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INDUSTRY OUTLOOK

REIMAGINING MFI: FINANCIALLY INCLUSIVE TRENDS & OUTREACH

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Introduction

Microfinance has long been recognized as a powerful tool for promoting financial inclusion, especially in emerging economies like India, where a large portion of the population remains outside the formal credit system. An empirical study of microfinance faces practical challenges and issues. Microfinance in India has been defined differently due to the semantic difficulty in conveying various meanings and the different connotations implicit in the term. As a result, efforts are required to develop a working definition of microfinance that reflects both continuity and change without being rigid.

Microfinance refers to providing financial services, such as small loans (microcredit), savings, insurance, and remittances to low-income individuals and households who are excluded from formal banking. Typically designed to be collateral-free and often organized through group models (e.g., Self-Help Groups or Joint Liability Groups), microfinance enables credit access for people facing exclusion due to income, geography, or gender.[1 2]

By offering small, collateral-free loans to low-income individuals, especially women and micro-entrepreneurs, microfinance institutions (MFIs) have significantly contributed to marginalized communities, poverty alleviation, livelihood support, and social empowerment. Over the past thirty years, microfinance has sparked a quiet revolution in rural India, significantly improving the lives of those at the "*bottom of the pyramid*," who are under-banked but not unbankable. However, the sector's rapid growth over the last two decades has also brought serious challenges related to credit quality, borrower over-indebtedness, regulatory fragmentation, and institutional vulnerability.

"Financial inclusion refers to the process of ensuring access to appropriate financial products and services needed by vulnerable groups, such as weaker sections and low-income groups at an affordable cost fairly and transparently by mainstream institutional players[3]." It complements initiatives in savings, insurance, remittances, and financial literacy to form integrated inclusion strategies. In practice, financial inclusion gained popularity in the early 21st century after financial exclusion was identified as a major source of poverty (Chibba, 2009). India's microfinance sector has evolved from informal, community-based lending practices to a structured ecosystem involving Self-Help Groups (SHGs), Non-Banking Financial Companies - Microfinance Institutions (NBFC-MFIs), Small Finance Banks, and other financial intermediaries. As of FY2024, the sector served over 60 million clients, with a gross loan portfolio exceeding ₹3 lakh crore[4].

According to the Global Findex Database, nearly 1.4 billion adults worldwide remain unbanked, most of whom live in developing countries, highlighting the urgent need for inclusive financial systems[5]. The importance of financial inclusion goes beyond just access to banking; microfinance plays a transformative role by providing small-scale credit and services to people traditionally excluded from formal banking, especially women and rural entrepreneurs[6]. As Chibba (2009) notes, "*financial inclusion has emerged as a critical policy priority to promote inclusive growth, reduce poverty, and achieve the Sustainable Development Goals (SDGs)."* In India, initiatives like Pradhan Mantri Jan Dhan Yojana (PMJDY) have significantly expanded access, but the real challenge is shifting from account ownership to meaningful financial use.[7] Therefore, financial inclusion and microfinance are not just policy goals but essential parts of sustainable and inclusive development.[8]

Complementing these efforts is the rapid growth of fintech innovations such as the Unified Payments Interface (UPI), Aadhaar-enabled Payment Systems (AePS), and mobile wallets, which have transformed access to financial services and payment systems, especially in underserved areas. However, this digital expansion has also revealed notable digital divides, particularly affecting women, the elderly, and remote regions. As Sinha and Piedra (2021) observe, "*India has witnessed an unprecedented expansion of access to financial services... but usage remains limited and uneven*." The combination of policy efforts and technological advancements shows promising prospects, but addressing inequalities in digital infrastructure, literacy, and trust remains crucial to fostering inclusive financial participation and moving forward to the next level.

Evolution of Micro Finance in India

Poverty is defined as the total of many factors, including not just income and calorie intake but also access to land and credit, nutrition, health and longevity, literacy and education, and safe drinking water, sanitation, and other infrastructure facilities.[9] Laureate Milton Friedman once said that "*The poor stay poor, not because they're lazy, but because they have no access to capital*."

The genesis of microfinance in India goes back to the 1970s and 1980s, when rural credit was mainly provided by informal sources, such as moneylenders, chit funds, and rotating savings groups. In 1972, the establishment of the Self-Employed Women's Association (SEWA) in Gujarat marked an early shift toward structured, women-centered financial empowerment, although formal microfinance institutions (MFIs) had yet to emerge. A key turning point occurred in 1992 with the launch of the Self-Help Group (SHG)-Bank Linkage Programme by NABARD, supported by the Reserve Bank of India.[10]

This initiative linked informal women's savings groups with formal banking institutions, offering collateral-free group loans. It established a community-based, participatory model of microfinance and soon became a globally recognized best practice. From the late 1990s to the 2000s, formal MFIs built as non-banking financial companies (NBFCs) emerged. Groups like SKS Microfinance, Spandana Sphoorty, and Bandhan expanded rapidly, supported by donor funds and venture capital. These MFIs aimed to fill the credit gap in underserved areas but operated with a strong commercial focus, raising concerns about ethical lending practices.[11]

A major setback happened in 2010 during the AP microfinance crisis when coercive recovery methods and increasing borrower distress led to a wave of suicides and public outrage. The backlash resulted in tighter sector scrutiny and a temporary dip in investor confidence. In response, the Malegam Committee (2011)[12] proposed regulatory reforms adopted by the RBI, including formal definitions of MFIs, interest rate caps, margin restrictions, and the introduction of credit bureaus to prevent over-lending and improve transparency for borrowers.

