Microfinance Institution

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Microfinance Institutions (MFIs) are organizations that provide financial services like microcredit, micro-savings, and micro-insurance to low-income individuals and families who are typically excluded from traditional banking services. MFI's provide funding to interested borrowers after careful risk assessment, helping them to train, set up and manage small-scale enterprises.

> Microfinance institutions in India contributes about **130 lakh jobs and 2% of GVA** as per a **National Council of Applied Economic Research** (NCAER) study.

Evolution of microfinance in India

Initial phase	1974	**Shri Mahila Sewa Sahakari Bank** was established **to provide financial services to women** in the unorganized sector.
	1984	**NABARD advocated Self Help Group (SHG)** linkage as a tool **for poverty alleviation**
Change Period	2002	Norms for unsecured lending to SHGs were aligned with other secured loans.
	2004	The **Reserve Bank of India** (RBI) included microfinance **within the priority sector** and recognizing MFIs as a tool for financial inclusion.
	2006	Allegations of high interest rates and **unethical recovery practices** led the government to shut down branches of some MFIs.
Growth and Crisis period	2007	Private equity players entered the market, leading to rapid growth in the MFI loan book
	2009	The Microfinance Institutions Network (MFIN) was formed and allows NBFC-MFI to become members.
	2010	The **Andhra crisis** unfolded involving unethical debt collection practices that led to borrower suicides. The government issued an Ordinance that significantly curbed MFI activities.
Consolidation and Maturity phase	2012	The **Malegam Committee** recommended changes, and RBI implemented new regulations.
	2014	RBI issued a **universal banking license** to Bandhan Bank, the largest microlender. MFIN was recognized as a self-regulatory organization (SRO)
	2015	The government launched **MUDRA Bank** to finance small businesses.
	2022	RBI's Revised Regulatory Framework of MFI's

Microfinance significance and Financial Inclusion

1. Improved Access to Credit

As of FY?2023–24, microfinance institutions (MFIs) disbursed over ?1.8 lakh crore, reaching 53 million rural clients.

Over 98% of borrowers are women, promoting gender-inclusive credit access.

Rural borrowers constitute over 74% of all MFI clients. (Economic Survey 2023–24)

2. Formalization of Financial Services

Reduces reliance on informal moneylenders by integrating borrowers into regulated NBFC-MFI structures.

Average loan sizes (~?37,000) are tailored for micro-entrepreneurship and consumption smoothing.

3. Women Empowerment & SHGs

Women-led SHGs have been instrumental in improving socio-economic conditions with 88% of SHGs linked to banks being women-led.

o**Kudumbashree in Kerala**, plays a vital role in enhancing the financial status of the less privileged women in the State through its thrift and credit program

SHG savings reached ?65,000 crore, linking 17.8 crore households with banks. (NABARD & RBI reports)

4. Digital & Tech Integration

MFIs increasingly use **UPI, eKYC, and Aadhaar-based disbursal**, deepening digital financial inclusion in remote areas.

5. Economic Participation & Livelihoods

Loans are used for income-generating activities (livestock, tailoring, petty trade), fostering **micro-enterprise growth and self-employment.**

6. Entrepreneurship Promotion

46% of microfinance loans are provided to families having monthly income less than Rs. 20,000 forworking capital for their income generating activitiesandassetsincluding livestock**.**

7. Impact on Health, Social Capital, and Economy

Microfinance has a positive effect on various aspects of life, including health and education, which can subsequently influence economic development

oFor example, research indicates that providing mothers with access to credit can **increase their children's school enrollment rates by approximately 1.9% for girls and 2.4% for boys, as observed by the Grameen Bank.**

Challenges in microfinance in India

1Over-Indebtedness

Individuals take loans from multiple microfinance institutions (MFIs) to repay existing loans, leading to a debt trap.

For instance: 8-10% of the sector's total assets under management are linked to borrowers with more than four lenders.

