

## Microfinance Sector at Cross Road

### Introduction

Microfinance plays a crucial role in promoting financial inclusion in India, particularly for low-income households, small entrepreneurs, and rural population who lack access to traditional banking services. Microfinance Institutions (MFIs) provide small loans, saving product and financial services to economically weaker sections, helping them start micro-businesses and improve livelihoods.

### Current scenario

Over the last two decades, the microfinance sector in India has grown rapidly with participation from bank, NBFC-MFIs, Small Finance Banks (SFBs), and other financial institution. The sector currently serves million of borrowers, mostly women from rural India. However, despite this growth, the sector is currently facing several structural and operational challenges. Recent data indicates a decline in loan disbursement, rising credit stress, and tightening lending practices.

### Microfinance Disbursement Trends in India

Period	Disbursed amount (in crore)	No of loans (in crores)
Apr'22 to Mar'23	321451	7.78
Apr'23 to Mar'24	389493	8.35
Apr'24 to Mar'25	290298	5.6

Analysis	
1. Growth Phase (FY23-FY-24)	Loan Disbursement increased significantly from Rs. 3.21 lakh crore to Rs. 3.89 lakh crore, reflecting strong demand for micro-credit
2. Decline phase (FY24-FY-25)	The sector experienced a sharp contraction, with disbursements falling to Rs. 2.90 lakh crore and loan accounts declining to 5.6 crore
3. Implications	The drop indicates tightening credit conditions and stress among borrowers and lenders.

Source: SIDBI Microfinance Data.

### Regional Performance of Microfinance

Microfinance activity in India is highly concentrated in a few states, which significantly influence the sector's overall growth.

Top States Growth & Performance						
Top 5 states	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Yoy Growth%
Bihar	8.67%	1.60%	-56%	-6.63%	-4.24%	-14.26%
	1.40%	1.91%	4.46%	8.59%	7.41%	6.01%
Tamil Nadu	0.54%	3.02%	-4.67%	-8.43%	-7.78%	-17.07%
	2.31%	3.10%	4.54%	5.91%	6.90%	4.59%
Uttar Pradesh	8.95%	0.77%	-489%	-6.22%	1.51%	-11.48%
	2.42%	3.10%	5.99%	9.04%	7.08%	4.66%
West Bengal	8.50%	2.82%	-24.42%	-5.01%	2.15%	-2.64%
	1.38%	1.53%	2.40%	3.72%	3.51%	2.13%
Karnataka	3.89%	6.40%	-2.34%	-7.67%	-7.68%	-11.43%
	0.96%	1.18%	2.36%	4.71%	10.81%	9.85%

