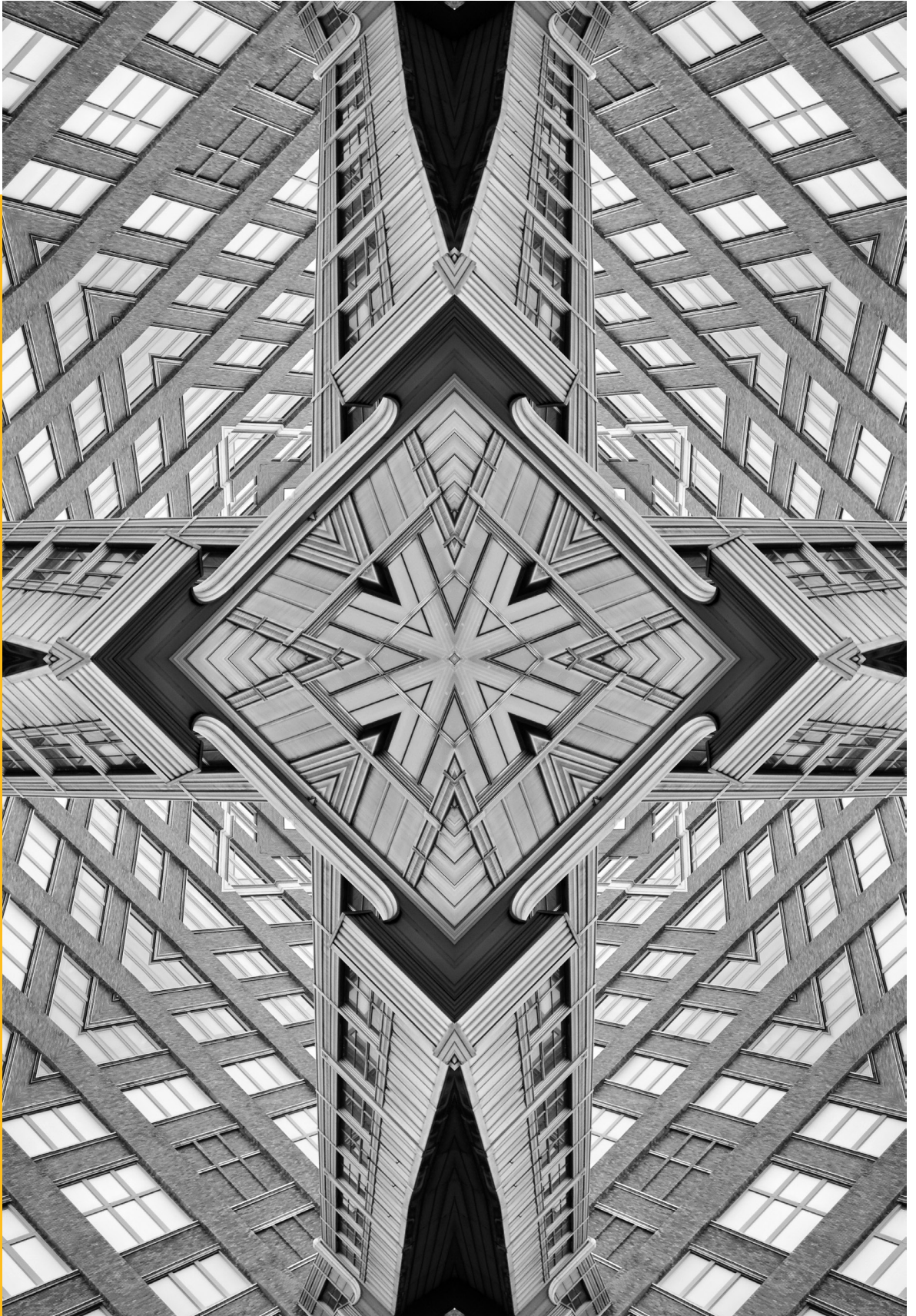


# Occasional Paper



**ISSUE NO. 470 MARCH 2025**

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# Fifty Years of Indian Microfinance: Challenges to Making a More Profound Impact

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## Abstract

Microfinance, which began in India 50 years ago, extends credit, insurance, loans, access to savings accounts, and money transfers to small business owners and entrepreneurs, especially those not served by the conventional banking system, or indeed the rest of the financial sector. This paper traces the history of microfinance in India and evaluates its impact. It finds that although the microfinance sector has emerged as a salient player in India's financial landscape, its footprint remains constrained by scarcity of cost-effective credit, limited financial and digital literacy among debtors, risks pertaining to customer data security, over-indebtedness of borrowers, and a lack of innovative customer-centric offerings by microfinance service providers. It makes a case for a multi-tiered strategy that includes a strengthened regulatory framework, innovative financial solutions tailored to the needs of the poor, and improved financial literacy propositions.



**M**icrofinance has a long and illustrious history in India. Introduced in Gujarat in 1974 by SEWA Bank, a division of the Self Employed Women's Association (SEWA),<sup>a</sup> it has since taken on the critical role of extending financial services to recipients neglected by the mainstream banking, financial services, and insurance (BFSI) players.<sup>1</sup>

Microfinance, also called microcredit, is a banking service targeting poor households and small enterprises in rural areas. Like conventional bankers, microfinance service providers also need to earn interest on loans and construct clear repayment schemes involving periodic instalments.

Microfinance typically suffers from a variety of risks, including credit risk and operational risks arising from gaps in internal procedures and systems. Table 1 lists the various risks to microfinance service providers.