2Interest Rates

While microfinance is intended to be an affordable source of credit for the poor, high-interest rates can make it difficult for borrowers to repay loans, leading to a cycle of poverty.

E.g. Most of the micro finance institutions **charge interest rates starting from 12% and can go up to 30%.**

3Regulation and Governance

Multiple regulatory authorities as they are registered as societies, cooperatives and companies affect effective control and lead to lack of transparency.

MF Banks in India **are regulated by the RBI, State governments through State Cooperative Societies Acts** (for cooperative banks) regulate microfinance cooperative banks and cooperative societies.

4External Shocks

Economic and environmental factors such as **natural disasters and economic downturns** can have a significant impact on the ability of microfinance borrowers to repay loans.

The gross non-performing assets **(NPAs) may rise to 4.5 per cent in FY25 from 2.8 per cent** in FY24 due to economic uncertainty.

5Regional Imbalances

There is unequal geographical growth of Microfinance institutions and SHGs in India. About **60% of the total SHG** credit linkages in the country are **concentrated in the Southern States.**

Initiatives taken by government for strengthening microfinance

1SHG-Bank Linkage Program

To increase the loan volume of the SHG and modify their money lending pattern from non-income generating activities to production-based activities.

2Pradhan Mantri MUDRA Yojana

To allow small businesses to borrow micro credit up to Rs.20 lahks (enhanced from 10 lakhs by the 2024 Union Budget) without collateral. These loans were given with the help of MFIs and other member institutions, which were refinanced by MUDRA Ltd**.**

3RBI in 2014 allowed non-deposit accepting NBFC-MFIs to also function as Business Correspondents (BCs) for commercial banks, abolishing a previous restriction on NBFCs.

4Regulatory Framework for Microfinance Loans by RBI 2022

Clarified various aspects such as Definition of Microfinance Loan, repayment limit etc.

5Refinance Support to MFIs NABARD

It has been providing financial assistance to MFIs under its Long-Term Refinance facility

6e-Shakti Programme of NABARD

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The primary goal of the E-Shakti Project is to **digitize the accounts of various SHGs** and to bring the members of the groups under the fold of Financial Inclusion.

7PM Street Vendor's AtmaNirbhar Nidhi (PM SVANidhi)

The Ministry of Housing & Urban Affairs launched this scheme to facilitate**collateral free working capital loans of up to Rs. 10,000/ of one-year tenure**, to approximately 50 lakh street vendors

Way forward

1Strengthening Regulatory Oversight

Enforce strict compliance with RBI's harmonised guidelines to ensure uniformity in practices across all microfinance players**.**

2Need for Balanced Oversight

Policymakers and banks must heed early warning signs to ensure stability in the microfinance sector without stifling credit delivery**.**

3Strengthening Regulatory Oversight

Implement stricter monitoring of over-indebtedness and multiple borrowings.

Ensure better compliance with RBI's 2022 Unified Microfinance Framework across NBFCs, banks, and SFBs**.**

4Build a Centralized Credit Information System

Expand credit bureaus to include SHG and informal sector loans.

Real-time borrower profiling can reduce loan stacking and improve risk assessment**.**

5Leverage Digital Platforms

Promote UPI-based microloans, digital repayments, and eKYC to lower costs and increase transparency.

Support fintech–MFI partnerships to innovate in rural credit delivery**.**

6Tailor Products for Diverse Needs

Offer customized financial products such as health insurance, crop loans, and emergency credit.

Introduce flexible repayment plans linked to seasonal income (especially for agri- and informal workers).

7Enhance Financial Literacy

Run large-scale financial awareness campaigns in regional languages.

Partner with SHGs, NGOs, and schools to build long-term financial behavior change.

8Regional Diversification

Encourage MFIs to expand to under-served states in central, northeast, and tribal regions to reduce geographic concentration risks.

Microfinance has helped bridge the gap between formal finance and the underserved. Strengthening institutions, improving awareness, and expanding outreach will ensure it continues to support India’s goal of inclusive and sustainable development.