Chapter Eight
ICICI Bank, India

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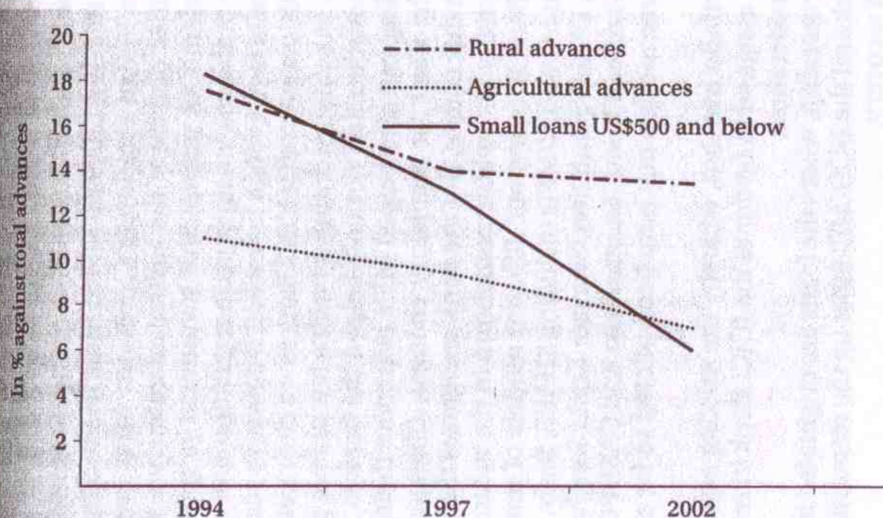
The trend and progress of the Indian microfinance sector shows slow and lopsided growth in the upscaling and outreach of micro-credit over the past decade. In 2002, Nearly US$1700m[1] was disbursed by micro-credit institutions (excluding the co-operatives) to about 12 to 15 million households. This works out to about US$120 per household. This is rapid progress from a tiny baseline, but for a country where close to 250 million people (about 50 million households) are officially considered poor, this cannot be regarded as a startlingly impressive achievement.

The overall picture of the demand for micro-credit in India as against current supply is disappointing. Demand is generally projected on the basis of average credit usage per household multiplied by the estimated number of poor households. Various studies show that the average annualized credit usage of poor households varies between US$60 and US$180. Multiplying this by 50 million, we are faced with the daunting figure of anywhere between US$3bn and US$9bn as the total demand for micro-credit.[2]

The supply of credit should be steadily increasing in order to meet this growing demand, but has in fact been doing quite the opposite, at least from the commercial banks in India. The proportion of bank loans below US$500 declined steadily from 18.3% of total commercial scheduled bank credit in 1994 to 5.3% in March 2002. The number of small borrower accounts has reduced from 55.8 million to 37.3 million.

Figure 8.1 *Trends of scheduled commercial bank advances to rural, agriculture and small loans as percentage of total advances*



Despite the self-help group (SHG)-bank linkage effort (which has reached more than one million groups and through them, some 15 million women), the gap between demand and supply has barely begun to be bridged. In March 2003, The SHG programme had an outstanding total of around US$200m, thus meeting 2.2–6.6 per cent of the estimated demand. Microfinance institutions (MFIs) are still fledgling efforts in terms of the number of poor people reached or affected. There is a long way to go yet before the poor of India receive the credit that they need in order to manage and improve their lives and break out of the vicious cycle of poverty.

It is in this context that the few interesting innovations in recent times, that signal a progressive movement towards commercialization or integration of microfinance with mainstream financial markets, must be seen. While several NGOs are moving into commercial microfinance by establishing exclusive entities, some of the commercial banks are taking proactive steps in order to relieve the sector of its perennial bottleneck of scarcity of funds and the resultant dilemma in enhancing outreach and attaining sustainability. Some modest policy changes have given a great impetus to these initiatives. These changes include the directives of the country's Central Bank, the Reserve Bank of India (RBI), to all banks to consider lending to MFIs as part of 'priority sector' lending and to exclude unsecured advances given by banks to SHGs against a group guarantee, for the purpose of computation of prudential norms.

