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**SERVICES FOR THE POOR: WHAT WORKS, WHY AND WHERE? AN OVERVIEW  
WITH SPECIAL REFERENCE TO MICROFINANCE. <sup>1</sup>**

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**Introduction: The Dimensions of the Problem**

Despite strong growth and significant progress in poverty reduction, Asia remains home to the majority of the world's poor. If an income of less than \$2 per day is taken as the yardstick, then some 1.9 billion individuals in Asia live in poverty or near poverty. Both income and non-income poverty are serious. The latter includes access to basic services but also covers factors such as social exclusion based on caste, gender or ethnicity.

South Asia has the largest share of Asia poor accounting for some 70% of the total. The vast majority of South Asia's poor are to be found in India. As stated by Srivastava, India remains at the epicenter of poverty both within South Asia and the World and the key to the realization of the Millennium Development Goals (MDGs) (Srivastava, 2005).

While average growth rates have picked up in South Asia in recent years, growth in South Asia has not been pro-poor. Since growth remains the strongest engine of poverty reduction, the key challenge for policy makers is to achieve more rapid growth that is pro-poor, that is growth which ensures that poor households actively participate in the growth process and benefit disproportionately. Achieving pro-poor growth requires the removal of institutional and policy biases against the poor and the adoption of direct pro-poor policies. An emphasis on employment and equity are both key aspects of pro-poor growth (Chatterjee, 2005). The concept of pro-poor growth is now giving way to that of 'inclusive growth', growth that provides expanded opportunities for all coupled with social protection for the chronically poor (Ali, 2007).

## **The Issue of Access to Services**

The lack of access to basic services is itself a measure of poverty (ADB, South Asia Economic Report, 2007). In the case of primary education, despite significant progress in enrollment rates, including among females, access amongst the poor and drop out rates are much higher than for other groups. The quality of poor and remote areas is another prevalent problem. In the case of health, the challenge of reaching the poor is even greater than in the case of education, with poor households experiencing high child mortality, high rates of malnutrition and under-nutrition, limited access and poor quality of health services. The figures at the end of the paper give some indication of the dimension of the problem with respect to education, health and nutrition.

With respect to water supply, on average less than 60% of South Asia's population has access to clean water, while access to sanitation is even less. Again access is worst in poor and lagging regions. Access to electricity is another service that can contribute to better standards of education and health while also bringing new economic opportunities. This is an area where there has been considerable progress. The rate of electrification has now reached some 75% of the population in India and Sri Lanka. By contrast, in Nepal less than 35% of the population has access to electricity. Equally, even where villages do have access to electricity, the cost of getting connected is often prohibitive. Finally, microfinance services have emerged as a key means of assisting the poor. But despite the growth in microfinance, only around 30% of South Asia's poor have thus far benefited from the provision of microfinance services.

In most countries, the provision of such services is dominated by the public sector. Yet public expenditure disproportionately benefits the rich. For example, in Nepal, 46% of education spending accrues to the richest fifth of the population while only 11% accrues to the poorest quintile (World Bank, World Development Report, 2004).

### **Reaching the Poor: The Pros and Cons of Targeting**

Given the persistence of poverty in Asia, including South Asia, and the weaknesses and leakages associated with universal programs of service provision, plus growing fiscal pressures, the targeting of service provision has become the primary way of improving the access of the poor to basic services (World Bank, World Development Report, 2000/01; Weiss, ed., 2005).

The more common types of targeting are as follows:

- **by activity:** e.g., primary health care/primary education where the distribution of benefits tends to be progressive; microfinance is another example;
- **by indicator:** usually in addition to an income measure to help identify the poor: e.g. size of landholding, family size, gender of head of HH;
- **by location:** projects/programs located in lagging regions of a country or remoter villages in more developed areas;
- **by gender or special target group:** programs on maternal and child health, street children;
- **self-targeting:** programs are designed in such a way that they are only attractive to the poor (again microfinance would be an example).