**Table 1: Risks in Microlending**

Type	Description
Credit risk	Risk of borrowers defaulting
Operational risk	Arises from gaps in internal procedures and systems, such as inadequate staff screening and consequent loan processing discrepancies, insufficient due diligence, and resultant scams.
Liquidity risk	Can arise from cash flow mismanagement and the resultant incapacity to fulfil short-term obligations.
Market risk	These arise from the interplay of market forces, e.g., the impact of interest rate volatility or economic downturns.
Foreign exchange risk	Arises from exchange rate volatility for institutions transacting in multiple currencies, particularly those borrowing in one currency and lending in another.
Reputational risk	Arises from adverse publicity or loss of trust, leading to client base shrinkage and/or financial instability.
Regulatory risk	Results from the effect of alterations in laws or governmental regulations on operations and profitability.

*Source: Author's own*

<sup>a</sup> The Self Employed Women's Association was set up in Ahmedabad in 1972 as a trade union to protect the rights of low-income women engaged in informal labour. It has since branched out to numerous other activities, including setting up SEWA Bank.

# Introduction

Early microfinance service providers largely worked with small credit schemes extending financial services to the poor. They were, however, often constrained by high costs and inefficiencies. The sector grew rapidly in the 1990s and 2000s, particularly with the rise of microfinance institutions (MFIs) and Self-Help Groups (SHGs),<sup>b</sup> but this growth brought its own set of problems. Elevated transaction costs remained an issue, along with borrowers' inability to furnish collateral, and their continued dependence on traditional moneylenders due to ease of access and flexible terms; there were also frequent regulatory challenges caused by inconsistent policies and the absence of a conducive legal framework. Yet, the sector continues to fulfil a critical role in providing financial services to the unbanked and under-banked, especially in rural areas.

With a loan portfolio exceeding INR 4.2 lakh crore (as of 30 June 2024) and a clientele comprising approximately 8 crore unique borrowers, the microfinance segment is now a major component of India's BFSI sector. Its 50-year journey has seen the creation of numerous MFIs and the gradual introduction of supportive government regulations.<sup>2</sup>

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<sup>b</sup> These are groups of 10 to 20 women running a savings-first business in which members' savings are utilised to finance loans. Although it is impossible to pinpoint the specific date for the inception of SHGs, the tradition of small groups of people coming together to create a savings and lending organisation is firmly ensconced in India's contemporary history, with NGOs playing a pioneering role in the early development and implementation of the SHG model.



# Evolution of Microfinance in India

The history of microfinance in India can be viewed in four periods. The first, during which microfinance began and slowly grew, extends to 1990. This was a period of ‘traditional microfinance’ focused on subsidised credit for the poor. The second was the period of ‘contemporary microfinance’, in which MFIs shifted from depending on subsidies to market-oriented strategies for credit extension. Throughout the 1990s, they promoted self-sustaining financial intermediaries<sup>3</sup> and witnessed the emergence of a new generation of financial service providers in the backdrop of economic reforms. The third phase, from 2000 to 2012, saw the remarkable transformation of microfinance. Finally, in the last period post-2012, the COVID-19 pandemic shock comes to the fore, as do the roles of improved technology and supportive government policy and regulatory oversight.

## **Phase I: Traditional Microfinance (1974-1990)**

In independent India’s developmental stratagem, institutional lending was viewed as a potent tool for increasing output and yield, as well as for poverty alleviation. In 1954, the All India Rural Credit Survey report revealed that informal lending—overwhelmingly by private moneylenders—dominated the rural credit space with a 70-percent share, whereas cooperatives and commercial banks provided only 6.4 percent and 0.9 percent of credit, respectively. Thus, cooperative lending was emphasised between 1950 and 1969.

The Lead Bank Scheme (LBS) was launched in 1969, the same year which saw the nationalisation of 14 commercial banks.<sup>4</sup> During the initial years of the LBS, branch expansion in unbanked/under-banked regions and credit formulation was implemented zealously. Since 1991, however, the process has decelerated, resulting in the aggregate number of rural and semi-urban branches of banks stagnating on a country-wide basis since 2001 (see Table 2).

**Table 2: Branch Expansion of Scheduled Commercial Banks (SCBs)**

Year	Number of Rural Branches	Number of Urban Branches	Total
1969 (June)	1,833	3,342	5,175
1991 (March)	35,206	11,344	46,550
2001 (March)	32,562	14,597	47,159
2005 (March)	32,082	15,403	47,485
2007 (March)	30,551	16,361	46,912

Source: Reserve Bank of India<sup>5</sup>

In May 1974, the SEWA Bank was registered as a cooperative bank under the dual jurisdiction of the Reserve Bank of India (RBI) and the Government of Gujarat. Since its establishment, it has been extending banking services to poor and illiterate self-employed women.<sup>6</sup> In the pre-reform era, the bank encountered difficulties in expanding its reach to support self-employed women due to the inaccessibility of bank branches. To mitigate these issues, SEWA Bank introduced solutions that made banking available to everyone despite limitations in location or mobility. Those solutions included the following:

- Doorstep Banking:** The bank's mobile vans and extension counters brought banking services directly to the clients' doorstep, extending services like deposits, withdrawals, and financial advice<sup>7</sup>
- Information Kiosks:** The bank set up kiosks to provide clients easy access to banking information and services, thereby enhancing their agency over their finances<sup>8</sup>
- Data Assimilation:** SEWA Bank enhanced the integration of its databases over time to streamline services, guaranteeing that clients' financial information was up-to-date and available at all locations, thereby facilitating faster decisions<sup>9</sup>



# Evolution of Microfinance in India

- d. Credit Cooperatives:** The bank established credit cooperatives to enhance women's access to finance, addressing the obstacles involved in dealing with conventional financial institutions.<sup>10</sup>

SEWA Bank's pre-reform banking model set an example of financial inclusion and proved a lifeline for many women, extending to them the financial instruments they needed to be economically productive.

