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INDUSTRY OUTLOOK

INDIA'S MICROFINANCE INDUSTRY: COMPELLING NECESSITY OF MFIs TO GO TO SCALE

13 February 2025

Introduction

Microfinance refers to providing financial services, including small-value loans, to households, small businesses, and entrepreneurs who lack access to formal banking services. The aim of microfinance is to help empower people who lack access to traditional banking services[1] and to promote economic development at the grassroots level[2] [3]. Microfinance goes well beyond microcredit and apart from micro loans (microcredit), it also includes micro insurance, micro savings to micro pensions. In other words, these people at the "bottom of the pyramid", are under-banked, but by no means un-bankable[4] [5] [6] [7] [8] [9].

It is thus an effective tool for financial inclusion, enabling a significant section of the population comprising the poor, the marginalized, and the relatively unbanked, to achieve social equity and empowerment. Broadly, two different approaches of the bank-led approach, Self-Help Groups-Bank Linkage Program (SHG-BLG) and the

Micro Finance Institution (MFI)-led approach are followed in India for extending microfinance services[10] [11]. This approach fosters a sense of community and mutual support, and particularly for the women[12] [13], it helps to reduce the risk for the lender.

The diversity of the microfinance sector in India is manifested in diverse firms providing low-income people with financial services like lending, insurance, and pensions. Five broad categories can be used to classify the various microfinance industry participants: Small Finance Banks, NBFC MFIs, Banks, and Non-profit MFIs. All these institutions, except non-profit MFIs, are under the regulation of the Reserve Bank of India (RBI). The majority of non-profit MFIs are registered as trusts or societies, and they are regulated by the corresponding acts. Most of the non-profit organizations (NGOs), which operate as financial intermediaries, are registered as trusts or societies.

Some of the distinguishing features of microfinance are low-income borrowers, small amount loans, short loan tenure, absence of any collateral requirements, usually repaid at higher frequencies, and most microfinance loans are aimed at generating income.

Contrary to popular perception, micro- finance is helpful not only to the poor, the marginalized and the vulnerable section of the society, but it is also greatly beneficial to Banks and financial institutions because of the huge volume of business available in this segment and remarkably high repayment rate of the loans and advances sanctioned and disbursed to the target population. This kind of thought has strong theoretical underpinnings [14] and cross-country empirical evidence. Accordingly, like the Shakespearean quality of mercy, it benefits both the giver (i.e., banks and financial institution) and the receiver (i.e., borrowers).

In India, the microfinance sector has expanded significantly with 168 Micro Finance Institutions (MFIs) operating across 29 States, 4 Union Territories, and 563 districts. A study by the National Council of Applied Economic Research (NCAER) estimated that microfinance contributed about 130 lakh jobs and 2% of the gross value added (GVA). It has been instrumental in creating opportunities for low-income households by providing credit access to 64 million unique live borrowers who were previously beyond the reach of the traditional financial services. It has the potential to reach all the 6.3 crore unincorporated and non-agricultural enterprises. The RBI defined microfinance as collateral-free loans given to households having annual incomes up to ₹3 lakh.[15]

The Indian microfinance industry has emerged as the mainstay of financial inclusion, driving socio-economic transformation across underserved regions of the country by providing small-value loans, savings, insurance, and other services to underserved populations. It plays a transformative role in poverty alleviation, women's empowerment, and fostering entrepreneurship in developing economies.[16] Over the last decade, Non-Banking Financial Companies-Microfinance Institutions (NBFC-MFIs), regulated by the RBI, have significantly expanded their operations, empowering over 8.1 crore unique borrowers as of September 2024, with an outstanding gross loan portfolio (GLP) of ₹4,08,049 crore and 14.6 crore loan accounts.[17]

Microfinance uplifted low-income families and also fostered rural development, women's empowerment, and poverty alleviation by small-value credit offerings and initiatives like Self-Help Groups (SHGs) by working in complementarity with the banking system. It thus promoted sustainable microfinance services to the underprivileged, thereby providing more inclusive development and reduce economic disparities. Supported by favourable government policies, this sector continues to bridge the gap between marginalized communities and formal financial systems, making it a potent catalyst for inclusive economic growth.

Snapshot of the Microfinance Industry of India 2025

- India's microfinance sector serves 64 million borrowers, 99% of whom are women, with a ₹6.67 lakh crore GLP. It drives financial inclusion, rural development, and women's empowerment. Key players include NBFC-MFIs (39.6%), banks (32.2%), and Small Finance Banks (16.9%).
- Between 2021–2024, GLP surged from ₹2.56 lakh crore to ₹4.08 lakh crore, despite a post-March 2024 dip. Unique borrowers reached 8.1 crore, with 14.6 crore active loan accounts. Loan disbursements grew 18% YoY to ₹3.74 lakh crore. The sector contributes ~130 lakh jobs and 2% to India's GVA.
- Challenges include rising delinquencies (PAR 31–180 days at ₹28,154 crore), over-leveraging (37% borrowers stressed), and operational risks (high outreach costs, regulatory scrutiny).
- Reforms include MFIN's cap on lenders (3 per borrower), RBI's stricter lending norms, and government schemes like enhanced MUDRA limits and SHG Bank Linkage.
- Future growth requires digital adoption, risk mitigation, funding diversification, and stronger governance. Prioritizing responsible lending and innovation will sustain its role in economic empowerment.

