



Microfinance Sector in India

For Prelims: [Microfinance Institutions \(MFIs\)](#), [Financial Inclusion](#), [SHGs](#), [Co-operative Societies](#), [Primary Agricultural Credit Societies \(PACS\)](#), [Companies Act, 2013](#), [NBFC-MFIs](#), [Reserve Bank of India](#)

For Mains: Significance of microfinance institutions in financial inclusion, poverty alleviation, and sustainable economic development in India.

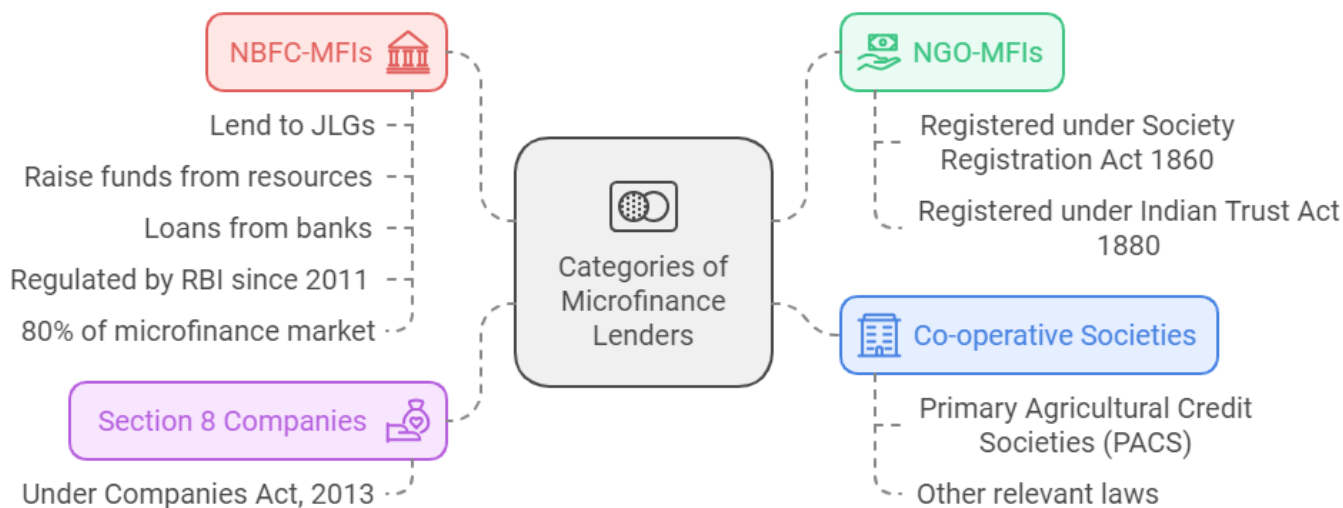
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Why in News?

The **microfinance sector** in India has played a pivotal role in **financial inclusion** by providing credit to underserved households. However, rising concerns over **credit expansion** underscore the need for **stronger regulations and responsible lending**.

What are Microfinance Institutions (MFI)?

- **About:**
 - MFIs are **financial companies** that provide **small loans and other financial services** to people who **don't have access to banking facilities**.
- **Objective:**
 - It aims to **empower low-income and unemployed individuals** by fostering **self-sufficiency**.
 - It plays a **crucial role in financial inclusion**, particularly benefiting **marginalized groups**, including women, by promoting **social equity and economic empowerment**.
 - **Regulatory Framework:** The RBI regulates MFIs under the **NBFC-MFI framework (2014)**, which covers **client protection, borrower safeguards, privacy, and credit pricing**.
- **Business Models in Microfinance:** [Self-Help Groups \(SHGs\) and Microfinance Institutions \(MFIs\)](#)
- **Categories of Microfinance Lenders:**



▪ MFIs in India:

- As of 31st March 2024, India's microfinance sector comprises **168 MFIs across 29 states, 4 UTs, and 563 districts**, serving **over 3 crore clients** with a loan portfolio of **Rs 4.33 lakh crore**.

Read More: [History and Evolution of the Microfinance Sector in India](#)

What are the Challenges for Microfinance Institutions (MFIs)?

