

# **Microfinance and Financial Inclusion in the Era of Fintech in India: Trends and Issues**

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## **1. Introduction**

In November 2023, Mr Amitabh Kant, former CEO of National Institution for Transforming India (NITI) Ayog and India's G20 Sherpa, launched a report titled, "Micro Matters: Macro View". This report is the India Microfinance Review for the financial year 2022-23, published by the Microfinance Industry Network(MFIN), an industry association of the microfinance sector in India. Mr Kant said in his report-launching address, "India needs to grow at around 10% for three decades to become a developed country. The building blocks will have a multiplier effect only if the credit demand is met as credit will be the driver of India's next phase of growth. Micro Finance Institutions (MFIs) are presently the most important institutions in the country as they have the ability to penetrate into rural areas, lend to last mile clients and contribute to inclusive growth." Let's go back to one of the speeches delivered by Dr. D Subbarao, former governor of the Reserve Bank of India (RBI), in 2009, where he emphasised the role of microfinance institutions in financial inclusion. To quote Mr. Subbarao, "A word also to microfinance institutions (MFIs). Many banks have partnered with microfinance institutions that provide financial services to relatively high-risk segments of the population. Microfinance has provided access to finance to an entire sector of people left behind by the formal financial sector – and micro finance has demonstrated how these low-income categories are indeed a 'bankable' proposition. But cost remains an issue. Interest rate charges – at 24-30 percent – seem too high." It's been one and half decades between these two speeches. Both microfinance and microfinance institutions have remained relevant to the people at the lower stratum of India's population in rural and semi urban areas, with women at

the forefront. This article presents an overview of the Indian microfinance sector, highlighting some key trends and issues.

## **2. Microfinance in India: Trends and Issues**

The Reserve Bank of India's consultative document on Microfinance (2021) defines microfinance as, "A form of financial service which provides small loans and other financial services to poor and low-income households. It is an economic tool designed to promote financial inclusion which enables the poor and low-income households to come out of poverty, increase their income levels and improve overall living standards. It can facilitate achievement of national policies that target poverty reduction, women empowerment, assistance to vulnerable groups, and improvement in the standards of living." The debate and discourse around microfinance have also assumed significance in India's progress towards attaining the sustainable development goal (SDG) of halving poverty by 2030. As measured by UN's multidimensional poverty index, 410 million people exited poverty between 2005-06 and 2019-21<sup>1</sup>. Microfinance is perceived to have played a crucial role along with other factors in alleviating poverty primarily through enhanced access to credit to the financially excluded women in rural areas.

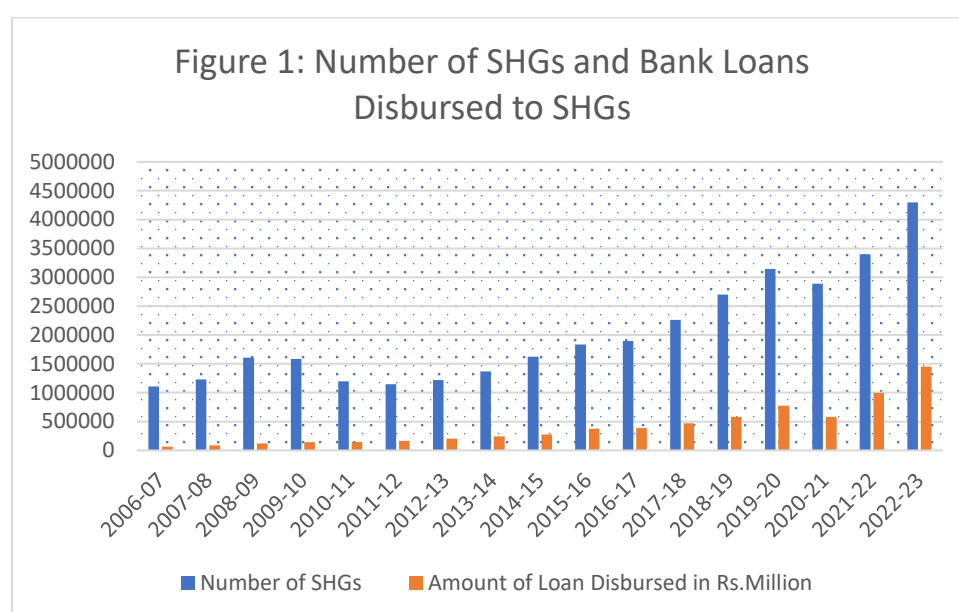
A background note available in FinDev Gateway<sup>2</sup> says the microfinance sector in India has witnessed four phases namely Phase I: Cooperative Movement, 1900 – 1969, Phase II: State Driven activities through National Banks and NGOs, 1969 - 1991, Phase III: Self Help Groups (SHGs) Bank Linkage program and Growth of NGO-MFIs, 1992 – 2000 Phase IV: Commercialization of Microfinance through the Non-Banking Financial Companies MFIs, 2000-till date. In phase IV, the industry has experienced fluctuations influenced by various

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<sup>1</sup> Economic Survey, 2022-23, Government of India.

