ICICI Bank and Micro-Finance in India*

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ASIA

INDIA

ICICI

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ICICI Bank and Micro-Finance in India

Introduction

This paper describes the activities of ICICI Bank, India’s second largest commercial bank. It introduces micro-finance and banking in India and describes how banks in India are currently engaging in micro-finance, followed by an introduction to ICICI Bank and a general description of the Bank’s micro-finance policies and practices. Three of the many micro-finance institutions with which the Bank is engaged are described, and the impact on the borrowers addressed. The sample institutions are:

• **Basix Finance** is one of India’s larger micro-finance institutions. ICICI Bank has made a small **equity** investment in one of the Basix group’s operating companies, and has also purchased a part of its micro-finance **crop loan portfolio**

• **Pragathi Seva Samithi** (PSS) is a quite small locally based NGO in Andhra Pradesh, which is involved in micro-finance as well as a whole range of other social welfare activities, and has promoted a number of federations of self-help groups. ICICI Bank has lent $100,000\(^2\) to its self-help group customers

• **BISWA** is a larger non-government organisation in Orissa, the poorest state in India, which is engaged in education, vocational training, health care and other welfare activities, as well as micro-finance through self help groups, and has taken bulk loans from a number of commercial banks. ICICI Bank has lent $250,000 to their client self help groups.

The three cases are selected because Basix is a leading MFI in India, and was the first to do business with the Bank. It remains the only MFI in which the Bank has taken equity. PSS and BISWA are respectively the smallest and the largest of the less well-known second-tier MFIs, which have been linked with ICICI with facilitation from CARE.

The map on the next page shows the location of the three institutions, and that of ICICI Bank’s head office.

1. **Micro-finance in India**

India has a relatively **well-developed financial sector**. There are 27 government-owned banks, operating nationwide; more than 20 major private banks, and several thousand public sector and co-operative banks, in urban and rural areas. There are some 66,000 commercial bank branches, and over 100,000 branches of other banking institutions. With 16,000 people

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1 Several informants, ranging from self help group members and other final borrowers, to senior bank executives assisted me in gathering this information. The women clients gave their valuable time and information freely, and are thanked. While they might never read this paper, I hope that their generosity will in due course be repaid through better financial services, to themselves and others in India and internationally. I need to also thank all the staff of ICICI Bank, ABN-AMRO Bank, Grameen Foundation, Basix Finance, the Bellwether Fund, Pragathi Seva Samithy, BISWA, Spandana and Jeevanjyothish MACS, the Saraswati, Pragathi, Onagallu and Laxmidunguri SHGs for all their help. Jitesh Panda of Shrishthi Foundation collected and presented the information from Orissa.

2 Indian rupees are converted to US $ at an approximate rate of Rs 50 = $1.00
per bank branch, India is ‘well-banked’ by comparison with most other countries at a low level of economic development. There are also several thousand non-bank financial institutions, whose main activity is savings mobilisation. Some of these, such as Sahara and Peerless, have nation-wide networks of branches and agents, and tens of millions of customers, while others operate locally.
The financial system is regulated and supervised by the Reserve Bank of India, and the financial and other requirements for new banking licences are extremely high. This prevents most micro-finance institutions from taking deposits.

There is also a large informal financial market, including village moneylenders and traders, local ‘chit funds’ and enormous numbers of extra-legal savings collectors and lenders. The poorest people are particularly dependent on these informal suppliers, with 36 percent of all rural credit needs, and 78 percent of the needs of the poorest rural people, being met by informal suppliers. (www.basixindia.com).

India came late to the new paradigm in micro-finance. This is unfortunate; since India’s 400 million desperately poor people need access to micro finance. The advantage is that India can now benefit from the experience of other countries. The government spend many years trying to alleviate poverty with massive programmes of directed credit. These programmes had limited success, and were often hijacked by the less poor and were used as a patronage mechanism by politicians and bureaucrats. They did however occupy the ‘institutional space’ which might otherwise have been filled by micro-finance providers.

While these programmes helped some people, they also left long-term scars on the country’s financial system. The cheap soft loans, often combined with subsidies, were distributed through the enormous network of some 150,000 bank branches, including rural co-operative banks (Harper et al, 2005). Recoveries were poor, often below 30 percent, and default was further encouraged by local and even national loan waivers.

Some independent institutions persisted in their search for more effective ways of bringing financial services to the un-banked. In 1976 the Self-employed Women’s Association (SEWA) opened a co-operative bank for urban rag-picker and other women in Ahmedabad. This grew successfully, but was not replicated, and the hard core of poverty was in the rural areas, where 70 percent of India’s over one billion people live.

In spite of the close proximity of Bangladesh, and the similar conditions of abject rural poverty, the Grameen Bank methodology did not spread significantly in India until the end of the 20th century. The rigorous approach the Grameen Bank used was perhaps too far removed from the low interest rates and soft policies of the government sponsored programmes.

The Mysore rehabilitation and development association (MYRADA) started in the late 1980s to experiment with the formation of what later became known as self-help groups (SHGs), based on traditional Southern Indian savings and credit groups, and on earlier experience in Thailand and Indonesia. SHGs are effectively micro-banks, with between ten and 20 women forming a group, on their own initiative, or with the help of an NGO or other self-help group promoter. Each member saves a regular small amount, usually between ten and 50 cents a week. They are encouraged to deposit their savings in a savings account with a nearby commercial or co-operative bank, and the Reserve Bank of India (RBI), the country’s central bank, has since 1994 allowed unregistered groups to open savings accounts and to borrow

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1 The most dramatic and most damaging case was in 1990, when the Government of India declared that all farm loans in rural areas under $200 which had been outstanding for three years or more need not be repaid at all. This benefited 32 million farmers, and cost the Government almost two billion dollars, but the main beneficiaries were the better-off farmers who owned land, not the poorer landless labourers (Shylendra et al 1994)
from banks. After a few months the group makes loans to its members from their common savings fund.

If the SHG need to supplement their savings fund, they can borrow from a bank. The members are free to set whatever interest rate they like on their loans, and they usually add on a substantial margin over what they pay the bank, in order to build their own group equity.

In the early 1990s, building on MYRADA’s experience, the National Bank for Agriculture and Rural Development (NABARD), the government’s instrument for financial deepening in rural India, started to encourage the banks to accept SHGs as customers, for savings and for loans. NABARD refinances banks’ loans to SHGs at 5.5 percent. This subsidy is still below some institutions’ cost of funds. The banks have generally lent to SHGs at 12 percent, and the resulting spread of 6.5 percent has usually been considered adequate to cover transaction costs.

NABARD also promote and finance capacity building for banks and NGOs, to promote SHGs and in that way ‘link’ them to banks. By early 2004 a total of 110 000 bank staff, 21 000 NGO staff, 25 000 Government officials and 430 000 SHG officers and members had been trained. NABARD also provides four million dollars in SHG promotion grants to NGOs and banks; these grants are disbursed on a performance basis, depending on the numbers of SHGs which have reached certain defined stages in their development (NABARD, 2004).

As a result of this massive programme of training and other support, SHGs have become the dominant delivery channel for micro-finance in India. By the end of 2004, almost 1.5 million SHGs, with perhaps 20 million members, were said to have borrowed from banks, and more savings accounts were opened, in order to qualify for loans. The numbers might be overstated, since many groups reconstitute after a period of inactivity, causing double-counting. Nevertheless, it is estimated that as many as 20 percent of India’s one hundred million poor households could have some access to formal financial services.

The small number of Grameen replicators has also grown very rapidly, particularly in recent years, although their outreach is still much lower than SHG. The outstanding portfolio of SHARE, the largest institution using the Grameen method, grew from 55 000 clients in 2001 to 600 000+ clients in 2005. Some 64 percent of all micro-finance clients in India are members of SHGs, 24 percent are borrowing from Grameen replicators, and the balance is taking small individual loans (Sharma, 2005).

2. Micro-finance Institutions in India

Specialised micro-finance institutions, or MFIs, have played a relatively small part in the evolution of micro-finance in India, with institutions such as MYRADA and SEWA being the pioneers. Since the late 1990s bank ‘linkages’ to SHGs is the dominant methodology, with as much as 80 percent of the market falling into that category. There are several large MFIs, occupying various niches, and they continue to evolve and grow in spite of the fast-expanding SHG linkage movement. In some states the SHG linkages are used by governments as a vehicle for the distribution of subsidies and other politically motivated largesse. This
contributed to outreach, particularly in the Southern State of Andhra Pradesh, but has not improved the quality or sustainability of the groups.

NGOs have always played the dominant role in promoting as opposed to financing SHGs, but a number of NGOs have themselves become involved in financial intermediation. They have done this for a number of reasons:

- The NABARD programme is focused on financing SHGs in rural areas. There is no comparable programme for the growing number of poor people in the cities, and some MFIs are filling this gap.

- There is a relatively small but very fast-growing group of Grameen replicators in India, which operate in areas of extreme poverty, or in urban areas, where SHGs are less prevalent. NABARD does not refinance Grameen-type loans, or urban loans, and NABARD-sponsored training relates entirely to the SHG methodology.

- India is well-banked in relation to its low level of development, but some of the poorer rural areas are not well-served, and many local branch managers are still not convinced of the merits of SHGs as customers. SHGs prefer to borrow from an NGO whose staff they know, rather than with a socially ‘distant’ banker who may still not be willing even to allow them to open a savings account.

- NGOs are always in search of ‘sustainability’, and for income sources that do not depend on donor goodwill. Micro-finance is seen as a way of doing this.

Some institutions have moved from conventional NGO welfare activities to micro-finance, and others started as MFIs. The RBI forbids unlicensed institutions from taking demand deposits, but some MFIs have found ways round this, such as by forming nominally independent savings co-operatives which take members’ deposits and then lend them to the non-bank finance company for on-lending.

This method of financing is quite recent, and has only been adopted by a small number of the larger MFIs which have the necessary organisational sophistication. Most MFIs have traditionally depended on donor grants for on-lending funds and for their operational expenses, but donors are coming to expect them to raise finance from commercial or at least semi-commercial sources. A sample of 90 Indian MFIs which had been rated by M-Cril, the country’s leading micro-finance rating agency, were by late 2003 raising 35 percent of their funds from institutional debt, as opposed to 31 percent from grants (M-Cril Microfinance Review, 2004). March 2005 data for the 62 main Indian micro-finance institutions compiled by Sa-Dhan, the institutions’ representative body, showed that they had together borrowed $52 million from commercial sources, while their outstanding portfolios totalled $71 million; they relied on donors and equity for the balance of their funds.

The major source of semi-commercial funds is the micro-credit fund of the Small Industries Development Bank of India (SIDBI). In 2004 the fund had a portfolio of 20 million dollars, lent to about fifty of the larger MFIs. SIDBI also provides generous capacity building support.
to its partner MFIs, as part of a $25 million grant from the British Department for International Development.

The SIDBI fund is not constrained by any shortage of finance, but most MFIs are anxious not to be over-reliant on one source, particularly since SIDBI is a government-owned development bank. The mission statement of Basix, one of the major MFIs and a borrower from SIDBI, contains the phrase “.....to be able to access mainstream capital...” Like many MFIs, in India and elsewhere, Basix wants to demonstrate in its balance sheet as well as its operations that micro-finance can be a viable business proposition, and accessing commercial bank loans is an important way of doing this. SIDBI loans require more formalities than commercial banks, such as special board resolutions and directors’ seats. There are thus many reasons why SIDBI has not achieved the high share of bulk lending to MFIs which has been achieved by PKSF in Bangladesh or similar funds elsewhere.

Interest rates are falling quite dramatically in India in recent years; the Reserve Bank’s indicative bank rate was 11 percent in January 1998 and 6 percent by the beginning of 2005. This influenced MFIs’ and banks’ shift away from development to commercial sources of finance for micro-finance activities. NABARD’s 5.5 percent refinance, and SIDBI’s bulk loans at 11 percent, were attractive when market interest rates were around 12 to 14 percent or even more. However, now SIDBI’s reduced rate of 9 percent is not competitive with the commercial bank offer to MFIs of bulk loans at 8 percent or even less and many banks have stopped taking NABARD refinance. The marginal cost of funds is little above 5 percent, and by lending their own surplus balances to SHGs they can avoid the ‘hassle’ of applying and accounting for NABARD refinance.

3. Banks and micro-finance in India

Banks have the major share of the Indian micro-finance market through their direct branch-based business with self-help groups.

The following table shows the SHG lending performance up to March 2004 of the five leading nationalised banks, and of the other main categories of banks.