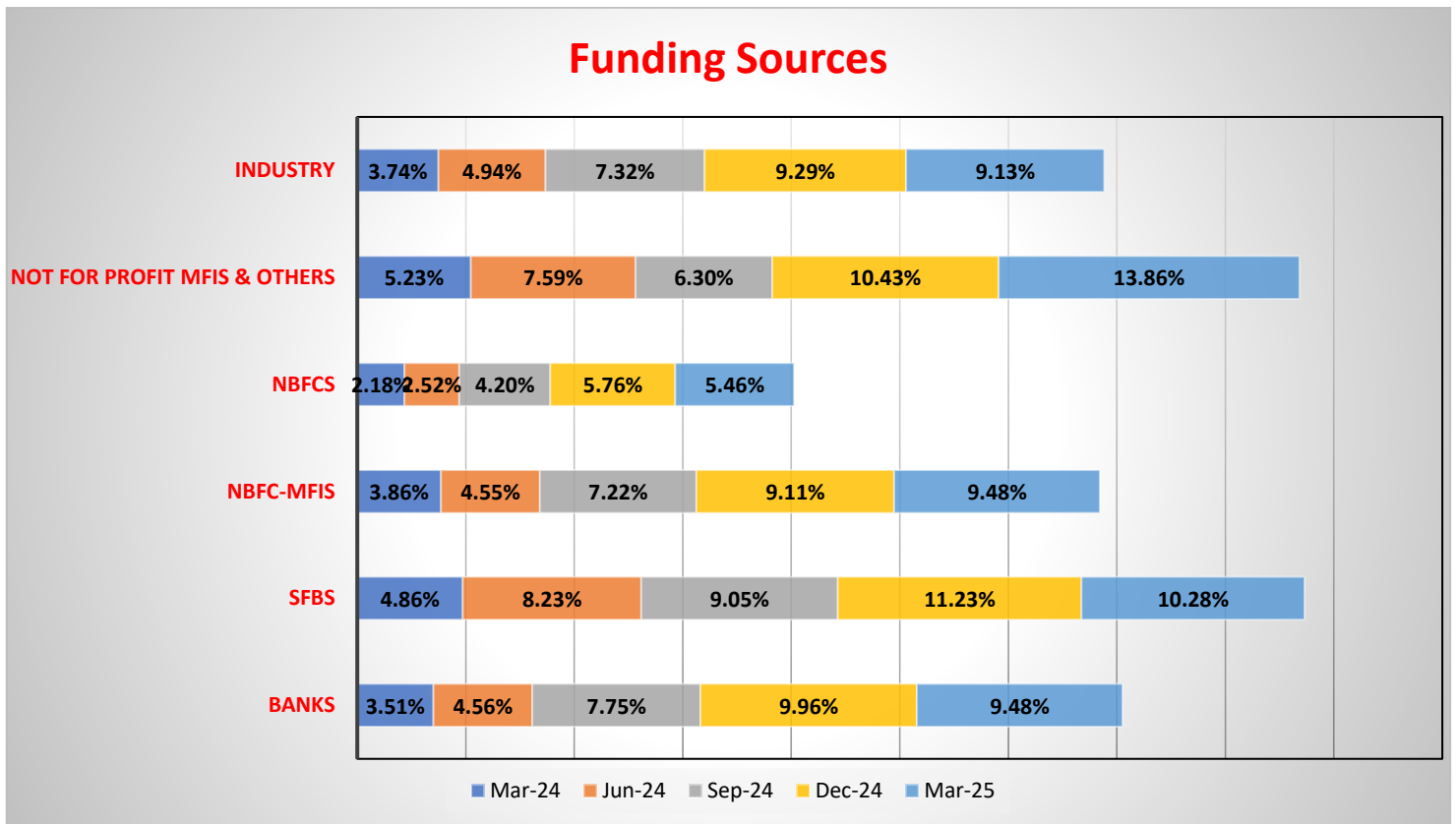
### Observations

- Karnataka recorded the highest growth (9.85%)
- Bihar and Uttar Pradesh also showed strong expansion due to rural credit demand.
- West Bengal growth remained relatively moderate compared with other states.

However, despite regional growth in some states, the sector overall experienced contraction due to structural challenges.

### Funding Sources of Microfinances institutions

MFIs depend on multiple sources including banks, NBFCs, and small finance banks.



Source: SIDBI Microfinance Data

### Observations:

- Small Finance Banks are emerging as major lenders in microfinance.
- Banks and NBFC-MFIs continue to dominate funding.
- The sector has become increasingly dependent on institutional funding.

### Major challenges faced by Microfinance in India

#### Declining Loan disbursement

- Recent data indicates a significant reduction in microfinance loan disbursement, reflecting declining demand and tighter credit policies.
- Disbursements declines by 25% in FY2025.
- Loan disbursement in one quarter fell 35.8% year-on -year.

**Reasons:**

- Weak borrower repayment capacity
- Rising delinquency rates.
- Lenders becoming cautious.

**Borrower Over- Indebtedness**

- A major issue in the microfinance sector is multiple borrowing by clients.
- Many borrowers take loans from several institutions simultaneously, which increases the risk of default.
- Regulators have also raised concerns regarding over-leveraging of borrowers and high interest rates in the sector.

**Rising NPAs and Asset Quality Stress**

- Asset quality deterioration has become a serious concern.
- The Microfinance portfolio has shown declining asset quality and rising delinquency levels.
- Sector loan portfolios have also contracted due to repayment stress.

**Regulatory Challenges**

The microfinance sector is regulated by the RBI. Recent regulatory changes include:

- Limits on borrower indebtedness
- Stricter loan assessment standards
- Revision in NBFC-MFI asset norms

These regulations aim to protect borrowers but may temporarily slow sector growth.

**Geographic Concentration Risk**

Microfinance is highly concentrated in a few states, increasing systemic risks

- Rural areas account for around 79-80% of microfinance loans in India.

This concentration exposes the sector to regional economic shocks, climate risks, and political factors.

**Consequences of Microfinance Sector Challenges**

Key Consequences of Sector Stress	
Issue	Impact on Sector
Loan disbursement decline	Reduced credit availability for poor households
Rising NPA's	Higher provisioning a financial stress for lenders
Borrower over-indebtedness	Increased default risk
Regulatory tightening	Slower expansion of MFIs
Funding constraints	Limited growth of lending operations

Economic Impacts
1. Reduced financial inclusion
2. Limited access to credit for micro-entrepreneurs.
3. Slowdown in rural economic activities
4. Pressure on banking sector and NBFC-MFIs

## Way Ahead of the Microfinance sector

Despite the current challenges, the long-term outlook remains due to:

- Increasing rural credit demand
- Growth of digital lending platforms
- Expansion of Small Finance Banks
- Government support for financial inclusion

The sector is likely to transition towards responsible lending practices, stronger credit assessment, and technology-driven models.

## Conclusion

The microfinance sector in India has been a powerful tool for poverty alleviation and financial inclusion, providing credit to millions of underserved individuals.

However, recent trends show declining disbursements, rising credit stress, and regulatory tightening, which have slowed sector growth. The data indicates a sharp decline in loan disbursements from Rs. 3.89 lakh crore in FY 2024 to Rs. 2.90 lakh crore in FY 2025, reflecting emerging structural challenges.

To ensure sustainable growth the sector must focus on:

- Responsible lending practices.
- Improved credit risk assessment.
- Stronger borrower protection
- Diversified funding sources.

With appropriate reforms and technological innovations, microfinance can continue to play a critical role in inclusive economic development in India.

## Summary

- Microfinance is essential for financial inclusion and rural development.
- The sector witnessed strong growth until FY 2024 but declined in FY2025.
- Loan disbursements fell due to credit stress, borrower over-indebtedness, and stickier lending practices.
- Regional concentration and rising NPA's remain key challenges.
- Long-term prospects remain positive with policy support and digital finance expansion.

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