*Kashf Foundation Focus Notes Series*
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# **Graduation Programs for the Extremely Poor:** Lessons from Kashf's Interest Free Lending Project

***Kashf Foundation has been implementing an Interest Free Program in District Jhang as part of the Government of Pakistan's larger Interest Free Loans Scheme. This focus note analyses key demographic trends amongst the Interest Free Loan Beneficiaries, examines the extent of their graduation with respect to poverty scores and income, and summarizes some of the success factors and challenges in terms of program impact.***

## BACKGROUND

The Pakistan Poverty Alleviation Fund launched an Interest Free Loans Scheme for vulnerable districts in 2014 where institutions could bid for access to finance along with a 10% administrative fee to provide interest free loans to very poor households, i.e. households with less than 40 on the Poverty Score-Card. This scheme was launched as a part of the Government of Pakistan's greater program to eradicate extreme poverty and create avenues for livelihoods for households that scored very low on the poverty score-card ranking.

Since their use in the Benazir Income Support Program, poverty scorecards have become widespread in targeting programs towards intended demographics in Pakistan[1]. According to the Government of Pakistan, poverty scores can be interpreted in the following manner[2]:

| Poverty Score | Poverty Level |
|---|---|
| 0 - 11 | Extremely Poor/Ultra Poor |
| 12 - 18 | Chronically Poor |
| 19 – 23 | Transitory Poor |
| 24 – 34 | Transitory Vulnerable |
| 35 – 50 | Transitory Non-Poor |
| 51 - 100 | Non-Poor |

The government strategy has been to provide cash transfers to households under 16.17 through the Benazir Income Support Program and support households with poverty scores up to 40 through interest free loans for small businesses. Households with poverty scores over 40 are not addressed through government programs are they have access to finance through microfinance providers.

Kashf Foundation sent an application for participation in the Interest Free Loans Scheme Program and received funding to run the program in district Jhang. This focus note presents experience and insights from the project and lessons for designing graduation programs.

Kashf has been running the program since April 2015 and has since disbursed approximately 7,500 loans under the program. Loan beneficiaries are provided credit-for-life insurance - the cost of which is borne by Kashf Foundation. With respect to program delivery; Kashf introduced Graduation Officers in an existing branch in Jhang to deliver this program, and while the program was open to women under 40 on the poverty score-card, staff was instructed to target households under 30. The loan amount given in these interest free loans was PKR 20,000.

## DEMOGRPAHIC ANALYSIS OF BENEFICIARIES

The average age of the beneficiaries in the Interest Free Program is 39 compared to an average age of 41 for Kashf's regular program (Kashf Karobar Karza). The average family size for Interest Free Loan Clients is 6 members while the same is 5 for Kashf's clients in its main program. Interest Free Loan (IFL) beneficiaries have an average number of 1 earner per household while this is 2 for the Kashf Karobar Karza (KKK).

In terms of average number of children per household; Interest Free Loan beneficiaries have an average of 4 children per household while the same is 3 for the Kashf Karobar Karza portfolio. These differences in demographics indicate the deeper penetration of the interest free program and demonstrate that the loans were targeted to an economically worse-off and more vulnerable population sub-set.

In terms of marital status, 89% of the beneficiaries are married (compared to 88% for the regular portfolio), 5% are widowed (compared to 7% for the regular portfolio), and 4% are single (compared to 3% for the regular portfolio). These are relatively similar for both cohorts with insignificant variations.

