

Microfinance in Transition: Guardrails, Growth, and the Future of Financial Inclusion

Executive Summary

India's microfinance sector has become a cornerstone of financial inclusion, enabling credit access for underserved populations, especially women, small farmers, and micro-entrepreneurs in rural and semi-urban areas. With a robust CAGR of ~28% from FY14 to FY24, the sector now serves over 7.9 crore unique borrowers across 92% of the country's districts, demonstrating its deep and widespread outreach.

Led primarily by NBFC-MFIs, the sector saw a strong post-COVID rebound. However, the RBI's March 2022 removal of interest rate caps, while enabling risk-based pricing, led to overleveraging and rising borrower stress. Regulatory mandates introduced in April 2022, requiring income and indebtedness assessments, faced implementation challenges due to incomplete credit data and inconsistent household income evaluations, contributing to increased borrower overlaps and multiple lending. In addition to this, the emergence of fintechs and non-NBFC-MFIs offering a wide array of credit options made access to funds easier, further contributing to multiple lending as lender + 4 rose to 5.36% as on December 31, 2024, from 3.6% in September 2021. Delinquency indicators worsened (PAR 30+ at 6.60% as of Dec 2024), field officer attrition rose to 40%, and slower agricultural income growth added to repayment stress. The RBI flagged "usurious" lending practices, barring some MFIs from fresh disbursements and prompting calls for reform.

In response, MFIN proposed new guardrails effective April 2025, including capping MFI lenders per borrower to three, a ₹2 lakh household indebtedness ceiling, and stricter underwriting norms. While these are expected to enhance long-term credit hygiene, they could trigger short-term pressures, muted disbursements, funding constraints for smaller MFIs, and rising competition for high-quality borrowers. In the long run, these reforms may improve asset quality, encourage responsible lending, and drive sector consolidation. However, preserving financial inclusion amid these structural shifts remains crucial. With ~37% rural coverage, the sector must balance prudence and purpose to ensure sustainable, inclusive growth in the years ahead.

“Balancing prudence with purpose will define the sector’s next chapter in inclusive growth.”

Introduction- Sector Growth and Outreach

The microfinance sector in India plays a critical role in advancing the country’s financial inclusion agenda by extending affordable credit to low-income, underbanked, and underserved populations, particularly in rural and semi-urban areas. By addressing the credit gap for individuals typically excluded from formal banking systems, MFIs empower women entrepreneurs, small farmers, and micro-businesses, thereby supporting livelihoods and local economic development.

Over the past decade (FY14 to FY24), the sector has witnessed remarkable growth, recording a compound annual growth rate (CAGR) of ~28%. This expansion has translated into a widespread geographical footprint, with microfinance institutions operating in over 730 districts, representing ~92% of India’s total districts across 36 States and Union Territories. As of December 2024, there are about 7.90 crore unique borrowers, which represents about 31 crore population. Such deep penetration underscores the sector’s growing relevance and its ability to deliver last-mile financial services to those who need it most. The following chart shows the growth momentum in MFI AUM despite having headwinds such as Currency Ban, Covid, and regional disturbances.

