

Rising Stress in Microfinance and Small Loans in India

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Why in News?

- The microfinance sector, small finance lenders, and unsecured personal loans in India are showing early signs of stress, primarily due to escalating borrower indebtedness.
- Key indicators reveal rising delinquencies (when the borrower fails to make payments on a loan, credit card, etc., by the due date), threatening asset quality, and profitability in these segments.

What is Microfinance?

- Microfinance or microcredit refers to **financial services extended to individuals or groups with limited access to traditional banking facilities**.
- These services include savings accounts, checking accounts, fund transfers, micro-insurance, and microcredit.
- By fostering **financial inclusion**, microfinance aims to **empower marginalised communities**, enabling them to achieve **social equity and economic self-reliance**.
- **Women are the primary beneficiaries of these services**, contributing significantly to their social and financial empowerment.

Microfinance in India:

- **Evolution:**
 - **SEWA** Bank, India's first microfinance institution, was established in Gujarat in **1974**. It celebrated its 50th anniversary in 2024.
 - NABARD introduced the **Self-Help Group (SHG) linkage model in 1984** to combat poverty.
 - **In 2004, the RBI classified microfinance as a priority sector.**
 - The Andhra Pradesh crisis in 2010, triggered by coercive debt recovery methods, resulted in **regulatory reforms**.
 - The RBI established the **Malegam Committee (2012)** to address concerns in the microfinance sector post the Andhra Pradesh crisis.
 - The launch of **MUDRA Bank in 2015** facilitated credit access for small businesses, boosting the microfinance ecosystem.
- **Microfinance business models:**
 - **SHGs:** Typically consisting of 10–20 members, SHGs focus on collective savings and leverage these savings to secure bank loans under NABARD's SHG-Bank Linkage Programme.
 - **Microfinance Institutions (MFIs)**
 - MFIs deliver financial services like credit, insurance, and remittances through Joint Liability Groups (JLGs) comprising 4–10 members with similar economic activities.
 - They operate on structured repayment schedules and earn interest, similar to traditional banks.
- **Types of microfinance lenders:**
 - **NGO-MFIs:** Registered under the Societies Registration Act, 1860, or the Indian Trusts Act, 1880.
 - **Co-operative societies:** Entities like Primary Agricultural Credit Societies (PACS) providing microfinance services.
 - **Section 8 Companies:** Non-profits under the Companies Act, 2013, offering microfinance services.
 - **NBFC-MFIs:** Account for 80% of the market and are regulated by the RBI. They rely on bulk loans from banks or their resources to lend to JLGs.
- **Current status:**
 - The microfinance sector has grown significantly, with **168 MFIs serving over 3 crore clients**.
 - It plays a critical role in **job creation**, contributing to 130 lakh jobs and 2% of India's Gross Value Added (GVA).

- RBI guidelines define microfinance as collateral-free loans for households with an annual income of up to ₹3 lakh.

Signs of Stress in the Microfinance Sector:

- **Rising delinquencies and asset quality risks:**
 - **Increased non-performing assets (NPAs):**
 - ESAF Small Finance Bank's gross NPAs surged to ₹1,279.3 crore (6.9% of advances) in September 2024 from ₹399.1 crore (2.6%) a year ago.
 - CRISIL estimates SFB NPAs to rise to 2.9% by FY25 from 2.3% in FY24.
 - **Microfinance challenges:** Early-stage delinquencies rose sharply, and collection efficiency dropped to 94% in Q2 FY25, down from 98% in the previous fiscal.
- **Challenges with borrower indebtedness:**
 - Credit card outstanding increased to ₹2.71 lakh crore in September 2024 from ₹2.30 lakh crore the previous year.
 - RBI imposed restrictions on NBFC-MFIs due to predatory pricing and inadequate borrower evaluation, reflecting regulatory intervention to curb growing risks.

Factors Driving Stress in the Microfinance Sector:

- **Operational and structural issues:**
 - **Over-leveraged borrowers:** Aggressive lending practices have led to sanctioning loans without adequate repayment capacity.
 - **Weak JLG model:** Declining attendance and accountability among borrowers exacerbate defaults.
 - **High staff attrition and fraud:** Operational disruptions caused by staff turnover and fraudulent practices hinder recovery efforts.
- **External challenges**
 - Socio-political risks, **such as debt-waiver campaigns and general elections**, along with natural disasters, further strain borrower repayment capabilities.
 - **Economic stress** in rural and semi-urban areas continues to limit the repayment capacity of small borrowers.

Regulatory and Institutional Responses to Deal with the Stress in the Microfinance Sector:

- **Regulatory actions:**
 - The RBI has issued a **"cease and desist order"** to some NBFC-MFIs to address issues such as loan netting and lending to ineligible borrowers.
 - It has also **tightened lending norms for unsecured loans** and urged institutions to adopt sustainable risk management frameworks.
- **Institutional adjustments:**
 - Banks and NBFCs are re-evaluating their underwriting standards and focusing on **risk mitigation**.

- The sector is witnessing a slowdown in growth, with MFIs' assets under management (AUM) expected to drop to 17–19% in FY25 from 29% in FY24.

Sector Resilience Amid Challenges and Future Outlook:

- **Strengths of the microfinance sector:**

- Despite vulnerabilities, the sector has **historically shown resilience, overcoming shocks like demonetisation and the pandemic.**
- **Investor confidence remains strong**, underscoring the sector's critical role in financial inclusion.

- **Future outlook:**

- Analysts predict **continued stress in FY25**, with delinquencies rising across unsecured and microfinance loans.
- **A cautious approach in fresh sanctions** and stronger recovery efforts are essential for stabilising the sector.
- **Regulatory oversight and institutional adaptability** will be key to navigating these challenges.

Conclusion:

- With strategic reforms, risk management, and regulatory support, the sector can overcome the current stress and continue serving underserved communities effectively.
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Q.1. What is the Lakhpati Didi scheme?

The Lakhpati Didi scheme is a Ministry of Rural Development initiative, which enhances access to credit, encourages entrepreneurship, and promotes financial inclusion among women Self Help Groups (SHGs) and individual entrepreneurs across the country.

Q.2. What are Small Finance Banks (SFB)?

SFBs are financial institutions that offer basic banking services to underserved and unbanked areas in India. They are similar to commercial banks, but on a smaller scale. They are governed by the RBI and are registered as public limited companies under the Companies Act, 2013.

Source: [As small and micro loans come under pressure, stress on small finance lenders could dent consumption further](#)

Source: <https://vajiramandravi.com/current-affairs/rising-stress-in-microfinance-and-small-loans-in-india/>

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