In practice, identification of targeted poor remains a major challenge. Technical, administrative and governance weaknesses can also lead to large leakages (Weiss, 2005). This includes a lack of data, weak administrative capacity, weak systems of accountability, corruption, bias by politicians to supporters and so on. Thus a World Bank survey in Uttar Pradesh found that 56% of the lowest income percentile did not have identification cards that allow access to the public distribution system (reported in Srivastava, 2005).

Some forms of targeting seem more effective than others. Thus, evidence suggests that regional/locational targeting appears to be a relatively blunt instrument. But this is likely to vary greatly depending on country context and the degree of income inequality in a region. Thus, channeling assistance to the Far and Mid West hill districts of Nepal would certainly reach many of the poorest of the poor in that country. But one of the problems of such geographically targeted support is that such poor or lagging regions usually possess only limited economic opportunities. Hence, even with targeted support, the potential to raise incomes or create employment may well be limited in the short to medium term, until perhaps there is greater investment for example in better roads, irrigation, or electrification. Self-targeting should have the advantage of lower administrative costs. But can also suffer from under-coverage as not all those eligible and in need come forward, either due to the lack of knowledge of what support is available or to avoid the social stigma attached to programs targeted at the poor. The general view is that broad targeting by activity, e.g., primary health and education are the most effective

form of targeting (Weiss ed., 2005). Microfinance, which also involves a major element of self-selection, is another targeted intervention that appears effective.

While targeting is usually adopted as a means of improving the effectiveness and efficiency in reaching the poor, costs associated with targeting, particularly administrative costs, are themselves often high. However, as Weiss has argued, if appropriate social weights are used for the benefits accruing to the poor then such costs can be justified (Weiss, 2005). The real issue is to determine which of the various alternative means of reaching the poor are the most efficient and cost effective.

ADB's approach to reaching the poor has certainly involved all of these different approaches to targeting. In Nepal, a Microcredit for Women Project clearly targeted poor women while the Rural Community Water Supply Project sought to improve access to clear water in poorer districts of the country. Targeting may also be a component within a more general program, for example the inclusion of a special scholarship program for children from poor families or girls. In Sri Lanka, ADB is using grant assistance under the Japan Fund for Poverty Reduction to assist poor households in getting connection to electricity and water in areas where these services are already being provided.

### **Making Services Work for the Poor**

The World Development Report (WDR) 2004, entitled *Making Services Work for Poor People*, provides a comprehensive review of the way services fail to reach the poor and at the same time ways in which services can be made to work for the poor. As the report argues, there is general agreement that the provision of services is a public responsibility. But at the same time, simply increasing public expenditure does not necessarily benefit the poor for the reasons touched on earlier. Even if ultimate responsibility for providing services rests with the public sector, this does not necessarily imply public provision. While in most countries there remains an intense debate on the issue of public versus private provision of services like education, health and water supply, both have their strengths and weaknesses. Much depends on the country context, the quality of governance and capacity to effectively regulate the market, as well as on the nature of service to be provided. Ironically, precisely because of the lack of access to or the poor quality of public service provision, the poor often rely heavily on private provision of services, even when

these are costly relative to those that are, at least in theory, available from the public sector. The WDR looks at a wide range of both public and private sector models for service provision.

Whether public or private is chosen, the key to making services work for the poor is the empowerment of communities: giving citizens a clear voice and encouraging their active participation in design and monitoring of providers. Community involvement and participation are a key to reaching the poor (WDR, 2004).

Among other key factors, ensuring political accountability is identified as one of the most critical. Decentralizing responsibility for provision helps to ensure accountability but depends on the capacity available at the local level and the commitment from the center. User fees are another topic on which there is usually intense debate. The WDR 2004 argues that there is no blanket policy. The decision on user fees depends on many factors, including the nature of the service being provided, as well as country context (fiscal constraints) and the ability to ensure access of poor. What one can say is that the willingness to pay usually exceeds willingness to charge! Pretty much all income groups and particularly the poor know the value of good quality services. Survey after survey undertaken in connection with development projects and programs has shown a strong willingness to pay. But politicians often offer to provide free or subsidized services as a means of gaining support; this in turn usually aggravates fiscal constraints that then feed through into a decline in the quality and availability of services. But efforts to reform service provision or introduce user charges have to take due account of the political economy of basic service provision.