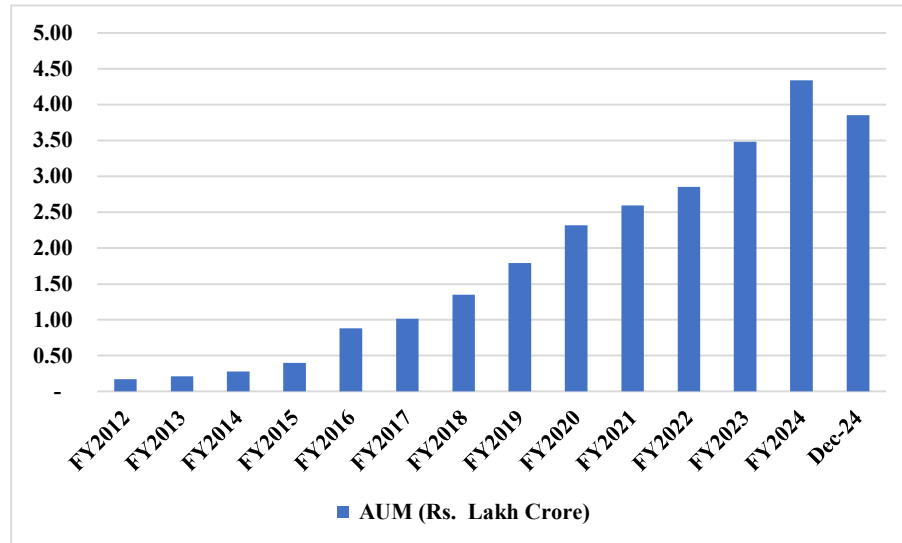


Chart 1.1 Source MFIN

Lending Ecosystem

The microfinance sector is served by a diverse set of lenders, including banks, NBFC-MFIs, Societies, Trusts, Cooperative societies, etc., NBFCs, SFBs, non-profit MFIs. Collectively, these institutions cater to rural and underserved populations by providing hassle-free, doorstep access to

financial services, thereby bridging the gap between formal finance and grassroots borrowers. NBFC-MFIs comprise the major share in the overall financing to the Bottom of Pyramid populations, as shown below (as of December 2024) -

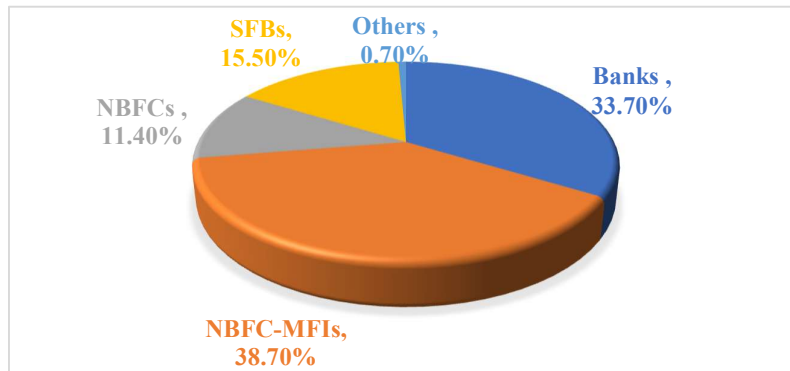


Chart 1.2 Source MFIN, MFI Lenders Concentration

Robust equity inflows, amounting to over \$1.73 billion raised by NBFC-MFIs over the past 9 years (FY2015-FY2023), combined with consistent access to debt capital, have played a pivotal role in fuelling the growth of India’s microfinance sector. These investments, along with sustained regulatory support from the RBI and proactive engagement by Self-Regulatory Organisations (SROs), have enabled MFIs to strengthen their capital base, expand geographical footprint, and deepen their outreach to underserved and financially excluded communities.

Disruption and Recovery (COVID):

While the Microfinance Industry was operating at a fast pace (average Y-O-Y growth of 27% during FY2017 to FY2020) post currency ban in FY2017, the sector got severely impacted due to the COVID-19 pandemic, as a large segment of its borrower base lost income-generating opportunities amid the nationwide lockdowns. During the COVID period, the disbursement slowed significantly (20% de-growth in FY21), leading to very low growth of ~12% in the AUM. However, the sector witnessed a strong rebound post-pandemic, marked by a sharp ramp-up in both loan disbursements and the gross loan portfolio (GLP).