Commercial banks and Indian microfinance

It is untrue to say that public sector commercial banking in India has never engaged with lower-income households. However, this engagement was engineered through the means of bank nationalization, the first phase of which happened in the late 1960s. The nationalized commercial banks were called upon to assume a social banking role, to expand their reach to the unserved or underserved segments of the population. As it turned out, this led the banks to distribute subsidized credit to a variety of targets, largely as part of a populist political agenda. When the NABARD-initiated SHG linkage model gained currency in the country in the early 1990s, banks were again brought in as critical partners in the microfinance movement. Unlike in the earlier episode of social banking, where the emphasis was almost entirely on meeting loan distribution targets, in this phase the accent was equally on ensuring loan repayment.

Unlike the public sector banks, the new private sector banks do not have the legacy of having implemented the subsidized loan schemes of the State in the pre-liberalization era of banking in India. One would, therefore, expect them to innovate in order to take advantage of the opportunities unleashed in the credit market for the poor population. ICICI Bank is the first bank to have understood the business potential of microfinance.

ICICI Bank[3]

ICICI Bank is currently India's second largest bank with total assets of about US$25 000m and a network of about 450 branches and 1800 ATMs. Up until 2001, it was a subsidiary of ICICI Limited, a development finance institution launched in 1955 with the purpose of purveying medium and long-term credit to Indian businesses. Since 1998, ICICI's shareholding in the bank has been reduced to 46 per cent through a public offering of shares in India (1998), an equity offering on the New York Stock Exchange (2000) and the merger of ICICI Bank and the Bank of Madura (2001). Then in 2001 and 2002, ICICI offered secondary market sales to institutional investors. Finally, in October 2001, the Boards of Directors of ICICI and ICICI Bank approved the merger of ICICI and two of its wholly owned retail finance subsidiaries, ICICI Personal Financial Services Limited and ICICI Capital Services Limited, with ICICI Bank. The merger was approved by the Reserve Bank of India in April 2002. ICICI Bank, the entity created, integrates the ICICI group's financing and banking operations, both wholesale and retail.

Entry in to microfinance

In 2001 ICICI Bank merged with the Bank of Madura, a private sector commercial bank in the southern state of Tamil Nadu. The 57-year-old Bank of Madura, with a network of 263 branches, had assets of US$800m and deposits of US$680m.

The Bank of Madura was noted for its SHG programme. The SHG concept was part of the corporate policy of the Bank of Madura. The bank staff had received extensive training on the promotion of SHGs (forming of groups, identification of income-generating activities, monitoring) with expenditure shared by NABARD. There was no local NGO that assisted the bank in promoting these SHGs as the bank equipped itself to promote, nurture and finance the groups and managed to maintain a very good repayment rate. With its acquisition of the Bank of Madura, ICICI Bank inherited this vast SHG network and portfolio and was forced to learn this new business.

At about this time, RBI stated that microfinance could be considered as part of 'priority sector lending' – a system under which 40 per cent of loans by commercial banks should be reserved for priority sectors, and 18 per cent of this to agricultural activities.

The reverse merger of ICICI Bank with ICICI took place in April 2002, one outcome of which was a huge asset size for the bank. The financial institution (ICICI Ltd.) did not have a priority sector obligation, which meant that most of these assets were in bonds and deposits. The merged entity suddenly needed to make a much stronger effort to meet its priority sector targets and the idea was to find these rural and priority sector assets without having to open a huge number of rural branches.

The focus of ICICI Bank on microfinance thus slowly emerged and was made stronger in February 2002, with the launch of the Rural and Micro Banking Group (RMBG) within the bank. Between March 2003 and March 2004, the bank's exposure to the microfinance sector increased from less than US$28m to more than US$63m and the number of borrowers from under 66 000 to over 280 000.