In 1975, Regional Rural Banks (RRBs) were instituted as inexpensive institutions mandated to extend credit to the poorest across India's credit-deficient areas, leading to the creation of one of the largest banking networks globally.<sup>11</sup> In 1981, the All-India Debt and Investment Survey unsurprisingly discovered that the formal financial sector's share in aggregate credit had surpassed 60 percent.<sup>12</sup>

The government began the Integrated Rural Development Programme (IRDP) in 1980-81 to direct subsidised credit to poor, self-employed people via banks. A bank wholly devoted to doing so, the National Bank for Agriculture and Rural Development (NABARD), was started in 1982.<sup>13</sup> The government also launched the Development of Women and Children in Rural Areas (DWCRA) scheme as part of the IRDP in 1982.<sup>14</sup> Unfortunately, the IRDP witnessed steep default rates, with over 4 crore defaulters, rendering it unsustainable. Banks encountered high losses in servicing the poor, as the subsidised interest rates were financially unviable. The abysmal experience of subsidised lending and subsidy-linked loans meant that neither banks nor most customers perceived microfinance as a bankable service. Thus the banking system was unable to mainstream microfinance as a core financial function, only engaging in it under regulatory duress.

The high default rate prompted the government to sanction a formal loan waiver in 1989, which negatively impacted credit culture. The waiver also validated the long-held perception among financial institutions that micro-lending was unprofitable.<sup>15</sup> The poor were viewed as credit-unworthy, with lending to the segment seen as incompatible with financial prudence. An alternative microfinance framework therefore became necessary.

## **Phase II: Economic Reforms and New-Age Microfinance (1991-1999)**

The financial sector reforms of the early 1990s encouraged policy thinkers to look for models and stratagems to deliver financial services sustainably to the poor. From 1987 to 1992, NABARD conducted studies of SHGs operating across India, and financially assisted a non-government organisation (NGO)—the Mysore Resettlement and Development Agency (MYRADA)—in framing operational principles for SHGs. Most SHGs had enough members and financial dealings for banks to be comfortable transacting with them, and were also receptive and adaptable to the requirements of their members. NABARD formally initiated the SHG-bank linkage programme in 1992.<sup>16</sup> The improved repayment rate encouraged banks to sustain SHG finance over the following years, thereby prompting the RBI in 1996 to include lending to SHGs as a mainstream banking function to be governed under their Priority Sector Lending (PSL) requirements.

The Rashtriya Mahila Kosh (RMK) was instituted by the government in 1993 to hasten the provision of loans to self-employed women in the informal sector.<sup>17</sup> While this initiative brought about some degree of women's empowerment through micro-lending, it gradually lost its relevance in the dynamic financial landscape and was therefore discontinued by the government from 2019-20.<sup>18</sup>

Some private MFI initiatives had also begun during the early 1990s—these were not-for-profits, conceived purely as community service initiatives. Yet unlike the public sector banks of earlier decades, they demonstrated low rates of default despite the risky lending segment they were serving. This was due to their greater efficiency and improved service to clients, which drove higher scale and lower cost, thereby emphasising process to achieve sustainability. They broke the long-held misconception about the credit-(un)worthiness of the poor, as well as the related notion that only doles and handouts could be used to improve their lot.

Drawing from these examples, NABARD's initiative towards SHGs also shifted focus around 1992 towards unsecured lending, complete

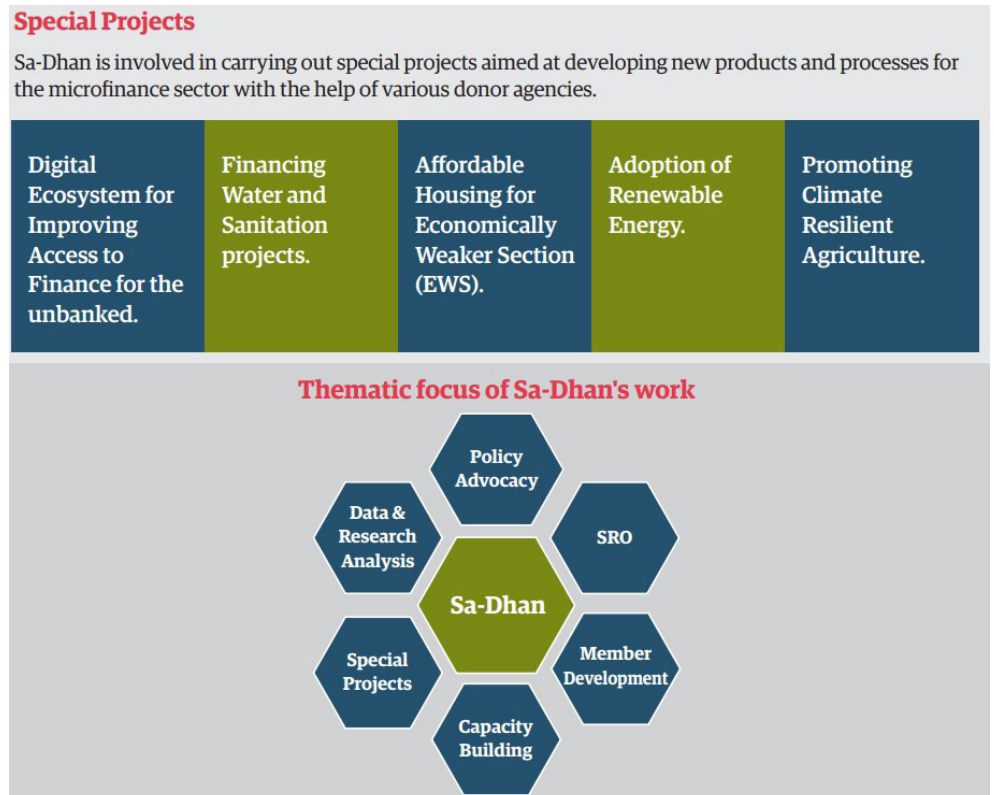


# Evolution of Microfinance in India

with repayment rules, and lending to only those who agreed to invest their savings and supervise their groups and group loans—consequently reducing transaction costs.<sup>19</sup> Microfinance developed further once the Small Industries Development Bank of India (SIDBI)—set up in 1990 to support the Micro, Small and Medium Enterprises (MSME) sector—started its Foundation for Microcredit division in 1998, with an initial funding of INR 100 crore.<sup>20</sup>