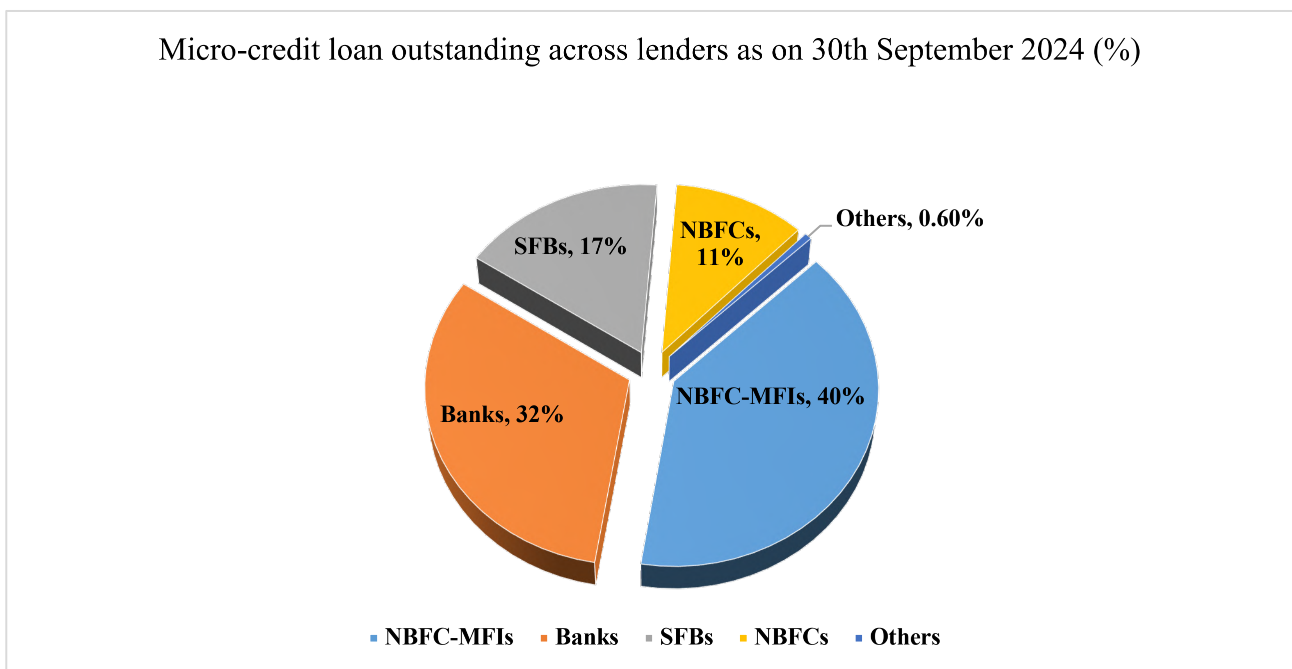
Nearly 99% of microfinance loans in India are extended to women from low-income households, with 98% of these loans provided through the Joint Liability Group (JLG) model. Under this model, a group of 5–10 borrowers collectively guarantee loan repayment, leveraging social collateral to mitigate default risks and reduce operational costs. These loans are collateral-free, and repayments are capped at 50% of the monthly household income to ensure affordability and repayment.

The microfinance industry comprises a diverse range of approximately 194 lenders, including banks, small finance banks, NBFC-MFIs, and NBFCs, reaching nearly 632 districts across the country. The geographic distribution of the loan portfolio shows a 76% rural and 24% urban split, with loans primarily used for income-generating activities and essential household needs like education, health, and housing. The sector, which is regulated by the RBI, except for non-profit MFIs, has demonstrated resilience, maintaining non-performing assets below 1% even despite recent external shocks.[18]

Performance of Microfinance Industry of India

As of September 30, 2024, India's microfinance sector reflects a diverse lending ecosystem, with NBFC-MFIs leading as the largest contributors with a portfolio of ₹1,61,470 crore, accounting for 39.6% of the total industry portfolio. Banks, the second-largest players, hold ₹1,31,432 crore, or 32.2%, leveraging their extensive networks for significant outreach. Small Finance Banks (SFBs) account for ₹69,007 crore (16.9%), while NBFCs and other MFIs contribute ₹43,429 crore (10.7%) and ₹2,434 crore (0.6%), respectively, catering to niche markets. The National Rural Livelihood Mission (NRLM) plays a crucial role through its SHG Bank Linkage Programme (SBLP), supporting 87.3 lakh SHGs with an outstanding portfolio of ₹2,59,093 crore. The sector's gross loan portfolio (GLP), including the SHG contributions, totals ₹6,67,142 crore, reflecting its extensive outreach and economic impact (see Chart 1).