Strengthening public sector management is another key ingredient of better service provision. On the one hand, a move to a medium-term budget framework can ensure adequate funding from the public sector, whether the public sector is taking a lead role in service provision or is simply supplementing cost-effective private provision. Development partners have an important role not only in supporting efforts to strengthen public sector management but also in ensuring that their interventions reflect strong ownership and government support and are well coordinated. Sector-wide approaches, especially in education and health are seen as another important way to strengthen service provision.

While few would argue with these ingredients of successful service provision for the poor, the fact remains that the enabling environment for the introduction of new approaches is

often weak. Change may face outright hostility. Hence, introducing new approaches and ensuring community empowerment and accountability for providers remains an immense challenge. The desire for change needs to be tempered by ground realities, including a realistic assessment of the political economy constraints to change. In practice we will often be working in a second or third best world, where some form of targeting may be the most practical means of trying to reach the poor.

### **Microfinance: A Means to Poverty Reduction**

Microfinance has been much in the news recently, in particular with the well-deserved award of the Nobel Peace Prize to Muhammad Yunus and the Grameen Foundation that he established. For many of the world's poor, even if they do benefit from improved access to services, limited access to other inputs can limit their ability to raise incomes and living standards. Access to microfinance is seen as particularly crucial in this respect. To many development practitioners, microfinance is **the** way to tackle poverty and achieve a sustainable reduction in poverty.

#### *What is Microfinance?*

Microfinance is best defined as the provision of a broad range of financial services, including deposits, loans, payments, money transfers and insurance to poor and low income households. It constitutes a range of innovative financial arrangements designed to attract the poor as either borrowers or savers (Weiss et al., 2003). It is worth emphasizing that while initially the main focus was the provision of microcredit, the trend nowadays is for the provision of a much wider range of financial services. These services can be provided by a range of different actors. When most people talk about microfinance they are referring to *Institutional Microfinance* provided through (i) formal institutions, such as rural banks and cooperatives, and (ii) semi-formal institutions or organizations, such as NGOs/SHGs. *Non-institutional (informal) microfinance* (credit and sometimes payment transfers) are also provided by shopkeepers, moneylenders, and middlemen. Institutional microfinance (formal and semi-formal) aims to provide an alternative to these more traditional and informal sources of microfinance which are generally regarded as high cost and often exploitative.

#### *The Development and Growth of Microfinance*

Membership based thrift and credit organizations, frequently established as cooperatives, and which grew in importance during the early part of the 20<sup>th</sup> Century were the precursors of today's microfinance institutions. However, the real growth in microfinance took place from the early 1970s. As noted above, the early focus was on provision of credit. Asia, and especially South Asia, was at the forefront of microfinance development, most notably in the form of the Grameen system and bank in Bangladesh. India now has the largest microfinance market in the world (Fisher and Sriram, 2002). It is seen as providing a route out of poverty (at least for non destitute poor (Weiss et al., 2003). For many of the poor clients of MFIs, their main interest is in savings, rather than credit, which can then be drawn on to smooth out consumption or to handle and safeguard against emergencies.

### *Key Features of Microfinance*

Most microfinance programs or systems have the following characteristics. They target the poor and nearly always involved group lending without collateral, with the group of borrowers together accepting the responsibility for repayment. Most microfinance programs also target women both because women (and children) are generally more deprived than men in poor communities and because they are seen as a much better credit risk than men, something that has certainly been borne out by experience. To be effective, microfinance needs to be linked to social mobilization and the provision or at least access to other services, such as extension advice, input and material supplies, marketing.