The following year, many of the private community development finance organisations set up an apex association called Sa-Dhan, whose myriad activities are shown in Figure 1.<sup>21</sup>

**Figure 1: Special Projects and Thematic Focus of Sa-Dhan’s Work**



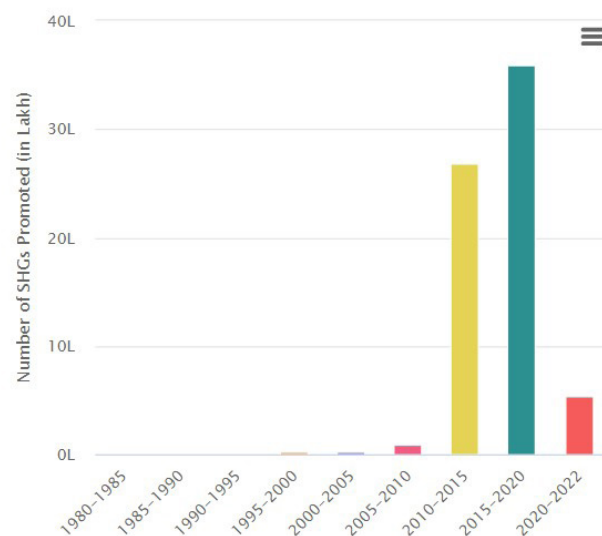
Source: Sa-Dhan<sup>22</sup>

# Evolution of Microfinance in India

The success of Sa-Dhan's micro-lending activities prompted the government to also start a new poverty alleviation programme from April 1999, the Swarnjayanti Gram Swarozgar Yojana (SGSY), which merged several existing rural development schemes and added a few more, among them microcredit provision. The objective was to raise the households (*Swarozgaris*) being assisted above the poverty line by guaranteeing them a significant continued level of income over a period. However, this programme too, encountered challenges, with an overwhelming majority of SHGs at first refraining from economic activities funded by bank credit and bolstered by subsidy. Fund utilisation over the 10 years of the programme was around 74 percent, with only 16 percent of the total funds utilised for infrastructure development.<sup>23</sup>

Alongside the Centre, many state governments also instituted projects and schemes such as the 'Mahalir Thittam' in Tamil Nadu (1997-98),<sup>24</sup> the 'Kudumbashree' in Kerala (1998),<sup>25</sup> and the 'Indira Kranthi Pratham' (IKP) in Andhra Pradesh (2000-01), often under the aegis of programmes sponsored by global bilateral and multilateral agencies. The IKP, a state-wide poverty alleviation programme seeking to improve livelihoods and quality of life of the rural poor, using their own existing organisations, was emulated by the National Rural Livelihoods Mission (NRLM)—successor to the SGSY and started in June 2011 (see Figure 2).<sup>26,27</sup>

**Figure 2: Number of SHGs Promoted Under NRLM (in lakhs)**



Source: Ministry of Rural Development<sup>28</sup>



# Evolution of Microfinance in India

## **Phase III: Era of Sweeping Transformation (2000-2012)**

Encouraged by the success of MFIs, commercial banks began lending to them, augmenting the funds raised through government-funded small credit schemes, grants, and subsidised finance. This led MFI growth to accelerate. However, with increased lending and the emergence of larger MFIs, other financial metrics like capital adequacy and risks came to the fore. Credit rating agencies began rating MFIs, with such ratings quickly becoming the norm and assuming particular importance while raising funds. The sector received a major fillip when the United Nations (UN) designated 2005 as the year of microcredit, and Muhammad Yunus of Bangladesh and the Grameen Bank he had founded jointly received the Nobel Peace Prize in 2006. As microfinance matured, however, it also became obvious that it needed scale and profitability to be sustainable.

Despite their pioneering role in mainstreaming microfinance, the NGO-led MFIs were unable to raise sufficient funds for rapid growth and had to mutate into for-profit non-banking finance corporations (NBFCs). As the viability of microfinance gained increasing visibility, other players entered the space directly, mostly as for-profit NBFCs. It also led private equity funds and other investors to invest in MFI equity.

It was at this stage that the need for a legal architecture for MFIs emerged as some of their transactions began involving ever-increasing sums of money, apart from catering to a highly sensitive market segment. Creditors also required assurance that the borrowing MFIs were suitably regulated. By then, microfinance regulation laws had been passed—after heated debates—in several other countries, and India too followed suit, albeit encountering an obstacle in its nascent stage.

If Andhra Pradesh was an early bird in state-backed microcredit with its IKP programme, it was also the state that nearly wrecked India's MFI ecosystem. As the number of its private MFI players multiplied—at one time, in 2010, the state alone accounted for more than one-third of all borrowers and half the total amount of loans disbursed in the country—some of them, especially

# Evolution of Microfinance in India

those which had entered the sector from purely commercial motives, began to engage in reckless lending and coercive collection practices.<sup>29</sup> The state government later alleged that around 80 individuals had committed suicide following the pressure brought on them by MFIs to repay their micro-loans, and in response passed an ordinance in October 2010, which later became the Andhra Pradesh Microfinance Institutions (Regulation of Money Lending) Act.<sup>30</sup> The Act laid down draconian conditions on the functioning of MFIs and penalties for breaching them.