The need to achieve priority sector targets was one important reason for ICICI Bank's entry into the business but, after the first pilot year, the emphasis has been to build a substantial and profitable business. As an independent effort and quite coincidentally, the bank's Social Initiatives Group, in pursuit of its own agenda within the bank, had evolved a number of new and viable ways of doing business in the microfinance sector and was able convincingly to demonstrate to the commercial groups within the bank and its insurance companies that it was possible to build a viable and substantial businesses in microfinance. A combination of these two factors is what has drawn the bank and its subsidiaries to this business in such a large manner.

There was one particular enthusiast for microfinance in ICICI Bank's senior management, but the move was well supported and encouraged by the board in general. The bank made a conscious effort to step up its entire rural and agricultural business portfolio - microfinance was a significant part of this and received as much attention as the rest.

Currently, the microfinance business is managed by the RMBG, which reports to one of the executive directors of ICICI Bank who is also a member of the bank's board. The business enjoys broad-based support within the senior management team of the bank and its board of directors. ICICI Bank has now started to gain public recognition for its work and this has helped further to strengthen its commitment to the sector.

In 2001, ICICI also made its first equity investment in an MFI, Basix, and, although the investment was small in terms of funding, it served to demonstrate the bank's view that the sector had the potential to be profitable. It was also intended to give the bank a closer view from inside a well-run MFI.

Models of microfinance delivery

The strategy of the bank has been to avoid entering the microfinance market directly. It works in partnership with institutions that provide these services to the poor and underserved. No additional branches were opened for the purpose. One reason for this could be that the expertise needed to appraise these clients and to play the role of a social intermediary already exists, and the bank (with its financial and structuring expertise) would do much better to go through existing channels than to build new ones.

A major hurdle in this process, however, was the existing regulatory framework in India for MFIs. Deficiency of capital is one of the major constraints to the growth of MFIs. Donor funds are limited, both in size

and availability, and MFIs cannot rely on these exclusively if they wish to scale up their activities. The other options are for MFIs to access public deposits and equity. Existing regulation makes it very difficult for MFIs to raise public deposits - not allowed if the MFI is a non-profit organization and a strong credit rating required if the MFI is a non-bank financial institution (NBFC). The entry-level share capital requirement for an NBFC is about US$400 000, an amount that is still beyond the capacity of most MFIs wishing to transform into a regulated entity. To this day, only one MFI in India has successfully raised equity both from Indian and foreign investors. MFIs registered as not-for-profit entities dominate the Indian microfinance scene and they are still considered an unattractive investment proposition. With capital adequacy problems, unsupportive regulation and a lack of resources, MFIs in India face a tough task when it comes to scaling up operations.

It is in this context that ICICI Bank saw a clear need for an innovative approach, eventually coming up with a few unique products and channels - innovation that not only helped the bank to meet its targets for rural lending but also helped MFIs overcome their capital constraints without the need for regulatory changes. Changes in regulation will happen in due course. But the bank recognizes the need for the microfinance activity not to lose momentum in the meantime.

ICICI Bank is trying out different models of microfinance delivery with about ten NGOs/MFIs including SHARE, Basix, Asmita, Spandana, PRADAN, Dhan Foundation, Swayam Krishi Sangham, Village Welfare Society, Grameen Koota, Sanghamitra and CASHPOR.

The three models that have been piloted so far are:[4]

- **portfolio buy-out**, whereby the existing assets of the NGO/MFI are assigned in favour of the ICICI Bank in return for a purchase consideration;
- **partnership**, where the loans are originated in the books of ICICI Bank and the NGO/MFI takes up the responsibility of monitoring and recovery;
- **on-tap securitizaton** or continuous 'portfolio buyout' of loans and assignment of receivables to ICICI bank by the NGO/MFI.

Sourcing criteria and operational guidelines for the bank and NGO/MFIs are stipulated in mutually agreed arrangements.

All the models have in-built collection incentives and risk-sharing arrangements through different, mutually agreed formulae. Essentially, all the structures have two components:

1. a financing instrument for the MFI portfolio or to its clients directly;
2. credit enhancements

The financing instrument could be a portfolio buyout of the MFI or a continuous arrangement of on-tap securitization to the MFI, or loans disbursed directly to MFI clients as in the partnership model. The credit