Within the broad definition of microfinance given above, there are now a wide variety of different providers of microfinance, ranging from the Grameen Bank and Grameen Bank Replicators to NGOs and Self-Help Groups. More recently, commercial banks have started to venture into micro-credit often as part of a Corporate Social Responsibility (CSR) initiative. (This is discussed further below.) With the exception of the latter, most MFIs remain heavily dependent on outside funding, including support from donors and development partners. To date, the majority operate on a 'Not-For-Profit' basis; profit maximization is not the primary objective of MFIs.

### *Outreach and Impact of Microfinance*

It is estimated that institutional microfinance now reaches some 1.5bn clients globally at least through the provision of credit (N. Fernando, personal communication). For Asia and South Asia there are no reliable estimates, but specialists in the field estimate that around 30% of the poor households who could benefit from microfinance are currently receiving at least some form of support. But in terms of share of credit needs of poor, it may be less than 1% of the need that is being served (Titus, in Fisher and Sriram, 2002). In practice, it is very difficult to accurately estimate coverage, while double counting of beneficiaries in a number of different schemes could mean that coverage is quite a lot less than outlined above.

Outreach and the importance of microfinance vary between and within countries; thus in India, microfinance tends to be concentrated in the southern states. These states are generally wealthier, have more vibrant economies and higher literacy. Hence the risks for both the Miss [MFIs] and borrowers alike are lower. While the base remains small compared to all those who could be eligible and benefit from microfinance, formal and semi-formal microcredit provision is growing rapidly. For example the Grameen Foundation clients increased by 75% in Asia between 2005-06 (Website of the Grameen Foundation.) The other key feature is the now also stronger growth in savings along with the gradual diversification into complementary services such as micro-insurance

But what has been its impact in terms of poverty reduction? The generally accepted view is that microfinance has been successful in helping poor households and specifically poor women in improving incomes and livelihoods and moving out of poverty. But does evidence support this? There have been a lot of studies and case studies, but as Weiss et al. 2003 argue, there have been few 'scientific' studies, while best practice case studies tend to bias the picture towards the positive. The study by Weiss et al. however provides a useful summary of what they term the more scientific studies in Asia since mid-90s, that is studies that do attempt a rigorous assessment of the counterfactual situation in the absence of microfinance, i.e. they undertake a proper 'with and without' assessment of changes in income and welfare rather than simply a 'before and after' study. The majority of these studies do show positive impact on income and other indicators e.g. health. The studies cited by Weiss et al. cover Grameen, BRAC, BRDB, SEWA, RRBs-India, as well as Village Banks/Credit Groups in Thailand and elsewhere)

The study by S. and F. Sinha (2002) for India, supports this general conclusion. But many studies also point to drop out rates as high as 30%, with many borrowers still poor and still

borrowing from non-formal sources (money-lenders) even after having access to MFIs. Equally, the majority of the poor, especially in rural areas, still relies mainly on informal sources (moneylenders) and have not yet benefited from microfinance. That said, one cannot measure the impact of microfinance in purely income or monetary terms. When effectively combined with social mobilization it can and does empower the poor, especially women, and impact on wider social, economic and political power structures. My own visits as ADB Country Director in Nepal to women's' groups operating under the Microcredit for Women Project, referred to earlier, confirmed the great importance that microfinance and group organization was playing in empowering the women, giving them a real voice in economic decisions of the household and starting to change power structures within both the household and the village.

### *Future Challenges*

Clearly a key challenge for the microfinance sector and MFIs is to increase outreach and impact of microfinance programs. This in turn is linked to the issue of sustainability and the ability to generate more of their own funds through deposits and members contributions. But is there a trade-off between sustainability and development impact?