From 2014 onward, the focus shifted to nationwide financial inclusion through flagship programs. The PMJDY opened over 500 million basic bank accounts, while the MUDRA scheme (2015) provided microcredit refinancing support to MFIs and small borrowers.[13] In a landmark move, Bandhan became a universal bank in 2015, transitioning from an MFI to a regulated commercial bank. The wave of digital transformation has changed the delivery of microfinance in India, with innovations like e-KYC, UPI, mobile-based lending, and Aadhaar-enabled payment systems helping MFIs expand outreach safely and efficiently.[14] While UPI, Aadhaar, and FinTech tools have proliferated, research is limited on how digital interfaces affect group dynamics, credit discipline, and borrower comprehension.

To sum up, the Indian microfinance odyssey evolved from grassroots initiatives to a regulated industry in distinct phases:

- 1974-1984 (Initial period): SEWA Bank in Ahmedabad (established 1974) became India's first women-focused MFI. NABARD began advocating for SHG linkage.

- 1984-2002 (SHG linkage phase): NABARD formally launched the SHG-Bank Linkage Programme in 1992, scaling access to formal savings and credit through SHGs, especially in southern states.
- 2002-2006 (Recognition and expansion): RBI included microfinance under Priority Sector Lending in 2004; norms for unsecured loans to SHGs were aligned with those for secured loans; expansion was followed by concerns about high interest rates and recovery practices.
- 2007-2010 (Growth and AP crisis): Private-equity investment accelerated MFI growth, but high interest rates, over-lending and coercive collection triggered widespread borrower distress culminating in the A P crisis in 2010, leading to the formation of the RBI's Malegam Committee, and new norms in 2011-2014.
- 2010-2014 (Institutional frameworks): RBI defined and regulated NBFC-MFIs (2011), with qualifying asset criteria, borrower protections, ceilings, and transparency norms. Microfinance Institutions Network (MFIN, 2014) and Sa-Dhan were recognised as SROs to monitor compliance.
- 2014-2020 (Scale and innovation): Demonetization in 2016 disrupted cash-based microfinance operations. The COVID-19 pandemic (2020-21) severely disrupted incomes, triggering substantial NPAs and contraction in disbursements. The sector, however, grew at ~28% CAGR. NBFC-MFIs raised $1.7 billion+ from equity investors (2015-23) and achieved deep district coverage (≈92% of districts by Dec 2024). SHG and MFI lending coexist across major states.
- 2020-2023 (Shock and rebound): COVID-19 disrupted income sources and repayments in FY21, leading to portfolio contraction. From FY22, the rebound was strong: disbursements rose to ₹1.13 lakh crore, and by 2023 to ₹1.728 lakh crore.

Status and Outreach

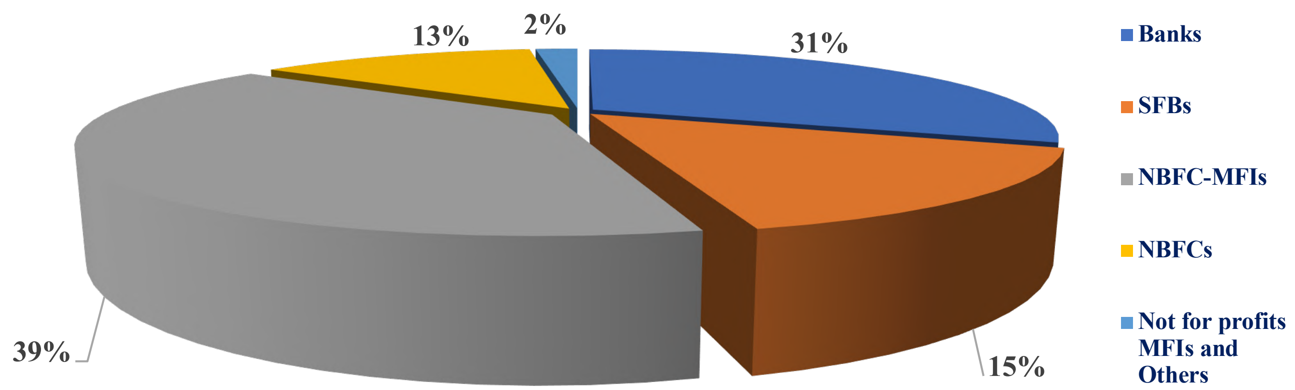
In India, microfinance is a pillar of financial inclusion, empowering women, rural artisans, small farmers, and micro-entrepreneurs. India's SHG-bank linkage programme by NABARD has become the world's largest microfinance model, today encompassing over 1.4 million SHGs and nearly 20 million women members, with banks' lending up to four times the group's savings.[15]

The current status of microfinance in India is characterized by rapid growth and increasing demand for financial services. The microfinance sector in India has grown significantly over the years, with many MFIs providing a range of financial services to low-income individuals and small businesses. Some of the current trends in microfinance include the increasing use of technology, the growing importance of digital financial services, and the need for more effective regulatory frameworks.

As of March 2025, the sector's gross loan portfolio (GLP) stood at ₹ 381,200 crore, with approximately 14 crore active loans, registering a 7% year-on-year decline, highlighting persistent asset-quality woes, reduced risk appetite among lenders and withdrawal from high-risk geographies. The portfolio outstanding as of December 2024 was ₹ 348,015 crore, with NBFC-MFIs holding the largest share.