- **Profitability and Economic Sustainability:** MFIs **rely on subsidies**, face **high operating costs**, and limited capital access. Most **MFIs cover costs** but **only a third are truly profitable after capital expenses**.
 - To cover costs, they **charge high interest rates**, which can **burden borrowers**.
- **Regulatory Gaps:** The **RBI framework** mandates **household income and liability assessments**, but **lack of documentary proof** and delayed credit bureau data hinder **accurate evaluation**, especially by unregulated lenders.
- **Rising Competition:** **More regulated and unregulated players in the sector** have **increased credit supply**, sometimes **without stringent due diligence**.
- **Poor Model Selection:** MFIs in India mainly use the **SHG or JLG lending models** whose **effectiveness is often questioned** and also their selection is often **random rather than scientific reasoning**.
 - The choice of the lending **model impacts the repayment burden on weaker sections** and affects the **long-term sustainability of MFIs**.
- **Gender Bias:** Women face significant barriers in accessing financial services and are **15-20% less likely than men** to have a **bank account or access formal credit**.
 - However, studies indicate that women have a **17% higher loan repayment rate** compared to men.

Read More: [Challenges for Microfinance Institutions](#)

RBI Guidelines on Microfinance Lending (2022)

- Microfinance loans are **collateral-free for households** with **annual incomes up to Rs 3 lakh**.
- Lenders must ensure **flexible repayment policies** and **assess household income**.
- The **cap on the number of lenders per borrower is removed**, but loan repayments **cannot exceed 50% of monthly income**.
- The requirement for **NBFC-MFIs** to maintain **75% of their loan portfolio in microfinance (reduced from 85%)**.
- Entities must **report income discrepancies** and **household income details**.
- **No prepayment penalties**; late fees apply only to **overdue amounts**.

What are the Government Schemes Related to Microfinance?

- [Pradhan Mantri Mudra Yojana \(PMMY\)](#)
- [Self-Help Group \(SHG\) - Bank Linkage Program](#)
- [Credit Guarantee Fund for Micro and Small Enterprises \(CGTMSE\)](#)

What are the Proposed Reforms for Sustainable Growth of the Microfinance Sector in India?

- **Strengthening Credit Assessment:** Establish a **standardized household income evaluation model** and **enhance real-time liability tracking** by increasing credit bureau data uploads from fortnightly to weekly.
- **Enhancing Borrower Identification: Mandate Aadhaar-based KYC for MFIs** to prevent credit duplication and ensure accurate liability assessment.
 - **Expand credit bureau participation** to include all institutional lenders (both regulated and unregulated) for greater transparency.
- **Adopt Need-based Lending Models:** MFIs should choose lending models **based on borrower needs** rather than relying only on SHG or JLG.
 - MFIs should **expand beyond credit to include savings, insurance, and micro-investments**, ensuring broader **financial inclusion and reduced credit dependency**.
- **Gender-Inclusive Financing:** Promote **gender-inclusive financial policies** by improving women's access to banking and credit.
- **Robust Impact Assessment:** Conduct comprehensive and unbiased evaluations of microfinance interventions to accurately measure their **effectiveness in poverty alleviation** and ensure **data-driven policy improvements**.

Read More: [What are the Challenges and Way Forward for India's Microfinance Sector?](#)

Drishti Mains Question:

What are the key challenges for microfinance institutions in India, and how can they be mitigated?

UPSC Civil Services Examination Previous Year Questions (PYQ)

Prelims:

Q. Microfinance is the provision of financial services to people of low-income groups. This includes both the consumers and the self-employed. The service/ services rendered under microfinance is/are (2011)

1. Credit facilities
2. Savings facilities
3. Insurance facilities
4. Fund Transfer facilities

Select the correct answer using the codes given below the lists:

- (a) 1 only
- (b) 1 and 4 only
- (c) 2 and 3 only

(d) 1, 2, 3 and 4

Ans: (d)

Mains:

Q. Can the vicious cycle of gender inequality, poverty and malnutrition be broken through microfinancing of women SHGs? Explain with examples. (2021)

PDF Reference URL: <https://www.drishtiias.com/printpdf/microfinance-sector-in-india>