Certainly the potential for growth is high. Microfinance channeled through specialized MFIs and NGOs, remains a popular area of support amongst development partners and INGOs. An expansion in global philanthropy (e.g. the Gates Foundation) is providing new sources of support. There is also growing interest in microfinance from more formal financial institutions such as commercial banks, both domestic and foreign and given the high rates of payment under microcredit systems, the credit risks would be far less than those being experienced in the US sublime mortgage market! The Standard Chartered Bank has recently set aside \$500 m globally to support MFI initiatives (Nimal Fernando, Verbal communication). But it is also important for MFIs to reduce their dependence on outside sources of funding and support. To do this, they need to focus much more on generating savings deposits. Sustainability remains an issue for many specialized MFIs and NGOs engaged in microfinance but there is significant scope to improve efficiency and sustainability by for example offering a wider range of products e.g. insurance along with credit and savings. Providing staff with clear incentives and proper training and adopting the use of IT can also dramatically improve the productivity of staff MFIs and help to increase outreach with out having to take on additional staff.

Competition amongst MFIs can be an important spur to greater efficiency and sustainability, as well as encourage enhance outreach. The establishment of the Micro-Credit Ratings International Ltd in India in 1998 is seen as an important step in this process. In terms of ownership, most evidence supports the view that private or group ownership is best. Significantly, in an interview during his recent visit to Sri Lanka in August 2007, Muhammad Yunus argued that one should keep governments and the public sector out of microfinance delivery systems. However, there are a few exceptions, such as Bank Rakyat Indonesia (BRI) which is one of Asia's more successful MFI providers. While building sustainability is vital for longer-term viability, some subsidy element may be needed to support MFI programs, especially if business and other services are provided. This is where door funds can play a useful role.

One of the key areas of debate surrounding sustainability relates to interest rates. Most MFIs charge rates in excess of 15-20% often on a per season basis. Government and MFI critics often see these rates as excessive, especially when compared with the subsidized rates available from government rural banks. But the high rates charged for microcredit reflect the relative shortage of capital available to the poor in rural areas, high administrative costs and the risk of default, although as the experience of female group lending has shown this is not such a problem. While high rates can be justified, they clearly do limit some of the opportunities that beneficiaries can pursue. Competition between different MFIs, measures to increase the supply of credit to MFIs, and other means to reduce risks are all means of reducing interest rates.

One other key to improved sustainability is achieving and maintaining high repayment rates. Generally, repayment rates under microfinance schemes have been extremely high. However, this strong repayment culture is often undermined by the actions of governments responsible for implementing public sector credit program where even in the absence of natural disasters or crop failures, politicians may introduce repayment moratoriums primarily to gain political support. While these more conventional rural and agricultural credit schemes may not be available to microfinance clients, such as poorer farmers and landless workers, nonetheless such actions can 'contaminate' MFIs and expose them to calls to be more lenient on repayment.

An important feature of the last few years has been the growing interest on commercial banks in microfinance. In late September, ADB sponsored a workshop in Manila specifically aimed at increasing the role of commercial banks in microfinance. Commercial bank involvement may be on their own account or in partnership with MFIs and NGOs. Some

commercial banks are also seeking to operate through traders and shopkeepers. A key factor that has helped commercial banks to move more actively into the sector has been the availability and use of new technology. Apart from the scope for improved efficiency that this brings in operating a branch network, new technology like mobile phones, linked for instance to a network of shopkeepers and traders and used as a means to effect payments and other transfers, was recently launched by the NDB bank in Sri Lanka. This offers the potential to enhance outreach at relatively low cost recently, even by-passing a branch network, although it has to be recognized that this services is not as yet able to reach the poorest of the poor.

One of the other key challenges for the microfinance sector is ensure proper, cost effective regulation. This needs to be strong enough to protect poor savers and appropriate to the needs of different providers, but also light enough to encourage innovation. While the government has to set overall regulatory framework, evidence suggests that independent regulation, separate also from the central bank, is best.

## **Conclusions**

Despite mixed evidence on its impact, microfinance is one of most effective means of achieving poverty reduction. Credit alone is not enough. This has to be supported by a range of other inputs and services, including such things as micro-enterprise business services, if microfinance beneficiaries are to have the capacity to move out of poverty and to stay out of poverty. Insurance services are also needed to cover unexpected events and shocks that can destroy savings. By reducing risks, insurance in turn will reduce costs. As we have seen, to be successful, microfinance also needs complementary support in form of social mobilization.