<table>
<thead>
<tr>
<th>Public Sector Banks</th>
<th>Branch/outlet numbers</th>
<th>Amount lent to SHGs</th>
<th>Number of SHGs</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Bank of India</td>
<td>9033</td>
<td>$137 mn.</td>
<td>131,700</td>
</tr>
<tr>
<td>Canara Bank</td>
<td>2424</td>
<td>$19 mn.</td>
<td>24,700</td>
</tr>
<tr>
<td>Andhra Bank</td>
<td>1227</td>
<td>$73 mn.</td>
<td>81,600</td>
</tr>
<tr>
<td>Indian Bank</td>
<td>1377</td>
<td>$49 mn.</td>
<td>47,200</td>
</tr>
<tr>
<td>Indian Overseas Bank</td>
<td>1427</td>
<td>$22 mn.</td>
<td>31,500</td>
</tr>
<tr>
<td>Other public sector banks</td>
<td>53583</td>
<td>$104 mn.</td>
<td>200,000</td>
</tr>
<tr>
<td>Private Banks</td>
<td>7590</td>
<td>$47 mn.</td>
<td>21,700</td>
</tr>
<tr>
<td>Regional Rural Banks</td>
<td>15,000</td>
<td>$255 mn.</td>
<td>405,000</td>
</tr>
<tr>
<td>Co-operative Banks</td>
<td>106,000</td>
<td>$74 mn.</td>
<td>134,600</td>
</tr>
</tbody>
</table>

Source: NABARD 2004, op. cit
According to the M-Cril sample of 90 MFIs they had lent about $165 million to almost two million people, or one fifth of the banks lending to around one tenth of the numbers of borrowers. This is because many of the MFIs make relatively large loans to individuals, as opposed to loans to SHGs or through Grameen groups. There are also a few very substantial Grameen replicators among the MFIs, with several hundred thousand borrowers each, and their members tend to borrow small annual loans, unlike SHG members who may only borrow once, or even not at all, and whose SHGs may repay the banks over as long as three years.

The 31 major private banks in India have very limited branch networks and serve mainly salaried individuals and corporate clients. ICICI Bank, for instance, India’s second largest bank in terms of its assets, has only 470 branches, of which only 88 are outside the main cities. The private banks have less than 5 percent of the direct SHG market, and only one small private bank, the Krishna Bharathi Samruddhi Local Area Bank (KBSLAB), part of the Basix group, specialises in micro-finance.

All banks, including private banks, have to reserve 40 percent of their advances for what is called the ‘priority sector’, which is broadly defined as rural areas, small industries, exporting firms and housing, and within this 18 percent must be reserved for agriculture. An alternative way of meeting this target is to lend the equivalent amounts to government-controlled institutions such as NABARD or to SIDBI at un-remunerative interest rates of 6 percent or less, which then pass the funds on to priority sector borrowers or to state governments which invest them in rural infrastructure or for other qualifying purposes. There is, however, very strong pressure on all Indian banks to do a substantial amount of direct priority sector business, and not to buy themselves out of their obligations with indirect investments. The RBI can even cut the interest paid on NABARD or SIDBI bonds if it is perceived that a bank is using them to buy its way out of its priority sector obligations.

There is thus a strong incentive for banks to find ways of achieving their priority sector targets, which apply irrespective of whether the bank has or has not a branch network through which it can deliver qualifying loans directly. The banking community are coming to appreciate that micro-finance loan portfolios have many advantages:

- On-time recoveries of over 95 percent are normal. This is particularly remarkable to Indian bankers who have become accustomed to defaults of well over 50 percent under government-sponsored programmes.
- They are relatively insensitive to price; micro-finance customers value access above cost, and MFIs are similarly willing to pay the cost of convenient and accessible funds.
- Micro-finance is fashionable and private banks, particularly those which are foreign-owned, are anxious to show governments and the general public that they are socially responsible. Micro-finance lending can be both profitable and good for image-building.
- It is to be hoped that some micro-finance customers will one day become mainstream banking clients.
A number of commercial banks, in the private and the public sectors, have therefore started to make bulk loans to MFIs, and to make longer term equity investments in what may eventually be a major distribution channel for all kinds of financial products.

Some of the nationalised banks have also started to supplement their direct branch-based SHG business with bulk loans to MFIs. They may do this in areas where their own branch network is weak, or where particular MFIs have a very strong presence. In March 2004 the State Bank of India had lent almost $20 million in bulk loans to MFIs (Harper, Singh, op.cit.). Some feel that MFI’s are the most efficient way of entering the micro-finance market, since they have a specialised outreach and organisational culture, while others feel that SHG is a better route. The true transaction costs of dealing direct with SHGs is debatable since many branch staff is under-employed so that the marginal cost of their time is very low. It is generally agreed, however, that the initial cost of promoting an SHG cannot easily be absorbed by a bank.

The newer private banks, however, do not have the option of choosing whether to deal directly or indirectly with micro-finance customers. Without their own branch networks, they have to deal through MFIs. In 1998, Global Trust Bank, a new and very aggressively managed private commercial bank, lent $800 000 to Basix Finance; this was the first loan by a private commercial bank to an MFI, and was also the first loan to a for-profit micro-finance company, rather than to an NGO. The interest rate was below the Bank’s prime rate, at 10.5 percent, since NABARD had agreed to refinance it at 6.5 percent. The money was not necessarily destined for SHGs, and NABARD waived its normal requirements that refinanced funds were only to be lent to SHGs; the interest cap on the on-lending rate by the MFI was also waived.

Since that time, a number of other Indian and foreign commercial banks have lent substantial sums to MFIs. ABN-AMRO, a multi-national bank based in the Netherlands, is a good example of how a more progressive foreign bank has become involved in micro-finance.

ABN-AMRO Bank had previously experimented with direct micro-finance in Brazil, and opened four specialised micro-finance branches for this purpose. The results were disappointing, achieving only a million dollars of business in four years, partly because of the public’s general and often well-founded mistrust of banks in Brazil. In India they are trying a different, indirect approach. They appointed a dedicated Vice-President for micro-finance, and she has recruited two assistants who have some earlier knowledge and experience of micro-finance. This group seeks out suitable MFIs and makes bulk loans to them, at interest rates between 9 and 12 percent. The loans are secured only against the underlying portfolios, and the MFIs are required only to submit a simple monthly return of the repayment performance. By early 2005 ABN-AMRO had a micro-finance portfolio approaching $5 million to six MFIs, with a further two million dollars under negotiation with four institutions.

This business is now part of the Bank’s social corporate responsibility department, but it is planned to move it into mainstream banking in the near future. It is estimated that the micro-finance portfolio will reach 12 million dollars by the end of 2005, and that it may eventually stabilise at around 30 million dollars. This should be seen in the context of ABN-AMRO’s total India business of some two billion dollars.
4. ICICI Bank

4.1 The origins of the Bank

ICICI Bank is India's largest private bank, and its second largest bank of any kind. It was established in 1994, and by early 2005 its assets exceeded US$26 billion. It has 470 branch offices, mainly in urban areas and larger district towns, and nearly 2000 ATMs, and has 15,000 employees. By contrast State Bank of India, the largest Indian bank, was originally formed in 1806, and has 9,033 branches and over 200,000 employees. SBI’s assets amount to some 70 billion dollars.

Between 1994 and 2001 ICICI Bank was a subsidiary of ICICI Limited, a public sector development finance institution which was promoted by the World Bank and the Government of India in 1955 to provide medium and long term credit to private Indian firms. In 1998 ICICI Limited reduced its shareholding in the Bank to 48 percent through a public offering, and in 2002, ICICI Limited and its other subsidiaries were absorbed into ICICI Bank through a reverse merger. ICICI Bank has subsidiaries in the United Kingdom and Canada, branches in Singapore and Bahrain and representative offices in several other territories. The Bank's shares are listed on the Mumbai Stock Exchange and on the New York Stock Exchange (NYSE); it was the first non-Japanese Asian company to be listed in New York.

ICICI Bank aims to be a leader in every field of banking in India, whether it is corporate banking, foreign transactions, housing, insurance or conventional services for the salaried middle class. They follow a highly centralised model of decision making, whereby all lending decisions are made at head office in Mumbai, using credit scoring techniques. The branch offices act as cash handling centres, and the smaller rural district town offices have only two or three staff. The Bank has recruited a large force of independent agents, or franchisees, who originate loan business from their respective territories, and with specialised customers such as vehicle and home appliance dealers and home builders, and pass them through the branches to head office for immediate decisions.

The Bank takes the view that most of its competitors, with their large full service branch networks, are strong at deposit mobilisation, and weak at making loans. The average ratio of deposits to advances for the Indian public sector banks in 2003 was 2.1 to 1; the equivalent figure for ICICI Bank was 0.68 to 1 (IBA Bulletin, 2003). The Bank’s business model forces it to rely heavily on inter-bank loans as well as other longer term sources of finance for some 45 percent of its resources. These bear higher interest rates than short term deposits, although the transaction costs of mobilising such finance are much lower, and the Bank is therefore determined to turn around its assets as quickly as possible. They therefore package and sell on their assets to other financial institutions whenever possible, and they have designed a variety of approaches to reducing the risks inherent in these packages of loans in order to maximise the price they can get for them (Giddy, 2004).
4.2. ICICI Bank and Microfinance

ICICI Bank entered the micro-finance market in 2002. Among the reasons for entering the market is its goal to lead in every field of Indian banking. Other includes:

- The reverse merger meant that ICICI Limited’s portfolio was aggregated with that of ICICI Bank for the purposes of calculating the Bank’s priority sector lending quota. This created urgent need for additional qualifying assets, since the returns on compensating ‘penalty loans’ to institutions such as NABARD and SIDBI were likely to be lower than ICICI Bank’s average cost of funds.

- ICICI Bank had purchased the privately owned Bank of Madura, in Southern India, in the year 2001. The Bank of Madura had a substantial portfolio of loans to 600 SHGs, and ICICI Bank had somehow to integrate these accounts into its business model.

- The Bank of Madura’s experience showed that micro-finance loans were of high quality, and that the market would pay relatively high interest rates for good quality service. ICICI Bank’s management believe that their model of offering services through specialised intermediaries, such as car loans through vehicle dealers, housing finance through builders, or micro-credit through micro-finance institutions, can offer better quality service than banks can through their multi-purpose branch networks.

- ICICI Bank’s management believe that their microfinance clients will migrate into mainstream banking, and microfinance is a form of customer development.

- The Bank is highly visible, and has an obvious branch presence in the richer parts of Mumbai, Delhi and micro-finance offers a way to demonstrate the Bank’s commitment to social as well as economic and financial goals.

ICICI Bank started its micro-finance activities under its Social Initiatives Group (SIG). This Group is half-way between the corporate responsibility area and the for-profit business. The SIG is responsible for strategic sector-wide developments, and its success has already led to competition from other banks, learning from the pioneering work of SIG.

The bulk of the micro-finance activity has now been transferred to mainstream business. The five-member micro-finance team is located in the rural and micro-banking and agri-business group, within the wholesale banking division. They have also set up a specialised centre for practical action-directed research in micro-finance, which is located in Chennai, in an existing staff training centre of the Bank.

As a private sector bank, ICICI Bank feels that it should focus on improving individuals’ capacity to access formal financial services, rather than working at the community level. The Bank therefore endeavours to deal direct with individuals or with their SHGs when they are organised in this way. They sometimes work through community SHG federations or similar bodies, but the emphasis is on developing individual customer relationships whenever possible.
By early 2005 ICICI had a portfolio of about $66 million through 27 partner MFIs, and loans through a further 11 institutions were under negotiation. Indian micro-finance has grown rapidly but inequitably; Bihar and Uttar Pradesh, which are home to 37 percent of India’s poorest people, only have 9 percent of the over one million SHGs (NABARD 2004, ibid.) ICICI Bank is attempting to reverse this trend, and a number of its partner MFIs, including Cashpor, one of the largest, are located in the poorer Northern States.

The Bank aims to increase its micro-finance portfolio to $4 billion dollars, working through 200 MFIs. There are some 1600 MFIs in India, but only about a dozen of these are presently of sufficient size or strength to be suitable partners for ICICI Bank. The Bank is trying to develop their capacity, through practical training, and also through a programme of mentoring whereby senior staff of the Bank, not from the micro-finance team, make regular visits to assist MFIs to improve their systems and to adopt some elements of a banking culture. This programme is thought to be of great benefit not only to the MFIs but also to the mentors, who may previously have had little or no exposure to the realities of poverty in their own country. The Bank is also collaborating with the CARE CASHE project to develop second-tier MFIs (see section 6).

ICICI Bank is packaging and selling on its micro-finance loans, to for instance UTI Bank, one of the larger private banks. In this way ICICI can enhance the quality and price of these assets. It may eventually be possible to create an international secondary market in micro-finance debt, such as already exists for many other securitised assets, but the priority sector eligibility of the Bank’s loans to MFIs means that they are presently more attractive to Indian banks.

