The future of microfinance: Propelling growth, fuelling prosperity

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Foreword by PwC

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Microfinance plays a crucial role in financial inclusion. For India to realise its vision of becoming a $5 trillion economy, microfinance is an important driving force which can facilitate financial inclusion for a large part of the country's population.[1] This white paper, developed by Sa-Dhan and PwC India, presents a detailed view of the current status of the MFI sector. It also focuses on the future of the sector and how technology can be a crucial enabler for the sustainable growth of MFI in India.

Microfinance can be an important enabler for both financial inclusion and socio-economic development, granting vital access to formal credit and financial services for many underserved households. Its role in empowering low-income communities, particularly women, promoting entrepreneurship, and building resilience against economic shocks is important for inclusive economic growth.

Despite the decrease in portfolio and loan accounts, ticket size has remained stable, suggesting that lenders are more cautious and leaning towards building a loyal customer base. Early-stage delinquencies are improving on a quarterly basis, but stress in older buckets remains high. This calls for better affordability assessments, more meaningful customer engagement, and disciplined follow-up. Above all, the sector must balance its focus on quality with its core mission of bringing new to credit households into formal finance, ensuring that inclusion does not become a casualty of caution.

Today, technology has become a cornerstone of the microfinance sector eKYC and eSign, along with rule engines, bringing clarity and speed to this sector. Modern loan origination and loan management systems, together with analytics and AI, have strengthened underwriting and improved early warning signals. While technology is enabling digitisation of processes, challenges such as costs, legacy systems, and digital literacy can be addressed with phased rollouts, the right partners, and close alignment with industry policies.

The microfinance sector is heading towards multi-product, customer-first institutions which pursue growth, resilience, and ESG alignment. Achieving this objective requires teamwork across lenders, policymakers, investors, and technology partners.

We are proud to partner with Sa-Dhan for developing this white paper and hope that the document inspires action, fuels innovation, and supports inclusive growth.

1 PIB - https://www.pib.gov.in/Pressreleaseshare.aspx?PRID=1549454

Foreword by Sa-Dhan

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For India to achieve its goal of becoming a $5 trillion economy, it is essential for the country to extend financial inclusion to low-income households and micro-entrepreneurs, and ensure that they have reliable and affordable access to formal finance. Microfinance is an effective instrument for enabling this access and helps both women and underserved communities to strengthen their livelihoods, absorb financial shocks, and build trusted relations with the financial system. Over the last three decades, India's microfinance movement has matured from pioneering community-based models to professionally managed institutions operating at a national scale. It has also weathered periods of volatility, learned hard lessons on conduct and risk, and renewed its commitment to responsible finance.

The findings of this white paper reveal that the sector has deliberately moved from volume-led expansion to quality-focused growth. Institutions are tightening affordability assessments, leaning on known customers, and investing in operating discipline. Early-bucket delinquencies have reduced, even as ageing stress remains a priority. At the same time, technology adoption is accelerating across onboarding, underwriting, collections, and customer service, with institutions aligning public digital infrastructure and building 'trust by design' into day-to-day workflows.

The white paper is drafted based on a survey conducted by PwC and Sa-Dhan in September-October 2025. The paper discussed some of the major changes in the microfinance sector—prudent origination, careful rightsizing of tickets, and a willingness to evolve operating models while emphasising customer protection. It also highlights the sector's core strengths—deep field presence, social capital built through group structures, and a long-standing emphasis on women's empowerment—alongside the challenges that must be jointly addressed: over-indebtedness, funding confidence, workforce capacity, and the need to rebuild public trust following the aftershocks.

We hope that this white paper will serve as a practical guide for the microfinance industry. By anchoring growth in trust, conduct, and customer outcomes—while harnessing technology and collaboration—the microfinance community can significantly contribute to India's inclusive development.

Abbreviations

AI	Artificial intelligence
BC	Business correspondent
BBPS	Bharat Bill Payment System
CAGR	Compound annual growth rate
CKYC	Central know your customer
DPD	Days past due
FY	Financial year
IAMAI	Internet and Mobile Association of India
IT	Information technology
JLG	Joint Liability Group
KYC	Know your customer
LMS	Loan management system
LOS	Loan origination system
MFI	Microfinance institution
MLIs	Microlenders
MSME	Micro, small and medium enterprises
NABARD	National Bank for Agriculture and Rural Development
NBFC	Non-banking financial company
NBFC-MFI	Non-banking financial company microfinance institution
NGOs	Non-governmental organisation
OTP	One-time password (implied in digital onboarding)
PAR	Portfolio-at-risk
PMMY	Pradhan Mantri Mudra Yojana
RBI	Reserve Bank of India
RPA	Robotic process automation
SFB	Small finance bank
SEWA	Self-Employed Women's Association
SIDBI	Small Industries Development Bank of India
SHG	Self-help group
SRO	Self-regulatory organisation
UPI	Unified payments interface
WASH	Water, hygiene and sanitation loans

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Introduction

1.1. Purpose and scope

Microfinance is a service that provides small, unsecured loans and other financial services to low-income and underserved households. It is an economic tool designed to drive financial inclusion, elevate poor and low-income households out of poverty, increase their income levels, and improve overall living standards.