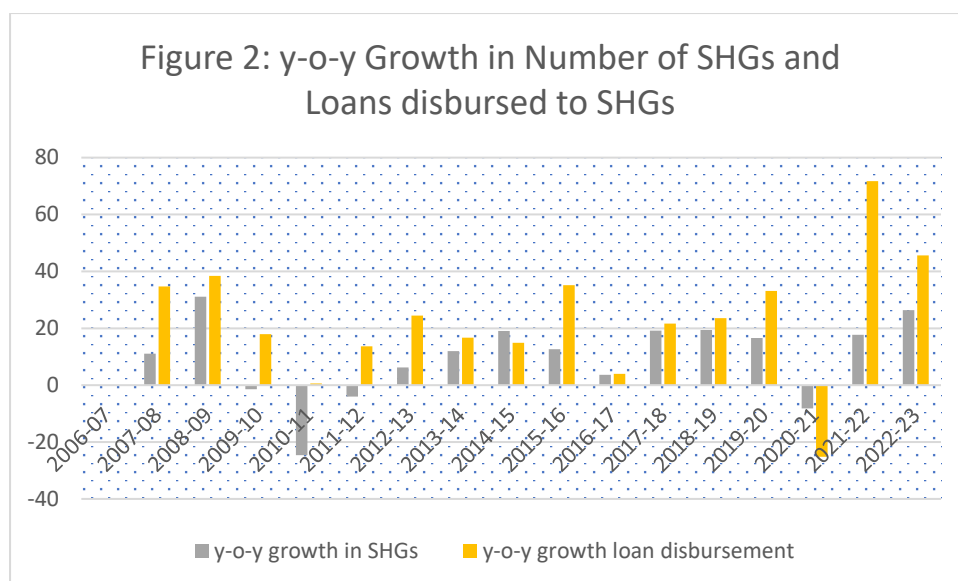
<sup>2</sup> CGAP's independent knowledge platform

factors, prompting responsive adjustments in policy. The Self-Help Group Bank Linkage Program (SHG-BLP) is the world's largest microfinance initiative, boasting an unparalleled client base and outreach. As indicated in the 2022-23 annual report of the National Bank for Agriculture and Rural Development (NABARD), there has been a notable 13% rise in the quantity of Self-Help Groups (SHGs) with linked savings and a substantial 25% increase in savings amounts compared to the previous fiscal year (2021-22). The positive trajectory in both the number and volume of SHG savings with banks has persisted over the past three years. Figure 1 refers to the three decades-old SHG bank linkage programme and presents the trend in bank loans disbursed to SHGs and the number of SHGs from 2006-7 to 2022-23, which is increasing.



Source of Data: Economic and Political Weekly Research Foundation (EPWRF)

Figure 2 shows the year-over-year growth in the number of SHGs and the loans disbursed to SHGs. The growth has consistently increased except in 2010-11 and 2020-21. The effect of COVID-19 is visible in 2020-21, with a dip in the number of SHGs and loans disbursed.