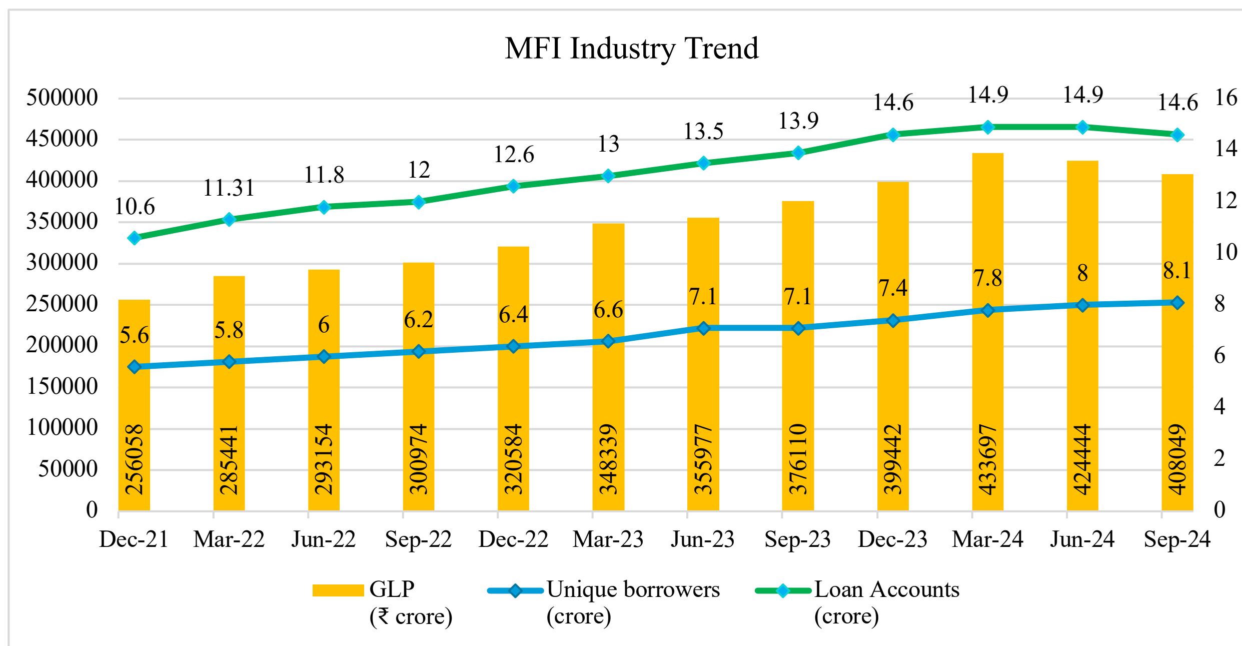
Chart 1: Micro-credit loan outstanding across lenders



Source: MFIN

The MFI industry grew robustly from December 2021 to September 2024, with the Gross Loan Portfolio (GLP) expanding from ₹2,56,058 crore to a peak of ₹4,33,697 crore in March 2024 before slightly declining to ₹4,08,049 crore in September 2024. The number of unique borrowers surged from 5.6 crore to 8.1 crore over this period, reflecting significant progress in financial inclusion and outreach to underserved regions. Similarly, loan accounts grew from 10.6 crore to 14.9 crore by March and June quarter of 2024, stabilizing at 14.6 crore in the September quarter, suggesting a shift in focus towards deepening borrower relationships rather than merely expanding accounts (see Chart 2).

Chart 2: Quarterly Performance of MFI Industry



Source: CRIF High Mark Credit Information Services

The performance indicators for 2022-23 and 2023-24 highlight robust growth in the lending sector across all key metrics. The number of loans increased by 6.02% (from 1329 lakh to 1409 lakh), while the gross loan portfolio grew significantly by 16.21% (from ₹351,521 crore to ₹408,507 crore), reflecting increased credit penetration and lending activity. The number of loans disbursed rose modestly by 4.83% (from 766 lakh to 803 lakh), but the amount disbursed surged by 18.06% (from ₹317,111 crore to ₹374,345 crore), indicating a shift towards higher-value loans. This can be further substantiated by the average loan per borrower, which grew by 12.74% (from ₹41,369 to ₹46,636), suggesting a focus on larger loan sizes and possibly higher-value projects. These trends reflect sustained demand for credit, enhanced outreach, and the sector's ability to cater to this demand effectively (see Table 1).

Table 1: Highlights of MFI Operations in India

Performance Indicators	2022-23	2023-24
No. of Loans (Lakh)	1329	1409
gross Loan Portfolio (₹ crore)	351521	408507
No. of Loan Disbursed (lakh)	766	803
Amount Disbursed (₹ crore)	317111	374345
Average Loan per Borrower	41,369	46,636

Source: NABARD, Status of Microfinance in India 2023-24

According to the CRIF MicroLend report for Q2 FY25, the microfinance sector experienced a 4.3% quarter-on-quarter decline in its portfolio, reducing to ₹414,000 crore as of September 2024.[19]

Loan Outstanding

The microfinance industry's agency-wise outstanding loans as of 2023-24 reveal a major share of NBFC-MFIs, which accounted for the largest share at 39.97% (₹1,63,275 crore), followed by banks with a 32.53% share (₹1,32,887 crore). Small Finance Banks (SFBs) contributed 16.61% (₹67,871 crore), while NBFCs significantly increased their share from 8.44% in 2022-23 to 10.68% in 2023-24 (₹43,620 crore). Non-Profit Entities constitute a minimal share of 0.21% (₹854 crore). The industry's total outstanding loans as of March 31, 2024, grew from ₹3,51,521 crore in 2022-23 to ₹4,08,507 crore in 2023-24, with the average loan per borrower remaining steady at ₹41,369 (see Table 2).

Table 2: Agency-wise Outstanding Loans (in ₹ crore)

Type of Lender	2022-23	% share	2023-24	% share
NBFC-MFIs	139632	39.72%	163275	39.97%
Banks	120016	34.14%	132887	32.53%
NBFCs	29664	8.44%	43620	10.68%
SFBs	58341	16.62%	67871	16.61%
Non-Profit entities	3778	1.07%	854	0.21%
Total (Industry)	351521		408507	
Average Loan per borrower (₹)	41369		41369	

Note: Outstanding Loans = Loans by various agencies to MFIs + SHGs + JLGs + others
Source: NABARD, Status of Microfinance in India 2023-24