This paper examines India's microfinance sector, which is an important sector for the country to achieve its vision of becoming a $5 trillion economy.[2] The white paper analyses key trends and challenges, providing insights into the sector's evolving landscape through a survey-based approach and detailed input from executives. It also explores business challenges, technological advancements, market dynamics, and risk management practices that drive growth and sustainability in microfinance.

Furthermore, the paper aspires to stimulate dialogue among industry stakeholders, policymakers, and practitioners to collaboratively explore avenues for improvement, innovation, and resilience in the sector.

1.2. Microfinance in India

Microfinance provides essential financial services and small loans to underserved small borrowers and microenterprises traditionally excluded from formal banking. It enables disadvantaged communities to start income-generating activities that improve their economic status. This model promotes financial inclusion and supports poverty alleviation by expanding access to credit and other financial products to those traditionally excluded from the formal financial system. This sector shall be crucial to the nation's development to achieve its economic goals.

In India, microfinance began in 1974 with the pioneering SEWA. Early credit cooperatives (early 1900s–1969) struggled amid governance issues and economic slowdown. Between 1969 and 1991, initiatives such as bank nationalisation, the Lead Bank Scheme, regional rural banks, and the Integrated Rural Development Programme aimed to improve rural credit but faced inefficiencies. NABARD initiated SHG-bank linkage programme after fine-tuning the model through an action research project with MYRADA, addressing earlier challenges in financial inclusion, thereby boosting the country's microfinance movement. Subsequently, the JLG model of financing by specialised institutions called MFIs emerged in the 1990s, leading to the growth of many institutions. In 2011, RBI introduced regulations to formalise and regulate the NBFC-MFI sector.

2 PIB - https://www.pib.gov.in/Pressreleaseshare.aspx?PRID=1549454

1.3. Impact of microfinance on customers

a. Access to formal finance

For low-income households, especially those headed by women, microfinance often provides an entry into the formal credit structure. It gives customers reliable credit, savings, and other financial services, such as insurance options, which help build financial histories. MFIs alone serve over 6.72 crore customers, 95% of whom are women, underscoring their vital role in extending credit to underserved and low-income households.[3]

b. Livelihood initiation and growth

Agriculture is an important source of income for the country; thus, microfinance plays a pivotal role in improving farmers' livelihoods by providing easy access to credit for agricultural needs. Many households have both farm and non-farm livelihood activities. The credit needs of these small and nano/micro-enterprises in the informal sector are supported by MFIs. With small, repeat loans and simple savings products, these micro-enterprises can invest in tools and inventory, and smooth working capital. Schemes such as Pradhan Mantri Mudra Yojana, PM SVaNidhi, and the Lakhpati Didi scheme have also converged with microloans to promote entrepreneurship. MFIs also help raise awareness and develop capacity building for climate-smart tools used in agriculture, which further enhances the lives of the farmers.

c. Building resilience

Access to microfinance helps many families manage unforeseen financial difficulties, such as health shocks or seasonal income dips. Products such as credit and basic insurance create a cushion that protects against unplanned crises and provides income-generating opportunities. About 91% of loans obtained through MLIs were used for income generation.[4]

d. Enabling borrowers

Microfinance runs on the principle of group lending through SHGs and JLGs. These groups, created for liability sharing and peer accountability, have helped develop customer maturity over time. In the field of financial inclusion, microfinance has been successful in bringing people with limited avenues for formal KYC and credit history into at the credit structure and providing them with access to loans. This has had a significant impact on both the individual and the family level. As a result of these efforts, customers have become more financially aware which enables them to explore other products, such as secured lending and insurance.

"Financial inclusion is never about dependence—it is about empowerment. We gave people options, not obligations. From no KYC to digital lending, the progress is undeniable. As we look towards Viksit Bharat @2047, women stand as a cornerstone of our growth story. Without the full participation of 50% of our population, the dream of becoming a developed nation remains incomplete. As microfinance institutions, our role extends beyond financial inclusion—it's about enabling true economic inclusion."