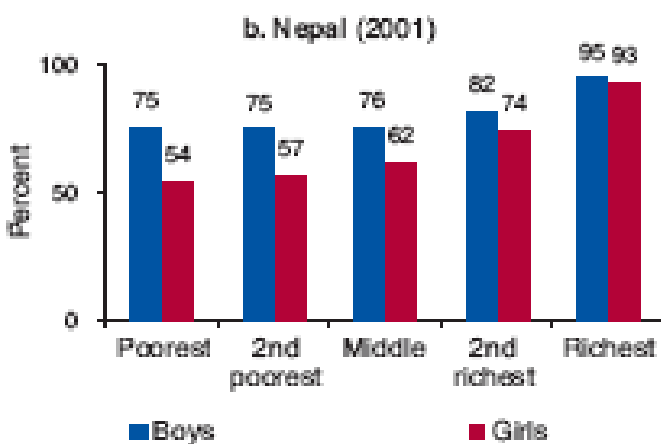
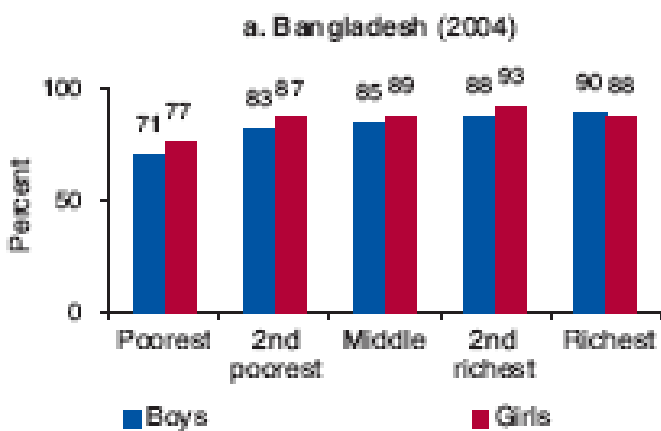
While regulation is essential to protect small savers and ensure proper management and accountability within MFIs, the regulatory environment needs to be appropriate and encourage competition and efficiency. Regulation should also be designed to encourage the kind of innovation, including the adoption of new technology that can enhance the sustainability of MFIs. Although sustainability is important, it should not lead to sacrifice of the development goal of microfinance. To this end, we need further research on the most cost-effective models of providing microfinance and increasing outreach.

That said, we should not look for a single 'blueprint'. What works will vary depending on socio-economic, cultural and geographic context of a country or even different parts of the same

country, especially in the case of a large country like India. So we should not search for a single 'best' model.

Certainly, microfinance is not a panacea to the problems of poverty. But this is not surprising. As Fisher (2002) has noted in writing on microfinance in India "development is complex" (p327). The causes of poverty and persistent poverty multi-faceted and require an equally multi-dimensional response. But microfinance, like growth, is, I believe, a necessary condition for poverty reduction; even if by itself it may not be a sufficient condition. One can also identify a 'virtuous cycle' where by microfinance contributes to growth and development which in turn reduces risks and the longer-term sustainability of microfinance. So 'yes', microfinance is a key weapon in our fight against poverty but we should not weigh it down with the baggage of unrealistic expectations.

## Percentage of Girls and Boys Aged 6–10 Years Attending School, by Wealth Quintile

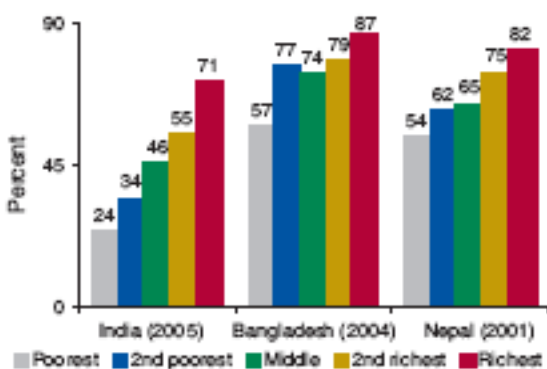


Sources: Demographic and health survey data (see pp. viii–ix).