4.3. ICICI Bank’s Delivery Models

The following table summarizes the performance of the main components of ICICI Bank’s micro-finance portfolio from 2002 to 2004.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>March 31, 2002</th>
<th>March 31, 2003</th>
<th>March 31, 2004</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Borrowers</td>
<td>Amount o/s</td>
<td>Borrowers</td>
</tr>
<tr>
<td>Direct Advances to SHGs</td>
<td>21,900</td>
<td>$3.41 mn.</td>
<td>65,080</td>
</tr>
<tr>
<td>Advances under Partnership with MFIs</td>
<td>-</td>
<td>-</td>
<td>867</td>
</tr>
<tr>
<td>Securitized Microfinance Portfolio</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Advances to MFIs for on-lending</td>
<td>-</td>
<td>$1.12 mn.</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>21,900</td>
<td>$4.53 mn.</td>
<td>65,947</td>
</tr>
</tbody>
</table>

The initial model, inherited from the Bank of Madura, was to lend direct to SHGs without any form of financial or management intermediation, in the same way as SBI and the other banks with large branch networks. This approach has not been continued, even in the old Bank of
Madura area, where the method has been abandoned in favour of a variant of the partnership approach which is described below.

The partnership approach accounts for over 90 percent of the Bank’s micro-finance portfolio and is expected to remain the dominant mode. The Bank carefully selects partner MFIs which have substantial outreach and high quality micro-finance portfolios. The selection process is based more on the quality of the portfolio, and of the MFI’s monitoring systems, rather than on the financial strength of the MFI itself, since the Bank lends to the MFI’s customers, and not to the MFI itself.

The loans are negotiated and disbursed to the SHGs or individuals, by staff of the MFI or other intermediary partner, acting as agents of ICICI Bank. The partner MFIs, and on occasion their partner SHG federations, co-operative societies or other institutions, are remunerated for originating and maintaining the accounts, and for recovering the loans. They may be paid a flat fee per SHG, as is the case with Dhan Foundation, a large multi-state MFI based in Tamil Nadu. Alternatively, and more commonly, the managing intermediaries are paid a percentage of the loan interest.

These fees are paid in addition to ICICI Bank’s interest charges, so that the SHGs or individuals actually pay in total similar rates to those they would pay if they were borrowing from the MFI. Their loan agreements state ICICI Bank’s interest rates, not the total including the fees. Three officers of each SHG and every individual borrower from a Grameen replicator sign loan agreements with ICICI Bank, not with the MFI. The agreements have to be accompanied by photographs of the signatories, and proof of residence, such as a voter’s or a ration card, although this individual identification may in special cases be waived and replaced by group attestation from the local village leader. This process ensures that the borrowers understand that they are customers of the Bank, and not of the MFI.

The previous Chairman of the Bank of Madura set up a Foundation under the name ‘Microcredit Foundation of India’ to take over the management of SHG accounts in the same way as other partner MFIs manage accounts for ICICI Bank. When the Bank of Madura was taken over by ICICI Bank in 2001, it was lending to 600 SHGs. At the time of the Foundation’s establishment his figure had grown to 4333 groups and by late 2004 over 8000 SHGs was borrowing from the Bank under the partnership arrangement.

An alternative approach was to make direct bulk loans to MFIs, similar to the method adopted by ABN-AMRO Bank. ICICI Bank made over $2.5 million of such advances in 2002 and 2003. Similarly, the Bank has also purchased packages of the existing assets of MFIs, on a branch or other basis, and in some cases they have set up on-tap portfolio purchase arrangements, whereby the Bank purchases receivables on an on-going basis. These approaches are convenient for the MFI, since they provide a continuous source of funds which is automatically in line with requirements.

Bulk lending and portfolio purchase with MFIs have more recently been de-emphasised, since the Bank is very anxious to build a consumer franchise at the level of the individual borrower, or at least her SHG. Loans to MFIs, particularly the larger ones with which the Bank prefers to deal, are felt to be too remote for this purpose, and the financial condition of most MFIs,
except for the few largest ones, is not such as to inspire confidence. ICICI Bank believes that the risks involved in direct loans to SHGs are much less.

ICICI Bank has adopted this apparently rather complex partnership method, rather than lending direct to MFIs or other intermediaries, for a number of reasons:

- Most Indian MFIs, apart from the largest institutions such as Basix, SHARE, Cashpor and a few others, undertake a wide range of social welfare activities as well as micro-finance, and are dependent on grants for their survival. ICICI feels that the quality of the individual or SHGs loans, when aggregated, is much higher than the quality of debt from the intervening MFIs, and sufficiently high to justify quite low rates of interest. If the intervening MFIs or other institutions are insolvent, the Bank still retains ownership of the loans.

- ICICI Bank wishes to develop a data base which is representative of India’s population as a whole. The direct lending approach gives the Bank unique customer numbers and data for future analysis and market development, and for further sales to the same customers. These might include life insurance from ICICI Prudential, and general insurance from ICICI Lombard.

- The Bank tries to ensure that the clients are aware that they are borrowing from ICICI, even if they never see anyone from the Bank itself. The Bank is confident that if they are satisfied, these customers will become loyal individual mainstream customers when they and the Bank are ready for this stage of their relationship.

- The priority sector requirements are enforced more strictly on private Indian banks than on public sector or foreign banks. There may be some doubt as to the qualification of loans to an MFI, which may be urban based, but there is no doubt about a direct loan to an SHG, or a Grameen replicator’s customer. This is particularly important when micro-finance loans are securitised and sold on to other Indian institutions. A $320,000 package of loans from SHARE, India’s largest Grameen replicator, has already been sold to Development Commercial Bank, an urban bank which is in need of priority sector portfolio.

**ICICI’s Risk Reduction Mechanisms**

ICICI Bank reduces its risk, and also ensures the commitment of the intervening MFIs, by taking first loss guarantees from the MFIs, which vary in amount according to the perceived quality of the portfolio. There are various ways in which this can be done, and the Bank chooses the approach depending on how long they have worked with the MFI, and on the MFI’s own preferences.

- The MFIs opens a fixed deposit for the required amount, which varies according to the Bank’s perception of the quality of the loans, and has thus far been between 8 percent and 15 percent of the amounts involved. This deposit cannot be withdrawn until the loans have been repaid, and can be drawn down by ICICI Bank to cover any losses.
• The MFI is given an overdraft limit with ICICI Bank, up to the required amount, and the Bank can require the MFI to exercise this, and can cover any losses from the resulting credit.

• The fees which are paid by the clients to the intermediary MFIs are locked in a separate account with the Bank until the debts are fully cleared.

• A third party can deposit the necessary guarantee on behalf of the MFI. The Grameen Foundation of the USA has done this for ICICI Bank loans through Cashpor and SHARE, India’s largest Grameen replicators.

Such guarantees can be used to enhance the quality of securitised loans which the Bank may choose to sell on to other institutions, and thus to improve the price obtained by the Bank. Alternatively, the loans and the associated MFIs’ obligations may be retained by ICICI Bank should it be decided not to package or sell on the assets arising from loans to a particular group of clients.

The Grameen Foundation is in the process of setting up Grameen Capital India. Eventually, it is planned that Grameen Capital will be able itself to buy portfolios from MFIs, to manage the risk through various forms of credit enhancement and then to sell them on to banks. It is anticipated that this will substantially broaden the market, since the banks, unlike ICICI Bank at the present time, will not need themselves to identify or assess the MFIs and their clients.

**The ICICI Bank delivery process**

ICICI Bank’s appraisal process is very simple, since it focuses not on the intervening MFIs but on the actual borrowers, whether they are SHGs or individuals. A member of the micro-finance team spends perhaps only one or at the most two days assessing a MFI’s portfolio. After a brief inspection of the MFI’s loan accounting and monitoring systems, they visit a random sample of customers, to check the validity of the head office records and the quality of the groups’ own records.

**The Bank is quite clear that their intention is not to rate the strength of the MFI's own balance sheet, but its capacity to facilitate the relationships between the Bank and SHGs or other actual borrowers to whom the Bank will lend.** They rate the MFI’s management capacity, the quality of its MIS and data reporting systems, the competence of its field staff and the quality of the training it provides to its SHGs and its own staff.

After the loans have been disbursed by the MFI staff (who draw the necessary funds from the nearest ICICI Bank branch), the accounts are monitored for the Bank by locally recruited contract staff and auditors. They follow a preset procedure to verify the monthly returns which are submitted by the MFIs. One full-time monitor is appointed for every partner whose portfolio exceeds one million dollars. These monitors are paid only about $100 a month, but reliable and reasonably well educated people can be hired in India for this amount. They are rigorously trained to follow the required procedures and to observe obvious danger signals.

The Bank is aware that if an MFI collapsed they would have some difficulties in recovering all their dues, in spite of these precautions. The monitoring procedures would give them early
warning of any serious problems, and that the first loss guarantees provide good protection in
the first instance. Also, as a last resort they can sell the remaining balance of any remaining
portfolio to another MFI, or could sub-contract the collection to an appropriate agency.
Fortunately, this has not yet happened and it is in fact very rare for an NGO or MFI in India
actually to cease to exist. They may withdraw from certain activities, for lack of support, but
it is likely that the SHG facilitation task would continue to be undertaken, since the Bank is
paying for it to be done.

ICICI Bank partnership approach does not provide its MFI partners’ customers with safe and
accessible savings facilities; its small branch network does not provide more than a very small
minority of its micro-finance customers with accessible savings services. The RBI regulations
forbid the widespread use of collection agents, and the Bank is experimenting with a money
market mutual fund product which is supervised by the Stock Exchange Regulator and is not
therefore subject to the same restrictions. This product might allow weekly or even daily
deposits and withdrawals, of as low as fifty rupees, but it is still being developed.

The Bank is also experimenting with a variety of technology-based approaches to financial
product distribution, such as smart cards and local kiosks, but their cost-effectiveness remains
to be proven. In addition to offering mainstream insurance products from its two affiliated
insurance companies, the ICICI group is also engaged with the Basix group, one of its earliest
MFI partners, in the development of micro-insurance products to cover crop and livestock
losses. This includes a unique rainfall insurance product, which is described later in this
paper. The Bank also assists the most disadvantaged with livelihood assistance. They are
therefore working in a few locations with their large scale agro-business clients, such as
millers or farm input suppliers, to develop mutually profitable ways of bringing poorer people
into the formal market place. Thus far, these non-financial initiatives have not proceeded
beyond the experimental stage, and no possibilities have emerged for combining them with
the Bank’s micro-finance partners.

In early 2005 ICICI Bank’s micro-finance portfolio amounted to no more than a third of one
per cent of the Bank’s total assets, but it is growing faster than most other areas, and is rather
more profitable than the average for the Bank’s business sectors. There is no need for the staff
who work in micro-finance, or for management who support them, to justify the micro-
finance portfolio by reference to its social or public relations benefits, or to view it as an
investment in future client development. The spread on micro-finance advances is as high,
and the transaction costs are as low, as in other sections of the Bank’s work, because the costs
have been effectively out-sourced to specialist institutions. This is fundamentally consistent
with the Bank’s approach to any other business sector, such as housing or vehicle finance, and
management are now confident that micro-finance has been securely mainstreamed within the
Bank.
5. ICICI Bank and Basix Finance

5.1 Basix Finance

Basix Finance is a new generation finance and livelihood promotion institution. Basix was established in 1996 and by early 2005, they had 85,000 poor borrowers. The head office is in Hyderabad in Andhra Pradesh, but its activities are spread over 44 districts and eight states of India. The main concentration of Basix’ business is in Andhra Pradesh and Karnataka in the South and in the adjacent State of Orissa in the East, but Basix is working to extend their work in poorer states such as Chattisgarh and Jharkand.

The average loan from the two lending institutions in the Basix group is $170. Half the loans are for farming and the other half for a wide range of non-farm activities, and about 30 percent of the customers are women. The two operating companies made a combined profit of about $150,000 in the year ending March 2004.

Basix’ mission is to promote a large number of sustainable livelihoods, including the rural poor and women, through the provision of financial services and technical assistance. Basix aims to earn a competitive rate of return for its investors, to enable them to access mainstream capital and human resources.

In pursuit of this mission, Basix has set up a four-company structure, as shown below:

- **Bhartiya Samruddhi Investments and Consulting Services Ltd (BASICS Ltd)** is the group holding company, through which equity and debt investments are made in the following three group companies, which were set up when Basix itself was started in 1996 or shortly thereafter.
- **Bhartiya Samruddhi Finance Ltd (Samruddhi)** is an RBI registered non-bank finance company (NBFC), owned by a number of Indian and foreign financial institutions, including a small equity shareholding from ICICI Bank. Samruddhi is engaged in the provision of micro-loans, and also retails insurance products and provides technical assistance services to some of its borrowers. As a small and relatively recently formed NBFC, Samruddhi is not permitted to mobilise savings, and has therefore taken bulk loans from many Indian and foreign sources, including ICICI Bank.
• Krishna Bhima Samruddhi Local Area Bank Ltd (KBSLAB) is an RBI licensed bank which provides micro-loans and savings services in three districts, and also retails insurance and provides livelihood services. KBSLAB is licensed under the Local Area Bank regulations which were introduced in 1996 by the RBI to allow smaller banks to set up and operate in restricted local areas. Only five such banks have been licensed, however, because of resistance from the established banks and their staff trade unions, and KBSLAB is the only such bank which specializes in micro-finance. Basix would like the activities of Samruddhi also to be undertaken under the banking regulations, since this allows for savings mobilization, but there seems to be no immediate prospect of this being possible. KBSLAB is presently negotiating a loan from ICICI Bank, since its customers’ savings balances are not yet enough to cover it’s lending. The ratio of savings to loans is however increasing, and it should in a few years be unnecessary for KBSLAB to take loans from other financial institutions.