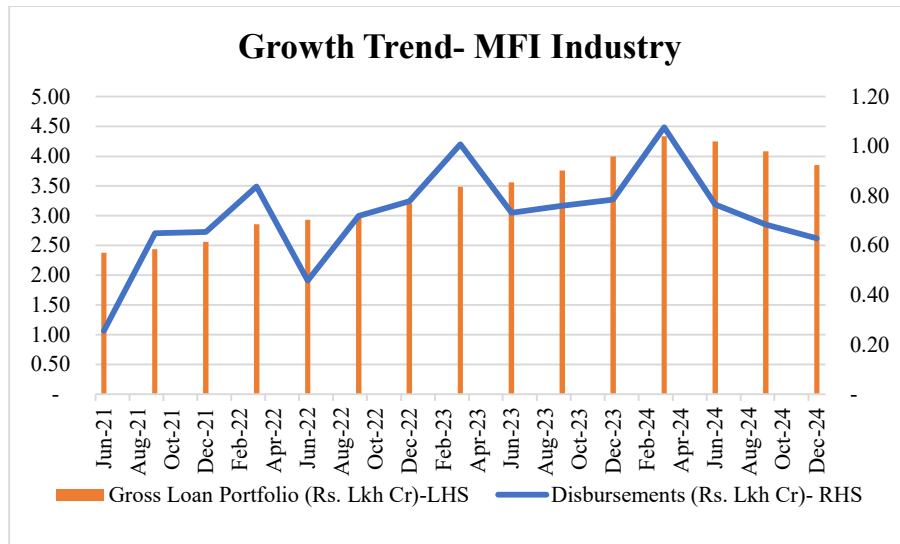


Chart 1.3 Source: MFIN

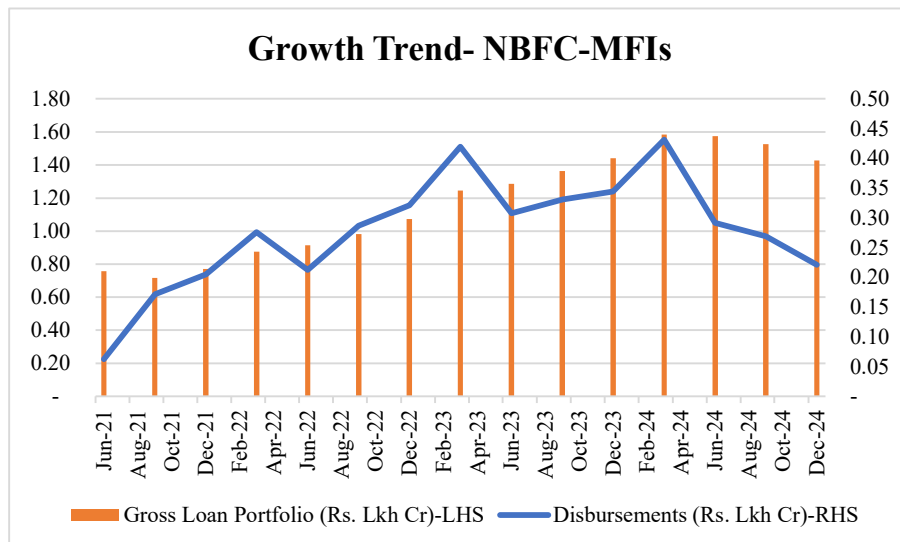


Chart 1.4 Source: MFIN

Regulatory Shift: Risk Based Pricing Framework

Apart from other aspects, a key regulatory shift that facilitated this recovery, post-COVID, was the RBI’s decision to remove the pricing cap in March 2022, allowing MFIs to adopt risk-based pricing mechanisms aligned with the credit profile of borrowers. While this pricing flexibility spurred aggressive growth in lending volumes, with MFIs expanding outreach and disbursing higher-value loans across geographies, it also resulted in borrower overleveraging, thereby resulting in the aggravated stress scenario in FY2025.

Key reasons for the stress that was built in the sector are as below -

- **Challenges in Indebtedness Assessment and Household Income Verification:** Under the regulatory framework adopted from April 2022 onwards, MFIs were mandated to assess both household income and existing indebtedness before extending credit. While this was aimed at promoting responsible lending, several operational challenges emerged on the ground.
 - A significant issue has been the limited availability of comprehensive indebtedness data. Borrowings from Self-Help Groups (SHGs), cooperatives, trusts, non-NBFC-MFIs, and certain fintech lenders—many of which are not integrated with Credit Information Companies (CICs)—often go unreported. This incomplete visibility hampers MFI's ability to gauge a borrower's full credit exposure.
 - Household income assessments by field officers are frequently subjective, particularly in rural and informal settings where incomes are seasonal, volatile, and largely unorganised. This lack of standardized income documentation has led to inconsistent evaluations across regions.