Purvi Bhavsar
MD and CEO, Pahal Finance

3 Sa Dhan, Bharat Microfinance Report 2025, https://www.sa-dhan.net/wp-content/uploads/2025/10/Bharat-Microfinance-Report_FY_2024-25_compressed.pdf
4 Sa Dhan, Bharat Microfinance Report 2025, https://www.sa-dhan.net/wp-content/uploads/2025/10/Bharat-Microfinance-Report_FY_2024-25_compressed.pdf

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Current landscape

2.1. Indian microfinance sector

India's microfinance sector entered FY2026 on a cautious footing, under the guidance of associations/SROs. The gross loan portfolio stood at ₹3,59,169 crore in June 2025, down 17% year-on-year (YoY) from ₹4,32,718 crore in June 2024, and at ₹3,81,225 crore in March 2025, down 6% quarter-on-quarter (QoQ). Unique borrowers declined to 7.98 crore in June 2025 from 8.28 crore in March 2025 and 8.66 crore in June 2024 (−8% YoY, −4% QoQ), while loan accounts fell to 13.21 crore in June 2025 from 13.99 crore in March 2025 and 15.93 crore in June 2024 (−17% YoY, −6% QoQ). Despite lower volumes and customer counts, the average balance per loan account was broadly stable at ₹27,198. This contraction reflects muted origination and a focus on stabilising existing portfolios.[5]

Sourcing softened further in Q1 FY2026. Disbursements totalled ₹57,127 crore in Q1 FY2026 from ₹71,644 crore in Q4 FY2026 and ₹79,593 crore in Q1 FY2025, down 28% YoY and 20% QoQ, with the number of accounts disbursed at ₹102 lakhs in Q1 FY2026 from ₹133 lakhs in Q4 FY2025 and ₹163 lakhs in Q1 FY2025 (−38% YoY, −23% QoQ). In contrast, the average ticket size rose to ₹56,077 in Q1 FY2026 from ₹53,825 in Q4 FY 2025 and ₹48,795 in Q1 FY2025 (+15% YoY, +4% QoQ). Fewer loans at higher ticket sizes suggest a tilt towards repeat borrowers, inflation-linked right-sizing, and tighter selection of new-to-credit customers. MFIs focus on quality and affordability checks rather than rapid customer acquisition, consistent with the need to protect household cash flows and avoid over-indebtedness. The tighter selection of new-to-credit customers reflects the sector's deviation from group lending practices, which was initially intended to secure lenders from the risks of lending to first-time borrowers. If the sector continues to distance itself from this segment, there could be concerns that it is failing to serve its intended purpose—financial inclusion.[6]

Portfolio quality showed mixed progress. Early and mid-delinquency buckets improved quarter-on-quarter but remained higher than last year. The PAR 31–90 days DPD was 2.4% in Q1 FY2026 compared to 2.8% in Q4 FY2025 and 1.5% in Q1 FY2025 (−0.4 pp QoQ, +0.9 pp YoY). The PAR 91–180 DPD was 3.1% in Q1 FY2026 compared with 3.4% in Q4 FY2025 and 1.1% in Q1 FY2025 (−0.3 pp QoQ, +2.0 pp YoY). The 180+ DPD bucket rose to 14.9% in Q1 FY2026, up from 12.6% in Q4 FY2025 and 9.1% in Q1 FY2025 (+2.3 pp QoQ, +5.8 pp YoY), indicating ageing stress and slow cures. The immediate task is to sustain near-term collection gains while addressing the root causes of long-dated delinquency through stricter affordability assessments, better customer engagement, and disciplined follow-up.[7]

Insights from the survey conducted by PwC and Sa-Dhan with 20+ leaders point to a two-track strategic posture in response to these conditions. Most respondents aim to strengthen and expand the core microfinance franchise, supported by process discipline and digital enablement. Additionally, many NBFC-MFIs are evaluating a transition to multi-product NBFC models and plan to expand beyond microcredit into adjacent segments, signalling a strategic move towards risk diversification. This diversification approach is further driven by the RBI's reduction in the minimum qualifying asset requirement.

Microfinance serves as an entry point for the underserved into the formal financial ecosystem. Existing MFI players, which have sustained the market for years, have built a loyal customer base that has evolved into a financially mature segment and may seek products beyond microfinance. Understanding these customer needs and anchoring the strategic direction in alignment with them is where the market and regulators are looking to move forward. MFIs also plan to expand their wallet share of microfinance customers by adding products such as micro-insurance and green loans (including WASH loans), testing alternatives to the traditional group model, and building new channels to increase customer lifetime value as the existing customer base matures.