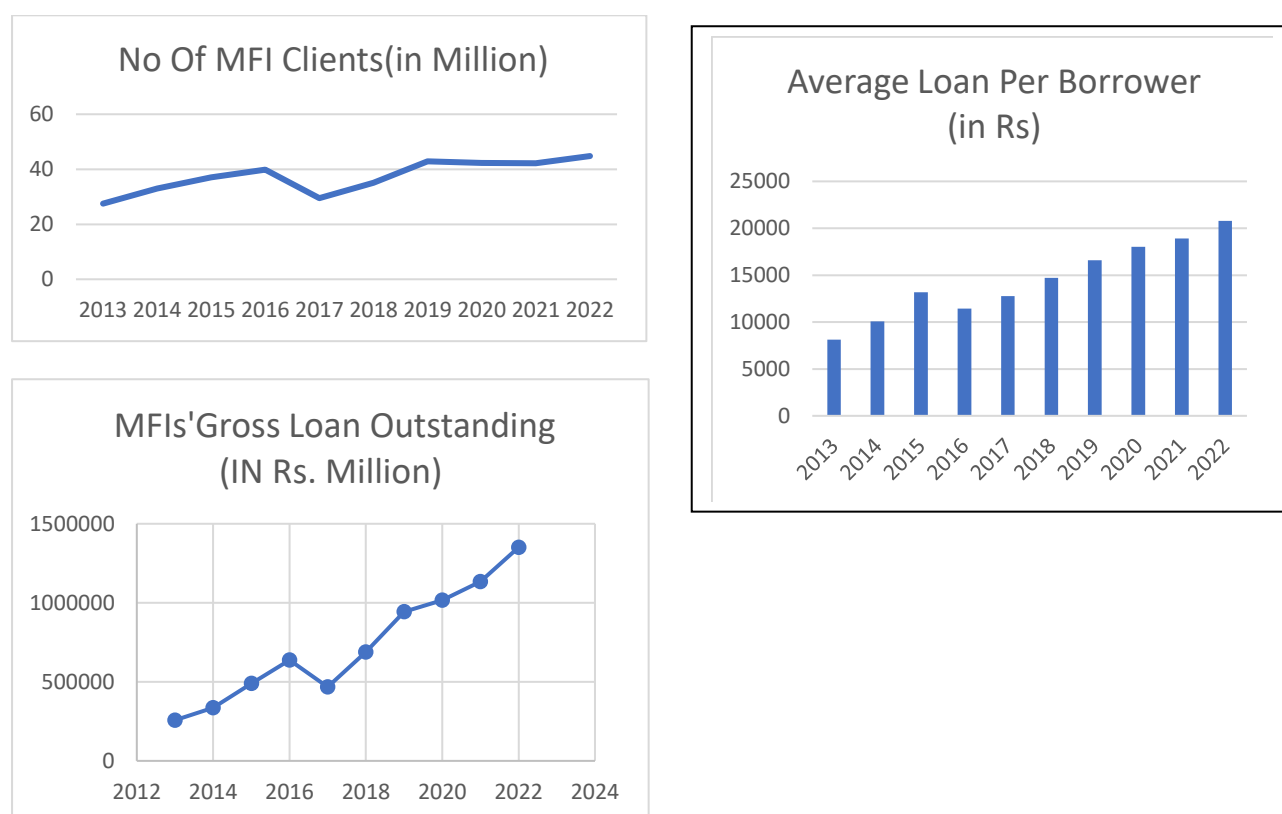
Author's calculation using EPWRF data

The analysis of banks' share in SHG savings and outstanding loans based on data from NABARD reveals that commercial banks held a substantial portion, accounting for 59% of savings and 69% of loans, with RRBs following at 31% and 26%, respectively. In the fiscal year 2022-23, credit disbursement to SHGs experienced growth across all regions compared to 2021-22, with the Central region witnessing the highest increase at 114%. In absolute terms, the Southern region led with disbursements totalling Rs. 95,2267 million to 1.9 million SHGs, while the Northern region recorded the lowest at Rs. 20,644 million to 0.1 million SHGs. Among the states, Karnataka topped the list with the highest number of SHGs credit-linked at 0.744 million, followed by West Bengal (0.676 million), Bihar (0.64 million), and Andhra Pradesh (0.527 million). On the policy front the RBI introduced the New Regulatory Framework for Microfinance Loans on 14 March 2022. This framework establishes uniform regulations for all entities within the microfinance space and promotes a level playing field safeguarding the interests of borrowers. Currently, the Deendayal Antyodaya Yojana-National Rural Livelihoods Mission (DAY-NRLM), operating under the Ministry of Rural Development, Government of India, spearheads the establishment and capacity enhancement of Self-Help Groups (SHGs) in rural India. NRLM boasts a significant presence, with 3.9 million SHGs

availing loan as of December 2023<sup>3</sup> with Rs. 1121238.3 million loans disbursed. In parallel efforts, the formation and linkage of SHGs in urban areas are undertaken by the Deendayal Antyodaya Yojana-National Urban Livelihoods Mission (DAY-NULM) under the Ministry of Housing and Urban Affairs, Government of India. NABARD's E-shakti project, introduced in 2015, is actively digitizing and updating data for Self-Help Groups (SHGs), aligning with the National Financial Inclusion agenda and the Digital India initiative. This project is designed to bring substantial benefits to all stakeholders involved.

Concerning the MFI model, the subsequent figures illustrate the expansion in the client base, gross loan portfolio, and the average loan per borrower.