As of early 2025, parcel-at-risk and gross NPAs soared (~13%), loan portfolio shrank 14% YOY, and lenders resorted to raising rates to contain losses. In a supportive institutional response, the RBI rolled back stricter risk-weight rules, eased qualifying asset norms, and lifted restrictions on certain NBFCs following governance improvements (e.g., Asirvad, Arohan, Navi, etc.). To mitigate state-level policy risks, ordinances in Karnataka (2025) and Assam limit coercive actions, possibly disrupting collection, but such measures are intended to protect borrowers.

Figure 1: Micro-credit loan outstanding across lenders as on December 2024 (%)



Source: SIDBI

Rising Stress-Surging Defaults and Delinquencies

Rising borrower stress and over-indebtedness stem from the fact that borrowers often have multiple microloans. Qualitative field studies report up to 4 to 6 simultaneous loans from MFIs, SHGs, app-based lenders, and informal moneylenders, resulting in debt stacking and stress.[16] Recovery practices strain social relationships; JLG peer-enforce mechanisms may no longer hold in fragmented urban or peri-urban communities. Despite the RBI cutting policy rates in 2025, many MFIs have raised lending rates to cover elevated credit costs, defaults, and operational challenges, i.e., a divergence from broader market trends.[17] The RBI reduced the qualifying asset requirement for NBFC-MFIs from 75% to 60% (June 2025), allowing diversification into MSME lending, housing finance and "*missing middle*" segments, improving efficiency and risk management.[18]

The RBI also reversed earlier elevated risk weights: reduced retail loan risk weights from 125% to 100% and removed additional capital surcharges on exposures to non-bank lenders—post change in RBI leadership.[19] The sector's non-performing assets (NPAs) mounted disconcertingly to 16%, with over ₹55,000 crore of loans at risk, mainly concentrated in states like Bihar, Tamil Nadu, Assam, and Odisha. This is supported by increasing portfolio-at-risk (PAR 30 to 180) levels, which climbed to 6.4%, indicating widespread borrower distress and repayment fatigue. From a financial standpoint, Net Interest Margins (NIMs) are squeezed due to high credit costs, now ranging between 5.4% and 6%, based on industry estimates. Loan disbursements declined by 31% in Q1 and 13% in Q2 of FY25, as MFIs adopted a cautious approach amid a volatile repayment environment. NBFC-MFIs, which dominate the sector, have seen their Assets Under Management (AUM) decrease sharply to just 4%, compared to 28% last year, highlighting both market correction and regulatory tightening.

Although women continue to constitute over 95% of MFI borrowers, the sector's future growth depends on restoring repayment trust, strengthening credit discipline, and diversifying financial products to meet evolving rural livelihoods.

Table 1: Microfinance Sector Status (March 2025)	
Category	**Status (March 2025)**
Gross Loan Portfolio (GLP)	₹3.81 lakh crore (↓7% YoY)
Non-Performing Assets (NPAs)	16% (↑ from 8.8% in FY24)
Delinquency (PAR 30-180)	6.4% (↑ from 2% YoY)
Net Interest Margins (NIMs)	Under pressure (credit cost 5.4%–6%)
Disbursement Trends	↓31% in Q1, ↓13% in Q2 (FY25)
NBFC-MFI AUM Growth	4% (vs 28% in FY24)
Regulatory Developments	Stricter RBI + MFIN norms (3-lender cap, ₹2L limit)
Borrower Profile	95%+ borrowers are women
Outlook (2025-2027)	GLP projected to reach ₹5L Cr by FY2027

Source: Compiled by the author using MFIN Micrometer Q4 FY25[20], RBI regulatory updates (2022–2024), and sector news reports including Business Standard, June 2025[21].

Nonetheless, resilience remains evident. The RBI's regulatory clarity expanded credit bureau coverage, stronger SROs, and innovations in fintech-MFI partnerships have made the Indian microfinance ecosystem one of the most dynamic globally. The AP crisis served as a wake-up call that reshaped the microfinance landscape in India. Them an unregulated, profit-driven expansion, the sector has transformed into a more mature, regulated, and inclusive system. With supportive policies, digital transformation, and a robust risk management framework, the Indian microfinance sector is well-positioned to play a critical role in advancing deeper financial inclusion in the years ahead.

Analytics of Usage versus Access Metrics

Usage and access metrics are crucial for understanding how microfinance influences financial inclusion. Usage metrics show the extent of the usage of financial services by individuals, while access metrics indicate the availability of these services. Access metrics include borrower counts (79 million borrowers), loan portfolio size (₹3.75 lakh crore), district coverage (~92% of districts), percentage of loans to women (~99%), and portfolio distribution among lender types (NBFCs, MFIs, banks, SFBs).[22] [23] However, metrics like loan disbursements and borrower counts do not fully capture actual usage, income impact, consumption smoothing, or entrepreneurial productivity. Therefore, usage metrics such as loan stacking frequency (how many borrowers have multiple loans), purpose of loans (whether for income generation, consumption, or emergencies), borrower outcomes (impact on household income, business survival, resilience to shocks), psychological and social effects (stress from multiple payments, interpersonal strain in JLGs), and digital adoption rate (percentage of borrowers using mobile/WhatsApp versus paper-based methods) require more detailed measurement.