• Indian Grameen Services (IGS) is a not-for-profit company engaged in research, development and training related to livelihoods. IGS has also set up the Indian School of Livelihood Promotion, to learn from and share the Basix group’s experience in livelihood development to other institutions in India. IGS receives its income from fees, from the returns on its corpus funds and from grants which it receives from time to time. ICICI Bank made a grant of $56 000 to IGS in 2003, for further study of possible IT applications to micro-finance.

The two operating companies had a combined portfolio of over $11 dollars at the beginning of 2005. Only $2.4 million of this amount was raised from customer savings and from security deposits, since the larger operating company has no banking license, and this means that bulk loan and on occasion equity funds have to be obtained from a variety of other sources to cover the balance of customers’ requirements.

At the end of 2004, companies in the Basix group were obtaining finance from SIDBI, UTI Bank and HDFC Bank in India, and from Canadian CIDA, via the Desjardins Foundation, Cordaid of the Netherlands, the Ford Foundation, Swiss Development Co-operation, and Shorebank of the United States. Additionally, the equity shareholders included ICICI and HDFC Banks, the International Finance Corporation (IFC), Hivos of the Netherlands and Shorebank.

Basix is also involved in distributing insurance products, both as a compulsory adjunct to its loans and as stand-alone products. Basix has sold insurance to about 100,000 people, but does not itself act as an insurer. It works closely with various companies on life, health, livestock and crop insurance.

One of Basix’ partners is ICICI Lombard, with whom Basix has for some time been developing and testing a unique crop insurance product, based on local rainfall figures.

Basix is perceived as a pioneer in Indian micro-finance, and has been responsible for many innovations and policy and regulatory changes which have been taken up nation-wide. Unlike other single product institutions, such as the Grameen replicators, Basix works through a wide range of intermediaries, and Basix also takes the view that generating employment in
disadvantaged rural areas is as useful as providing finance for self-employment. Basix therefore includes many non-poor people as its customers, since their businesses create jobs for others.

Basix realise that loans alone cannot enable most people, particularly the poorest, to lift themselves out of poverty. They also need assistance with their livelihoods, and they strong local institutions. Basix has a ‘triad’ of interventions, the other two components of the triad are livelihoods promotion, and institutional development for other livelihood promotion or financial service institutions which can support Basix’ clients.

In many ways these two functions, and particularly livelihoods promotion, are more difficult than the provision of financial services. Some quite dramatic successes have been achieved in dairy, vegetable and forest products, groundnut and cotton cultivation, but such initiatives do not reach the majority of Basix customers. Basix has come to accept that the growth of its financial business may be constrained by the need to prevent the other two components from lagging too far behind. This may on occasion disappoint financial partners, as well as some senior staff, but management feel that this is a price worth paying for the maintenance of the group’s mission.

5.2. The ICICI Bank Equity investment

The capitalization of the Basix group went through a number of stages.

- In 1996, when Basix was set up, it was funded by the Ford Foundation and Swiss Development Co-operation, using preferred shares with deferred interest and in anticipation of a public offering as a means of recovering their money by the year 2014. The Ford Foundation required that some Indian money should be invested in addition to the promoters’ equity of a $55 000, and it was stipulated that 70 percent of the group’s equity should be from Indian sources by 2008. There were some initial delays in authorizing the funds from the USA and Switzerland, and the Ratan Tata Trust fund, an Indian grant-making body promoted by the Tata industrial group, enabled Basix to start operations in June 1996 with a returnable grant of $200 000.

- In 2000 Samruddhi, the group’s NBFC was to be capitalized, and the same issue of the need for local shareholders arose. The IFC and Shorebank were both willing to invest, but non-bank finance companies were in bad odor in India because of a number of major embezzlement cases. Basix had to persuade the RBI to allow up to 50 percent foreign investment in an NBFC, and to persuade the two prospective equity investors, ICICI Bank and HDFC Bank, to overcome their reluctance to invest in a small and new institution in what was generally an unfamiliar and suspect field.

- This involved many visits to Mumbai by Basix senior managers, and Basix mobilised top level support in IFC and the World Bank to finally convince ICICI Bank to send one of its senior managers on a two-day fact finding visit to Basix in Hyderabad.

- The report was favourable, but ICICI Bank still demanded that Samruddhi’s capital
adequacy should be enhanced to 40 percent to cover the perceived high level of risk. After further lengthy negotiations ICICI Bank agreed to reduce the capital adequacy requirement to 20 percent, and to invest $200 000, for 5 percent of the company’s equity. HDFC invested $100 000 for a 2.5 percent shareholding, and other foreign investors took a total of about 46 percent, with IFC having 23 percent. The balance continued to be held by Basix Limited, the holding company.

- ICICI Bank’s investment was made under the Social Investment Group, not under the ICICI Group’s quite large venture capital division. Management of the investment was transferred in 2003 to the micro-finance section of the Bank, but ICICI Bank has not made any further equity investments in MFIs since. It is felt that the recently developed partnership approach, as described above, makes it unnecessary for the Bank to concern itself directly with the financial strength of its partners, since its loans are to SHGs and individual customers.

The Bank’s investment only increased Samruddhi’s funds by some 3 percent, but it was an essential part of the whole package which allowed the NBFC to be properly capitalized. No dividends were immediately payable to shareholders, and the money was essentially free of cost in the short to medium term, and the total equity investment was instrumental in reducing the company’s costs of funds to below 11 percent, one of the lowest for all Indian MFIs at that time. This was in spite of the fact that the quality of Basix’ loan portfolio was somewhat lower than that of its competitors, because of Basix’ continuing insistence that crop loans and on-farm lending were an essential part of any credible rural financial institution’s activities. The funds were soon profitably absorbed in profitable loans, and were not ‘parked’ in any long term high yielding securities.

ICICI Bank’s and the other shareholders’ investments in Samruddhi were seen as a major move towards the ‘main-streaming’ of micro-finance in India. The transaction required all parties to learn a great deal, and they have all made use of this learning in subsequent transactions with other Indian MFIs. The investment also had an immediate and positive impact on the credit ratings of Basix.

The new shareholding required little additional reporting or other administrative tasks apart from routine quarterly returns such as were already being produced. Basix transferred its main routine banking relationship to ICICI Bank in Hyderabad, and all Basix employees’ salaries are paid into their own accounts with the Bank. This involves no hardship for any parties, since ICICI Bank is generally considered one of the most efficient personal and corporate banking providers in the city. Basix has inevitably been compelled to maintain the large number of different bank accounts it operates throughout its area of operations, since ICICI Bank does not have a rural branch network outside the main district headquarters towns.

The evolution of the equity shareholdings in Samruddhi since its establishment in 1996 is summarised below:
<table>
<thead>
<tr>
<th>Year</th>
<th>Investor</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>Individual promoters</td>
<td>$140</td>
</tr>
<tr>
<td></td>
<td>Basix holding company</td>
<td>$80,000</td>
</tr>
<tr>
<td>1997</td>
<td>Basix holding company</td>
<td>$156,500</td>
</tr>
<tr>
<td></td>
<td>Individual promoters</td>
<td>$1,700</td>
</tr>
<tr>
<td>1998</td>
<td>Individual promoters</td>
<td>$600</td>
</tr>
<tr>
<td></td>
<td>Basix holding company</td>
<td>$623,500</td>
</tr>
<tr>
<td>1999</td>
<td>Basix holding company</td>
<td>$20,000</td>
</tr>
<tr>
<td>2001</td>
<td>Basix holding company</td>
<td>$1,130,100</td>
</tr>
<tr>
<td></td>
<td>IFC (World Bank)</td>
<td>$940,000</td>
</tr>
<tr>
<td></td>
<td>Shorebank (Chicago)</td>
<td>$470,000</td>
</tr>
<tr>
<td></td>
<td>Hivos (Netherlands)</td>
<td>$470,000</td>
</tr>
<tr>
<td></td>
<td><strong>ICICI Bank</strong></td>
<td><strong>$2,000,000</strong></td>
</tr>
<tr>
<td></td>
<td>HDFC Bank (India)</td>
<td>$100,000</td>
</tr>
<tr>
<td>2003</td>
<td>Basix holding company</td>
<td>$20,000</td>
</tr>
<tr>
<td>2004</td>
<td>Basix holding company</td>
<td>$40,000</td>
</tr>
<tr>
<td>2005</td>
<td>Basix holding company</td>
<td>$140,000</td>
</tr>
</tbody>
</table>

The holding company’s shareholding is now 49.49 percent of the total equity. The individual promoters are members of the holding company board, and when this company’s shares in Samruddhi are added to their shares this effectively retains majority control.

5.3. ICICI’s portfolio purchase

In 2003, two years after the Bank’s equity investment, ICICI Bank purchased some 3700 short term crop loans from Samruddhi for a total of one million dollars. The package was made up from the total crop loan portfolios of eleven different branches, and Samruddhi placed 15 percent of the amount in a ‘locked’ escrow account as a first loss guarantee for ICICI Bank, which could only be withdrawn when all the crop loans were repaid, net of any defaults.

This deal served Basix’s interests in a number of ways:

- Samruddhi was in need of additional funds for on-lending, and this deal increased Samruddhi’s funds with 15 percent. Once the precedent had been set, it would also have been relatively easy for Samruddhi to sell on further packages of loans, as and when the need for funds arose.
- Crop loans were the worst performing part of the Basix group’s portfolio. This deal removed the majority of this weak component from the NBFC’s books at one stroke.
- Samruddhi paid 8.75 percent for the facility, which was below the average cost of funds at the time. The cheapest alternative would have been to borrow from SIDBI at 11 percent, and the ICICI Bank purchase enabled Samruddhi to pay off earlier bulk loans from SIDBI, and from ICICI itself, which were costing 11 percent. Previous loans from SIDBI had also involved protracted and costly formalities, special board resolutions and other ‘hassles’.
- The farmers paid 24 percent interest on the original loans, and the 15 percent which was paid into the escrow account represented the margin between the interest rate which ICICI
was receiving and the amount which was being paid by the borrowers. Previous experience suggested that there would be some 2 percent of defaults, which would be drawn from the first loss guarantee account, but the net balance was still remunerative to Samruddhi.

- As a result of the earlier equity investment by ICICI Bank, both parties knew each other well, and the deal could be finalised with the minimum of formalities.

The deal also served ICICI Bank’s interests. The Bank needed to be able to demonstrate to the authorities that its loans to or through MFIs genuinely qualified as priority sector loans to small farmers. This deal provided the bank with 3700 individual accounts, complete with the names and locations of each borrower. It was believed that there could be no question as to the eligibility of this package and that the loan package could easily be securitized and sold on by ICICI Bank to any interested financial institution, together with the credit enhancement provided by the first loss guarantee.

This securitization deal was believed to be the first of its kind in Asia, and possibly in the world. The principle was of course familiar to ICICI Bank, since such deals are an essential part of their day-to-day business model. The micro-finance context was however unfamiliar to many of their staff, as was securitization as such to some on the Basix side.

Both sides had some minor but irritating problems with the provision and absorption of the required detailed data, which had not only to identify every farmer but also to show every individual loan schedule and every repayment, on a monthly basis. The actual preparation of the returns was all computerized from available data on Samruddhi’s existing management information system, but it did involve some extra administrative and programming time, particularly since each loan account had to be taken from the different branch records and consolidated with all the others in the complete package.

ICICI and other banks have learned from this experience and have made similar arrangements with other MFIs, such as a $2 million portfolio purchase, finalised three months after the Basix deal with SHARE, India’s largest and most rapidly growing Grameen replicator. On Basix’ side, there has been no need to repeat the arrangement, because the amount of crop lending is not increasing, and Samruddhi has received more equity finance which has temporarily alleviated the need for more funds.

Basix has maintained the percentage of its loans which are for agricultural purposes at around 50 percent, although much of this is for livestock and the crop loan component has been reduced. This is partly because of the high risks of crop lending, but also because female borrowers tend to invest in milk animals rather than crops, and because Basix believes that it is desirable to encourage diversification of rural livelihoods.

6. The CARE CASHE Facilitation

ICICI Bank and other institutions working with and through MFIs are constraint by the lack of strong, mature MFIs. The best ones already have large amounts of funds from ICICI and other banks, and from SIDBI. Some of them, such as Basix, are identifying less expensive
sources of funds, and there are a number of potential equity investors, i.e. Grey Ghost and Bellwether funds, further reducing the immediate need for debt finance.