As a result of these data and assessment gaps, the sector has witnessed a rise in borrower overlaps and multiple lending, contributing to over-leverage and eventual asset quality stress in certain geographies. Some of the examples are as below –

- Following the introduction of the scale-based pricing framework from April 2022 onwards, the share of unique borrowers in total MFI loan accounts fell to ~50% in June 2022 and remained in a similar range till December 2023, highlighting a growing trend of borrower overlaps and multiple lending (Chart 1.5). Besides, the declining trend in unique borrowers (as a % of total loan portfolio) from September 2021 onwards was attributable to the rebound in agricultural activities (Gross Value added [GVA] grew 3.5% YOY) and a jump in consumption expenditure during H2FY22, which led to same customer opting for multiple loans.

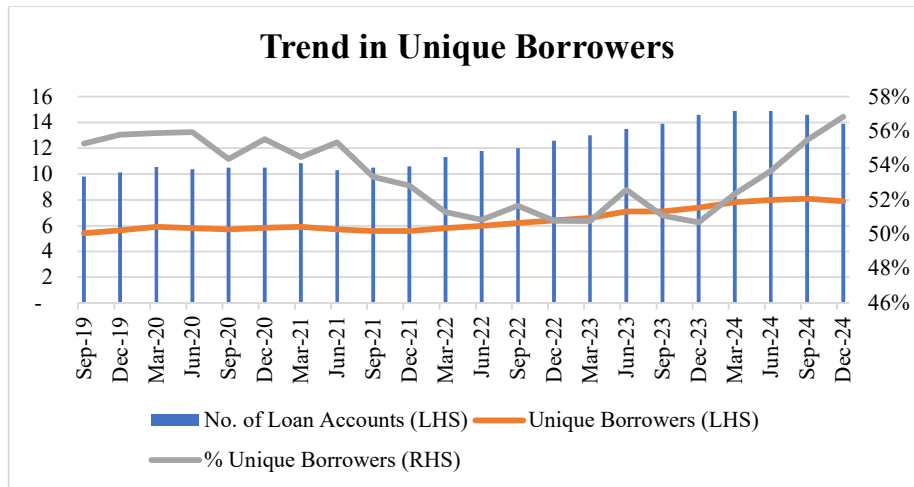


Chart 1.5 Source: MFIN

- According to the RBI’s Financial Stability Report 2024, the share of borrowers with loans from four or more lenders rose significantly, from approximately 3.6% in September 2021 to 5.8% in September 2024, reflecting increased borrower overlap and rising credit concentration. As of December 2024, this proportion stood at 5.36%, as reported by Sa-Dhan.
- **The removal of pricing caps** has led to a noticeable rise in lending rates charged to microfinance borrowers, raising concerns around affordability and borrower distress. In October 2024, the Reserve Bank of India (RBI) flagged instances of “usurious” interest rates being levied by some NBFC-MFIs, a trend that runs counter to the very objective of financial inclusion. As a regulatory response, the RBI barred certain entities, including Ashirwad Microfinance and Arohan Financial Services, from sanctioning new loans, citing concerns over their lending practices and adherence to responsible credit norms.