Executives rely mostly on customer feedback and market research, supported by financial performance metrics; employee feedback and peer analysis are secondary inputs helping them build a customer-centric approach. Early-bucket delinquencies have eased quarter-on-quarter, average balances remain stable, and origination is shifting towards better-known customers and right-sized tickets. This period is being described as laying the groundwork for quality growth, with trust, conduct, and operating discipline at the core.

5 Sa Dhan, Quarterly Microfinance Report, Q1 FY2026, https://www.sa-dhan.net/wp-content/uploads/2025/09/QMR-April-June25.pdf
6 Sa Dhan, Quarterly Microfinance Report, Q1 FY2026, https://www.sa-dhan.net/wp-content/uploads/2025/09/QMR-April-June25.pdf
7 Sa Dhan, Quarterly Microfinance Report, Q1 FY2026, https://www.sa-dhan.net/wp-content/uploads/2025/09/QMR-April-June25.pdf

2.2. Regulatory landscape and policy framework

As MFIs prepare to shift from stabilisation to disciplined growth, regulation will shape both the speed and quality of the recovery. Recent trends such as lower disbursement counts, higher average ticket sizes, and improving early-bucket delinquency are consistent with institutions tightening affordability checks and prioritising known customers. The next step is to align this operating stance with the evolving regulatory framework, to ensure that growth is delivered with clear guardrails on customer suitability, pricing transparency, data use, and portfolio diversification.

According to the RBI, a microfinance loan is a collateral-free loan given to a household with an annual income of up to ₹3,00,000. A household is defined as an individual family unit, comprising a husband, wife, and their unmarried children.[8]

Table 1: RBI's regulations on microfinance's lending criteria[9, 10, 11]

Year	Rural household income limit	CAGR in rural household income limit	Urban/ semi-urban household income limit	CAGR in urban household income limit	Loan amount (first cycle)	Loan amount (subsequent cycles)	Minimum loan tenure
2012	60,000		1,20,000		35,000	50000	24 months above 15,000
2015	1,00,000	18.56%	1,60,000	10.06%	60,000	100000	24 months above 30,000
2019	1,25,000	11.05%	2,00,000	7.57%	75,000	1,25,000	24 months above 30,000
2022	3,00,000	17.46%	3,00,000	9.6%	75,000	1,25,000	24 months above 30,000

More recently, the RBI has introduced changes that directly address over-indebtedness and balance sheet flexibility. The SRO guardrails introduced in 2025 capped the number of lenders per borrower, creating a simple, enforceable control on multiple lending.[12, 13, 14] This aligns with the sector's current emphasis on deeper affordability assessment, better use of bureaus, and early-warning systems. However, there are a few players that still do not come under the purview of SROs.

9 https://www.rbi.org.in/commonman/english/scripts/FAQs.aspx?Id=3366
10 https://www.rbi.org.in/commonman/english/scripts/Notification.aspx?Id=1022
11 https://www.rbi.org.in/commonman/english/scripts/Notification.aspx?Id=1804
12 https://www.rbi.org.in/commonman/english/scripts/Notification.aspx?Id=1428
13 https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=10497&Mode=0
14 https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=12256

At the same time, the 2025 reduction of the NBFC-MFI qualifying assets threshold from 75% to 60% gives institutions room to diversify into adjacent products[15] —such as small enterprise credit, gold loans, and other retail offerings—while keeping microfinance at the core. For MFIs planning a measured product expansion, this change supports customer graduation pathways and provides tools to more effectively manage liquidity and capital.

The survey's findings reveal that regulatory compliance is considered the responsibility of top management and has not been adopted at the level of individual accountability. To stay updated, respondents point to regular training and updates for compliance teams, participation in industry forums and associations, and consultation with legal and regulatory experts. MFIs can focus on capacity building and general awareness campaigns across the hierarchy on the importance of regulatory compliance and the processes to be followed in different scenarios. Institutions that systematise these practices—clear policy libraries, periodic refresher training, and early tech-policy reviews—are better positioned to scale without repeated process rework.

The road ahead is clear—broader eligibility and product flexibility coupled with tighter controls on borrower exposure and stronger conduct standards are the driving factors which will enable the microfinance industry to grow in a sustainable manner.