In India, there remains a significant gap between access and usage metrics, with many people having access to financial services but not using them regularly. Despite impressive progress in expanding financial access through large-scale account opening drives like PMJDY and SHG-

Bank Linkage Programs, the real challenge lies in encouraging meaningful usage of these services. A closer look at usage data across genders and regions shows that millions of accounts remain inactive or underused. For example, even though account ownership surpasses 78%, active use of digital payments, savings, and insurance remains significantly lower among women and rural communities. The following table compiles the latest data from NABARD, RBI, Global Findex, and other reputable sources to highlight the persistent gap between access and functional inclusion. This discrepancy emphasizes the need to shift from account-focused policies to those promoting behavioral trust, financial literacy, and embedded financial participation.

Table 2: User Vs Access Metrics as of 2023-24 (based on geography and gender)

Indicator	Overall	Women	Rural	Urban
Account Ownership (% adults)	78.50%	76.20%	74.60%	88.30%
Active Account Usage (90 days)	~55%	~39%	~41%	~69%
Digital Payments Usage	52%	36%	37%	71%
Savings in Formal Institutions	34%	26%	25%	46%
Access to Formal Credit	60.40%	45.20%	44.10%	69.80%
Usage of Micro-Insurance	<21%	<12%	~10%	~26%
SHG Account Usage (Active)	47%	47%*	47%	NA

Source: Compiled by the author using data from NABARD SOMFI 2023-24[24], NAFIS 2021-22, Global Findex 2021[25], RBI Digital Payments Index 2023[26], MFIN Micrometer Q4 FY2024[27], IRDA Annual Report 2023[28], and PMJDY Dashboard[29].

Crisis and Resilience in India’s Microfinance Sector

The microfinance sector in India faced several crises, including the AP Microfinance Crisis of 2010. This crisis highlighted the need for more effective regulatory frameworks and better governance practices within the microfinance sector. The AP crisis resulted from over-lending, coercive recovery methods, and high interest rates, which led to suicides and long-term reputational damage in the mid-2000s.

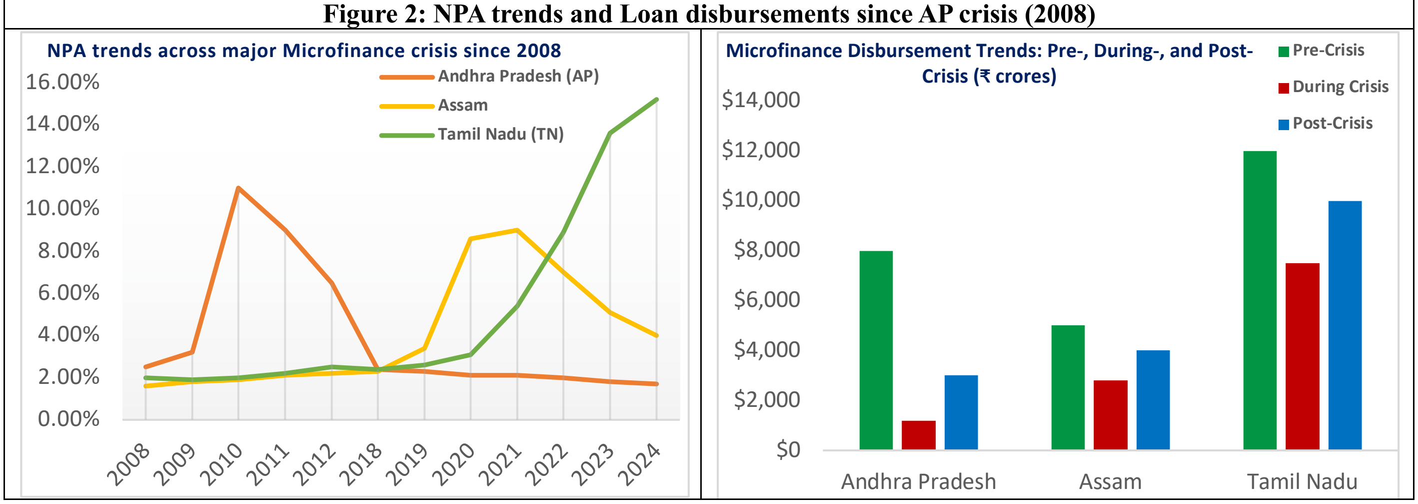
Despite these challenges, India's microfinance sector has shown resilience and adaptability, with many MFIs continuing to serve low-income individuals and small businesses. The NBFC-MFIs expanded aggressively, especially in AP, driven by commercial motives and private capital. Overlapping borrower bases, coercive collection practices, and exorbitant interest rates caused widespread borrower distress. Reports of suicides among indebted women clients sparked public outrage, prompting the Andhra Pradesh government to pass the AP Microfinance Institutions (Regulation of Money Lending) Ordinance, 2010.

This law severely restricted MFI operations by imposing strict recovery rules, requiring local government approval, and demanding detailed loan documentation. The consequences were severe: loan collections plummeted, investor confidence declined, and the sector’s reputation suffered greatly. The crisis exposed critical issues such as the lack of credit bureau data, inadequate borrower assessment, poor governance, and the absence of specific regulatory oversight for MFIs.

