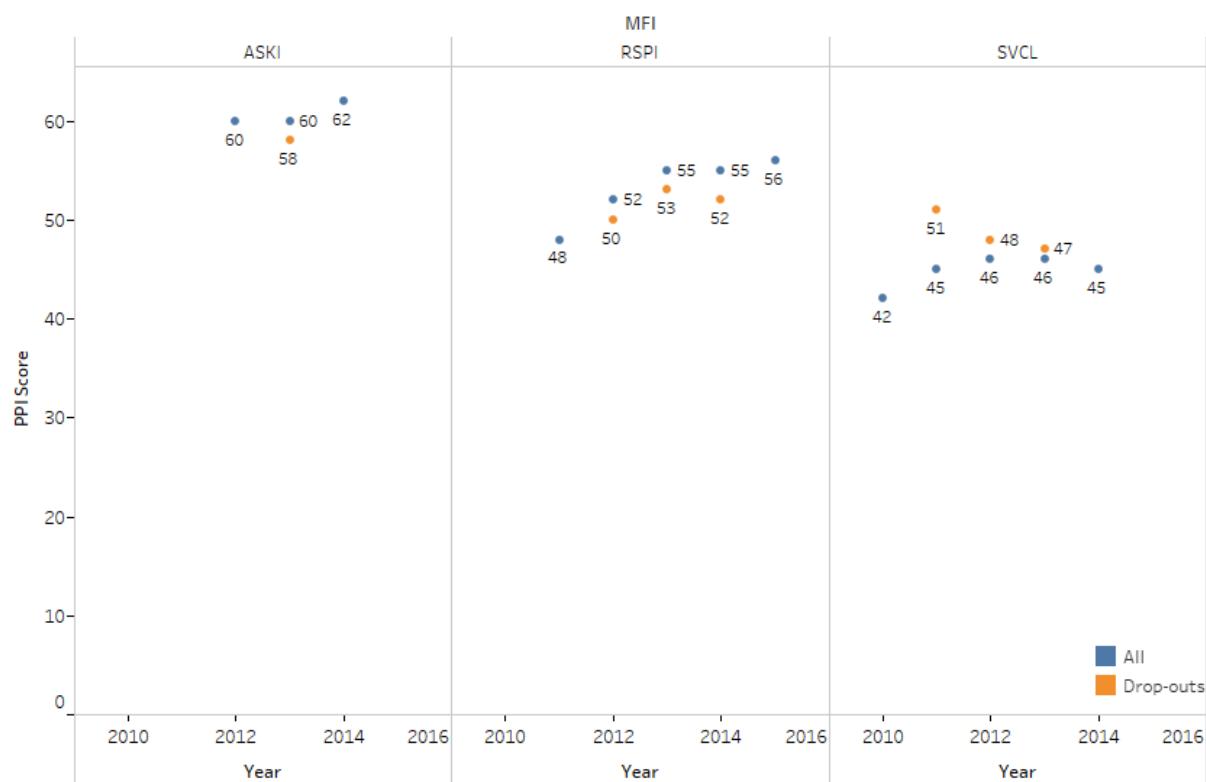
While the study was not specifically looking at client exits, the study shed some light on this issue. The researchers compared the PPI scores of clients who stayed with the MFI for the entire period of study against those who left the MFI. Results are mixed; borrowers that leave MFIs may have increased or decreased poverty levels at the time of exit compared with those who took one extra loan. The findings show that the PPI score of borrowers dropping out of ASKI and RSPI was lower than those who borrowed an extra loan at these MFIs (see Figure 2). The PPI score of SVCL borrowers upon exit is higher but statistically insignificant.

¹² 2012-14 for ASKI, 2011-15 for RSPI, and 2010-14 for SVCL

¹³ International Fund for Agricultural Development- IFAD (2016). Rural poverty report 2016. Rome.

Borrowers with increased poverty levels at exit imply ‘mission drift’ or reduced focus on their mission, at MFIs. While exit borrowers with reduced poverty levels suggest financial losses to MFIs due to challenges in bringing new customers aboard plus the loss of future cash flow from old creditworthy borrowers¹⁴. Thus, when borrowers leave, MFIs compromise both social and financial performance. Therefore, monitoring exit borrowers and addressing the reasons for attrition is extremely vital for MFIs to achieve a double bottom line performance.

Figure 2: Comparing poverty of all borrowers with exiting borrowers



Conclusions

The potential gains from microfinance have been recognized by most social investors and microfinance institutions, which in most cases have prioritized rural regions for financial services, presuming larger social returns on rural investments. MFIs also presume that rural borrowers are poorer than their urban counterparts. As a social investor, Oikocredit does not leave social outcomes to chance, and thus we conducted thorough research by using readily available data from three MFIs to validate these assumptions. The research study suggests that by comparison with urban poor, rural borrowers experience a higher reduction in their poverty levels over time. This translates into a higher social effect for rural-oriented MFIs. The research paper also suggests that, on average, rural borrowers are poorer than urban borrowers. Overall, the study confirms that targeting disadvantaged rural people through pro-poor credit market interventions is an effective strategy for MFIs to reduce poverty and realise higher social returns. Furthermore, monitoring exit borrowers and addressing client attrition is extremely vital for MFIs wanting to achieve a double bottom line performance.

¹⁴ PPAF (2010). Client Attrition in Microfinance: Experience and Practice.