These larger and more innovative MFIs also have savings facilities, which are obviously more convenient, being available from the same institutions which provide loans. SHARE, India’s largest and most rapidly growing Grameen replication promotes nominally member-owned co-operative structures to meet this need, which operate through the same offices as the lending NBFC. Basix’ Local Area Bank (LAB) license also enables their customers to save, at least in the three districts where KBSLAB is licensed to operate.

These savings facilities also provides the institution with a new and potentially less expensive source of funds for on-lending, and KBSLAB is approaching the point where its savings liabilities will equal or exceed its loan assets. It is probable that as regulations are liberalised and MFIs become more sophisticated, there will be more such innovations, thus further reducing MFIs’ need for bulk funding.

Given the shortage of strong MFIs, and the vast size of the market, there is obviously a need to develop the capacity of the large number of smaller MFIs which already exist. SIDBI has been trying for some years to build their capacity, with the help of a $25 million grant from the British Government, with some limited success. It is obviously difficult for a large formal banking institution to become directly involved in all the diverse training, mentoring and consultancy activities which this involves, and there is also a serious shortage of locally relevant and effective capacity building capacity.

ICICI Bank, in keeping with its policy of out-sourcing not only particular functions, but also their management, has chosen instead to work with CARE, a large international development agency, through CARE’s ‘CASHE’ (Credit and Savings for Household Enterprise) project, a British aid funded micro-finance promotion programme which has since 1999 been working to develop micro-finance activity in the three states of West Bengal, Orissa and Andhra Pradesh. Madhya Pradesh has also recently been added to its area of operations.

CASHE aims to develop the capacity of the middle range MFIs within its area, and works primarily with 25 so-called ‘tier one’ partners. These institutions were previously unable to access bulk finance from banks on their own, but their management were committed to expanding their micro-finance activities. Duplication has also been avoided whenever possible; the tier one partners together covers a substantial part of their respective states, including the more disadvantaged areas. CASHE has provided direct support to all these partners, including Pragathi and BISWA, whose interactions with ICICI Bank are described later in this paper.

CARE also supports some of the operating costs of its partner MFIs, on a declining basis. This has been particularly important in the State of Andhra Pradesh, where many of CASHE’s partner MFIs work through Mutually Aided Co-operative Societies (MACS) which have been registered under the relatively new MACS Act of the State of Andhra Pradesh. This allows co-operatives to be free from the state interference, and other assistant agencies, have promoted MACS as federations of SHGs. Other states are now introducing similar acts, but Andhra Pradesh has been the pioneer.
CASHE also has a revolving loan fund from which it provides bulk loans to its partner MFIs. This fund was initially not included in the CARE proposal to DFID, since the aim was to assist MFIs and SHGs to borrow from local Indian sources, but the British aid agency had insisted that such a fund should be included, mainly because the total cost of the project without such a fund, some seven million dollars, was said to be too small to be worth processing.

By October 2004 some $1.5 million of this fund had been disbursed, and about one million dollars was outstanding. More significantly, the MFIs had borrowed about two million dollars from banks, and the 18,000 SHGs which the partners had promoted had borrowed a total of some four million dollars from banks.

The revolving loan fund has almost certainly ‘crowded out’ some local funds, but CASHE management have eagerly welcomed the opportunity of working with ICICI Bank to enable the customers of their partner MFIs to access ‘real’ local money.

CASHE’s collaboration with ICICI Bank started in early 2004 when ICICI Bank staff was looking for ways of identifying and working with partner MFIs beyond the strongest 12-15 institutions with which they and other banks were already engaged. They asked the CASHE staff for ideas, and the synergy was immediately obvious.

ICICI Bank and CASHE have now evolved a mutually satisfactory working relationship. The stages are as follows:

- CASHE has been working with its partners for some time, and has satisfactorily lent to and recovered from them, for up to four or five years. When CASHE is satisfied that an MFI and its clients are ready to ‘graduate’ to a full fledged banking relationship, it is recommended to the Bank. CASHE in no way guarantees the eventual loans, and has no financial interest in the transactions.
- The Bank staff then carries out their quite simple and rapid appraisal of the partner MFI’s systems, and visit and appraise a sample of whatever intermediaries the MFI works through, such as SHG federations, or SHGs themselves, and their individual members.
- If the MFI is approved, and none have been turned down thus far, the Bank and the MFI sign a memorandum of understanding with the Bank,
- After a delay of up to two weeks, the loan is approved, and the money is passed from the nearest ICICI branch to the MFI. The loan is not to the MFI, however, but is merely held in trust and passed on by the MFI to the actual borrower groups or individuals.
- The money is disbursed to the actual borrowers, by the MFI, and the borrowers, whether they are groups or individuals, sign detailed agreements, with ICICI Bank.

As is clear from the above, CASHE has no legal responsibility and plays no part in the procedure after recommending a particular partner MFI to the Bank.

By early 2005 five arrangements of this kind had been finalised under the collaboration between CASHE and ICICI Bank, and a total of $1.5 million had been disbursed. This amounted to less that 2.5 percent of the Bank’s total micro-finance portfolio, but this quite small amount had been lent through almost a quarter of the MFIs with which the Bank was
dealing. While these MFIs and their customers are absorbing much less than the larger MFIs the Bank anticipates that these smaller relationships will in due course grow to rival the top level MFIs.

The clients pay a fee to the MFI, as well as to any SHG federation or other intermediary which may be assisting in the facilitation of their loans from ICICI Bank. This is charged as a supplement on the interest rate charged by ICICI Bank. The MFIs are responsible for collecting the repayments, and they deduct their fees before crediting the repayments and interest charges to ICICI Bank’s account.

CASHE itself covers its initial capacity building costs from its DFID grant, so that the Bank bears none of this cost. By early 2005, this cost worked out to approximately $1.50 per client reached, which was not felt to be an excessive figure. The CASHE project is however due to finish in 2008, and CARE and ICICI Bank have started to evolve a new approach to MFI capacity building in Madhya Pradesh, where the Bank will cover the costs, as an investment in customer development.

CARE is also working with other banks which have followed ICICI Bank’s pioneering example, and aims to build its facilitated disbursements to and through MFIs from the present figure of $1.5 million to a cumulative total of $400 million by 2010.

7. Pragathi Seva Samithi, Warangal (PSS)

PSS was registered under the 1860 Societies Act in 1991, and is located in Warangal District in Andhra Pradesh. Its name means Services for Progress Organisation. PSS is one of the smaller of the five MFIs whose SHG customers have received loans from ICICI Bank since 2002, with facilitation from CARE. They have borrowed a total of $100 000 from the Bank, which has been distributed direct to individual SHGs under the ICICI Bank partnership model. PSS itself and 19 of the 22 mutually aided co-operative societies, or MACS, which PSS has promoted to aggregate the needs of its SHG since 1998, have facilitated the ICICI Bank loans to the SHGs.

Warangal is about 100 kilometres to the East of Hyderabad, with a population of just over three million, and three quarters of them earn their livelihoods from farming and related activities. Although it used to be relatively well off, the area has recently suffered heavily from drought. Cotton is the most popular crop in the area, and this too has led to problems, both because of drought and because of the high cost of seeds, fertiliser and pesticides. The returns from cotton can be very high when conditions are right, but the losses can also be proportionately high. Over 1000 cotton farmers have committed suicide in Warangal since 1998, because of the load of debts they accumulated through buying ever-increasing quantities of herbicides and pesticides.

PSS covers the poorest parts of the District, and its work covers a wide range of welfare and related activities, including disability, child labour, street children, nutrition, HIV/AIDS, sexual health, watershed development, and the promotion of organic farming. PSS has been heavily involved in SHG promotion and micro-finance for some seven years, and uses SHGs
as an entry and support strategy for many of its other activities. PSS has mobilised the MACS as a means of mutual support for the SHGs, and as a channel through which the SHGs can access funds. PSS has also promoted over 200 SHGs specifically for people with disabilities, and these will in due course be federated into a MAC.

PSS has an annual budget of around $240 000, and employs 99 full time workers, 140 part-time staff and almost 200 volunteers. The NGO is funded from a number of government programmes, and about 80 percent of its funding is from foreign agencies such as Oxfam, Actionaid and Swiss Development Co-operation.

PSS has promoted over 1250 SHGs, organized into 22 MACS, with altogether 20 000 members. At the end of 2004, the SHG members owed about $750 000 to their SHGs, and the SHGs themselves owed about $200 000 to various banks. The balance of the SHGs’ funds were from their own savings, their accumulated earnings and their loans from PSS, which had had to change its by-laws in order to be able to borrow from CASHE and on-lend to the MACS. The main source of funds for PSS was the CASHE revolving loan fund, for which they were paying interest at the rate of eight per cent. PSS had borrowed a total of $80 000 from this source (Microscan, 2004).

In order to cover part of its risk, ICICI Bank has required PSS to deposit 15 percent of the loans to the SHGs, as a first loss guarantee. This deposit earns the Bank’s normal rate of 5.5 percent interest, but the account cannot be closed until all the SHG loans have been repaid. Any defaults can be recovered from the deposit, before it is returned. There has as yet been no need to exercise this right, but PSS are well aware of the possibility.

As a result of ICICI Bank’s satisfactory experience with PSS, the State Bank of India, the largest bank in the country, and Corporation Bank, are becoming interested in lending to PSS’ affiliated MACS, and possibly to PSS itself. They are finding that many branch managers are reluctant to deal direct with SHGs, because their members’ absorption capacity, are too small to be economic.

7.1 The PSS MACS and their SHGs’ ICICI Bank loans

*The Jeevanajyothi MACS*

The Jeevanajyothi MACS is one of the 19 MACS whose member SHGs have received loans from ICICI Bank. It was registered in 2002, and it had evolved from an earlier multi-purpose co-operative which was promoted by PSS in 2002, initially to introduce integrated pest management techniques to farmers. It has 76 member SHGs, and 722 members. They are all women and many are from the so-called ‘scheduled’ castes and tribes who have been always in India been both socially and economically marginalized.

The financial situation of the Jeevanajyothi MACS at the end of 2004:
<table>
<thead>
<tr>
<th><strong>Assets/Use of Money</strong></th>
<th><strong>Liabilities/Sources of Money</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans outstanding with member SHGs</td>
<td>Members’ savings</td>
</tr>
<tr>
<td>$17500</td>
<td>$7590</td>
</tr>
<tr>
<td>Fixed deposits</td>
<td>Loans from PSS</td>
</tr>
<tr>
<td>$760</td>
<td>$10500</td>
</tr>
<tr>
<td>Cash at bank</td>
<td>Accumulated surplus</td>
</tr>
<tr>
<td>$1460</td>
<td>$1630</td>
</tr>
<tr>
<td><strong>$19720</strong></td>
<td><strong>Total</strong></td>
</tr>
<tr>
<td></td>
<td>$19720</td>
</tr>
</tbody>
</table>

The salary of the managers of the MACS are subsidised by the CASHE project, on a declining basis over four years, from 100 to 25 percent of the total annual cost of $720. The managers supplement their earnings by keeping the records of member SHGs, at a monthly charge of 60 cents per group.

Two member SHGs of the Jeevanajyothi MACS have taken loans to a total value of $1700 from ICICI Bank. They realise that these loans are more expensive than loans to SHGs from the nearest branch of the Kakatiya Rural Bank, which won a prize for being the most successful regional rural bank. The SHG members nevertheless prefer to borrow from their MACS, or from ICICI Bank, because:

- When the SHGs borrowed from the Kakatiya Bank, all the members of the group had to go to the branch, costing them $6 in bus fares, in addition to sixty cents each in lost wages. After that, the two officers had to make two further visits to the branch, which cost the group a total of around $2 for each trip, including a small allowance for lunch, since they had to wait a long time to be served at the bank.

- Loans from the Kakatiya bank were insufficient to enable the women to buy buffalos, which cost around $100 each, or to make any other significant investment. They appreciated that the small amounts available from the bank had to an extent relieved them of the need to take emergency loans from the local moneylender at an effective rate of about 10 percent a month, but they needed more money to make a significant impact on their household incomes.

- Women from other MACS asked the manager of the nearest branch of the State Bank of Hyderabad, another nationalized bank, for loans, but he said that it was impossible since he had received no instructions from his regional office to make such loans (he had also warned them against the dangers of taking loans from more than one source).

- The loans from ICICI Bank, in the same way as direct loans from their MACS, were more expensive than from the Kakatiya Bank, but part of the extra cost went to support the MACS, which was their own institution.