While AP's 2010 crisis is the most well-known, more recent disruptions in Assam and Tamil Nadu show that microfinance vulnerabilities are often regional and structurally ingrained. In Assam, the 2019 crisis resulted from over-lending, borrower coercion, and political mobilization, leading to the passage of Assam's MFI (Regulation of Money Lending) Act, 2020, which halted recoveries and capped interest rates. This caused a sudden pulling back of lending, deterioration in asset quality, and shutdowns for smaller MFIs. Similarly, Tamil Nadu, home to many NBFC-MFI portfolios, experienced a wave of delinquencies and repayment fatigue after COVID-19. Reports indicate that over 33 MFIs are headquartered in the state, facing rising defaults due to borrower over-indebtedness and regulatory confusion.[30 31]

The results were stark: portfolio-at-risk (PAR) increased significantly in both states, and collection efficiency dropped below 80% in multiple districts. Several MFIs exited these markets or paused disbursing new loans, undermining trust and sustainability. According to the Inclusive Finance India Report (2021), "*Assam's crisis revealed how uncoordinated lending and weak credit discipline can collapse localized ecosystems*."

Figure 2: NPA trends and Loan disbursements since AP crisis (2008)



Source: NABARD's status of Microfinance in India

The chart above illustrates sharp regional spikes in NPAs: AP in 2010 (11%) due to its regulatory crisis, Assam in 2020-21 (over 9%) after state-level lending restrictions, and Tamil Nadu with a steady rise post-COVID, peaking at 15.2% in 2024. These trends highlight region-specific financial stress and emphasize the need for targeted oversight. Microfinance disbursement volumes across Andhra Pradesh, Assam, and Tamil Nadu (TN) show notable declines during crises, followed by partial recoveries. Andhra Pradesh experienced the steepest drop after the 2010 crisis, while disbursals declined in TN during 2022-23 due to rising NPAs.

Assam's disbursement decline coincided with the 2019-21 regulatory freeze and borrower protests, as shown by the bar chart. These cases underscore the urgent need for risk-aware governance, borrower protection, and region-specific regulatory buffers in India's expanding microfinance landscape.

Persistent challenges include the lack of formal credit history, high outreach costs in remote areas, high indebtedness, low digital and financial literacy, customer data protection and privacy concerns, and strategic and credit risks. There are also serious concerns about over-leveraged borrowers and overlapping credit exposures leading to rising delinquencies. Institutional initiatives involve data localization, caps on multiple lending, mandatory priority sector lending, Micro Units Development and Refinance Agency Ltd. (MUDRA) Yojana, Pradhan Mantri Mahila Shakti Kendra, loan co-origination by banks and NBFCs/MFIs, regulatory sandboxes, and public credit registries (PCR).[32]

There is insufficient cross-sectional data on inter-MFI borrowing, credit stacking, repayment behaviors, and psychosocial stress, especially post-pandemic, making it essential to study these issues thoroughly to understand the evolving microfinance landscape in India. As stated elsewhere, "*There has to be a renewed thrust on borrower-centric approaches, fostering innovation, strengthening risk management, providing financial education, diversifying loan products, exploring alternative funding sources, developing internal capacity, and policy changes, India's microfinance industry to maintain market integrity and resilience*" (Raza and Sharma, 2024). The sector demonstrated recovery and resilience after the pandemic, rebounding strongly: FY22 and FY23 saw rapid growth, with disbursements rising to ₹1.13 lakh crore (FY22) and ₹1.73 lakh crore (FY23). A diverse ecosystem of lenders including banks, NBFC-MFIs, SFBs, and trusts helped spread risk. Support from organizations like MFIN, Sa-Dhan, mainstream investors, and capital inflows (~$1.7 billion) strengthened capitalization.

Regulatory Reforms and Sector Rebuilding

Regulatory reforms have played a crucial role in promoting the growth and stability of the microfinance sector in India. The RBI has implemented several regulatory reforms, including the creation of a separate category for microfinance institutions and the introduction of prudential norms. These reforms have helped to promote transparency, accountability, and stability in the microfinance sector. The RBI, under the Malegam Committee (2011), issued a comprehensive regulatory framework to restore stability and protect borrowers. It defined the NBFC-MFI category and imposed criteria such as:

- Caps on interest margins (10 to 12%)
- Limits on loan sizes and repayment tenures
- Mandatory disclosure of interest rates
- Avoidance of multiple lending and coercive recovery

The Malegam Committee (2010-11) recommendations led to the establishment of the NBFC-MFI segment (with qualifying asset, income limits, pricing caps), borrower protection norms (50% repayment cap, no prepayment penalty), and disclosure standards. The RBI mandated that NBFC-MFIs become members of SROs (MFIN or Sa-Dhan) to monitor compliance and implement a Code of Conduct.

Empirical evaluation, however, remains patchy of the impact of the Malegam Committee-inspired norms, Self-Regulatory Organizations (MFIN, Sa-Dhan), and cap provisions on industry behaviour.

The formation of credit bureaus like CIBIL and Equifax for MFIs was another key reform to prevent borrower over-indebtedness. In parallel, the sector witnessed the rise of Self-Regulatory Organizations (SROs) such as MFIN and Sa-Dhan, which helped enforce the code of conduct, data sharing, and client protection principles.

The sector gradually recovered, with NBFC-MFIs becoming more professional, tech-driven, and better integrated into the broader financial system. The RBI's move to bring microfinance under the purview of priority sector lending (PSL) further boosted liquidity and formal banking linkages.