15 https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=12856&Mode=0

Figure 1: Key players in the microfinance ecosystem

Regulators and policymakers

Ministry of Finance, GoI

- Formulates policies for broader financial inclusion
- Coordinates with RBI, NABARD, and others
- Oversees sector alignment with national economic goals
- Engages international bodies to boost resources and expertise

RBI

- Central regulator for NBFC-MFIs
- Sets prudential norms, capital adequacy, and interest rate caps
- Ensures borrower protection and transparency
- Maintains NBFC-MFI registry
- Engages in policy formulation for financial inclusion and sector stability

SRO (Sa-Dhan/MFin)

- Industry association representing diverse microfinance entities
- Promotes transparency, accountability, and ethical lending
- Sets operational standards and codes of conduct
- Advocates policy, conducts research, facilitates stakeholder dialogue
- Offers capacity-building and training for members

Development and support institutions

NABARD

- Focus on rural development and agriculture finance
- Refinance support: MFIs and banks
- Pioneer of the SHG-bank linkage model for rural inclusion
- Builds capacity of MFIs and SHGs
- Advocates policy for microfinance growth and sustainability

SIDBI

- Actively supports capacity building initiatives for MFIs
- Refinance support: MFIs and banks
- Promoting the overall development of the microfinance sector, advocating for policy changes and fostering innovation
- Enhance financial inclusion for unbanked and underserved populations

MUDRA

- MUDRA significantly contributes to the financial inclusion of small entrepreneurs and self-employed individuals
- Aims to develop and strengthen the ecosystem for micro-enterprise finance

Lenders and financial institutions

NBFC-MFIs

- Offer flexible loan products tailored to the needs of the underserved communities.
- Conduct field-level client outreach and provide financial literacy.
- Ensure timely loan disbursement and collection while maintaining financial sustainability.
- Comply with regulatory norms and maintain transparency with borrowers.

Other financial institutions

- Extend financial products including savings, loans, insurance, and remittance.
- Promote financial inclusion by integrating microfinance into their service offerings.
- Provide wholesale funding or refinance loans to NBFC-MFIs.
- Support capacity building and technical assistance for grassroots groups.

Grassroots organisations

SHG

- Mobilise savings regularly from members to create common fund.
- Facilitate internal lending and peer support.
- Act as bridge between members and formal financial institutions.
- Build social capital and promote financial literacy within the community.
- Encourage joint liability and responsibility.

JLG

- Collaborate to access credit from banks or NBFC-MFIs.
- Share joint liability ensuring that all members repay their loans.
- Facilitate mutual support to reduce default risks.
- Maintain group discipline and financial management.
- Promote trust and accountability among members for successful credit utilisation.

2.3. Technology adoption and innovation

With eligibility widened and exposure caps clarified, the next lever for renewing growth is execution at scale, which depends on a digital operating backbone that embeds regulatory guardrails into daily workflows—from affordability checks and consent to disclosures, collections, and grievance resolution. Technology can enable compliant growth with consistency across diverse geographies and customer profiles.

a. Technology in microfinance: Digitising the customer lifecycle

Survey responses show a spectrum of integration of technological solutions in the microfinance sector. Some institutions report highly integrated operations with most processes automated, whereas others are moderately integrated, with key workflows digitised. According to the respondents, annual technology budgets vary from less than ₹1 crore to above ₹10 crore, reflecting differences in scale and maturity.

Investment decisions are prioritised based on customer impact, regulatory compliance, strategic alignment, innovation, and cost-effectiveness. Success is measured through increased customer satisfaction, operational efficiency, employee productivity, faster turnaround times, and revenue growth.

On the customer side, MFIs are moving to digital-first journeys:

1. Convenient loan applications through online and mobile channels, supported by eKYC and eSign, reduce branch dependency and speed up onboarding.
2. Seamless digital repayments via mobile apps, UPIs, and BBPS make collections more predictable and cash light, improving safety and reconciliation.
3. Comprehensive mobile platforms provide customers with real-time views of balances, schedules, and service options, improving transparency and control.

These capabilities support trust by design with clearer disclosures in the vernacular, explicit consent logs, and faster grievance resolution backed by tracking and workflow systems.

On institutional efficiency, technology is reshaping risk, service, and growth as follows:

1. Digital credit risk assessment uses bureau data and internal histories to support data-driven scoring and affordability checks. Several CTOs cite analytics and AI-enabled models as significant innovations that improve underwriting and early warning.
2. Cashless disbursements directly to

bank accounts increase security and traceability, aligning with inclusion and conduct standards.

3. Post-disbursement engagement leverages analytics for reminders, repayment behaviour monitoring, and targeted offers. Institutions use APIs for validation and digital signatures, as well as modern LOS and LMS infrastructure, to streamline origination and servicing.

4. Technology can also build more inclusive microfinance by re-including borrowers through alternative data.

Digitisation and tech adoption help reduce operational costs by automating processes and shortening TAT.