The women believe that it would be even better to borrow direct from their MACS, rather than from ICICI Bank, since such loans as are available from the MACS cost 18 percent, as opposed to the effective rate they pay for ICICI Bank loans of 24 percent, and they wish further to develop their own institution. They appreciate, however, that it is difficult for the MACS to access more funds, and they are satisfied with the more expensive loans for now. They have used their loans for a variety of purposes, including the purchase of goats and sheep, for sums as small as twenty to thirty dollars.
The Pragathi MACS, Deekshakuntla

All the members of the 53 SHGs who have formed the Pragathi MACS in Deekshakuntla are from the scheduled or untouchable castes, and 10 of these groups have received loans totalling $4000 from ICICI Bank. The financial situation of this MACS:

<table>
<thead>
<tr>
<th>Assets/Use of Money</th>
<th>Liabilities/Sources of Money</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans outstanding with members SHGs $18 900</td>
<td>Members’ savings $7120</td>
</tr>
<tr>
<td>Fixed deposits $2800</td>
<td>Members shares $85</td>
</tr>
<tr>
<td></td>
<td>Accumulated surplus $4505</td>
</tr>
<tr>
<td></td>
<td>Loans from PSS $10 000</td>
</tr>
<tr>
<td><strong>Total</strong> $21 700</td>
<td><strong>Total</strong> $21 700</td>
</tr>
</tbody>
</table>

The ten SHGs which received loans from ICICI Bank were selected because many of their members had not been able to borrow before, since the funds they had been able to obtain from their MACS, or the local banks, were insufficient. They received loans of between $880 and $200; and while many had asked for larger sums, or very small amounts the MACS manager, in consultation with PSS, decided that the distribution should be more equitable than their requests.

Six members of the Chaityanya SHG shared the $600 which their group received. None of them had taken loans from the SHG before. They used their loans as follows:

- Mrs. Ilama borrowed $100 to install a drinking water tank for her house. She planned to repay the loan in ten months from the money she earned from her dairy animal, and she hoped both to improve her family’s health and to save the time and labour they presently spent fetching water from the village pump.
- Mrs. Srimati took $100 to add to the inventory of her small grocery shop, hoping that the new stock would increase her daily profit from four to five dollars.
- Mrs. Bathula borrowed $100 to buy two good quality goats, which she planned to fatten and sell after a year for $140.
- Mrs. Venkatamba and Mrs. Boma Gani both borrowed to buy buffalos for milk production. Mrs. Venkatamba added $60 from her own savings to the $100 she took from the SHG, and bought a buffalo which, she hoped, would earn her about 80 cents a day from milk. Mrs. Boma Gani borrowed $90 and bought a rather lower quality buffalo, but hoped that it would produce milk worth 60 cents a day.
- Mrs. Trikovela spent her $100 loan to buy corrugated iron sheets to replace the grass roof of her family’s mud-walled house. She planned to repay the loan with the earnings from her vegetable vending business, but there was also a financial saving in that the new roof would make it no longer necessary to replace the grass roof every year or so, at the cost of some twenty dollars.

All these women are clear that they owe these sums to their SHG, but some are not sure whether the SHG itself has borrowed from their MACS or from ICICI Bank. Those who think that the loans are from the MACS believe that the MACS have borrowed from ICICI Bank. This confusion is understandable, since the group was borrowing from the MACS until it received this loan from ICICI Bank; the MACS had borrowed from PSS, which in turn had
borrowed from the CASHE fund. The women know that they are responsible for covering any defaults by their fellow SHG members, and that the other SHGs in the MACS can not help them if the whole SHG is unable to pay.

**The Spandana MACS**

Twelve of the 42 SHGs in the Spandana MACS have received loans from ICICI Bank. The financial position of this MACS, at the end of 2004 was as follows:

<table>
<thead>
<tr>
<th>Assets/Use of Money</th>
<th>Liabilities/Sources of Money</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans outstanding with member SHGs</td>
<td>Members’ savings</td>
</tr>
<tr>
<td>$33 400</td>
<td>$6500</td>
</tr>
<tr>
<td>Fixed deposits</td>
<td>Interest received 2004</td>
</tr>
<tr>
<td>$2820</td>
<td>$3120</td>
</tr>
<tr>
<td>Expenditure 2004</td>
<td>Other income 2004</td>
</tr>
<tr>
<td>$1000</td>
<td>$110</td>
</tr>
<tr>
<td>Cash at bank</td>
<td>Profit for 2002/2003</td>
</tr>
<tr>
<td>$100</td>
<td>$1090</td>
</tr>
<tr>
<td>Loans from PSS etc.</td>
<td></td>
</tr>
<tr>
<td>$26 500</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>Total</strong></td>
</tr>
<tr>
<td>$37 320</td>
<td>$37 320</td>
</tr>
</tbody>
</table>

The twelve SHGs have borrowed a total of $18 000 from ICICI Bank. The Spandana MACS is the second smallest of the MACS which have been promoted by PSS, in terms of its number of members, but although they are by no means wealthy the members are generally rather better-off than most of the SHG members in the other MACS. They have thus been able to borrow larger sums than the others, and have borrowed some three times more than the average SHG.

The twelve beneficiary SHGs were selected because they had not been able to borrow from the CASHE loan which PSS had borrowed and had in turn on-lent to the MACS and thus to their SHGs. The Saraswati SHG was typical; they borrowed a total of $2600 from ICICI Bank, which was shared by thirteen of the fifteen members. They used the loans for a wide variety of activities, as shown below:

<table>
<thead>
<tr>
<th>Saraswati SHG, stated purposes for ICICI loans</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Buffalo purchase, for milk</td>
<td>5 members.</td>
</tr>
<tr>
<td>Dowry for daughter’s marriage</td>
<td>2 members</td>
</tr>
<tr>
<td>Trading, in fish + beedi (local hand-rolled cigarette) leaves</td>
<td>2 members</td>
</tr>
<tr>
<td>House repair, building toilet</td>
<td>2 members</td>
</tr>
<tr>
<td>Buying an embroidery machine</td>
<td>1 member</td>
</tr>
<tr>
<td>Stocking husband’s paan (betel nut) shop</td>
<td>1 member</td>
</tr>
</tbody>
</table>

The financial position of the Saraswati SHG in early 2005 was approximately as follows:

<table>
<thead>
<tr>
<th>Assets/Use of Money</th>
<th>Liabilities/Sources of Money</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans outstanding with members</td>
<td>Members’ savings</td>
</tr>
<tr>
<td>$3150</td>
<td>$750</td>
</tr>
<tr>
<td>Cash at bank</td>
<td>Loan from ICICI Bank</td>
</tr>
<tr>
<td>$50</td>
<td>$2600</td>
</tr>
<tr>
<td>Savings deposit with MACS</td>
<td>Balance of loan from Kakatiya bank</td>
</tr>
<tr>
<td>$750</td>
<td>$600</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>Total</strong></td>
</tr>
<tr>
<td>$3950</td>
<td>$3950</td>
</tr>
</tbody>
</table>

The SHG had earlier paid out its accumulated surplus to its members as a 14 percent dividend on members’ savings; they thought that this was the most equitable way of dealing with the
fact that some members had taken more loans than others. These figures show that the loan from ICICI Bank has almost trebled the amount of money available to the members of the Saraswati SHG. The loan has been similarly important to the other 18 SHGs who borrowed from ICICI Bank.

Their original loan from the Kakatiya Bank was now almost paid off, and they had completely cleared the balance of an earlier loan for $1000 from a branch of the State Bank of Hyderabad, not the same one whose manager had refused to lend to another SHG. These loans were at 12 percent, and still lower rates were being discussed, and were thus much less expensive than the ICICI Bank loan, which effectively cost much more.

The members had been assured, however, that ICICI Bank would lend them larger sums in the future, and they felt that the cost of the money was less important than getting the money in the quantities they needed, and when they needed it. The Bank has also stated that new loans can be considered after 50 percent of the first loans have been repaid; this is a major improvement on other banks’ loans to SHGs, which are usually for a three year term, with no possibility of a fresh loan until the first has been repaid in full.

The members of the SHG are aware that their loan is actually from ICICI Bank, although they have never seen a staff member or branch of the Bank. They have chosen to add a margin of 6 percent for their SHG, making an effective total cost of 24 percent, since they have a practice of regularly distributing the SHG’s surplus to the members as a form of compensation to the members who chose not to take loans. They are also happy to pay the 6 percent margin which is added by the MACS, because the MACS is benefiting. It is their own institution, and they want it to grow. The ICICI Bank rate of 9.75 percent is written in the agreement which their officers have signed, but they know that the additional margin is shared by the MACS and PSS, in payment for their services.

**The Orugallu MACS**

The Orugallu MACS is different from the others which PSS have promoted, in that the members of its constituent SHGs live in the urban slums of Warangal town, not in small villages and hamlets in the countryside. Warangal is a medium-sized town with a population of about 250,000 people. As is usual in Indian towns of any size, a substantial proportion of its people live in slums in appalling squalor. Relatively few of the poor in India’s cities have been reached by micro-finance, partly because there is still a lingering and mistaken belief that urban people are richer than those in rural areas, and because NABARD, the main SHG promotion agency, is concerned only with rural development. There is no equivalent institution to support micro-finance for the urban poor.

There are 62 SHGs, with 802 members, all from the scheduled castes, in the Orugallu MACS, and three of the SHGs have taken loans from ICICI Bank, for a total of $2,000. Thirteen of their members have taken loans from the Bank’s funds, for the following purposes:
Akhle, Jagruthi and Sreelaxmi SHGs, stated purposes for ICICI loans

<table>
<thead>
<tr>
<th>Purpose</th>
<th>Members</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bullock cart and bullock for transport business</td>
<td>4 members.</td>
</tr>
<tr>
<td>Housing repair and improvements</td>
<td>2 members</td>
</tr>
<tr>
<td>Increase inventory of grocery shop</td>
<td>2 members</td>
</tr>
<tr>
<td>Set up cycle and auto-rickshaw repair shop</td>
<td>2 members</td>
</tr>
<tr>
<td>School fees</td>
<td>1 member</td>
</tr>
<tr>
<td>Set up trade in sarees</td>
<td>1 member</td>
</tr>
<tr>
<td>Chillie trading</td>
<td>1 member</td>
</tr>
</tbody>
</table>

The loans varied between $400 and $100. These SHGs have not been able previously to borrow from any banks, although there are several bank branches not so far from the slums where the members live. This is because the banks generally confine their SHG loans to rural areas, which qualify for priority sector status and can be refinanced by NABARD.

The returns to trading and similar activities are usually higher in urban than in rural areas. The bullock cart owners reckon to earn around $50 a month from an investment of $200 and the chilli trader hopes to earn $2 a day from her $200 investment. Most of the businesses are actually run by the husbands of the SHG members, but their wives claim that their access to the necessary capital has substantially improved their status in their families.

### 7.2 The financial impact of the ICICI loans on final borrowers

The ICICI Bank loans did increase the amounts of money available to the SHGs in Warangal and thus to their members. The amounts lent, the repayment schedules and the possibility of further loans, mean that the SHGs are finally able to lend their members enough to invest in micro-business ventures, on and off the land, which have the potential substantially to increase their incomes.

This has not come without some cost, however. It is difficult to compare interest rates, or the cost of funds when aggregated with the service fees which are payable to the MACS and to PSS on the ICICI Bank loans, since interest rates in India are falling. However, it is useful to compare the three different routes through which loans are reaching SHGs:

- Local bank branches to SHGs – 12 percent, but reducing in Warangal and elsewhere in India to 9 percent or possibly even less.
- CASHE revolving loan fund to PSS to MACS to SHGs – 8 percent to PSS, 10 percent to MACS, 18 percent to SHGs.
- ICICI Bank to SHGs, with fees to MACS and PSS – 9.85 percent plus 0.15 percent processing fee equals 10 percent to PSS, plus 2 percent fee equals 12 percent to MACS, plus 6 percent fee equals 18 percent to SHG.

PSS is presently discussing with the MACS the possibility of reducing their facilitation fees. This will not be easy, since the MACS are fragile member-owned institutions and bear their own administrative costs as the CASHE subsidies run down. PSS itself may also be able to make some reduction in its fees, although they do have to bear the substantial cost of supervising the SHGs, collecting the repayments and remitting them to ICICI Bank, and
preparing detailed monthly reports on the performance of each SHG. The first loss guarantee fund is also a burden for PSS, since it yields only 5.5 percent and the organisation has little spare cash resources and is under constant pressure to increase its activities.

ICICI Bank may in the future lend to the MACS, perhaps at 12 percent plus a small management fee to PSS, rather than direct to the SHGs, although this would only be possible after several cycles of satisfactory recovery from the SHGs, and if the MACS were themselves firmly and profitably established.

8. Bharat Integrated Social Welfare Agency (BISWA), Sambalpur, Orissa.

8.1 BISWA

BISWA is a NGO registered under the Societies Act. The word ‘Bharat’ means ‘national’, but the institution has thus far confined its activities to Orissa, the poorest state in India by most measures, and to the neighboring state of Chattisgarh. BISWA was established in 1995 by K C Mallick, who had spent the previous twenty years in various management positions with State Bank of India. Micro-finance is one of the main activities of the organization, and they also work in other welfare activities, such as vocational training, the rehabilitation of leprosy patients, solid waste management, education, health and family counseling. The word “biswa” also means “universe” in Hindi and in Oriya, the local language of Orissa.