A major policy shift occurred in March 2022, when the RBI released a revised regulatory framework for microfinance. The earlier asset-based definition of NBFC-MFIs was replaced with a regulation applicable to all REs (Regulated Entities), including NBFCs, Banks, and SFBs, offering microloans. The RBI (2022) introduced standardized borrower protections: capping household repayments at 50% income, mandatory income/liability assessments, standard fact-sheet disclosure, interest-rate ceilings, and banning prepayment penalties. These norms apply to regulated MFIs and credit institutions for annual incomes up to ₹3 lakh. The key highlights of the 2022 framework include:

- Removal of the interest rate cap, allowing market-based pricing
- Introduction of Household Income Assessment (₹ 3 lakh annual income cap)
- Emphasis on responsible lending norms, transparency, and repayment capacity-based underwriting
- Standardized pricing disclosure templates for customer awareness

This shift marked a transition from entity-based to activity-based regulation, reflecting the growing convergence of financial services and digital delivery. In June 2025, the RBI reduced the qualifying asset threshold for NBFC-MFIs from 75% to 60%, allowing them to diversify into MSME, micro-housing, and transitional credit lines, without losing core microfinance identity, thus improving the sustainability and capital utilisation of lenders. In February 2025, the RBI lowered risk weights on microcredit from 125% to 100% and reversed surcharges on bank exposure to non-bank lenders, improving capital access and reducing cost burdens for institutions.

The RBI lifted restrictions on multiple NBFCs (Asirvad Micro Finance, Arohan, Navi, etc.) after compliance improvements, enabling smoother operations and lending revival post-intervention. While regulatory easing offers institutional breathing space, the wider evaluation question is whether borrower protections, multiple-lender credits, livelihood linkages, and transparency norms have reduced over-indebtedness and borrower harm. Compliance by unregulated NGO or Trust-based MFIs remains weak. This is due to uneven state-level oversight and a lack of uniform statute, raising the need for formal integration into the unified framework.

Following is a table showcasing all the major regulatory developments shaping the Indian microfinance sector since the AP crisis (2008-2025), highlighting pivotal reforms by the RBI and state governments. The timeline illustrates a transition from crisis-response mechanisms, such as the 2010 Andhra Pradesh Ordinance, to more proactive, borrower-centric frameworks like the 2022 revised MFI guidelines and 2025 risk weight revisions. These reforms aim to enhance transparency, credit discipline, and sustainability across the sector.

Table 3

Regulatory Change	Key Impact
AP Microfinance Ordinance (2010)	Restricted MFI activities in AP; led to massive decline in collections and investor confidence.
Malegam Committee Recommendations (2011)	Recommended setting up a regulatory framework, interest caps, and client protection measures.
RBI Definition of NBFC-MFI (2012)	Defined NBFC-MFIs with specific criteria; formalized the sector and its supervision.
Creation of MUDRA Bank (2015)	Launched to refinance MFIs and promote inclusive micro-lending across small enterprises.
Bandhan Licensed as Universal Bank (2015)	First MFI (Bandhan) transformed into a full-service commercial bank under RBI license.
Digital Onboarding via e-KYC (2016)	Allowed Aadhaar-based client verification; facilitated scale-up of digital lending.
RBI Microfinance Regulations (2022)	Borrower-centric regulation applicable to all lenders offering microfinance loans.
Removal of Interest Rate Cap (2022)	Lenders are allowed to set rates transparently via board policies instead of RBI caps.
Household Income-Based Loan Limit (2022)	Loan size tied to household income; mandatory income assessment for all clients.
Mandatory Credit Bureau Reporting	Required all MFIs to submit borrower-level data to credit bureaus to avoid over-lending.
Client Grievance Redress Norms (2023)	Improved client protection frameworks; centralized complaints system being planned.
Assam/Tamil Nadu Crisis Responses (2023-24)	Crisis responses included moratoriums, stricter audits, and client-side protections.
Introduction of ESG-linked Rating Factors (2024)	Rating agencies urged to integrate social, gender, and digital inclusion metrics.
Digital Lending Oversight Guidelines (2023)	Targeted digital MFIs: mandatory disclosure norms and privacy-compliant loan practices.
Borrower Education & Literacy Mandates (2024)	Literacy modules mandated before onboarding borrowers in vulnerable districts.
Risk Weight Revision for NBFCs & Banks (2023-25)	Risk weights increased for banks/NBFCs on unsecured loans to MFIs in high-risk areas.

Source: Compiled by the author from Reserve Bank of India circulars (2011-2025), NABARD Status of Microfinance in India Reports (2008-2024), and secondary research from Inclusive Finance India Reports, MFIN, and relevant policy documents.

Stakeholder Engagement and Policy Alignment for Inclusive Financial Strategies

Stakeholder engagement and policy alignment are essential for promoting inclusive financial strategies in India. The government, RBI, and other stakeholders have implemented several initiatives to promote financial inclusion, including the Jan Dhan Yojana and the Pradhan Mantri Mudra Yojana. While these initiatives have helped to increase access to financial services and promote financial inclusion, stakeholder alignment challenges persist. Power asymmetries exist between borrowers (low-income, often women) and lenders, leading to information imbalances, pressure in group dynamics, and weak voice. There are gaps in uniform regulation - NGO-MFIs and smaller trust-based lenders operate outside NBFC-MFI regulation and may not follow borrower protection norms. There are also issues of dissonance between grassroots pace and regulatory timing: borrowers may face delays in relief or options when policy changes lag; and digital divide: while institutions upgrade backend systems, borrower interfaces remain manual, limiting real-time communication, scalability of social collateral models, and data-driven tailoring.