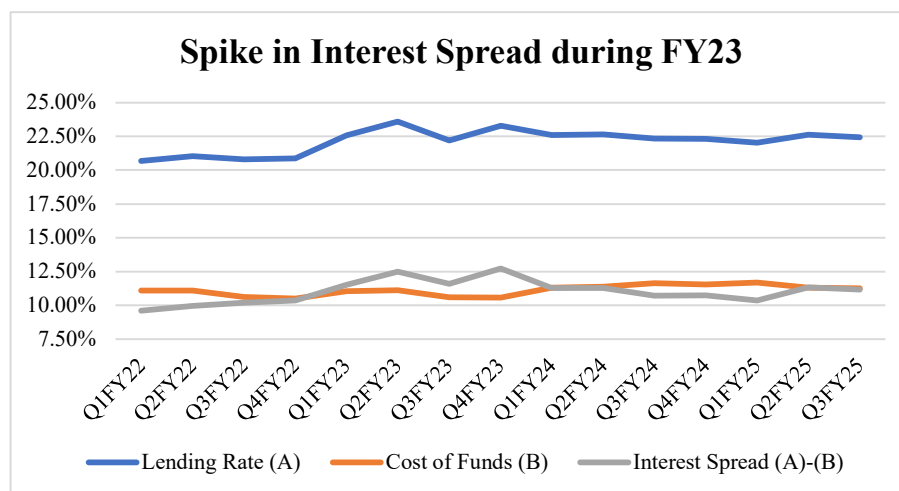


Chart 1.6 Source: Sa-Dhan

Apart from the consequences of the regulatory framework as mentioned above, the following parameters further supported the rise in delinquency levels and the ongoing stress in the MFI lending-

- The sector witnessed a **high attrition rate of nearly 40% among field officers (as per Sa-Dhan)**, driven largely by the pursuit of better employment opportunities and improved work-life balance. This trend is further accentuated by young professionals migrating to urban centres, seeking roles that offer greater stability, career progression, and lifestyle advantages. High attrition presented on-ground challenges to conduct regular meetings with borrowers for collections impacting the accurate assessments of household income by the field officers.
- **Stress in the borrower Industry** - As per the Sa-Dhan 2023 report, approximately **65% of microfinance loans** are extended to borrowers engaged in agriculture and animal husbandry. However, GVA growth in this segment declined from 4% in FY23 to 1.4% in FY24, severely impacting borrowers' repayment capabilities.

Figure 2.24: Share of MFIs Income Generation Loans under Different Sub-sectors as on March 2023