The survey's findings also highlight some technological innovations that have delivered impact—mobile apps and digital payments for customers, LOS/LMS modernisation for straight-through processing, data analytics, and AI for credit scoring and risk assessment, and HRMS/performance systems to stabilise field productivity. However, challenges in adoption and implementation remain as regulatory and additional compliance requirements exacerbate complexity while high implementation costs and uncertain near-term ROI slow decision-making. Limited digital literacy among customers and a shortage of skilled IT professionals constrain rollout. Integration with legacy systems, data security concerns, and resistance to change are the greatest hurdles in building end-to-end tech stacks.

Institutions are addressing these gaps through phased rollouts, early tech policy reviews with compliance teams, and targeted partnerships. Some are prioritising credit models and collection digitisation as the first wave, followed by customer self-service and advanced analytics. Others are investing in interoperability with public digital infrastructure—UPI/BBPS for payments, Aadhaar/CKYC for onboarding, account aggregators for consented data—to improve reliability and lower costs.

To summarise, technology is central to delivering the sector's new growth playbook by providing consistent conduct at scale, sharper risk selection, and better customer experience. MFIs can convert digital adoption into lower ageing stress, improved unit economics, and a stronger trust narrative by aligning investment priorities with regulatory requirements and customer outcomes.

03

Trends and challenges in microfinance

3.1. Emerging trends in microfinance

a. Industry trends

As of year-end FY2025, the total microfinance loan accounts stood at ₹1,399 lakhs (YoY decline of 13%), with a total outstanding value of ₹3,81,225 crore (YoY decrease of 14%).

NBFC-MFIs maintain the largest market share across loan accounts and loans outstanding, with 539 lakh loan accounts (39%) and a total outstanding value of ₹1,48,419 crore (39%). Table 2 highlights the survey's findings regarding MFI's outstanding loans and accounts share based on the type of microlending institutions.

Table 2: MFI loan's outstanding and accounts share (by type of institution)

Microlender	Rural household income limit	CAGR in rural household income limit	Urban/ semi-urban household income limit	CAGR in urban household income limit	Loan amount (first cycle)	Loan amount (subsequent cycles)
NBFC-MFIs	1,48,419.00	39	−18	539	39	−19
Banks	1,24,431.00	32	−10	466	33	−11
SFBs	59,817.00	16	−20	216	15	−12
NBFCs	45,042.00	12	0.2	163	12	−4
Others	3,516.00	1	34	15	1	34
Industry	**3,81,225.00**	**100**	**−14**	**1,399**	-	**−13**[16]

After an extended period of accelerated growth, rising delinquency rates signalled emerging vulnerabilities, prompting microlenders to shift towards more prudent, quality centric lending practices. The reduction in loan accounts and the contraction in loans outstanding reflect a deliberate recalibration by microlenders amid elevated credit risks in the microfinance industry. The reduction was not driven by a decrease in demand but by an intentional shift by the industry towards risk management, ensuring higher asset quality. Driven by the guardrails introduced by the SRO, such as capping microlenders at three and total credit exposure at ₹2 lakh per borrower, the attempts have focused on reducing the industry's overleverage to a better position, prioritising asset quality rather than risky growth.

16 Sa Dhan, Bharat Microfinance Report 2025, https://www.sa-dhan.net/wp-content/uploads/2025/10/Bharat-Microfinance-Report_FY_2024-25_compressed.pdf

b. Demographic shifts

The microfinance ecosystem has significantly advanced financial inclusion, particularly for women, through models such as the SHG bank linkage and JLGs. These initiatives have enabled low-income population of the country to have access to financial services. As of FY2025, NABARD and DAY-NRLM-supported SHG Bank Linkage programme held an outstanding loan portfolio of ₹3.04 trillion, while the more commercial JLG model, supported by NBFC-MFIs, NBFCs, and the banking system, had ₹3.81 trillion in outstanding loans.

While MFIs traditionally prioritised women due to their higher repayment rates and positive impact on household welfare, these models, driven by market maturation and a broader focus on holistic household financial inclusion, are evolving to facilitate diversification of borrowers. Consequently, the share of women borrowers declined from 99% in FY2022[17] to 95% in FY2025,[18] reflecting a shift towards including other family members through models such as individual lending, even as women continue to constitute the majority of beneficiaries. This is mainly because MFIs are now actively taking steps to understand the entire household's financial service requirements, rather than focusing on the customer. This shift could also be linked to the reduction in the qualifying assets criteria from 75% to 60%, where other customer segments and products now cater to households.[19]

c. Shifts in customer channels[20]

The microfinance sector, which has historically catered to underprivileged and underserved communities, is now undergoing a transformation in its typical customer profile, driven by access to the internet, information, and digital literacy.