Supportive institutional measures are essential for promoting the growth and impact of microfinance in India. Some of the supportive institutional measures include providing funding and technical assistance to MFIs, promoting financial literacy and awareness, and supporting research and development in the microfinance sector. Despite decades of well-intentioned reforms, financial inclusion efforts often fall short because they are driven by fragmented, top-down models that exclude key actors from decision-making processes.[33] While numerical access to banking has improved, especially post-PMJDY, systemic gaps in usage, trust, and responsiveness remain. This section critically examines the roles and influence of core stakeholders and makes a case for a more participatory, power-aware, and integrated framework to deepen inclusion.

Inclusive strategies require coordinated policy instruments, e.g., CGTMSE empowers MSMEs with collateral-free credit guarantees (₹5 lakh to ₹5 crore), supporting overlaps with micro-entrepreneurs transitioning out of microcredit into small business categories. Financial literacy and grievance mechanisms: capacity-building by NABARD, state-led borrower education, and channels for raising complaints. Collaboration with state governments: For instance, state ordinances or waivers (like Karnataka) must align with central rules to ensure both borrower protection and minimal disruption to financial flows. Fintech integration: platforms that embed credit-worthiness checks with CGTMSE eligibility and bureau scoring, reducing turnaround times and reducing fraud.

Power Asymmetries

Power asymmetries refer to the unequal distribution of power and influence among stakeholders. In the microfinance sector, power asymmetries can lead to exploitation and unequal access to financial services. It is essential to address power asymmetries by promoting transparency, accountability, and stakeholder engagement.

India's financial inclusion ecosystem is governed by a complex network of actors that include central ministries, regulatory bodies, MFIs, civil society organizations, and community-based groups like SHGs. However, governance often occurs in isolated silos. For example, schemes under the Ministry of Finance (such as PMJDY, MUDRA) rarely intersect meaningfully with literacy programs managed by the Ministry of Rural Development. Banks and MFIs operate in competitive, risk-averse silos, often bypassing community-level institutions or local self-governance structures. More nuanced insights are needed on intra-household decision-making, women's agency, and whether financial inclusion translates to real empowerment. As Tripathy, Purkayastha, and Das (2020) observe, "*inclusion fails when it is treated as a siloed, top-down delivery system rather than a participatory, co-designed ecosystem*." This fragmented governance hampers holistic inclusion, leading to duplicated efforts, low community engagement, and a growing trust deficit, especially in tribal, Dalit, and remote rural areas. A major obstacle to effective stakeholder engagement is the power imbalance that stifles the voices of the actual beneficiaries.

MFIs, regulators, and credit bureaus hold disproportionate control over financial design and delivery. Borrowers, particularly low-income women and rural workers, often remain unheard despite being the most affected. As Olsen (2017)[34] states in her Political Stakeholder Theory, "*inclusion must be rooted in legitimacy and justice, not just outreach metrics*". For example, the 2011 Malegam Committee outlined the operating framework for MFIs in India, but without direct input from borrower communities. Likewise, the rapid digitization of financial services has increased exclusion for those with limited digital literacy or phone access. Sinha and Piedra (2021) found that "*poor inter-agency collaboration created gaps between intent and implementation over 24 years of Indian inclusion policies*." This disconnects between policymakers and lived realities arises from an approach that views financial inclusion as an administrative requirement rather than a citizen-driven process.

Borrower Vulnerability

Borrowers, mainly low-income women, often have limited financial literacy. Standard fact-sheets are not always comprehensible, and group dynamics occasionally override warnings. The JLG system puts peer pressure on individuals; in urban and mixed societies, these social bonds are weakening, undermining repayment discipline and community accountability.

Credit Stacking & Debt Burden

Without seamless bureau data across unregulated MFIs, borrowers may borrow illegally beyond their repayment capacities. Anecdotal evidence notes up to 4 to 6 loans per borrower, resulting in repayment stress and loan default cycles Operational Costs and Pricing MFIs face high operational costs (field staff, door-step collections), and limited access to low-cost funds, forcing interest rates up - even as borrowers are constrained. Despite the RBI reducing policy rates, MFIs raised rates in 2025 owing to higher credit costs and delinquencies.

Industry Risks

Fragmented regulation: NGO- and trust-based MFIs may not fall under RBI norms, resulting in inconsistent standards and a lack of borrower protection. SRO compliance load places an administrative burden on smaller institutions, but effectiveness varies. State-level policy volatility, such as loan-waiver announcements or anti-recovery statutes, disrupts credit discipline and normal flows. Data systems lag: while the backend is digitizing, the borrower interface and field systems still rely on manual forms, inhibiting real-time monitoring and client empowerment.

Table 4: Integrated Stakeholder Alignment & Policy Action Framework for Inclusive Financial Strategies

Stakeholders	Strategic Role	Key Action Areas	Policy Recommendations
Policy Makers	Strategic Enablers and regulators	Inter-agency coordination; Decentralized governance	Establish Local Inclusion Councils at the district level with SHGs, banks, MFIs, panchayats; Mandate stakeholder participation in policy design
Financial Institutions (Banks, NBFCs, MFIs)	Service providers and financial innovators	Customer-centric product delivery; Responsible lending and grievance redressal	Adopt a "Responsible Finance Code" linked to digital credit; Standardize grievance redress protocols across channels
Civil Society & NGOs	Capacity builders and community intermediaries	Financial/digital literacy; Trust-building at last mile	Recognize NGOs as formal inclusion partners; Integrate civil society in onboarding, monitoring, and grievance mechanisms
Researchers & Academia	Evidence generators and knowledge integrators	Policy monitoring and real-time evaluation	Create funded research-practice partnerships; Institutionalize feedback loops between field research and central policymaking
Beneficiaries (End-Users)	Primary stakeholders and rights-holders	Usage, co-design, accountability	Reframe users as co-designers through community advisory boards; Democratize credit score access and correction; Link financial products with customized digital literacy modules

Source: Author compilation based on insights from Tripathy et al. (2020), Olsen (2017), Sinha & Piedra (2021), and RBI/NABARD policy frameworks.