Figure 3: Progress of the MFI model: 2013-2022



Source of Data: The Bharat Microfinance Report for years 2013-2022, Sa-Dhan

<sup>3</sup> [Dashboard-NRLM eGov Application-Government of India](#)

The client base of MFIs increased from 27.5 million in 2013 to 44.8 million in 2022. The average loan per borrower increased two and a half times from Rs.8112 in 2013 to Rs.20789 in 2022. The gross loan portfolio also shows an increasing trend excepting years 2017 and 2020. Microfinance is not about micro-credit only. Beyond the loan products, MFIs have also started providing a bouquet of financial services called the credit-plus services and products, including micro-insurance, micro-pension, and other specific credit products in housing, health, renewable energy etc., to meet the unmet demand of their credit beneficiaries. Further, the MFIs also provide developmental services to their clients, including business development, vocational training, marketing, financial literacy, and technical and legal assistance. As of March 31, 2022, the total count of microinsurance agents reached 99,961, with a significant 80 percent affiliated with private sector life insurers<sup>4</sup>. Among these agents, NGOs, SHGs, MFIs, and Business Correspondents collectively constitute six per cent, while the remaining 94 percent primarily comprises other micro insurance agents, prominently represented by Common Service Centres (CSCs). Similarly, the National Pension System (NPS-Lite) and Atal Pension Yojana (APY) are two prominent pension schemes accessible to individuals, distinct from insurance-based pension programs. Also, certain Microfinance Institutions (MFIs) and Self-Help Promoting Institutions (SHPIs) actively undertake initiatives to raise awareness within their memberships, encouraging them to enrol in the Atal Pension Yojana (APY).

### **3. Fintech, Digital India and Microfinance**

Microfinance institutions used to deal with cash for disbursement of loans and collection of payments. Then, their beneficiaries started opening bank accounts and the disbursements were credited to their bank accounts. The introduction of the Prime Minister Jan Dhan Yojna(PMJDY) in 2014 increased banking penetration and helped the MFI sector. With the

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<sup>4</sup> Annual report, 2021-22, Insurance Regulatory and Development Authority of India.

introduction of Aadhar(Unique identification), shifting from traditional banking to digital mode became easy with electronic Know Your Customer(e-KYC) authentication services. Several other experiments on technology adoption took place in the MFI sector around 2008-09. The objectives were to reduce operating and cash management costs, increase the security of both customers and MFI agents, increase the ability for low-cost expansion for the MFI, and increase speed and convenience<sup>5</sup>. Around this time India Stack was born. As stated in [indistack.org](http://indistack.org), “India Stack is the moniker for a set of open APIs and digital public goods that aim to unlock the economic primitives of identity, data, and payments at population scale”. The India Stack and the Jan Dhan, Aadhar, and Mobile(JAM) trinity catalysed technology adoption by the MFIs. A study by Acharya and Parida(2015)<sup>6</sup>, funded by IMTFI, studied how micro credit linked life insurance claim payments were made by pre-paid cards designed by M2P solutions with Bajaz Allianz general insurance for beneficiaries of the then Utkarsh Microfinance limited in some villages surrounding Varanasi. There were regulatory restrictions on cash payments, and many beneficiaries didn’t have a bank account or deficient KYC. Hence, the insurance company came up with the idea of one time pre-paid card to settle claims. But there was a big push to cashless transactions after the demonetisation of 2016 and the National Payments Corporation of India's introduction of Unified Payments Interface(UPI). Now, MFIs have embraced digital payments to some extent. For instance, as per Sa-Dhan’s report, 2022, the average cashless disbursement was 79% in 2021-22. But, the NBFCs and NBFC-MFIs disbursed more than 90% of their loans in cashless mode. Several Microfinance Institutions (MFIs) have implemented cashless collection methods, such as UPI mode, Bharat Bill Payment, and QR code-based transactions. Despite these efforts, the adoption rate remains relatively modest, hovering between 10 to 15%. In contrast, there has been a notable surge in the efficient