The new law created a widespread impression among borrowers—primarily in Andhra Pradesh, but with ripple effects across the country—that microfinance loans need no longer be repaid. Defaults soared, leading to many companies closing down or moving out of the state. It also prompted the RBI to set up the Y. H. Malegam committee the same year to examine the MFI segment closely. The Malegam committee's recommendations led to the RBI creating a comprehensive regulatory architecture for NBFC-MFIs, encompassing interest rate ceilings, margin ceilings, and guidelines on fair practices.<sup>31</sup>

Thus, Indian MFIs have traversed a long road from non-profit setups to profitability-oriented ones, drawing massive commercial borrowings and equity investments.<sup>32</sup> They have begun utilising sophisticated methods to source funds such as securitisation and debentures, as well as tapping into capital markets in recent years.<sup>33</sup> However, empirical research has found that many of them have witnessed a 'mission drift': they have been expanding their gross loan portfolios but lag in terms of outreach—the number of customers served—which clearly shows a diversion of focus from social aims to financial performance.<sup>34</sup> Balancing financial objectives with social goals remains a key challenge for the sector.

## **Phase IV: Embracing the Future (post-2012)**

To regulate MFIs, the Centre also introduced the Micro Finance Institutions (Development and Regulation) Bill<sup>35</sup> in the Lok Sabha on 22 May 2012, spelling out the services that could be included within its ambit and setting limits on the size of its transactions. However, the bill was rejected by the Parliamentary standing committee to which it was referred and has since



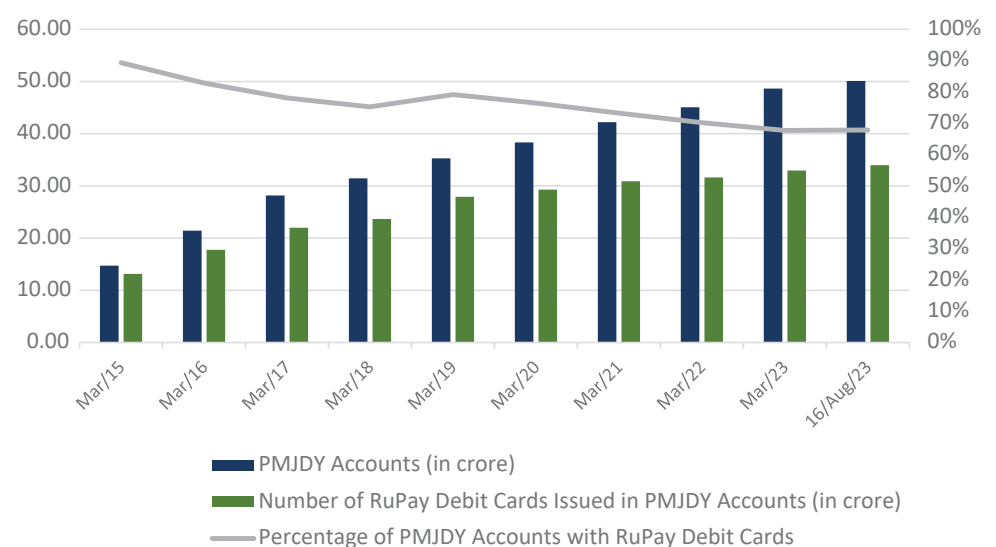
# Evolution of Microfinance in India

lapsed. Nonetheless, there have been other favourable developments since, such as the RBI, in 2014, allowing non-deposit accepting NBFC-MFIs to also function as Business Correspondents (BCs) for commercial banks, abolishing a previous restriction on NBFCs.<sup>36</sup> It has also withdrawn the maximum distance requirements on banks in selecting their BC outlet locations in regard to this category of NBFCs.<sup>37</sup> Together, these steps intend to improve financial inclusion through the extension of banking services by implementing the recommendations of the Nachiket Mor Committee of 2013 on hastening the supply of credit to those at the base of the pyramid and increase of catchment area of the BCs, including through possible inclusion of new entities as BCs.

The Centre set up the Financial Inclusion and Development Department (FIDD) in 2014 to further bolster financial inclusion.<sup>38</sup> It even approved the upgrade of Bandhan Financial Services—a leading microfinance institution, nearly three-fourths of whose clientele came from rural areas—into a full-fledged private bank. Bandhan Bank was officially launched on 23 August 2015 in Kolkata, and at the time of writing has 501 branches across India.<sup>39</sup>

On 28 August 2014, the Centre also started the Pradhan Mantri Jan Dhan Yojana (PMJDY),<sup>40</sup> a financial inclusion scheme that seeks to ensure that every adult individual has a bank account, and with it, access to financial literacy initiatives and other financial services. The programme also provides accident insurance benefits up to INR 1 lakh per year built into the RuPay Debit card every account holder is entitled to. Figure 3 shows that card issuances are struggling to keep up with new account openings, highlighting the need for a ramp up.<sup>41</sup> Further, it launched the Micro Units Development and Refinance Agency (MUDRA) Bank on 8 April 2015, to refinance and regulate the microfinance sector.<sup>42</sup>

**Figure 3: Number of PMJDY Accounts and RuPay Debit Cards Issued (2015-2023)**



Source: Author's own, using data from the Ministry of Finance<sup>43</sup>

While Bandhan Bank satisfied the criteria to become a full-fledged bank, eight other MFIs were included as well in the list of 10 entities which the RBI, in September 2015, approved as Small Finance Banks (SFBs).<sup>44</sup> It demonstrated the importance of microfinance in the RBI's calculus.<sup>c</sup>

The impact of improved technologies on microfinance has also been transformational. Digital platforms have reduced running costs and turnaround times for MFIs, rendering them more efficient and scalable.<sup>45</sup> Loan applications, disbursements, and repayments can now all be processed online by MFIs, decreasing the need for physical branches, and increasing the penetration of services to remote areas. Mobile phones have also emerged as crucial tools of financial inclusion—MFIs can now reach clients in rural and underserved regions leveraging mobile banking and payment applications, thereby enabling easier and quicker transactions.