The table above emphasizes coordinated efforts among policymakers, financial institutions, civil society, researchers, and beneficiaries to co-design inclusive, sustainable financial strategies. It seeks to bridge systemic gaps by aligning regulatory action with grassroots realities and participatory governance. More specifically:

- the RBI sets prudential norms, qualifying asset rules, pricing, and disclosure mandates.
- The Government (Ministry of Finance, MSME ministry, NABARD): Promotes SHG linkage, guarantee schemes (such as CGTMSE for MSMEs), credit cards, and infrastructure support.
- Industry Associations / SROs (MFIN, Sa-Dhan): Monitor member compliance, enforce Code of Conduct, offer training, and best practices dissemination.
- MFIs: NBFC-MFIs, Small Finance Banks, Federations, Trusts-conduct outreach, credit appraisal, recovery, servicing.
- Borrower communities: Women borrowers, SHG groups, JLGs-end users with unique needs and social dynamics. Fintech and credit bureaus: Provide alternative-data tools, digital onboarding, risk models, and credit-bureau linkage.

Way Forward

India's microfinance journey, from SEWA Bank's early vision to the extensive SHG-bank linkage program and a century of institutional development, has expanded access to credit for millions of low-income women and entrepreneurs. With a gross loan book exceeding ₹3.8 lakh crore and nearly 79 million borrowers by mid-2025, microfinance remains crucial for financial inclusion and grassroots economic resilience. However, the sector faces challenges: rising NPAs, borrower overcommitment, and operational pressures threaten its sustainability.

Regulatory reforms in 2025, such as risk-weight adjustments and easing of qualifying asset requirements, serve as practical corrections and steps toward stability. At this pivotal moment, institutional measures like expanding credit bureau coverage and data sharing, including mandates for NGO-MFIs and smaller institutions to report borrower details, along with accelerating digital onboarding and customer engagement through WhatsApp/SMS fact sheets, digital reminders, and grievance helplines integrated with Tier-1 systems, are essential. Using alternative data scoring models, leveraging mobile usage, UPI behaviour, festival spending, and airtime top-ups, especially for new borrowers without credit history, would also be helpful. Financial literacy and empowerment modules, integrated with SHG federations, state welfare programs, and digital literacy campaigns and pathways for graduation, such as providing MSME credit cards with CGTMSE guarantees to borrowers transitioning into small business segments, are vital. Effective regulatory oversight requires empowering SROs with stronger enforcement tools, including field audits and peer reviews, to ensure adherence to the Code of Conduct and transparency.

Preparing for crises involves developing contingency plans and borrower relief mechanisms during shocks like pandemics or natural disasters. India's financial inclusion story has shifted from counting accounts to focusing on how meaningfully they are used. This report emphasizes that meaningful usage, particularly among low-income, rural, and digitally excluded communities, depends on how well institutional actors coordinate, listen, and adapt. Microfinance must evolve from a credit-first approach to a capability-cantered model that emphasizes flexibility, trust, and co-creation in product and policy design.[35]

Closing the gap between access and effective usage requires more than just new products or schemes; it demands embedded systems of cooperation among stakeholders to create genuine meaning and value for the poor, marginalized, and disadvantaged—what Mahatma Gandhi called "*the teeming millions of India*".[36] The future of microfinance in India involves key initiatives such as promoting digital financial services, expanding access to funding, and strengthening regulatory frameworks. Prioritizing stakeholder engagement, transparency, and accountability is essential to growing and deepening microfinance's impact. Government agencies should adopt participatory design frameworks; MFIs need to embrace responsible finance principles; civil society must be recognized as a policy partner; and beneficiaries should be empowered to co-design solutions.

A strategic roadmap should include a phased development plan, starting with short-term survival strategies and progressing toward a comprehensive transformation. An outline might be:

Phase 1 (0-2 years): Improve data infrastructure, borrower protections, financial literacy, and digital engagement; launch pilot programs integrating alternative scoring models and digital joint liability groups (JLGs).

Phase 2 (2-5 years): Scale up pathways to small-credit MSME products with guaranteed coverage; formally incorporate NGO-MFIs into unified norms; develop resilience frameworks for shock response.

Phase 3 (5+ years): Assess impact on usage metrics, borrower livelihoods, and sustainability; refine frameworks based on field data; move toward offering holistic financial services, including credit, savings, insurance, and remittance solutions, digitally and locally.

The goal of transforming India's microfinance sector into an inclusive, resilient, and sustainable system requires balancing growth with dignity and social empowerment. Achieving this involves shifting from access-focused growth to impact-driven inclusion: closing research gaps on usage, embedding digital engagement, aligning stakeholders from regulators to state institutions, and empowering borrowers to actively shape the ecosystem. The challenge is mainly institutional, not technical.[37] Inclusion is a practice, not just a product; a journey, not a simple destination; a continuous process, not a one-time event.[38] While ambitious, this vision is achievable through coordinated efforts among all stakeholders. With prudent policymaking, strong institutional capacity, and technology-driven borrower engagement, India's microfinance sector can become more stable, inclusive, and equitable, fuelling the India of 2047 envisioned by economic planners.

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