BISWA has promoted over 4,000 SHGs, with 64,000 mainly women members, in almost 2,000 villages in 22 different districts of Orissa, more particularly in the western part of the state. Some 98 percent of its SHGs are in poor rural areas, but in some urban areas, such as Sambalpur town where BISWA’s head office is located, they have also promoted SHGs of women in the urban slums.

Western Orissa includes the ‘KBK’ area, the three districts of Kalahandi, Bolangir and Koraput, which are notorious for the poverty of their mainly tribal population and the well-publicized starvation deaths that seem to occur every few years. Sambalpur is just north of this area, but is also very poor. The district is famous for its hand woven cloth, which is considered by some authorities to be the most beautiful hand woven material in the world. Little of the revenue earned from this trickles down to the weavers and their families, however.

8.2 BISWA’s sources of funds

ICICI Bank has lent a total of $250,000 to SHGs promoted by BISWA, and through them to 4,351 final borrowers Before this loan became available, BISWA had itself taken finance from a number of different organizations, for on-lending to its SHGs. The outstanding balances, interest rates and terms of these funds were as follows, in January 2005:
<table>
<thead>
<tr>
<th>Institution</th>
<th>Amount outstanding</th>
<th>Interest</th>
<th>Term</th>
<th>Instalments</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Bank of India</td>
<td>$24 000</td>
<td>8.75%</td>
<td>36 months</td>
<td>Quarterly</td>
</tr>
<tr>
<td>The Balasore Gramya Bank (the local regional rural bank)</td>
<td>$12 650</td>
<td>8.75%</td>
<td>36 months</td>
<td>Quarterly</td>
</tr>
<tr>
<td>CARE CASHE project</td>
<td>$10 250</td>
<td>8%</td>
<td>24 months</td>
<td>Half-yearly</td>
</tr>
<tr>
<td>Rastriya Mahila Khosh (RMK), the central government women’s fund</td>
<td>$94 680</td>
<td>8%</td>
<td>36 months</td>
<td>Quarterly</td>
</tr>
<tr>
<td>Friends of Women’s World Banking (an MFI network, affiliated to SEWA Bank)</td>
<td>$3 340</td>
<td>12%</td>
<td>36 months</td>
<td>Quarterly</td>
</tr>
</tbody>
</table>

These loans had enabled BISWA to lend directly to 1168 SHGs; the ICICI Bank loan went to a further 297 groups. State Bank of India is considering offering an overdraft limit of some $220 000, at 7.5 percent, and HDFC, another private bank which has been introduced to BISWA through the CASHE project, has offered a loan of $120 000, possibly increasing to $500 000 within a fairly short period. The United Bank of India is also offering loans on the same terms as State Bank of India, and, as described later in this paper, BISWA has negotiated a loan from ABN-AMRO Bank for $10 000 at 11 percent interest, which is yet to be disbursed.

In addition, BISWA mobilizes SHG savings from the SHGs which it has promoted, and the balance of these savings was $10 500. The SHGs receive 5 percent annual interest on these savings. It is not strictly legal for an NGO such as BISWA to take people’s savings in this way, but, as they do with many similar NGO/MFIs in India, the authorities turn a blind eye to the practice.

RMK makes very small loans, since it aims to reach large numbers of small MFIs. The CARE CASHE project is diverting its attention and its funds to smaller MFIs which need its assistance more than established partners such as BISWA, which are being encouraged to replace the CASHE funds with loans from commercial sources, such as ICICI Bank. The CASHE project will in any case be terminated by 2008, so loans from this source cannot be relied on for the long term.

The loan from ICICI Bank was disbursed into a special account opened for the purpose at the ICICI Bank branch in Sambalpur, in 2004. BISWA did not take the $250 000 loan from ICICI Bank on its own books, since the loan was immediately distributed to the SHGs direct, with fees payable to BISWA in the same way as fees were paid to the MACS and PSS in Andhra Pradesh. In the case of BISWA, however, the SHGs pay 14.25 percent interest, which is made up of a 5 percent service charge for BISWA added to the 9.25 percent interest charged by ICICI Bank. The ICICI Bank loan has enabled BISWA to assist the 297 SHGs to obtain loans, which would not have otherwise been possible because BISWA did not have sufficient funds. This brought the total number of borrowing SHGs to the total of 4351 and the ICICI...
Bank loans represented an expansion in the total funds outstanding with SHGs of about 50 percent in just three months.

The SHGs’ loans are repayable over eighteen months, but ICICI Bank have made it clear that they wish to maintain and expand the arrangement, so long as the repayment experience is satisfactory. Thus far, the 297 SHGs which have taken the ICICI Bank loans have achieved 100 percent on-time repayment. This is slightly better than the average SHG repayment rate of 98.6 percent, partly because BISWA ensured that the SHGs which borrowed from the Bank were well-established, with previous high repayment rates. The Bank has informally indicated that a 95 percent repayment rate will be sufficient to ensure that they continue to support BISWA’s SHGs, and they have stated that they hope that BISWA’s SHGs will be taking a total of some $3.5 million within the next year or so. BISWA anticipates that the Bank’s loans will eventually make it possible for SHG members to access larger sums than are available from other sources, and the 5 percent service charge should they hope be sufficient to cover BISWA’s operating expenses as the portfolio increases.

If the $25 000 loan at 9.25 percent is aggregated with the other funds shown above, as if it was a loan to BISWA itself, this would marginally increase the weighted average cost of funds, from 8.7 percent to 9 percent. This nominal increase, however, is a cheap price to pay for the larger and more flexible loans which ICICI Bank is willing to make available to the SHGs.

8.3 The financial impact of the ICICI Bank loans

BISWA has been active in micro-finance for ten years. During this time the SHGs have accumulated about $280 000 worth of savings, and the SHGs have borrowed almost one and a half million dollars, direct from banks and from BISWA.

BISWA on-lent to SHGs at 18 percent, plus a two dollar service charge, and the group members pays 24 percent to their SHGs. The spread of 6 percent has been retained by the SHGs to build their own funds, or has been distributed to the members as a dividend, depending on the wishes of each group. The rate of 14.25 percent which the SHGs are paying to ICICI Bank represents a considerable reduction in their costs. This reflects the general market situation of falling rates, where some banks are lending direct to SHGs at as low as 9 percent. It is also desirable as the SHGs mature and members borrow more substantial sums; it is not difficult for a women to pay 2 percent or more a month for a loan of $50 for emergency medical expenses, but when she is borrowing $200 or more for an investment such as a dairy animal the cost of money becomes more critical. The SHGs are free to set whatever on-lending rates they prefer, but at the present time most are lending to their members at 2 percent a month, or 24 percent a year.

BISWA is also an agent of the Life Insurance Corporation (LIC) of India, the country’s largest life insurance company, which is government owned. BISWA has sold some 3000 SHG members the heavily subsidized life policies, available from LIC, and BISWA receives a five cent commission on the annual premiums of four dollars.
In addition to income earned from interest margins, fees and commissions, BISWA has also been able to tap other sources of assistance to cover its operating costs. NABARD paid $6000 for the promotion of 200 SHGs, under its promotion support scheme, and BISWA has also been a partner of the CASHE project. In addition to training and other support, CASHE has also paid $14,000 in 2004 to assist with the costs of BISWA’s micro-finance programme. These grants will be reduced and terminated over a four year period.

BISWA must also carry the first risk of defaults on loans to the SHGs which it has introduced to ICICI Bank, by opening a guarantee deposit with ICICI Bank’s branch in Sambalpur, in the same way as PSS did in Warangal. In this case, however, the deposit is for 12 percent of the loan rather than 15 percent of the outstanding balances, because the ICICI Bank team member who visited BISWA and a small sample of its affiliated SHGs assessed that the quality of their records and their repayment performance was somewhat better. Nevertheless, this first loss guarantee deposit imposes a heavy burden on BISWA’s limited cash resources and it is hoped that ICICI Bank will relax this requirement or replace it with an overdraft account, which would only be drawn down if there were any defaults and would therefore not tie up any of the NGO’s scarce cash resources.

The transaction with ICICI Bank was fairly simple, and in many ways less difficult than the earlier bulk loans from other banks. The initial introduction was made by the CASHE representative who had worked with BISWA for some time, and only two further meetings were required, over a period of six weeks. BISWA estimate that the whole transaction, including setting up the necessary recording and reporting formats, and informing the SHGs of their obligations, took four days and the approximately cost was $400.

As a result of the ICICI Bank loans, BISWA has been able to retire a number of its earlier loans from banks and other sources. By January 2005, the ICICI Bank loan represented over half the funds which were available to BISWA’s associated SHGs. This has materially reduced the cost of funds to the SHGs, since their loans from BISWA cost them 18 percent whereas the ICICI Bank loan costs 3.75 percent less.

The actual transaction costs for BISWA are very low; the funds are transferred to its special account in Sambalpur within two hours of the 12 percent guarantee deposit being in place, and can then be disbursed to the SHGs, in cash or by cheque, within a day or so. BISWA has every incentive to transfer the funds to the SHGs quickly, since interest is charged by the bank from the moment the funds are transferred. Until the funds reach the SHGs, BISWA itself has to cover the interest costs.

The ICICI Bank reporting systems have not posed any significant problems for BISWA, since their existing systems already generate more information than is required by the Bank. The Bank requires a quarterly audit of each SHG’s repayment record, which takes some time to carry out. BISWA plans to ask the Bank to reduce the frequency to twice a year. The Bank’s auditor has also suggested that BISWA should keep identification data at its head office for every SHG member who takes a loan from the ICICI Bank money. This would not be at all easy, since many women in rural Orissa do not have voter identity cards or any other document with which to prove identity.
The SHGs must maintain separate records for the use of loans from ICICI Bank, including a cash book to trace the movement of the money and pass books for each borrowing member. This does not cause too many problems, and BISWA is in the first instance meeting the cost of the extra stationery that is needed, but the maintenance of such records at the SHG level does add to the cost of the whole operation for BISWA and the SHGs.

Effectively, apart from the few relatively minor record keeping requirements mentioned above, the ICICI Bank loan has not fundamentally changed the SHG financing practices, apart from the lower interest rate to the SHGs, and the fixed term of 18 months. Earlier loans from other sources were more flexible in their terms. The BISWA board had to pass a special resolution to allow the institution to carry out the complete transaction, and it has been made clear that BISWA must never suggest that the ICICI Bank loan is its own liability, but otherwise the transaction is fairly similar to those with other lenders.

8.4 Remaining challenges

ICICI Bank requires that the service charge to SHGs shall not exceed five per cent, and while BISWA hopes that this reduction from previous on-lending rates may eventually be compensated by larger volumes, but they would prefer to take a higher margin to be sure to sustain the quality of their services to the SHGs and their members. As part of the ICICI arrangement BISWA must undertake as many tasks as if it was before, when taking bulk loans from the Bank and on-lending to the SHGs. BISWA must also facilitate the transactions, and bear the opportunity cost of maintaining the first loss guarantee deposit, and cover the expenses involved in additional record keeping.

In addition to more readily availability funds, the main benefit to BISWA has been its enhanced credibility among banks such as HDFC, ABN-AMRO and SBI. Most of these banks are keen to provide bulk loans to well-established institutions such as BISWA, at competitive interest rates. BISWA is one of the first MFIs in Orissa to have undertaken SHG linkage with ICICI Bank, and this will undoubtedly help BISWA, and other MFIs, to access loans from a wider range of institutions.

A representative of ABN/AMRO Bank negotiated a bulk loan for $200 000 with BISWA, and, unlike the ICICI Bank loan, the borrower is BISWA itself, not the SHGs. The interest rate is 11 percent, and BISWA plan to on-lend the funds to their SHGs at 18 percent, thus making a rather larger margin than the fee which they get from SHGs for facilitating the loans from ICICI Bank.

The interest rate to the SHGs is higher, but BISWA believe that they should diversify their sources of funding, in the interests of their clients and their own institutional future. BISWA plans to set up a non-bank finance company as a vehicle for its micro-finance business. This new institution will take bulk loans from banks, and BISWA hopes that institutions such as ICICI Bank will invest in the equity of its new NBFC, as they have with the NBFC in the Basix group.

This company will eventually work through federations of SHGs; BISWA has already
promoted seven of these, and three have been registered as Mutual Benefit Trusts (MBT). The SHGs are the members of the Trusts, and it is planned that each Trust will cater to a maximum of about 1000 members in a given locality. This will give the SHGs the option of working with their Trusts, and thus with BISWA, or direct with their local bank branches. In this way, BISWA believes, the SHGs and their members will be genuinely empowered.