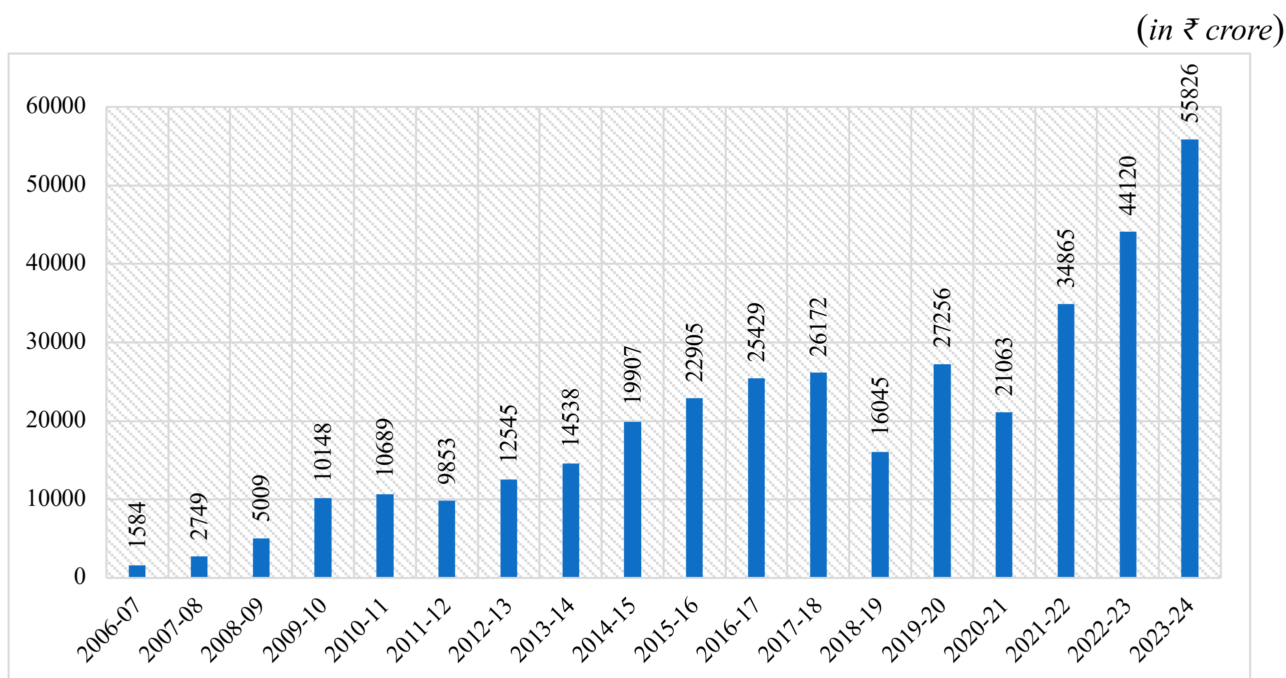
Despite this growth, a notable trend from 2020-21 to 2023-24 shows banks losing their share in total loans outstanding, which declined from 43.67% to 32.53%, as NBFC-MFIs and SFBs gained ground. In 2023-24, the share of NBFC-MFIs and SFBs remained unchanged from 2022-23 levels, signalling a stabilization in their market share.

Bank Credit to MFIs

The bank credit to MFIs in India over the last five years shows a consistent upward trend, indicating strong growth in lending. Starting at ₹27,256 crore in 2019-20, bank credit to MFIs rose to ₹34,865 crore in 2021-22, reflecting a growth of approximately 27.9% over two years. This upward trajectory continued significantly, with credit reaching ₹44,120 crore in 2022-23 and further increasing to ₹55,826 crore in 2023-24, marking a sharp growth of 26.5% in a single year (see Chart 3). The data highlights the increasing reliance on MFIs to extend financial inclusion and cater to underserved segments, with banks playing a crucial role in supporting the sector's expansion.

Chart 3: Bank Credit to MFIs trend

(*in ₹ crore*)



Note: Bank Credit to MFIs does includes credit to SHGs, JLGs etc.
Source: CMIE | Infomerics Economic Research

Among the banks groups, the private sector has the largest share of the MFIs' bank loans followed by public sector banks and co-operative banks (see Table 3).

Table 3: Outstanding Bank Loans of Micro Finance Institutions (MFIs) by Bank Groups

(in ₹ crore)

Year	Commercial Banks					RRBs	Co-operative Banks
	Total	Public Sector	Private Secor	SFBs	Foreign Banks		
2006-07	1584.28	450.8	971.45	0	162.03	0.2	0.01
2007-08	2745.24	895.45	1819.42	0	30.37	3.58	0.02
2008-09	4977.89	876.11	3309.68	0	792.1	31.2	0
2009-10	10095.32	5195.74	4202.25	0	697.33	52.22	0.01
2010-11	10646.84	5754.26	4458.92	0	433.66	42.01	0
2011-12	9810.98	6543.18	3078.21	0	189.59	37.51	4.75
2012-13	12467.72	8368.46	3968.19	0	131.07	70.66	6.83
2013-14	14307.57	9070.8	5049.69	0	187.08	222	7.97
2014-15	18720.62	11178.83	7276.95	0	264.84	1186.62	0
2015-16	22682.85	9944.93	12538	0	199.93	210.23	11.76
2016-17	25089.18	11689.36	13095.18	0	304.63	78.75	261.54
2017-18	26039.52	9367.17	16280.85	0	391.5	64.16	68.51
2018-19	15896.47	5828.38	9158.35	632.75	277	14.5	133.84
2019-20	26711.87	9556.73	16607.27	92.87	455	28.03	515.93
2020-21	19223.73	8107.11	12609.88	15.53	0	37.65	1831.61
2021-22	32960.71	14250.74	18623.77	86.21	0	80.32	1824.34
2022-23	42410.52	16992.74	25228.28	189.5	0	113.74	1595.53
2023-24	53301.97	23910.81	33158.32	0	0	132.81	2390.74

Source: CMIE | Infomerics Economic Research

Loan Disbursement

Table 4: Loans Disbursed by Banks and Financial Institutions to Micro Finance Institutions (MFIs) by Bank Groups

