

Microfinance in India

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Microfinance in India : Bridging the Financial Divide through Ethical Lending

Context

Access to formal financial services remains a challenge for millions of low-income households in India, particularly in rural and remote areas. Traditional banking institutions often fail to serve these segments due to lack of collateral, high transaction costs, and logistical barriers. In this context, **microfinance** has emerged as a powerful tool to ensure **financial inclusion** by providing small loans and essential financial services to the underserved.

Introduction

Microfinance refers to a system of delivering **small loans, savings, insurance, and other financial services** to individuals and households who are **excluded from the formal banking sector**. It aims to support **low-income and poor households**, enabling them to start small businesses, manage emergencies, and improve their standard of living.

Key Features of Microfinance:

- Provides **small loans** and other services to **low-income households**.
- Serves as a **banking substitute** for those lacking access to traditional financial systems.
- Follows standard lending practices with **interest rates** and **repayment schedules**.
- Promotes **safe and ethical lending**, especially for small businesses.
- Ensures real-time data sharing with **Credit Information Companies (CICs)**, ahead of the mandated 15-day deadline.
- Operates on **thin profit margins**, often offering loans without collateral.

- Even minor increases in interest (e.g., **0.15%**) attract public attention.
 - Plays a major role in **developing countries** such as **India, Bangladesh, DR Congo, Indonesia**.
 - In India, loans **below ₹1 lakh** are classified as **microloans**.
 - The **Malegam Committee** recommendations led to RBI's regulatory framework for **NBFC-MFIs** in **2011**.
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Contributions of Microfinance

- **Expands banking coverage** to over **75 million low-income clients** across **720 districts**, including **112 aspirational districts**.
 - Delivers **last-mile services**, including home or village-based loan delivery in rural areas.
 - Involves substantial costs such as **travel, logistics, and salaries** for field staff.
 - Contributes **2.03%** to **India's Gross Value Added (GVA)**.
 - Provides employment for nearly **13 million people**, as per **2021 NCAER study (2018-19 data)**.
 - Promotes **women empowerment, digital adoption**, and discourages **urban migration**.
 - Ensures **transparency** by disclosing **minimum, maximum, and average interest rates**.
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Regulation of Microfinance in India

- The **Microfinance Industry Network (MFIN)** limits borrowers to a **maximum of three regulated lenders**.
- The total outstanding loans from all lenders must not **exceed ₹2 lakh**.

- The **Reserve Bank of India (RBI)** caps repayment obligations to **50% of household income**, preventing over-indebtedness.
 - **MFIN conducts quarterly reviews of CIC data** to monitor credit exposure and enforce lending norms.
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Current Status of the Sector

- **Portfolio at Risk (1-90 days)** is at **4%**, indicating **96% of loans are being repaid** on time or within the acceptable window.
 - The **total microfinance credit** stands at **₹3.55 lakh crore**, forming **2% of India's total banking sector credit**.
 - **95.6%** of borrowers are associated with **fewer than three lenders**, reducing the risk of excessive debt.
 - **84%** of borrowers have loans below **₹1.2 lakh**, showing **moderate borrowing levels**.
 - **Portfolio at Risk (1-90 days)** is a key metric that reflects the percentage of loans overdue. A lower percentage indicates **strong recovery and healthy loan books**.
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Major Challenges

- **Weaknesses in KYC verification** after the **2017 Supreme Court ruling**, which disallowed storing **Aadhaar numbers** in CIC databases.
- Alternative identification methods like **voter ID** are **less reliable**, increasing the risk of **fraud or duplication**.
- **Bank funding to NBFC-MFIs dropped by 54%**, despite liquidity in the system, leading to a **funding crunch**.
- Nearly **7 million low-income clients** lost access to formal microfinance due to lending constraints.
- **Public perception** around pricing is often based on incomplete information, ignoring

benchmark interest rates, delivery costs, and loan risks.

- **Informal credit** continues to account for **31% of rural loans**, highlighting the need for **strengthening regulated microfinance**.

Conclusion

Microfinance continues to play a **critical role in empowering low-income households**, particularly in rural and underserved regions. To sustain and expand its impact, there is a need to **strengthen regulatory clarity, improve KYC infrastructure, and address funding limitations**. A **more informed and balanced discourse on loan pricing** will also help build public trust and enhance the sector's credibility. As India moves forward on the path of inclusive growth, microfinance must remain a **central pillar in reaching the unbanked and uplifting the poor**.



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