With 85.5% of Indian households owning at least one smartphone in FY2025, digital channels are increasingly poised to serve the expansion of the microfinance market. As of 2025, India ranks second globally in the number of Internet users, with over 850 million users and a penetration rate of more than 60%. The rural user base now exceeds that of urban areas, making it easier for MFIs to reach the last mile, at scale, with channels such as social media and mobile apps. Smartphones and social media have made it easier for customers to find, compare, and use financial products. Many customers lack a formal credit history but have rich digital footprints, such as UPI and mobile activity. With consent, MFIs can use data to model campaigns, assess risk, and tailor services.

17 Sa Dhan, Bharat Microfinance Report 2022, https://www.sa-dhan.net/wp-content/uploads/2023/05/BMR-2022_c.pdf
18 Sa Dhan, Bharat Microfinance Report 2025, https://www.sa-dhan.net/wp-content/uploads/2025/10/Bharat-Microfinance-Report_FY_2024-25_compressed.pdf
19 https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=12856&Mode=0
20 IBEF, https://www.google.com/url?sa=t&source=web&rct=j&opi=89978449&url=https://ibef.org/news/india-s-internet-users-to-exceed-900-million-in-2025-driven-by-indic-languages&ved=2ahUKEwjC-dWCpdiQAxURcvUHHb9nHoUQFnoECFEQAQ&usg=AOvVaw3NBWSESe0tsM7iwY9JECpB

d. Regional trends

The diverse landscape of the Indian subcontinent presents another challenge. As there is no one-size-fits-all solution, different growth stories of microfinance emerge across different states in India. India's microfinance sector presents a diverse landscape, with some regions exhibiting remarkable growth while others show a steady to limited growth.

A YoY analysis indicates that 32 states and union territories experienced decline in the number of loan accounts and loans outstanding during the period.[21] However, the following four northeastern states registered an increase in terms of loan accounts, although their overall share in the microfinance industry remains limited:

29% Nagaland

17% Arunachal Pradesh

5% Meghalaya

1% Assam

Similarly, the following four states with relatively smaller microfinance footprints saw growth in terms of loans outstanding:

29% Arunachal Pradesh

24% Nagaland

14% Telangana

8% Meghalaya

However, the principal states with the highest loans outstanding saw contractions in both the number of loan accounts and loans outstanding, reflecting broad-based negative growth. These states are as follows:

State	% decrease in accounts	% decrease in outstanding
Tamil Nadu	20	20
Karnataka	12	17
Bihar	9	12
Uttar Pradesh	8	10
West Bengal	8	9

21 Sa Dhan, Bharat Microfinance Report 2025, https://www.sa-dhan.net/wp-content/uploads/2025/10/Bharat-Microfinance-Report_FY_2024-25_compressed.pdf

These figures show that in markets where several borrowers are overextended and recoveries have become more difficult, lenders have pulled back on fresh lending, and total loans outstanding have declined. New state regulations, including the Karnataka Micro Loan and Small Loan (Prevention of Coercive Actions) Bill of 2025 and the Tamil Nadu Money Lending Entities (Prevention of Coercive Actions) Act 2025, have also made lenders more cautious owing to potential operational roadblocks in these markets and additional compliance requirements. Table 3 depicts the state-wise distribution of microfinance loans and outstanding.