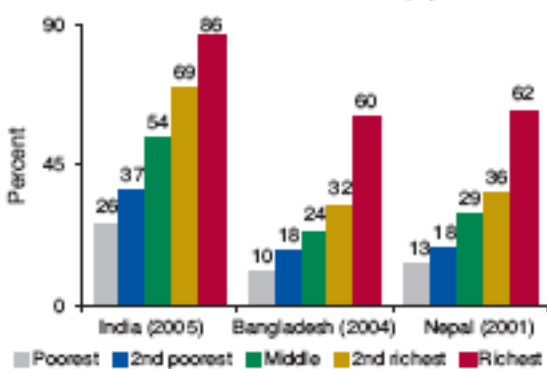
Source: ADB (2007), South Asia Economic Report, Social Sectors in Transition

## Wealth-Based Differentials in Access to Maternal and Child Health services

a. Children 12–23 months fully immunized (BCG, measles, and 3 doses each of polio/DPT, %)



b. Mothers who had at least 3 antenatal care visits for their last birth (%)

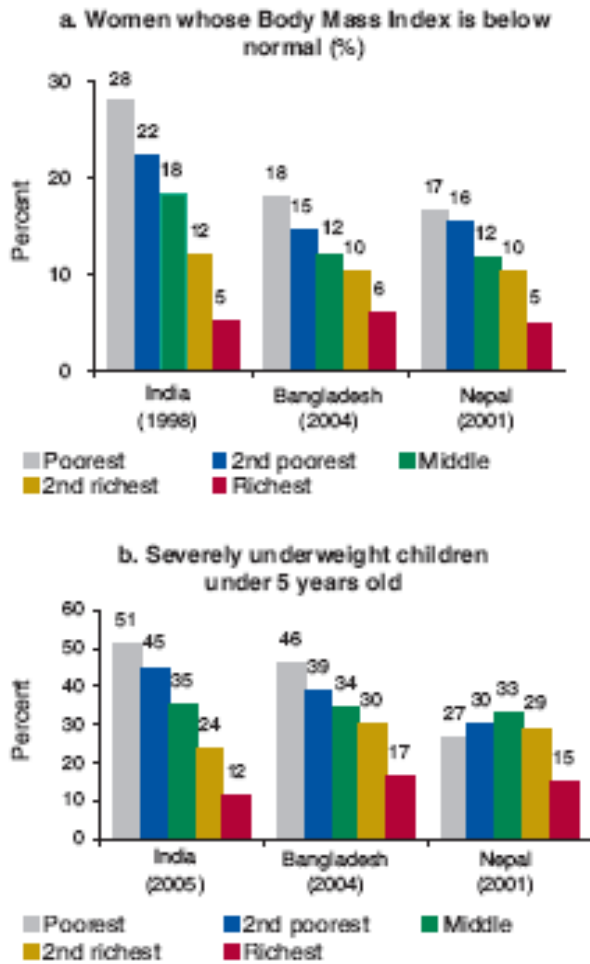


BCG=the bacille Calmette-Guérin vaccine against tuberculosis; DPT=diphtheria, pertussis, and tetanus.

Sources: Demographic and health survey data (see pp. viii–ix).

Source: ADB (2007), South Asia Economic Report, Social Sectors in Transition

## Maternal and Child Malnutrition, by Wealth Quintile



Note: The weight-for-age in figure 2.5b is assessed as below the -3 standard deviation z-score.  
 Sources: Demographic and health survey data (see pp. viii–ix).

Source: ADB (2007), South Asia Economic Report, Social Sectors in Transition

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