



DAILY EDITORIAL ANALYSIS

TOPIC

**FUNDING MICROFINANCE
IN INDIA**

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Context

- The microfinance sector in India has been in the news for reasons like issues of over-leverage, higher delinquency and unhealthy collection practices.

About the Microfinance Sector in India

- Microfinance offers **crucial banking services** to low-income individuals or groups who otherwise wouldn't have access to financial services.
- Microfinance institutions (MFIs)** provide various services including microloans, savings accounts, and financial education, primarily in developing countries.
- MFIs** including NBFCs, NBFC-MFIs, small finance banks (SFBs), and banks, serve nearly **eight crore poor households** by offering **doorstep, collateral-free credit**.

Trends Shaping Microfinance Funding



- Digital Transformation:** Fintech partnerships are enabling MFIs to reduce operational costs and improve credit assessment, making them more attractive to investors.
- Blended Finance Models:** Combining concessional funding with commercial capital is helping de-risk investments and attract private sector participation.
- Green Microfinance:** Funding is increasingly directed toward environmentally sustainable projects, such as **solar energy loans or climate-resilient agriculture**.
- Gender-Lens Investing:** Investors are prioritizing MFIs that empower women entrepreneurs, recognizing the multiplier effect of female financial inclusion.

Concerns & Challenges in the Microfinance Sector in India

- Overdependence on Debt Capital:** Most MFIs rely heavily on debt from banks and financial institutions that makes them vulnerable to interest rate fluctuations and liquidity crunches, especially during economic downturns.
- Limited Equity Infusion:** Investors are cautious due to concerns over asset quality, regulatory risks, and limited exit options.
 - It restricts the sector's ability to scale and absorb shocks.
- Geographic Concentration of Lending:** MFI operations remain concentrated in around 250 districts, leaving two-thirds of the country under-penetrated, especially in the Northeast and tribal belts, undermining the sector's core mission of inclusion
 - States like Odisha, Kerala, Tamil Nadu, and Rajasthan have witnessed a material rise in overdue loans, while Uttar Pradesh shows deterioration in early-stage delinquencies.

- **Overleveraging of Borrowers:** Multiple loans from different institutions have led to unsustainable debt levels.
 - ♦ In several states, the average loan outstanding per borrower now exceeds per capita income, raising alarms about repayment capacity.
- **Regulatory Tightening:** The RBI's push for stricter household income assessments and compliance norms has led to regulatory embargoes on major players like Asirvad Microfinance and Arohan Financial Services.
 - ♦ While necessary for borrower protection, these measures have slowed disbursements and increased operational complexity.
- **Structural Challenges:**
 - ♦ **High Interest Rates:** Many MFIs continue to charge high margins, raising concerns of borrower exploitation and financial distress, despite access to low-cost capital.
 - ♦ **Shrinking Loan Portfolios:** The gross loan portfolio fell by 13.5% to 3.75 lakh crore in FY25, reflecting cautious lending amid rising defaults and regulatory pressure.
 - ♦ **Policy Backlash:** Historical events, such as the Andhra Pradesh ordinance in 2010, still cast a shadow.
 - The Supreme Court overturned the restrictions in 2023, but the sector's reputation and investor confidence remain fragile.

Government Efforts & Initiatives in the Microfinance Sector in India

- **RBI's Regulatory Framework for Microfinance Loans:** The RBI introduced a unified regulatory framework effective from April 1, 2022, **applicable to all Regulated Entities (REs)** including NBFC-MFIs, banks, and housing finance companies. Key features include:
 - ♦ **Uniform Definition:** Microfinance loans are defined as collateral-free loans to households with annual income up to 3,00,000.
 - ♦ **Repayment Flexibility:** REs must offer borrower-friendly repayment schedules based on board-approved policies.
 - ♦ **Income Assessment:** REs are required to assess and report household income to Credit Information Companies (CICs).
 - ♦ **Repayment Cap:** Monthly loan repayments must not exceed 50% of household income, ensuring responsible lending.
- **PM SVANidhi Scheme:** It is a flagship initiative **launched by MoHUA** to provide working capital loans to street vendors. Recent developments include:
 - ♦ **Extension** till March 31, 2030 with a total outlay of 7,332 crore.
 - ♦ **Enhanced Loan Limits:** First tranche up to 15,000, second up to 25,000, and third up to 50,000.
 - ♦ **Digital Empowerment:** Introduction of UPI-linked RuPay Credit Cards and cashback incentives for digital transactions.
 - ♦ **Expanded Coverage:** Now includes census towns and peri-urban areas, beyond statutory towns.
 - ♦ **Impact:** Over 96 lakh loans disbursed totaling 13,797 crore; 47 lakh digitally active beneficiaries have conducted over 557 crore transactions.
- **RBI's Advisory Role in MSME Credit Flow:** RBI's Standing Advisory Committee (SAC) influences microfinance, while focused on MSMEs indirectly by promoting:
 - ♦ **Unified Lending Interface (ULI)** and **Account Aggregator Framework** for seamless credit access.
 - ♦ **Digital Solutions** for alternative credit assessment and faster disbursement.
 - ♦ **Fair Lending Practices** and proactive rehabilitation for distressed borrowers.

Path to Sustainable Growth

- **Geographic Expansion:** Expansion into newer geographies is crucial to reduce over-saturation and ensure balanced growth.
- **Strengthening Credit Assessment:** Robust evaluation of household income and existing liabilities is key for sound underwriting.
 - ♦ MFIs need to integrate better assessment frameworks to avoid over-indebtedness.
- **Managing Non-Microfinance Portfolios:** RBI's recent relaxation on non-qualifying assets provides growth avenues, but institutions need expertise and caution to diversify without risking financial health.

Source: TH

Daily Mains Practice Question

Q. Discuss the key challenges associated with funding microfinance institutions in India. How can policy reforms and innovative financial instruments help ensure sustainable capital flow to the sector?