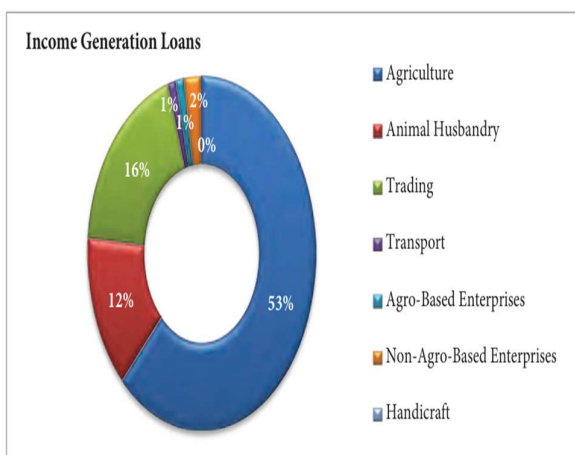


Chart 1.7 Source: Sa-Dhan 2023 Report

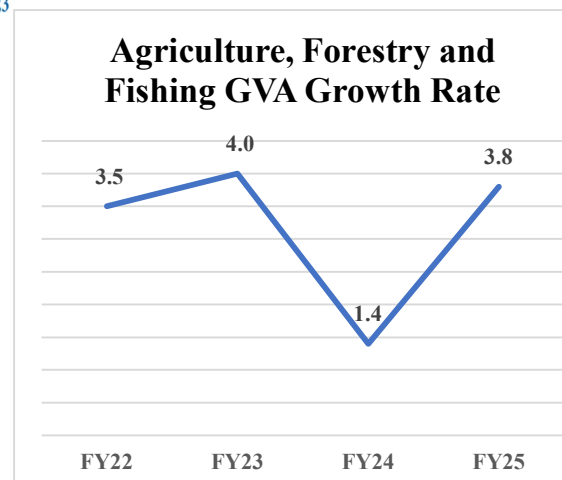
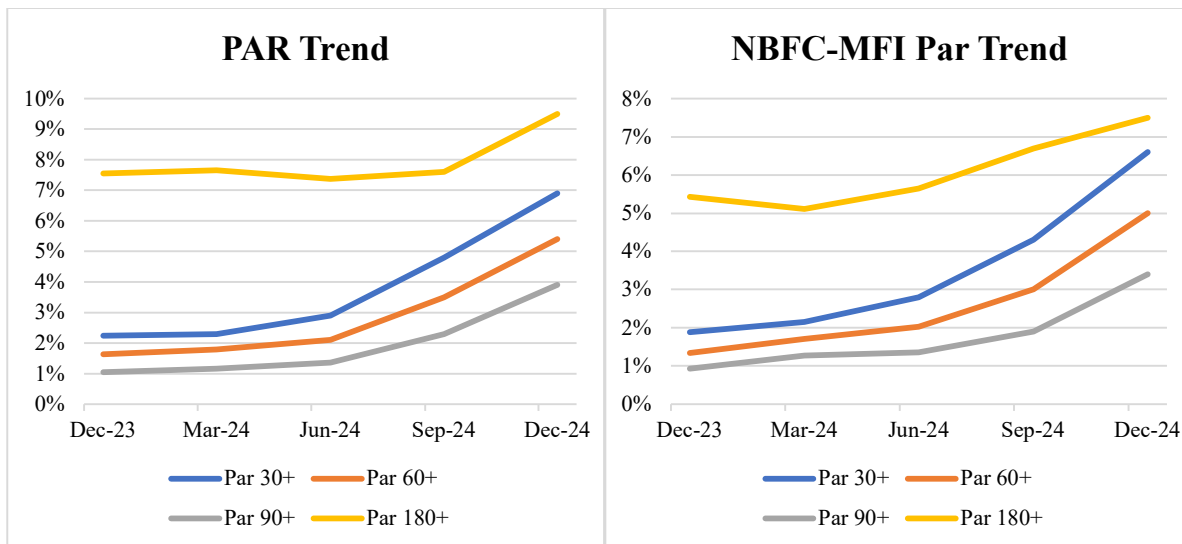


Chart 1.8 Source: [Press Release: Press Information Bureau](#)

Stress Buildup

The cumulative effects of these factors led to an increase in borrower stress and instances of multiple borrowings by individuals, leading to a surge in delinquency levels during FY25 (Chart 1.6), pushing SRO to intervene to ensure the long-term sustainability of microfinance lending.



Par30+ =Overdues (OD) between 31-179 days, Par 60+= OD between 60-179 days, Par 90+= OD between 91-179 days and PAR 180= OD above 180 days.

Chart 1.8 Source: Equifax Data

MFIN's Response

In response, the MFIN has proposed critical guardrails for NBFC-MFIs, effective April 2025, including:

- Capping the number of MFI lenders per borrower to three, down from four;
- Imposing a household indebtedness cap of Rs 2 Lakh, inclusive of both microfinance and unsecured retail loans.
- Stricter underwriting norms, including disallowing disbursement to borrowers with DPD > 60 days (previously 90 days) on any loan above Rs 3,000 with any regulated entity.

Impact of Guardrails

As the sector embraces guardrails, the near-term landscape may witness operational tightening and competitive strain. Yet, these shifts lay the foundation for long-term resilience, improved credit hygiene, and a more sustainable industry structure.

- **Short-Term Impacts**

1. **Constraints on Business Growth:** The portfolio growth during H1FY2026 would possibly be muted as –