## POVERTY SCORE VALUES

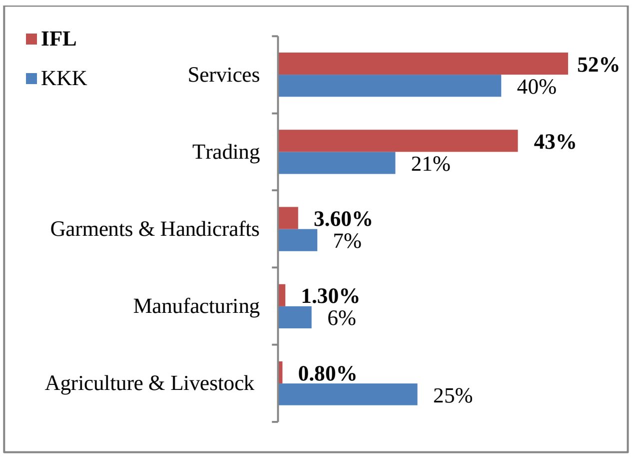
The average poverty score value for the households availing the interest free loans has been 23 with a minimum of 8 and the maximum of 29. The table below shows the distribution of the interest free loan beneficiaries across the poverty scores juxtaposed with the distribution of the regular Kashf portfolio.

| Poverty Score | IFL Distribution | KKK Distribution |
|---|---|---|
| **>5 & <=10** | 0.17% | 14.50% |
| **>10 & <=15** | 4% | |
| **>15 & <=20** | 14% | 23% |
| **>20 & <=25** | 49% | |
| **>25 & <=30** | 32% | |
| **>30 & <=40** | 0% | 32.5% |
| **>40** | 0% | 30% |

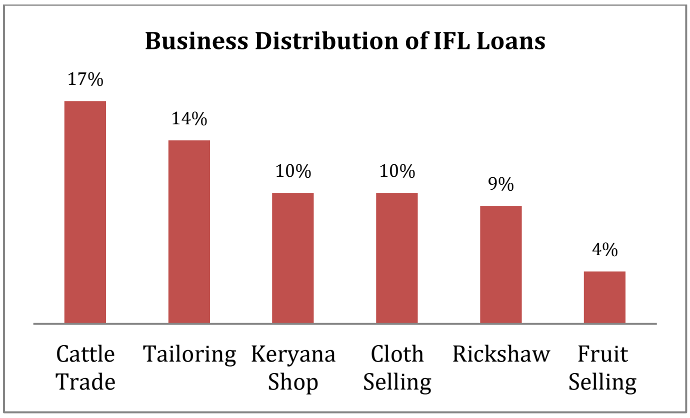
The data above demonstrates that a majority of the interest free loans have been disbursed to households within the 21 to 25 range, while the majority of the Kashf Karobar Karza loans are to households in the 30 - 40 range. While Kashf's regular program targets the Transitory Vulnerable groups, the beneficiary distribution over the poverty scores shows that Kashf was able to create a distinct target group for the Interest Free Loans and catered to the needs of chronically and transitory poor under the program.

## LOAN UTILIZATION

Beneficiaries of the Interest Free Loans used the loan for many productive uses – in terms of the distribution across sectors, a majority of loans were used for Services, followed by was trading and Garments and Handicrafts. The graph below shows the variations for loan utilization among the Interest Free Loan beneficiaries and the Kashf Karobar Karza clients.




Within the Interest free loan portfolio, the business use distribution is as follows: 17% of loan beneficiaries have used their loans for cattle trade, followed by tailoring and keryana shops (grocery stores). The distribution can be seen in the following table.




## HOUSEHOLD INCOME AND EXPENSES FOR INTEREST FREE LOAN BENEFICIARIES

The average household income for the interest free loan users was Rs. 12,154 with a minimum of Rs. 7,000 and a maximum of Rs. 22,000.

| Average HH Income | Min HH Income | Highest HH Income |
|---|---|---|
| 12,154 | 7,000 | 22,000 |

With respect to expenditures, the highest spending on average was on food, followed by rent, and spending on marriages/occasions. Other expense categories included education, travel, medical, mobile and clothing. This trend is in line with typical spending patterns for low-income households which usually spend more money on food and housing.