(in ₹ crore)

Year	Total Banks	Commercial Banks					RRBs	Co-operative Banks
		Total	Public Sector	Private Sector	SFBs	Foreign Banks		
2006-07	1151.56	1151.34	330.74	739.33	0	81.26	0.23	0
2007-08	1970.15	1968.6	469.27	1480.98	0	18.35	1.51	0.04
2008-09	3732.33	3718.93	561.94	2709.16	0	447.83	13.4	0
2009-10	8062.74	8038.61	4276.6	3362.09	0	399.92	24.14	0
2010-11	7605.18	7601.02	3742.67	3842.86	0	15.5	4.16	0
2011-12	4965.87	4950.98	3723.92	1227.06	0	0	13.28	1.61

2012-13	7431.24	7422.66	4377.32	3045.34	0	0	4.58	4
2013-14	9636.48	9468.83	5713.8	3665.02	0	90	163.18	4.48
2014-15	13906.33	13858.64	6686.98	6991.66	0	180	47.69	0
2015-16	19382.56	19324.14	5795.49	11620.64	0	1908	52.42	6
2016-17	17336.48	17091.33	5141.13	11852.7	0	97.5	37.83	207.33
2017-18	22228.23	22133.6	9486.14	12421.71	0	225.75	55.93	38.7
2018-19	13720.95	13645.23	8928.09	3971.64	593.5	152	5.16	70.56
2019-20	19133	18626.91	8742.51	9675.4	69	140	13.07	493.02
2020-21	12120.34	10625.84	3556.75	7638.08	10	0	19.26	1515.24
2021-22	23173.45	21691.41	9564.92	12041.5	85	0	33.26	1448.78
2022-23	36756.99	35163.81	18262.25	16754.55	147	0	82.32	1510.86
2023-24	28152.12	26308.28	10126.55	19526.73	0	0	100.91	1742.93

Source: CMIE | Infomerics Economic Research

This rapid growth in terms of loans disbursed by banks and financial institutions to MFIs stemmed from changing regulatory reforms, mass adoption of UPI-based payments, developments in small finance banks and several initiatives by the government and regulatory authorities. Accordingly, this sector emerged as a catalytic element of upscaling the unorganised sector, driving businesses, creating productive employment and creating meaning and value in the lives of millions of beneficiaries.

Technology has been critical in slashing overall turnaround time (TAT), operational costs for lenders and credit access costs for the borrower. However, the much larger share of NBFC-MFIs and banks makes the sector susceptible to risks, such as rising delinquencies, borrower indebtedness, and regional disparities. While SFBs and SHGs diversify the ecosystem, their relatively smaller scale and resources pose challenges in navigating systemic risks. The sector must focus on effective risk management, financial literacy programs, and robust policy support to sustain growth. A balance between scaling operations and maintaining asset quality is essential to ensure the resilience and long-term sustainability of India's microfinance industry.

Globally, the Indian microfinance sector is the second largest after China in terms of borrowing customers, exhibiting its remarkable scale and impact. With a customer base nearly three times that of Indonesia, the next largest market, India's microfinance sector has extensive coverage, reaching over 50% of households and 10% of the country's population through Self-Help Groups (SHGs) and Joint Liability Groups (JLGs). This impressive reach highlights its pivotal role in fostering financial inclusion and supporting economic empowerment on a global scale.[20]

Risks and Challenges

The Indian microfinance industry is confronted with significant challenges stemming from lack of formal credit history, high outreach costs in remote areas and high level of indebtedness because of improper assessment. There are issues of competitive disadvantage compared with mainstream banks; difficulty in acquiring reliable data for appraisals; limited reach to the urban poor; low digital and financial literacy; customer data protection and data privacy; and strategic and credit risks. The sector has also to grapple with lack of collateral; difficulty in accessing clients in remote areas due to poor infrastructure, limited operational flexibility and vulnerability to fluctuations in banking policies; lack of financial principles and services; and limited product offerings, excluding low-wage workers from essential financial services.

In this disconcerting overall setting, there are major challenges from over-leveraged borrowers and overlapping credit exposures. While the proportion of borrowers with three or more active lender associations has declined, those with high credit exposure continue to show elevated delinquency rates. Borrowers with both microfinance and retail loans face a delinquency rate of 37%, reflecting increased credit risk. This overlap deepens financial stress among borrowers, particularly in states like Uttar Pradesh and Odisha, where delinquency rates are alarmingly high.

Evidently, then, the MFI sector's headwinds arise from the overall setting and industry-level issues. At the macro level, there were issues of national elections, debt-waiver campaigns by states, scorching heat-wave, high field-staff attrition with frequent staff changes eroding the quality of loan disbursal and collection, surging defaults and delinquencies, particularly in the top ten states (Bihar, UP, Tamil Nadu, and Odisha accounted for 62% of the incremental delinquency), raising the credit cost for NBFC-MFIs. At the industry level, overleveraging, excessive debt, rising delinquencies, and slowing borrower cash flows caused concern. Valuations of MFI companies plummeted to all-time lows, starkly reflected in banks with a 6% MFI loan book, e.g., IDFC First Bank facing the stock market heat. The overleveraging of the MFIs on top of the decelerating macro-economy constrains borrowers' cash flows and consequently shrinks their repayment capacity.

These factors individually and collectively led to a disconcerting situation of mounting portfolio at risk (PAR) (loans with an overdue of 31-180 days) of microfinance loans to low-income groups doubling from ₹ 14,617 crore to ₹28,154 crore by September 2024 in a year. The CRIF High Mark[21] report revealed that the delinquencies in the 31-180 days overdue category worked out to 6.8% of the total portfolio of ₹ 4.14 lakh crore

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exposure of microfinance firms, including banks and NBFCs, as of September 2024 as against 3.8% of ₹ 3.84 crore portfolio in September 2023.