<sup>c</sup> SFBs provide basic banking services including accepting deposits from and lending to underserved sections, especially small and marginal farmers and small business units.

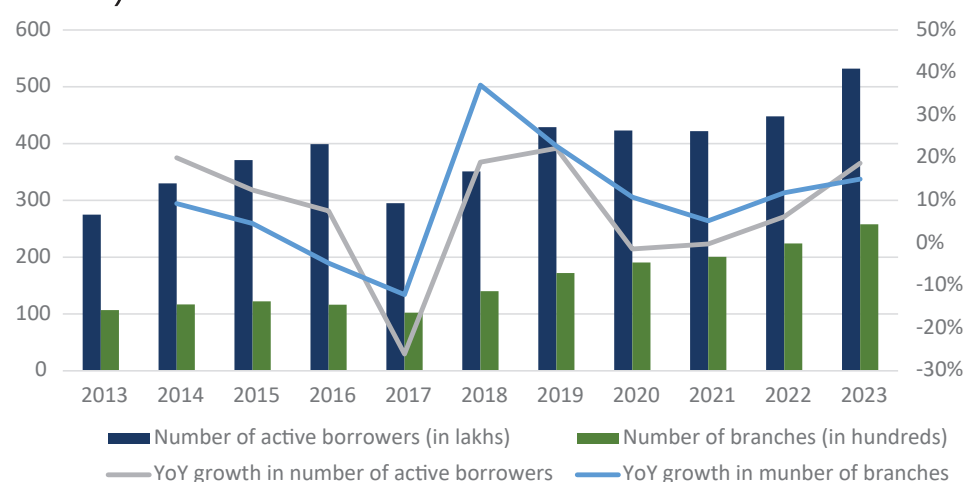


# Evolution of Microfinance in India

However, the COVID-19 pandemic from 2020 to 2022 set the segment back, with lockdowns and economic disruptions hurting the solvency of many borrowers. There were increased defaults and financial stress among clients, forcing MFIs to adjust quickly to digital transactions and loan restructuring.<sup>46</sup>

Despite the COVID-19 fallout, the microfinance segment's overall performance has been encouraging, establishing its resilience. At the end of 2022-23, microfinance funding by both NBFC-MFIs and banks to Joint Liability Groups (JLGs)<sup>d</sup>—apart from SHGs—reached INR 3.52 trillion, at a year-on-year (YoY) growth rate of 21 percent. (The actual loan disbursement was slightly lower at INR 3.32 trillion.<sup>47</sup>) The microfinance branch network, as well as its clientele, has also witnessed significant expansion (see Figure 4).

**Figure 4: Yearly Trends of the Microfinance Sector's Borrower Outreach and Branch Count (2013-2023)**



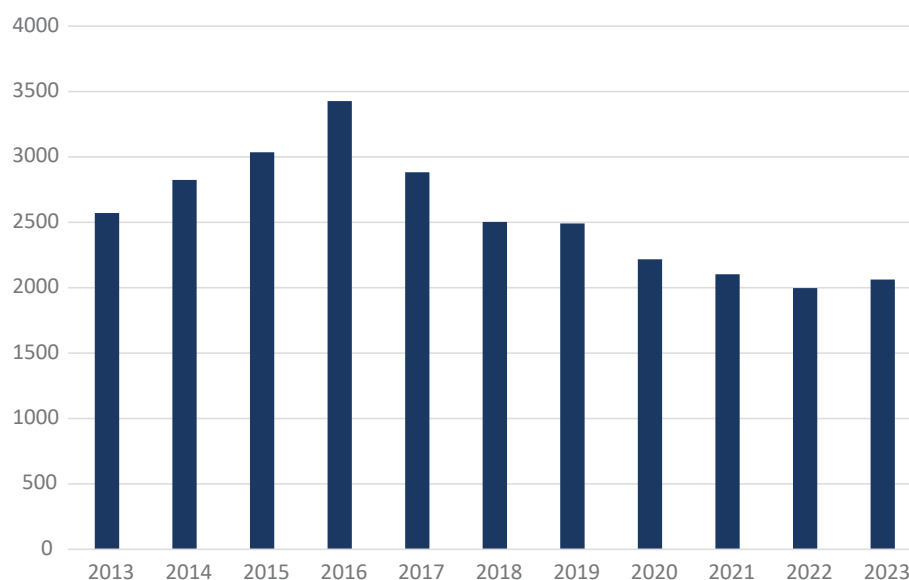
Source: Author's own, using data from Sa-Dhan<sup>48</sup>

<sup>d</sup> Financial institutions prefer to extend microfinance loans to either self-help groups (SHGs) or joint liability groups (JLGs) rather than individuals. JLGs are groups of four to 10 people who take loans either individually or collectively, but guarantee one another's loans, using internal monitoring to ensure repayment. There were 25.79 million JLGs in the country at the end of 2022-23.

