

November 22, 2006

The Chairman and Managing Director
All Scheduled Commercial Banks
(Including Regional Rural Banks)

Dear Sir,

Microfinance - Joint fact-finding study with the banks

In a joint fact-finding study on microfinance conducted recently by Reserve Bank and a few major banks, the following observations have been made:

- (i) Some of the microfinance institutions (MFIs) financed by banks or acting as their intermediaries/partners appear to be focussing on relatively better banked areas, including areas covered by the SHG-Bank linkage programme. Competing MFIs were operating in the same area, and trying to reach out to the same set of poor, resulting in multiple lending and overburdening of rural households.
- (ii) Many MFIs supported by banks were not engaging themselves in capacity building and empowerment of the groups to the desired extent. The MFIs were disbursing loans to the newly formed groups within 10-15 days of their formation, in contrast to the practice obtaining in the SHG - Bank linkage programme which takes about 6-7 months for group formation / nurturing / handholding. As a result, cohesiveness and a sense of purpose were not being built up in the groups formed by these MFIs.
- (iii) Banks, as principal financiers of MFIs, do not appear to be engaging them with regard to their systems, practices and lending policies with a view to ensuring better transparency and adherence to best practices. In many cases, no review of MFI operations was undertaken after sanctioning the credit facility.

2. We are bringing these findings to your notice to enable you to take necessary corrective action where required.

Yours faithfully,

(Rosemary Sebastian)
General Manager