The incremental rise in the 31-180 days PAR category of microfinance institutions stood at ₹ 8,117 crore for the quarter ended September, taking the overall incremental rise in PAR to ₹ 13,468 crore for the 12 months ended September. PAR was 4.6% of advances in June 2024. MFIs also reduced their exposure from ₹ 4.32 lakh crore to ₹ 4.14 lakh crore during the three months ended September 2024. This position contrasted the gross non-performing assets (GNPA) ratio of scheduled commercial banks (SCBs) falling to a 12-year low of 2.6% of advances in September 2024. The distressing situation in the MFI sector was compounded by stringent regulatory action on some entities, including an embargo on disbursements amid concerns regarding loan pricing and an increase in risk-weighted assets for banks.

While the overleveraging of the MFIs is a function of a complex interplay of various forces and factors, some of the important issues could be isolated and identified as the RBI's uniform microfinance lending guidelines, removal of loans per borrower cap, removal of pricing caps, and an industry-wide decline in group discipline. Viewed thereof, the MFI self-regulatory body (SRO) announced the implementation of 7 'covenants' to address the emerging ground- realities (November 2, 2024). But subsequently, the implementation of the covenant relating to capping of lenders per borrower to 3 was shelved till April 1, 2025. These are early days but there are emerging manifestations of stability and recovery and there does not seem to be any reason for systemic concern.

The RBI's *Financial Stability Report* (December 2024) highlights rising delinquencies in the microfinance (MFI) and personal loan segments as key risks to the banking sector's asset quality. Stricter regulatory scrutiny on unsecured loan growth and tightened underwriting standards limits credit disbursement in these segments. Further, subdued consumption demand exacerbates stress. These factors are expected to weigh on credit growth over the next six months, with 40% of respondents anticipating a marginal decline in credit demand. Addressing these vulnerabilities will require balancing growth with prudent risk management to sustain asset quality and falling industry's group discipline**.** Viewed thereof, the MFI self-regulatory body (SRO) announced the implementation of 7 'covenants' to address the emerging ground-realities (November 2, 2024). But subsequently, the implementation of the covenant relating to capping of lenders per borrower to 3 was shelved till April 1, 2025.

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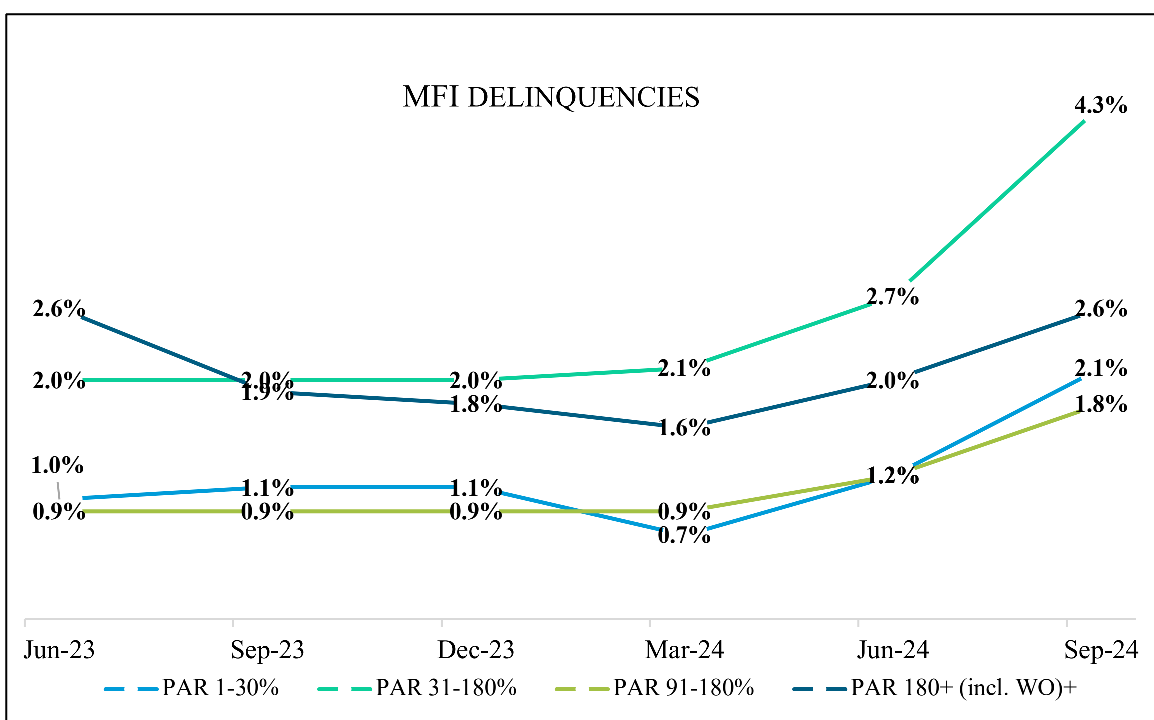
Delinquency

Delinquency rates have risen across all delinquency bands during the second quarter of FY25. PAR (Portfolio at Risk) loans overdue by 1-30 days increased to 2.1% from 1.2% in June 2024, and those overdue by 31-180 days rose to 4.3% from 2.7% in June. The loans overdue by 31 to 180 days was higher for SFBs (5.4%) compared to other major lenders. However, NBFCs reported the lowest PAR 31-180 (2.3%) as of Sep 2024. There has been a reduction in borrowers with three or more active lender associations across various states, indicating a move towards more prudent lending practices (see chart 4).