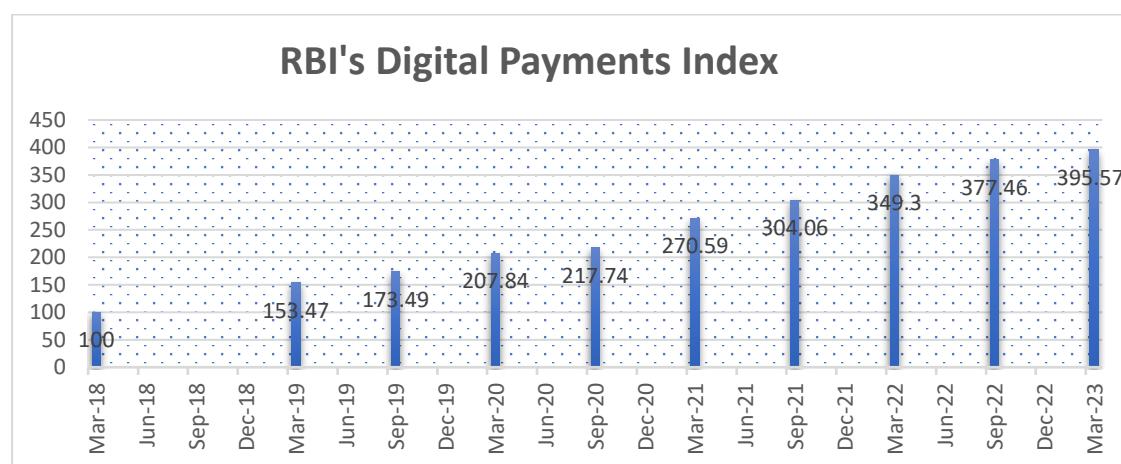
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<sup>5</sup> Microfinance India, State of the Sector Report 2009, Sage.

<sup>6</sup> [imtfi.uci.edu/files/docs/2017/Acharya\\_Parida\\_Final\\_Report.pdf](http://imtfi.uci.edu/files/docs/2017/Acharya_Parida_Final_Report.pdf)

flow of cash through cash points facilitated by Fintechs in recent times. The advancement is truly noteworthy, particularly when viewed from the perspective of UPI users. Some cases of MFIs adopting digital transformation are as follows. Satya Microcapital limited sanctions and disburses loans through its e-sign process. Satya's clients can scan the QR code on the loan card using their smartphones and repay digitally. Further, an in-house mobile application also helps the clients in giving comprehensive information to the clients/customers. In another case, Muthoot Microfin Limited has digitalized the entire loan process for its customers from origination to collection. For Muthoot, the digital collection increased from Rs.1680 million in 2022 to Rs.10960 million in 2023<sup>7</sup>. These digital transformation experiences of the MFIs go well with the macro picture in India. The digital payments index published by the RBI shows increased digitisation of payments nationwide.

Figure 4 : Growth of Digital Payments in India



Source of Data : Reserve Bank of India

The RBI-DPI encompasses five critical parameters for assessing the expansion and adoption of digital payments. Among these criteria, payment enablers contribute 25 percent to the index, payment infrastructure (demand-side factors) holds a 10 percent weightage, payment

<sup>7</sup> <https://muthootmicrofin.com/wp-content/uploads/2023/05/Digital-Adoption-Update.pdf>



infrastructure (supply-side factors) accounts for 15 percent, payment performance contributes 45 percent, and consumer centricity carries a weightage of five percent.

A survey on the digitisation of MFIs was conducted by KPMG in collaboration with MFIN in 2021. The findings indicate that nine out of ten MFIs use cashless channels for disbursement. Still, only 40% of the MFIs use technology to onboard customers, and half of the MFIs surveyed use AI/ML for credit assessment.

#### **4. Concluding remarks**

In the realm of microfinance, the predominant focus lies on microfinance loans. In 2022, the Reserve Bank of India (RBI) introduced a revised regulatory framework to establish an equitable landscape for all regulated entities within the sector. The framework defines a microfinance loan, “as a collateral-free loan given to a household having annual household income up to ₹3,00,000. For this purpose, the household shall mean an individual family unit, i.e., husband, wife and their unmarried children”. Further, the framework says, “All collateral-free loans, irrespective of end use and mode of application/ processing/ disbursal (either through physical or digital channels), provided to low-income households, i.e., households having annual income up to ₹3,00,000, shall be considered as microfinance loans”.

The framework also delineates guidelines on household loan repayment obligations, the conduct expected towards microfinance borrowers, recovery protocols, staff training, and qualifying asset criteria. Despite the challenges posed by the COVID-19 pandemic, the microfinance sector has exhibited resilience in its growth trajectory. Following the implementation of the amended regulations in the new framework, Microfinance Institutions (MFIs) face a dual challenge. First, they must adapt their systems and processes to comply with the new requirements. Secondly, they grapple with finding a delicate equilibrium between digital transformation and the distinctive human touch for which MFIs are renowned. A crucial

question arises: Will the integration of digital processes compromise the personal connection without physical meetings or the traditional role of field agents, potentially replaced by mobile apps? Moreover, consideration must be given to the customer's trust in digital adoption and their perceptions of safety and security in digital transactions.

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