Concurrently, microfinance funding to SHGs also attained an all-time high of INR 1.88 trillion outstanding in 2022-23. (There are now over 6.9 million SHGs linked to banks.<sup>49</sup>) Thus, the overall level of microfinance funding stood at INR 5.4 trillion at the end of 2022-23, equivalent to almost 10 percent of the sum disbursed under PSL by banks, making this segment an important player on the Indian financial sector landscape.<sup>50</sup> The growth of active borrowers as well as disbursing branches post-2021 is evidence of post-pandemic recovery in both demand for and supply of microfinance.

However, there has been a sustained decline in the number of active users per branch, which began well before the pandemic. This suggests a need to look beyond branch expansion to sustain the sector's lateral expansion (see Figure 5).

**Figure 5: Yearly Trend of Active Borrowers Per Branch (2013-2023)**



*Source: Author's own, using data from Sa-Dhan<sup>51</sup>*

Beginning on 1 April 2022, the RBI has introduced harmonised regulations for all entities engaged in microfinance (naming them ‘regulated entities’), seeking to create a level playing field, addressing problems of over-indebtedness, and ensuring transparent pricing and fair practices.<sup>52,53</sup> These provide the following benefits to the sector:

- a. **Clarity and Transparency:** They have homogenised the information given to debtors, especially about loan conditions, thus assisting them to make informed financial decisions.<sup>54</sup>
- b. **Borrower Protection:** Loans now need to be collateral-free and not linked to a lien on the borrower’s account, thereby reducing the risk for debtors.
- c. **Flexible Repayment Modes:** Debtors can no longer be penalised for making early payments (as some MFIs used to earlier).<sup>55</sup>
- d. **Curbs on Indebtedness:** The norms stipulate the maximum indebtedness allowed for debtors, curtailing the risk of over-leveraging.<sup>56</sup>

The regulations protect both borrowers and MFIs.<sup>57</sup> However, some of their facets, such as the assessment of household income (its real indebtedness), should be made more objective. More data on indebtedness from credit information companies (CICs) should be captured by integrating MFIs, cooperatives, Nidhi companies and SHG-lending under their umbrella, so that an appropriate assessment of a borrower’s liabilities is feasible.<sup>e,f</sup> This is particularly important in unsecured lending, where loan-collateralisation is absent. While collateral-free lending does promote financial inclusion by relaxing the eligibility for micro-loans and thereby opening the gates to poorer borrowers, empirical research indicates that poorer debtors are more likely to be over-indebted.<sup>58</sup>

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e Credit information companies are independent third-party agencies that collect financial data of individuals related to loans, credit cards, and other credit information; compile this data into credit reports; and share this information with their members, like banks and NBFCs.

f A type of NBFC that are recognised under Section 406 of the Companies Act, 2013, Nidhi companies are instituted to lend and borrow money from their members—usually small and medium enterprises (SMEs). With at least seven members in their core committee or group, Nidhi companies are government-regulated and offer different membership benefits like lower interest rates, simpler access to finance, and financial security.

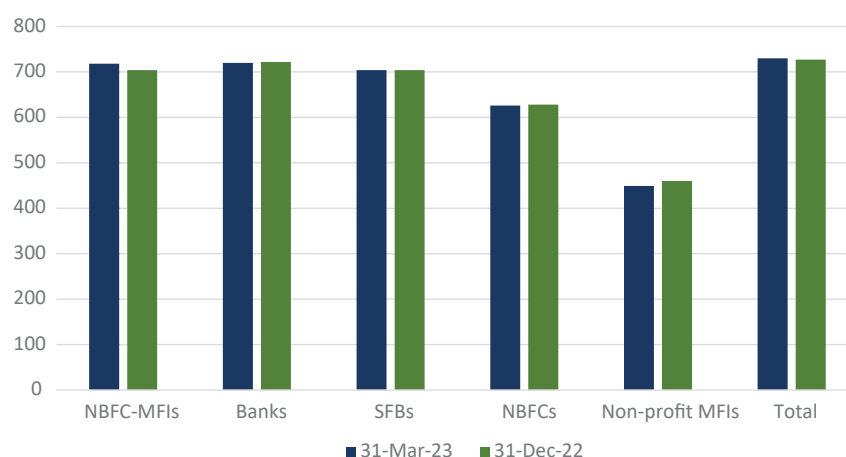


While the microfinance sector has promoted financial inclusion by extending credit to the poor even in remote areas, most of the lending remains geographically concentrated. CIC data shows that MFI clientele grew by almost 19 percent in 2022-23 over the previous year.<sup>59</sup> Microfinance has reached 730 of the 800-odd districts in the country, with banks and NBFC-MFIs having reached 720 and 718 districts, respectively (see Figure 6).<sup>60</sup> Though data gathered directly from MFIs shows more modest growth than the CIC figures, that there has been growth is undeniable. However, it is also seen that while microcredit may have touched almost every district across the country, it remains concentrated in a limited number states and districts. Only 10 of India's 28 states (plus eight union territories) account for approximately 84 percent of the microfinance portfolio, with the top five claiming 55 percent (see Figure 7).<sup>61</sup> Likewise, the top 200 districts make up about 71 percent of the portfolio, with the top 25 accounting for around 17 percent.<sup>62</sup> No doubt this spatial concentration could be a means of credit risk management by micro-lenders, given that geographic diversification has been associated with higher credit risk, possibly because the oversight of remote operations presents significant hurdles.<sup>63</sup> Some other reasons for the skewed distribution are outlined in the following points:

1. **Distribution and Delivery:** Southern states including Tamil Nadu, Karnataka, and Kerala have well-developed microfinance distribution and delivery networks, making microfinance operations easier.
2. **Finance:** In certain states, a weak banking syndicate contributes to MFIs encountering difficulties in securing sufficient funding.
3. **Climatic Conditions:** States prone to extreme climatic conditions and events, like some in northeastern India, need financial offerings such as micro-insurance and microloans tailored to these conditions which only a few micro-lenders currently provide because of challenges including insufficient institutional knowledge of climate-associated hazards; limited documented evidence of climate phenomena and related risks; inadequate MFI-staff training and institutional capability gaps; and inadequate awareness of access to clean finance, low-carbon technologies, and markets.<sup>64</sup>