Chart 4: Q-o-Q increase in MFI Delinquency across all DPD Bands



Note: Delinquency is inclusive of 180+ PAR 180+ (Incl. w/o) % is for loans disbursed in last 24 Months. Source: CRIF

Despite these challenges, NBFCs have shown resilience, emerging as the fastest-growing segment with a 26.3% year-on-year growth and a modest 0.7% quarter-on-quarter increase. In contrast, other lender types have experienced declines. NBFCs have managed lower delinquency rates through focused borrower selection, geographic diversification, and flexible loan products tailored to borrower needs. Their use of advanced analytics, digital collections, and strong grassroots engagement further

enhances repayment compliance. Also, their presence in low-delinquency states and proactive monitoring mitigate risks effectively.

Table 5: Delinquency % by Value

	As on 30 June 2024				As on 31 March 2024			
	PAR 31-60	**PAR 61-90**	**PAR 91-180**	**PAR 180+**	**PAR 31-60**	**PAR 61-90**	**PAR 91-180**	**PAR 180+**
Banks	0.8%	0.7%	1.2%	9.1%	0.5%	0.8%	0.8%	11.7%
SFBs	1.3%	1.2%	1.6%	10.8%	0.7%	1.1%	1.1%	9.6%
NBFC-MFI	**0.9%**	**0.7%**	**1.2%**	**7.2%**	**0.5%**	**0.5%**	**1.0%**	**6.7%**
NBFCs	0.6%	0.4%	0.8%	12.0%	0.3%	0.3%	0.6%	12.1%
Others	1.2%	1.1%	2.6%	30.7%	1.1%	1.0%	2.1%	32.2%
Industry	**0.9%**	**0.8%**	**1.2%**	**9.1%**	**0.5%**	**0.7%**	**0.9%**	**9.6%**

Sources: CRIF High Mark, Sa-Dhan

The CRIF Highmark highlighted that 14.3% of active microfinance borrowers hold an active retail loan as of September 2024.[22] Among these borrowers, 37% are delinquent on either microfinance or retail loans, or both, suggesting higher credit risk for borrowers with multiple loan exposures. Bihar, Tamil Nadu, Uttar Pradesh, and Odisha accounted for 62% of the incremental delinquencies. The top 5 states in terms of overall industry portfolio are Bihar, Tamil Nadu, Uttar Pradesh, Karnataka and West Bengal, these top 5 states account for approximately 58% of the total portfolio of the industry.[23]

The Indian microfinance sector has been criticized m for its high cost of borrowing. High-interest rates, especially from NBFC-MFIs, remain a contentious issue despite regulatory action by the RBI in October 2024. Although these measures aim to curb exploitative practices, the yields on loans remain high, reflecting challenges in reducing operational costs. This double whammy of financial distress for borrowers and reputational risks for lenders underscores the need for rationalizing interest rates while simultaneously improving operational efficiency. Such measures would not only enhance borrower welfare but also strengthen the sector's credibility.

The post-pandemic, initial surge in microfinance credit further compounds these challenges. With lending growing at a CAGR of 33.5% (NBFC-MFIs) between June 2021 and March 2024, the sector showed some extent of resilience too.[24] However, this rapid expansion has led to over-leveraging and asset quality concerns, as evidenced by rising delinquency rates. Stakeholders must focus on prudent credit monitoring, borrower education, and calibrated growth strategies to ensure long-term sustainability.

This balance between growth and stability is crucial to mitigating risks and preserving the sector's role in financial inclusion.

The RBI regulates MFIs in India through the Non-Banking Financial Company-Micro Finance Institutions (NBFC-MFIs) framework, issued on 1 July 2014. The guidelines cover aspects like eligibility for registration, client protection, prevention of borrower over-indebtedness, privacy, and pricing of credit. MFIs generally comply with these regulations, contributing to stakeholder confidence in the sector.

The sector faces heightened regulatory scrutiny due to governance challenges within certain NBFCs, particularly those operating at the margins of regulatory oversight. Supervisory actions by the RBI in late 2024 highlight the need for stronger governance frameworks. While tighter regulations may restrict credit availability for vulnerable borrowers in the short term, collaboration between regulators and industry stakeholders can ensure reforms enhance transparency and efficiency without stifling access to credit.

Regional disparities in indebtedness levels further aggravate systemic risks. States exceeding the national average in borrower leverage face heightened vulnerability to localized economic shocks. Such imbalances demand region-specific interventions, including enhanced financial literacy programs and localized credit assessment models. Policymakers must address these disparities to prevent regional financial stress from cascading into broader sectoral instability.

The operational challenges such as declining portfolio quality, reduced originations, and the persistence of smaller-ticket loans weigh heavily on the sector. These issues, coupled with high funding costs for MFIs, necessitate innovative strategies such as digital transformation to streamline operations. By addressing these structural inefficiencies and fostering a culture of responsible lending, the microfinance sector can achieve a more balanced, sustainable growth trajectory while continuing its mission of financial empowerment.