## GRADUATION OUT OF POVERTY

To assess graduation out of poverty, Kashf analyzed poverty scores, income and expenses of repeat IFL beneficiaries. In the data set that was analyzed 70% of beneficiaries returned to the institution to renew their loans.

| Loan Cycle | % | # of Family Members | # of Earners | Avg Poverty Score Value |
|---|---|---|---|---|
| 1 | 30 | 6 | 1 | 23 |
| 2 | 26 | 6 | 1 | 23 |
| 3 | 44 | 6 | 1 | 23 |

The analysis shows that each loan cycle had similar household dynamics with respect to number of family members, and number of income earners per household.

Additionally, average poverty scores across the loan cycles remained constant. However, when comparing the changes in the poverty scores from one loan cycle to the next, graduation became evident. 38% of the beneficiaries demonstrated an increase in the poverty scores from Loan Cycle 1 to Loan Cycle 2, 38% of beneficiaries showed improved poverty scores when comparing Loan Cycle 2 to Loan Cycle 3, and 45% of beneficiaries that had been with Kashf for three successive years showed an improvement in their poverty scores (comparing Loan Cycle 1 poverty scores to Loan Cycle 3). The following table shows the distribution of the change in the poverty score value.

| Δ in Poverty Score | Loan Cycle 1 – Loan Cycle 2 | Loan Cycle 2 – Loan Cycle 3 | Loan Cycle 1 – Loan Cycle 3 |
|---|---|---|---|
| $0 < \Delta \leq 2$ | 16.3% | 17% | 17.9% |
| $3 \leq \Delta \leq 5$ | 15.8% | 15% | 19.8% |
| $6 \leq \Delta \leq 9$ | 4.1% | 5.4% | 5.8% |
| $10 \leq \Delta \leq 13$ | 1.2% | 0.7% | 1.8% |
| $14 \leq \Delta \leq 16$ | 0.16% | 0% | 0.1% |
| $17 \leq \Delta \leq 18$ | 0% | 0.1% | 0% |
| *Total* | *37.56%* | *38.2%* | *45.3%* |

Moreover, the table above also demonstrates that the extent of increase in poverty score- both in terms of total households whose score has increased and the percentage of households whose score has improved by 6 or more bases points- increases with continued access to the program.

To look at other indicators of graduation, Kashf undertook an analysis of the average net disposable income and the average monthly income across the loan cycles.

| Loan Cycle | Avg. Net Disposable Income | Avg. Income |
|---|---|---|
| 1 | 4,414 | 12,188 |
| 2 | 4,382 | 11,976 |
| 3 | 4,333 | 12,236 |

The analysis revealed that Average Net Disposable Income reduced over the loan cycles which when juxtaposed with the variances in average monthly income suggests that the households are increasing their expenditures (as there isn't a reduction in monthly income except for Loan Cycle 2). The expenditure categories however, across the three loan cycles have remained the same which means that clients are spending more money on food expenses.

The data analysis has shown in-part that the IFL program has shown considerable success in helping repeat beneficiaries graduate out of poverty. This is evident from the fact that 45% of the program beneficiaries have increased poverty score values as they have transitioned across loan cycles. Moreover, a decline in Net Disposable Income without a similar dip in the Average Monthly Income, especially comparing Loan Cycle 1 and Loan Cycle 3 clients suggests that the households have increased their expenditures – since the largest expenditure category is food related, on food expenditure thereby improving food security.

However, since the average poverty scores have remained the same across the three loan cycles, there have been a number of households whose poverty scores have not changed or have worsened. The table below shows the percentage of households with no change to their poverty score or a reduction in their poverty scores.

| | Loan Cycle 1 – Loan Cycle 2 | Loan Cycle 2 – Loan Cycle 3 | Loan Cycle 1 – Loan Cycle 3 |
|---|---|---|---|
| No change | 17% | 20.1% | 15.6% |
| Reduction | 45.5% | 41.8% | 39.1% |

To determine key features of the 'graduating' beneficiaries i.e. those that had seen an increase in their poverty scores, an analysis of common features amongst the cohort was undertaken which showed the following attributes:

1. The top business categories in the co-hort with the improved poverty scores had invested in Upholstery Services (20%), Cattle Sale and Purchase (19%), Tailoring (13%), Cloth Sale (12%), and Crockery Sale (11%). This meant that businesses chosen for loan utilization are a major contributing factor for success.
2. Loan usage – 50% of the beneficiaries that showed an increase in poverty scores had used the loan themselves, followed by 37% of the cases where the husbands had used the loans. Loans used by women in the household had a disproportionately higher percentage in the successful household cohort which means that in cases where women use the loans there are greater chances of graduation.
3. These households had better dependency ratios with a little less than 4 children per average per household and a less over 1 earner per household. Household with improved dependency ratios – i.e. higher number of earning members and lower number of children are over-represented in this co-hort.

## ROUND-UP OF PROGRAM

Kashf was very effective in terms of targeting the program to the right target segment. There had been internal concerns over cannibalization of the regular Kashf target market share prior to the start of the program, however as the poverty score distribution and demographic status of the Interest Free Loans beneficiaries shows Kashf was able to market, mobilize and disburse the program to the intended beneficiaries which were worse off than its regular target market. To be able to effectively cater to the intended beneficiaries, Kashf undertook the following:

- Identification of clear Union Councils where the interest free program was to be run;
- Development of thorough and clear manuals and SOPs for marketing, client mobilization, client selection, disbursement, and post-disbursement activities;
- Hiring of a new set of staff members – 'Graduation Officers' - to deliver this product;
- Training and orientation of hired Graduation Officers and regular policy refreshers.

Another success for the program was the use of the loan for productive purposes – Kashf was able to ensure that 99% of loans were used for businesses. This was checked through post loan-utilization checks by Operations teams and Field Audit (Compliance) teams. This can also be seen through the loan purpose analysis as a concentration of the business use is in the conventional sectors where low-income households usually set up businesses.

With respect to improvements, research from BRAC styled graduation programs from around the world[3] have shown that conditional cash transfers for consumption smoothening for a specified transition period are an important contributor to graduation, especially with respect to food security. These enable participating household to meet non-business expenses, including addressing food insecurity, and allowed the household to spend business income on the expansion/improvement of the business. If the program would have provided for such consumption smoothening support, graduation rates would have been higher.

Moreover, experience from successful graduation programs has shown that vocational skills training/enhancement coupled with life skills trainings have a very significant impact on success of the program to graduate beneficiaries out of poverty[4]. Thus, if the loans had been accompanied by skills development and training on financial management and business management, more clients would have been able to sustainably graduate out of poverty.

Another key learning from successful graduation programs[5] has been that beneficiaries have higher chances of graduating out of poverty when a productive asset is transferred alongside or prior to access to loans. Choosing the right asset for transfer is a key determinant of success and in Pakistan's context would have to vary from district to district. The efficacy of asset transfers has also indicatively been validated in the Kashf analysis as trading businesses where the household gets a productive asset are over-represented in the cohort of graduating households.

In a similar vein, complimentary products and services that help build household resilience such as savings programs and insurance services can also help improve the success rates of graduation programs. Savings and insurance services help protect the household from endogenous and exogenous shocks which help smoothen consumption even in lean times for these households thereby preventing them from falling back into poverty.

For future programs, mapping progress out of poverty could be more comprehensive if resources (monetary or in-kind) are available to program implementers to map indicators that constitute multi-dimensional poverty before project inception. These include measures such as food security, savings, empowerment and health which could not be mapped in this study due to unavailability of baseline data on the sample.

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**Authors: Ayesha Riaz and Zainab Saeed**

Phone: +92 (42) 111 981 981
E-Mail:info@kashf.org
Website: www.kashf.org

[1] The Benazir Income Support Program is a government led unconditional cash transfer program for low-income women which was initiated in 2008.
[2] Pakistan Poverty Alleviation Fund (2012) – available at http://www.ppaf.org.pk/doc/programmes/4-ReportOnPSC.pdf
[3] CGAP (2011), Reaching the Poorest: Lessons from the Graduation Model.
[4] *Ibid*
[5] *Ibid*