

Taking Action for the World's Poor and Hungry People

关注贫困，行动起来

Beijing, China • October 17–19, 2007

SPEAKER SUMMARY NOTE

Session: Strategies for Effective Implementation of Interventions
Speaker: *Sona Varma, Economic Adviser, ICICI Bank, India*
Title: Scaling Up Micro-finance Initiatives by the Private Sector: The Case of ICICI Bank, India

Background¹

A wide network of co-operative banks traditionally provided rural finance in India post-independence. Co-operatives flourished in the 1950s–60s, and focused largely on agricultural credit. The co-operative structure broke down in the late 1970s–early 1980s. This gave rise to the dilemma of how to meet the credit needs of a large section of the rural population who had no access to institutional finance.

The late 1980s and early 1990s saw the beginnings of what was to become the self-help group-bank linkage movement in India, a movement that has been described as the largest micro-finance intervention in the world.² The National Bank for Agriculture and Rural Development (NABARD)³ proposed that self-help groups (SHGs), typically groups of 10-15 women, be linked to wholesale suppliers of credit, in an effort to channel institutional credit to the rural poor. This led to a pilot project in 1992 under which commercial banks in India were allowed to lend to SHGs. Thus began the start of micro-finance operations in India.⁴

The SHG-Bank linkage model grew rapidly. Initially, it offered promise as a model of public/private partnership for the provision of micro-finance, as it was backed by regulatory policies that allowed commercial banks to lend to unregistered groups without taking collateral.⁵ However, the model also faced a number of challenges. It soon transformed into a purely public model as state owned banks and other public entities used the model to increase provision of credit, and private players gradually retreated. The model was susceptible to political capture, as politicians looking to disburse handouts in election times used SHGs for this purpose. It also became clear that the SHG model could not be scaled up rapidly enough to meet the large demand for financing in rural areas. The current market for microfinance in India is estimated to be of the order of \$25 billion, and alternative channels for credit delivery in rural areas were badly needed.

This led to the growth of micro-finance institutions (MFIs) that played the role of intermediating credit to the rural poor. MFIs in India take many forms; there are NGO MFIs, co-operative MFIs and company MFIs. This third category includes barely 20 MFIs but accounts for over 80 percent of the MFI

¹ Adapted from Thorat, Yashwant, Howard Jones, and Marylin Williams (2007) "Rural Financial Institutions and Agents in India: A Historical and Contemporary Comparative Analysis," Paper for International Conference on Rural Finance Research, Rome, Italy, March 2007.

² Christen, 2006 in Thorat et al. 2007.

³ An apex development bank mandated to facilitate credit flow for agriculture, small scale and cottage industries and other rural activities.

⁴ Micro-finance arrived somewhat late in India. For example, Bangladesh's NGOs were already implementing a flourishing micro-finance business when the first operations started in India.

⁵ As of March 2007, 41 million people had been linked to commercial banks via this program, and the cumulative credit disbursed was over \$4 billion. The SHG model accounts for the bulk of micro-finance lending in India.

portfolio. Company MFIs have seen explosive growth in India, largely aided by the ability of the MFIs to leverage funds from commercial banks. These MFIs have grown faster than the SHG-Bank linkage model in recent years and have an outstanding loan portfolio of about \$1 billion to about 10.5 million borrowers as of March 2007.⁶

Private Sector Initiatives to Scale up Micro-finance: The Case of ICICI Bank, India

The rest of my remarks will focus on the private provision of micro-finance in India, given its ability to rapidly scale up access to finance for the underserved. In 2000, the Reserve Bank of India, India's central bank, allowed bank lending to MFIs to be classified as priority sector lending.⁷ This released large amounts of commercial bank financing for MFIs and allowed them to scale up their lending operations rapidly. A number of commercial banks, especially ICICI Bank, recognized the opportunity provided to partner with MFIs to expand outreach in rural areas. From a virtually non-existent portfolio in 2001, ICICI's microfinance portfolio grew to about \$ 350 million as of March 2007. Let me describe 6 important issues related to the scaling up of microfinance with the help of the private sector.

1. ***The private sector is essential in this effort.*** The micro-finance market in India is simply too large to be met by donor finances. Innovative partnerships between equity and debt providers, NGOs, MFIs, government and other stakeholders hold the key to successfully meeting the demand for micro-finance, including micro-credit. While the bulk of private sector financing to MFIs has been provided in the form of loans, Indian MFIs are also attracting equity capital.
2. ***Innovative models and delivery channels are also crucial to reach scale.*** When Indian banks started lending to MFIs, they soon found that the MFIs were unable to absorb large loans due to capital constraints. ICICI Bank pioneered the partnership model, under which banks lend directly to clients with MFIs acting as loan originators, facilitators, collection agents etc, while the loan is directly on the books of ICICI Bank. The MFI posts a first loss default guarantee thus sharing the risk of the portfolio with the bank up to a pre-specified limit. This model helped overcome the capital constraint faced by most MFIs and allowed micro-finance operations to be scaled up rapidly.
3. ***Credit is not the only financial service that is required.*** Micro-finance clients have an equally important need for savings accounts, insurance products, and remittance services. The private sector can play an important role in providing these services. ICICI Bank's insurance arm, ICICI Lombard has teamed up with BASIX, a microfinance company to provide weather insurance to farmers. Similarly, there are wonderful examples of private insurance companies providing micro insurance in partnership with NGOs and MFIs. Moreover, many banks, including ICICI Bank is working to develop reliable remittance products for India's vast migrant labour that works outside of their home states. The private sector has a unique ability to adapt cutting edge products usually designed for prime clients to the needs of the poor – and this can provide valuable gains for the poor.
4. ***Financing efforts need to be coupled with capacity building efforts for MFIs.*** Incubation and training of MFI staff, good MIS technology and technological innovations such as the use of point of sale devices for safer, faster transactions are important.
5. ***Similarly financing of clients need to be coupled with efforts at building livelihoods.*** A credit plus model is needed to ensure development of skills and market linkages.
6. ***Finally, impact evaluation is important and should not be neglected in the rush to provide financing.*** The microfinance movement world over has come under attack as a stop-gap solution to poverty. Reliable longitudinal studies are needed to track the impact of micro finance on clients' lives.

⁶ Ghate, Prabhu (2007), "State of the Sector Report, 2007." Microfinance India, New Delhi.

⁷ Banks in India are required to provide 40 percent of their net bank credit to sectors considered priority—agriculture, small scale industry, loans for the vulnerable, etc. Micro-finance was added to this list in 2000.