Institutional Initiatives

The RBI has launched a slew of initiatives, such as data localization, a cap on multiple lending, a regulatory sandbox and public credit registry (PCR). Despite these and other well-conceived initiatives, e.g., mandated priority sector lending, Micro Units Development and Refinance Agency Ltd. (MUDRA) Yojana, Pradhan Mantri Mahila Shakti Kendra, SIDBI’s Prayas Scheme, loan co-origination by banks and non-banking financial companies (NBFCs)/MFIs to mitigate the risk of lending to NBFCs with most of the credit risk borne by the participating institutions and private sector investment to

support small entrepreneurs excluded from traditional financial services and reach new geographies, the sector continues to be characterized by an absence of robust risk management frameworks.
The Microfinance Institutions Network (MFIN) has introduced stricter norms effective January 1, 2025, to foster a sustainable microfinance ecosystem, protect borrowers, and mitigate default risks. These measures aim to promote responsible lending practices and reduce borrower indebtedness. Key changes include reducing the number of lenders per borrower from four to three, capping total loan exposure at ₹2 lakh, and identifying delinquent borrowers after 60 days of overdue payments instead of 90 days. Also, MFIN mandates a transparent fee structure to eliminate hidden charges and has set a target to link 50% of borrower accounts to PAN cards by March 2025.[25]

Complementing these efforts, the government has launched initiatives to strengthen microfinance and support MSMEs. The Self-Help Group (SHG) Bank Linkage Program focuses on increasing loan volumes and shifting SHG lending patterns from non-income-generating activities to production-based initiatives. Under the Pradhan Mantri Mudra Yojana (PMMY), loans of up to ₹10 lakh are provided to non-corporate, non-farm small and micro enterprises through commercial banks, NBFCs, and other institutions. Loans under PMMY are categorised as Shishu (up to ₹50,000), Kishore (₹50,001 to ₹5 lakh), Tarun (₹5 lakh to ₹10 lakh) and Tarun Plus (₹10 lakh to ₹20 lakh).[26]

The 2024-25 Union Budget also introduced a new credit guarantee scheme for MSMEs in the manufacturing sector. This scheme enables MSMEs to purchase machinery and equipment without collateral, backed by a self-financing guarantee fund that provides coverage of up to ₹100 crore per applicant. Also, the Micro Units Development and Refinance Agency (MUDRA) loan limit was doubled to ₹20 lakh for entrepreneurs who have successfully repaid earlier loans, offering favourable loan terms to promote the growth of micro-enterprises and small businesses.

The RBI has directed banks to cease issuing new loans to borrowers with outstanding previous loans to address unfair practices in the microfinance sector, such as exorbitant interest rates and hidden fees. This measure aimed at preventing the "ever-greening" of loans, ensuring transparency and healthier lending practices. Furthermore, the government has authorized microfinance institutions and NGOs to borrow funds to use as security deposits when applying for loans from the Small Industries Development Bank of India (SIDBI). These entities can receive up to 75% assistance for the security deposit, facilitating easier access to funds for on-lending purposes.

The Road Ahead

An examination of development study and empirical cross-country evidence clearly brings out that microfinance helps to alleviate the financial problems faced by the poor people. Microfinance has a significant impact on poor people's confidence, courage, and skill development.

Let us now turn to a medium- and long-term frame of reference. We are certainly conscious of Lord J.M. Keynes' famous comment made about a century ago "*in the long run, we are all dead*"! But we do maintain that in issues of great criticality like the MFIs, sometimes it is necessary, and even desirable, to step back and look at things in a longer perspective. The Indian microfinance industry is poised for significant growth and transformation as it navigates the challenges of rising delinquencies, operational inefficiencies, and regional disparities. Despite these hurdles, the sector remains a basic element of financial inclusion, with immense potential to empower underserved communities through innovative and sustainable practices.

The inability of MFIs to get sufficient funds hampers the growth of the sector. Hence, it becomes imperative for MFIs to explore alternative sources of funding for steady growth. This is a tall order and requires coordinated and concerted measures with a sense of urgency to explore new investment channels to reduce the cost of funds for MFIs by partnerships with corporates, impact investing and other platforms, developing customer-centric products by analysing shifting consumer demand, enhancing fintech innovation through controlled testing in a regulatory sandbox, and developing analytics-based underwriting and collection models. Streamlining governance and risk management through revised regulations and technology-enabled solutions and empowering and assisting women in business and skill development through new products and partnerships will also help to transform the ground-realities.

The sector must leverage technology, partner with local businesses and optimize field force to drive technology-driven solutions for growth and long-term resilience. Digital transformation can streamline operations, reduce costs, and enhance credit monitoring. Initiatives, such as, data analytics, external validation, digital financial literacy programs will further empower borrowers, fostering improved financial decision-making and repayment discipline. This requires customized products and services, collaboration with urban local bodies as partners in progress, leveraging of digital channels, including effective use of mobile technology, partnership with local agents and investment in infrastructure.

Addressing regional disparities is critical to sustaining growth. States with higher indebtedness levels require targeted interventions, such as localised credit assessment models and tailored financial products. Strengthening community engagement and borrower education in these regions will help mitigate systemic risks and enhance credit quality by broad spectrum measures, such as, micro-insurance, savings products, and digital payments.

Enhanced regulatory oversight and governance frameworks are essential to maintaining the sector's credibility and stability. Recent measures by the RBI to curb exploitative practices and promote transparency are steps in the right direction. Collaboration between regulators, lenders, and policymakers will be the key to ensuring these reforms benefit both borrowers and the broader financial ecosystem.

Going forward, it is necessary for the form and substance of the MFI reforms to enhance their growth and resilience to meet the revolution of rising expectations. Towards this end, the sector must balance its dual objectives of growth and stability. By prioritizing borrower-centric approaches, fostering innovation, strengthening risk management, providing financial education, diversifying loan products, exploring alternative funding sources, building internal capacity, and policy changes, India's microfinance industry can continue to be a catalyst for socio-economic transformation, driving inclusive growth and financial empowerment across the nation.

There has also to be a sharper focus on digital platforms, value-added services, regulatory reforms, development of standardized valuation frameworks, enhanced credit risk assessment and promotion of financial literacy *inter-alia* by financial literacy campaigns, partnership with schools and colleges to move to a new and a higher orbit.

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