BISWA trusts that the SHGs will prefer to save and to take loans from their own Trusts, and thus from BISWA, rather than going direct to their local commercial bank branches, even though the loans may cost them 5 percent or more above the direct rate from the banks. ICICI Bank have also indicated that they may in future be willing to deal direct with the Trusts; if this happens, BISWA will be required to perform a similar management function to that which they presently do for the loans to SHGs, with similar fee-based remuneration.

BISWA now have a wide range of options for financing. They are aware that the members of SHGs require timely service above all, and loans to SHGs from ICICI Bank are electronically credited to BISWA’s account in Sambalpur, for onward transmission to the SHGs, on the same day that BISWA sends an e-mail requesting the funds, sometimes even before the papers have been completed.

ICICI Bank is also willing to lend to any SHG which BISWA recommends. Nevertheless, BISWA do not want their SHGs to become entirely dependent on ICICI Bank. It is always possible that the Bank will exercise its right to securitize the loans, and sell them to a less amenable partner. BISWA also generally prefers to take direct bulk loans from banks, since BISWA can exercise total control over such funds, and over the on-lending rate which they charge the SHGs. ICICI Bank may in future increase the management fee of 5 percent which they allow to BISWA, but BISWA feel that this rate barely covers their costs, particularly if the opportunity cost of the first loss guarantee fund deposited with the Bank is taken into account. They would prefer in any case to be able to control the on-lending rate themselves.

8.5 Stories from a two SHGs

The Laxmidunguri Gosthi SHG in Durgapalli Village
The Laxmidunguri SHG was promoted by BISWA in 2000, and has eleven members, all women. Their village is a few kilometers from Sambalpur town, and most of them work in petty trading of some sort. This group is outside the area covered by the MBTs which BISWA has promoted.

The financial position of the group in January 2005 was approximately as follows:

<table>
<thead>
<tr>
<th>Assets/Use of Money</th>
<th>Liabilities/Sources of Money</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans to 10 members from ICICI Bank loan</td>
<td>$2000</td>
</tr>
<tr>
<td>Cash at bank</td>
<td>$15</td>
</tr>
<tr>
<td>Savings deposit at SHG federation</td>
<td>$30</td>
</tr>
<tr>
<td>Savings deposit with BISWA</td>
<td>$295</td>
</tr>
<tr>
<td>Loan to one member</td>
<td>$40</td>
</tr>
<tr>
<td>Members’ savings</td>
<td>$380</td>
</tr>
<tr>
<td>Loan from ICICI Bank</td>
<td>$2000</td>
</tr>
</tbody>
</table>
The members had decided that one member whose husband might misuse her money should borrow from the group’s own funds rather than from the ICICI Bank loan, since there was a substantial risk that she would not be able to repay. The other ten women each took a loan of $200 from the ICICI Bank money, and they used their loans to buy rickshaws for their husbands, for vegetable vending and for small grocery shops. They decided to charge themselves 2 percent a month for these loans, as they had in the past.

The group had taken two loans before taking the ICICI Bank loan. In the first case, they asked for $800 but received only $400. The second time, they requested $1400 and were lent $840. When they had repaid this, they applied for $1600, and to their surprise they were told they could have $2000. They were informed that this loan would be from ICICI Bank, and they said that it was well worth paying a higher interest rate to get the amount of money they needed, and when they needed it. They had also found it necessary to make several visits to the nearby branch of the Balasore Gramya Bank for their earlier loans, and, to them, time was money.

The President and Secretary of the SHG signed the loan agreement with ICICI bank, and were quite aware of the fact that that was from the Bank, and not from BISWA or the Balasore Gramya Bank like their earlier loans. They were also told that they would have to repay the loan over one and a half years, in eighteen monthly installments, and this was noted in their individual passbooks. They decided nevertheless to repay over twenty months, since this made the calculations so much easier. They reasoned that they could if necessary draw on their savings to pay the last three installments all at once.

**The Bhalubahal SHG**

The Bhalubahal SHG was started in September 2001, with 14 members. They initially saved ten rupees a week, or about twenty cents, and the members then decided that they could manage twelve rupees. They found it was easier to keep records of round numbers, however, so they reverted to the original ten rupee figure.

The group had taken a total of five loans by early 2005. The first three loans were from BISWA, for $280, $980 and $1400; the SHG paid BISWA 18 percent interest, or 1.5 percent a month, and they charged themselves 24 percent, or 2 percent a month, for the loans they took from their group. In each case, every member took a loan, for approximately the same amount. In November 2004 the SHG took a fourth loan, for $2000, from ICICI Bank. The members were not entirely clear as to the source of this loan, nor the interest rate, since they were paying 9.25 percent to the Bank and additional fees to BISWA and to their new Mutual Benefit Trust (MBT) which BISWA had promoted for some 40 SHGs in the area. They still charged themselves 2 percent a month for their individual loans.

In February 2004 the group had been advised by BISWA to transfer their accumulated savings balance of $800 from the local branch of the State Bank of India to the MBT. They left the minimum permitted balance of $10 in the bank account, but they planned to withdraw this also and to close the account when the MBT was properly registered. By early 2005 their

| from own funds | $2380 | Total | $2380 |

| Total | $2380 |

| Total | $2380 |
savings balance with the MBT had reached $580, and the group used this balance, plus a loan from the MBT, to prepay their loan from ICICI Bank and thus to qualify for a further and much larger loan of $3920. The members borrowed this money from their SHG at 2 percent a month, as before, and they used it for a variety of purposes, such as paddy and vegetable cultivation, and cattle and sheep rearing. The highest individual loan, for $400, was used to recover the title to household’s land which had earlier had to be mortgaged, at an exorbitant rate.

The members were not altogether clear as to how they were going to be able to repay the second ICICI Bank loan on time, since their savings account with the MBT was now exhausted and they had also to repay their loan from the MBT, but the BISWA advisers reassured them that all would be well. The members were keen to have their own institution, rather than being dependent on their local bank branch, and they were willing to pay a higher price for their loans since the difference would go to build their own MBT.

9. ICICI Bank and Cashpor

CASHPOR, which is an acronym for Credit and Savings for the Hardcore Poor, is a Grameen replicator which operates in Eastern Uttar Pradesh, one of the poorest parts of India. In mid-2004 Cashpor had a portfolio of around three million dollars, lent to some 50 000 women borrowers through its 32 branches.

Cashpor’s main source of funds has until recently been a range of Indian and foreign funders. The organization, like all MFIs, has always had difficulty in raising money because it is not permitted to raise deposits from its customers, but Cashpor also labours under an additional handicap because it does not use the standard Indian self-help group methodology, and is therefore effectively ineligible for assistance from NABARD or other official sources. Cashpor has also been seriously undercapitalized, and its rapid growth has made it impossible to achieve substantial profits since it takes over twelve months for new branches to reach breakeven.

Cashpor is therefore an ideal partner for ICICI Bank. Its outreach has outpaced its financial strength, and it is not able itself to borrow the sums it needs for its clients. ICICI Bank has therefore made an arrangement with Cashpor which is similar to their loans to SHGs which are originated and managed by BISWA and PSS. One critical difference, however, is that the loans are actually made direct to the individual women, since the Grameen system does not involve any form of financial intermediation. The groups of five members, through their centres of six or seven groups, act as guarantors, and they facilitate the whole process of loan appraisal, cash handling and recovery, but their weekly meetings are conducted by Cashpor field staff and every woman has her own loan account with Cashpor.

When a member borrows, she signs a loan agreement with ICICI Bank (every Cashpor borrower, like every borrower in the Grameen system, must learn to sign her name as part of member qualification. The signing process is often slow and laborious, but even this modest level of literacy is an important step for village women in this part of India. The agreement states that the interest rate charged by the Bank is 8.75 percent. Cashpor adds a 3.75 percent fee, making the total interest 12.5 percent, and Cashpor also charges a 6 percent flat up-front
fee. This 12.5 percent total plus 6 percent fee is the same as Cashpor charges when the loans are being made with its own funds, not from ICICI Bank, so there is no effective difference for the borrower. The centre leader countersigns the loan agreement, signifying that the Centre’s members guarantee the loan. The documentation refers to the Centre as an SHG, which is incorrect since the members are the borrowers; the group only facilitates and guarantees the loans.

The Bank has negotiated a similar first loss guarantee arrangement, consisting in this case of an overdraft facility, on which interest is payable at 19.5 percent, which the Bank can draw up to the required amount if necessary. This was initially set at 12 percent of the amount outstanding, but this was reduced to 8 percent for later transactions because of the early good experience.

By early 2005, ICICI Bank had $1.75 million to 24 000 Cashpor clients, which was around one third of the total clientele at the time. The Bank has committed a further $2.75 million for Cashpor borrowers, to cover loans until the end of 2005.

In addition, ICICI Bank has made an unsecured loan of $360 000 to Cashpor, at an average rate of about 9.5 percent, to cover the operating deficits of the branches in the areas where the Bank is lending to Cashpor members. This loan has a 42 month grace period, and it is estimated that the branch profits will generate the necessary repayments after the end of this time.

10. Outstanding Issues

ICICI Bank designed and implemented a very innovative and apparently effective strategy for engaging in the growing micro-finance market, despite the fact that the Bank has only 88 branches outside the major cities. Although the Bank’s outreach has thus far been limited, it is growing fast, and large numbers of poor people are becoming able to access formal credit for substantially larger sums than has previously been available. This can enable them not only to alleviate their immediate needs but also to lay the foundations for sustained improvements to their livelihoods.

ICICI has mobilized a number of specialist institutions with long experience of social mobilization and financial intermediation. These institutions, particularly the smaller and less experienced ones (with which they must deal to reach the bulk of the market) are often financially weak, poorly capitalized, and dependent on grant funds for their survival. Many are registered as charities, and while they can legally borrow and on-lend, they do not constitute good risks for the Bank.

The Bank has therefore devised means whereby it can use the expertise and networks of these institutions, without taking on the risk of actually lending money to them. The Banks loans are made direct to self-help groups, or even to individual micro-borrowers, whose aggregated credit risks have been shown to be very low. The intermediary institutions provide their services for a fee, which is bundled with the interest paid by the final borrowers.
The Bank has also worked closely with CARE, a donor funded institution which builds the capacity of NGO/MFI intermediaries. The Bank has been able to benefit from their institutional development services, thus far at no cost, and is presently planning a cost-sharing initiative which will, it is hoped, eliminate the need for donor subsidy to support Care’s capacity building services.

ICICI’s strategy is working well, the portfolio is growing, and the loans are as profitable, as the Bank’s other more traditional assets such as housing or vehicle loans. By dealing direct with micro-finance clients, the Bank can satisfy the Reserve Bank requirements to lend to the so-called ‘weaker sections’, and has created assets, with the necessary credit enhancements, which can be securitized and sold on to other financial institutions.

There are, however, a number of outstanding issues and challenges which should be addressed before this strategy can be said to be completely satisfactory, for both the Bank and its final customers.

- The poor client needs access to savings facilities from the same institution with whom they interact on loans. ICICI Bank is presently unable to offer savings products to its SHG clients. They are trying to persuade regulators to allow more flexible use of savings collection agents, but it is unlikely that there will be much change in the foreseeable future, in view of the long history, of dishonest savings collectors. The threat is that ICICI clients might now go to their neighbouring bank branches for savings, and may then take loans from them.

- The Bank’s loans are made to the groups or to individuals, and not to the MFIs or other intermediaries or co-operatives, and the borrowers sign legal documents which state this. However, if the MFI’s are unable to recover the loans, it is unclear if ICICI will be able to. The Bank has no presence in or knowledge of the areas where the clients live, and has no staff to collect the recoveries. How will they recover debts, even net of the first loss guarantees?.

- The SHGs are paying between 15 and 24 percent interest for their loans, and individual borrowers from Grameen replicators such as Cashpor pay similar rates, or sometimes even more, including the fees they pay to the intermediating MFIs. Banks in India have made loans to well over a million groups, at 12 percent interest or less. Some branch managers are still reluctant to enter this business, but it is likely that SHG clients will soon be able to borrow from the more than 70 000 commercial bank branches and from many of the 93 000 primary co-operative societies. As SHG members become more sophisticated they will ‘shop around’ for less expensive loans, at rates which cannot be matched by ICICI Bank and its collaborating intermediaries.

- The ICICI Bank system is cumbersome, and is also in some sense demeaning for the MFIs who are really only loan agents. Some MFIs are becoming financially stronger, and can borrow bulk funds direct from ICICI Bank’s competitors, such as ABN-AMRO and others. Many of ICICI Bank’s best collaborators, particularly those taking the larger sums,
might prefer to take bulk loans direct, and to on-lend to their SHGs, thus enhancing their own status in the eyes of their clients.

In spite of these issues ICICI Bank is demonstrating that an urban-based private bank can effectively and profitably reach the rural poor. It is now main-stream business for ICICI and other Indian and foreign banks are following. This is increasing financial deepening, and a wider range of financial services is becoming available to the hundreds of millions of people who have hitherto lacked access to any formal financial services at all.
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