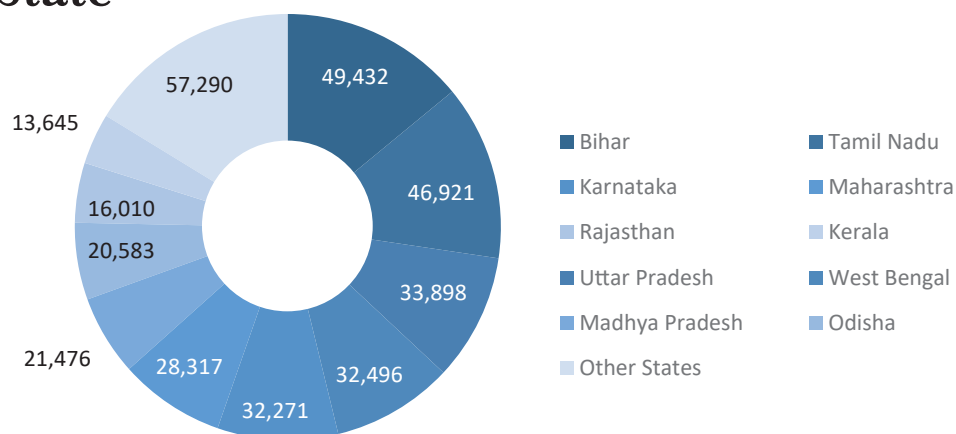
4. **Financial Literacy:** Financial literacy is a key differentiating factor between regions with varying levels of microfinance operations. Lack of awareness poses a significant challenge to increasing micro-lending.
5. **Women's Agency:** Micro-lending levels are also better wherever women are more empowered, particularly poor women, as the SEWA Bank example demonstrates.

**Figure 6: Spread of Microfinance, by Districts Covered and Lender**



Source: Author's own, using data from Sa-Dhan<sup>65</sup>

**Figure 7: Share of Outstanding Loans, by State**



Source: Author's own, using data from Sa-Dhan<sup>66</sup>

Microfinance has begun supporting various sustainability-centric domains such as affordable housing, climate action, water and sanitation, and health, to usher in holistic development at the bottom of the financial pyramid. Many projects being implemented use national and international funding, and support from member institutions, to pilot-test financial products.<sup>67</sup> Most recent sustainable impact initiatives by Indian MFIs can be classified under the following heads:

1. **Clean Microfinance:** Several MFIs are now embracing environmental sustainability, with credit provision frameworks promoting eco-friendly practices in areas such as renewable energy, sustainable agriculture, and green housing.<sup>68</sup>
2. **Digital Payments:** Digital payment systems are being promoted by MFIs to boost financial inclusion, leading to reduced reliance on cash as well as more transparent and efficient financial transactions.
3. **Credit Guarantee Schemes:** Revamped from 2023-24, these assist small enterprises by guaranteeing required credit to them when needed, which helps alleviate poverty and generate employment.<sup>69</sup>
4. **Water and Sanitation:** Six water and sanitation start-ups were recently awarded INR 25 lakh each at a sustainability summit for projects providing managed aquifer recharge, waste management solutions, water purification systems, and technology platforms for efficient water usage and soil health.<sup>70</sup>
5. **Health:** Apart from offering micro-insurance and health loans to the poorer sections, many MFIs have integrated health awareness programmes into their offerings, focusing on preventive health practices such as inoculation, family planning, nutrition, hygiene, and disease prevention.<sup>71</sup>

# Current Scenario

In 2022-23, Sa-Dhan and the RBI's Depositor Education and Awareness (DEA) Fund, along with 29 partnering MFIs, also launched an initiative to provide financial education to borrowing members through 1,500 workshops across the country, managing to reach 1.35 lakh recipients.<sup>72</sup> According to the *Bharat Microfinance Report 2023*, these MFIs engaged in a number of other activities as well beyond simply advancing of credit to empower the poorer sections, using funds sourced from the corporate social responsibility (CSR) corpus of companies.



**T**he 50 years of Indian microfinance have been challenging and eventful. The sector's growth has come from regulatory reform, technological advancement and adoption, and governmental intervention, enabling the provision of credit to millions of poor individuals who were previously beyond the reach of financial services. While the sector's corporatisation has promoted scale and efficiency through focus on professional management practices and financial viability, there continues to be debate over whether MFIs can combine increased productivity with extensive social outreach.

The sector's reach is still inhibited by inadequate availability of cost-effective finance, limited financial and digital literacy among borrowers, and risks related to customer data security. Over-indebtedness of borrowers and scarcity of innovative customer-centric propositions by microfinance providers are also impediments to growth. The geographical concentration of micro-lending in relatively few areas did not happen by chance. To increase outreach, MFIs need a multi-tiered strategy, including a stronger regulatory framework, better financial literacy propositions—especially those provided as credit-plus initiatives—and innovative financial solutions tailored to the needs of the poor. Such reforms could transform the Indian microfinance landscape in the coming years and allow the market to introduce still more evolved products, better service delivery, and better operating practices. It could also attract sizeable domestic and foreign investment.

Encouragingly, microfinance has been given a much-needed respite, in terms of higher yields and lower credit costs in recent years, allowing MFIs to earn improved loan spreads. The sector's emergence from the COVID-19 pandemic with increasing profitability is indeed proof of its resilience. [ORF](#)

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