- Given the higher delinquencies and PAR of 6.60% in 30+dpd and 3.40% in 90+dpd as on December 31, 2024 (Source: Equifax), the rejection rates would be higher, thereby leading to lesser disbursements.
 - A strategic slowdown in loan originations as the lenders would adjust to the new norms and increase their focus on 0+dpd collections.
 - Fund availability would be a challenge given the negative pressure on the sector, especially for small and mid-sized MFIs – their ability to acquire new borrowers would be limited.
2. **Rise in GNPA Levels:** The adoption of new norms alongside seasonal stress (e.g., heat waves) may elevate GNPA levels given the lower denominator (AUM), which was impacted in FY2025. However, MFIs may increasingly resort to ARC transactions to offload stress assets, which could reduce reported GNPA ratios.
 3. **Competitive Pressures:** With a shrinking borrower kitty amidst expectations of higher rejection rates, MFIs to compete amongst each other to acquire the high-quality borrowers. Large MFIs, backed by strong balance sheets and lower cost of funds, would be in an advantageous position when compared to small and mid-sized MFIs. Besides, the ability to deliver faster loan disbursements and enhanced customer service would act as a key differentiator.
- **Long-Term Impacts**
 1. **Improved Loan Performance:** Over time, tighter underwriting, digitized collections, and reduced over-indebtedness are expected to drive better asset quality and customer discipline, aided by competitive pressure for responsible lending.
 2. **Higher Operating Costs:** Customer-centric approach predominantly focusing on product delivery, service, and quick turnaround time would require higher manpower and might lead to higher opex. Further, appointment of branch-level credit managers to mitigate discrepancies in Household Indebtedness reporting by field officers would possibly inflate per-branch operating cost.
 3. **Fundraising Challenges for Smaller MFIs:** One significant byproduct of this guardrail is the potential rating pressure on smaller MFIs. With profitability constrained, delinquencies elevated, and operational costs rising (due to added compliance and field verification requirements), the credit profile may deteriorate for players unable to adapt. This, in turn, could restrict their access to capital markets

and push them into a vicious cycle of funding stress—ironically increasing their dependence on informal funding channels. Also, Equity investors may favor larger MFIs, forcing smaller players to explore M&A opportunities or diversify their business models. Also, the promoter dilution will be more as the valuation would dip.

4. **Industry Consolidation:** As smaller players struggle, larger and select mid-sized MFIs with sound balance sheets are expected to scale efficiently, supported by lender confidence and stronger profitability (NIMs, ROAs). This could shift market share toward fewer players, reshaping the sector’s structure. These structural changes also provide an opportunity to take over the smaller MFIs by the larger and stronger ones.
5. **Reduced Borrower Choice:** While industry consolidation would result in efficient operations due to economies of scale and higher ROA for MFIs, the borrowers would have fewer options to choose from in the market.

Conclusion

The microfinance sector is at a pivotal point, balancing sustainable growth with responsible lending. The MFIN guardrails are a timely step to curb over-indebtedness and strengthen asset quality, though they may create short-term operational and financial strain, especially for smaller MFIs. While growth could slow temporarily amid tighter liquidity and rising competition, the reforms are likely to enhance credit discipline, portfolio quality, and long-term sector resilience. However, the key challenge will be ensuring that such structural reforms do not dilute the broader goal of financial inclusion. As of March 2024, about 37%* of India’s rural population is covered by the MFI industry. A balanced approach, combining policy support, innovative credit assessment, and strategic partnerships, will be essential to sustain outreach while reinforcing the sector’s foundation.

*Unique Borrower as on December 31, 2024 -7.90 crore of which 75% is rural portfolio.

1 borrower caters to a family of four, the rural population served= $7.90 \times 75\% \times 4 = 23.70$ crore

Total Rural Population for 2023 – 90 crore of which ~30% is rural affluent population so target audience of MFIs is $70\% \times 90$ crore – 63 crore

Hence, MFI reach = $23.70/63 = 37.62\%$

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About MPFASL

MP Financial Advisory Services LLP is a financial consultancy firm providing Credit Risk Advisory, Debt Syndication, Private Credit Assessment, and Financial Strength Assessment services to corporates across India. Since 2013, we have provided Credit Risk consultancy services to over 350 corporate clients spanning over 18 industry verticals. Having completed over 450 credit risk advisory assignments with a cumulative debt volume of over Rs. 3.00 Lakh Crore, MPFASL boasts of a 95+% success ratio in obtaining deserving credit ratings for its clients.

Before venturing into entrepreneurship, Mr. Mahendra Patil was part of CARE Ratings during 2006 – 2013 where he looked after credit rating assignments of more than 500 companies ranging from various sectors. Additionally, he was part of the Internal Credit Rating Committee at CARE Ratings.

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