Table 3: State-wise distribution of microfinance loans and outstanding

S.no.	State/UT	March 2025 loan accounts (₹ lakh)	March 2024 loan accounts (₹ lakh)	March 2025 loan outstanding (₹ crore)	March 2024 loan outstanding (₹ crore)	YoY growth for loan accounts (%)	YoY growth for loan outstanding (%)
1	Bihar	202.32	221.75	57,712	65,487	−9	−12
2	Tamil Nadu	151.63	188.42	46,833	58,239	−20	−20
3	Uttar Pradesh	151.16	163.74	41,774	46,304	−8	−10
4	West Bengal	122.92	132.99	36,730	40,328	−8	−9
5	Karnataka	126.5	143.91	35,351	42,560	−12	−17
6	Maharashtra	111.3	124.7	29,596	33,304	−11	−11
7	Madhya Pradesh	81.09	93.46	21,653	24,870	−13	−13
8	Odisha	83.81	98.05	20,719	25,615	−15	−19
9	Rajasthan	56.33	67.83	14,930	18,144	−17	−18
10	Kerala	40.47	48.83	11,273	14,159	−17	−20
11	Jharkhand	42.64	49.15	11,149	13,118	−13	−15
12	Gujarat	40.9	46.68	10,913	13,107	−12	−17
13	Andhra Pradesh	50.01	68.65	7,322	8,346	−27	−12
14	Assam	25.89	25.65	7,082	7,410	1	−4
15	Chhattisgarh	24.43	28.16	6,553	7,390	−13	−11
16	Telangana	29.55	39.67	5,717	5,015	−26	14
17	Haryana	18.67	22.98	5,138	6,236	−19	−18
18	Punjab	17.44	23.89	4,372	5,684	−27	−23
19	Tripura	6.74	7.18	2,169	2,314	−6	−6
20	Uttarakhand	6.27	7.3	1,749	2,077	−14	−16
21	Puducherry	2.2	2.71	671	842	−19	−20
22	Delhi	2.15	2.67	616	795	−20	−23
23	Himachal Pradesh	0.56	0.64	160	182	−12	−12
24	Goa	0.6	0.67	155	195	−12	−21
25	Meghalaya	0.52	0.5	139	129	5	8
26	Sikkim	0.4	0.42	131	133	−6	−1
27	Mizoram	0.43	0.43	111	121	−1	−9
28	Arunachal Pradesh	0.35	0.3	105	81	17	29
29	Others	0.52	0.71	90	172	−28	−48
30	Jammu and Kashmir	0.27	0.28	80	83	−1	−4
31	Manipur	0.38	0.46	80	104	−18	−23
32	Nagaland	0.21	0.16	68	55	29	24
33	Chandigarh	0.18	0.21	46	54	−16	−15
34	Andaman and Nicobar Islands	0.05	0.05	18	20	−1	-10
35	Dadra and Nagar Haveli	0.04	0.05	14	16	−13	−12
36	Daman and Diu	0.02	0.03	7	9	−11	−20
37	Lakshadweep	0	0	0.02	0.03	−25	−39
38	**Industry**	**1,399**	**1,613**	**3,81,225**	**4,42,700**	**−13**	**−14**[22]

22 Sa Dhan, Bharat Microfinance Report 2025, https://www.sa-dhan.net/wp-content/uploads/2025/10/Bharat-Microfinance-Report_FY_2024-25_compressed.pdf

e. Portfolio quality

Traditionally, the group lending model has ensured a high collection rate, driven by peer accountability, despite some hiccups in repayments in recent years. Additionally, with increasing average ticket size and diminishing group sizes, maintaining collections has become challenging. The impact of these can be seen in the PAR data. Table 4 highlights asset quality as per the PAR segments.

PAR bucket	June 2025 (%)	March 2025 (%)	March 2024 (%)
PAR 30–179 DPD	5.5	6.2	2.1
PAR 60–179 DPD	4.4	4.8	1.6
PAR 90–179 DPD	3.1	3.5	0.9
PAR 180+ DPD	14.9	12.6	9.6[23]

The PAR data for 30–179 DPD, 60–179 DPD, and 90–179 DPD have seen a similar trend with a peak at year-end FY2025 compared with the end of FY2024 numbers and a significant decrease at the end of Q1 FY2026 owing to the deliberate efforts of industry and SRO to ensure higher asset quality. Unfortunately, the PAR 180+ DPD bucket has continued to rise from 12.6% in March 2025 to 14.9% in June 2025. When checked for 180+ PAR of loans disbursed in the past two years, it reflects the same trend; however, the numbers are significantly lower. This potentially indicates challenges in regularising customers who have previously missed repayments, underscoring the importance of achieving the highest possible regular collection rates. While the sector recovers from the shock of disruptions, portfolio quality levels have yet to reach pre-FY2021 levels.

Although PAR 180+ has increased, many MFIs ultimately write off these exposures. Write-offs improve reported portfolio quality; however, at a market level, credit bureaus continue to reflect these accounts as severe delinquency. As a result, the underlying risk persists for lenders and borrowers. MFIs should adopt structured re-entry programmes to bring viable customers back into formal credit, tied to repayment behaviour.

If done well, re-inclusion can convert write-offs into recoveries, reduce PAR 180+, and expand access. Borrowers often prioritise the repayment of secured loans, such as housing and gold loans, which involve collateral/personal assets or private borrowing with strict terms, making the microfinance loans riskier. Moreover, once borrowers fall into an NPA category, they find it challenging to raise funds from MFIs, which in turn reduces their focus on repaying and regularising their dues with MFIs. This also leads to an increase in the number of MFI borrowers being excluded from the formal system. The higher inflation, especially food inflation during FY2025, is also a major force behind microfinance customers struggling to make regular loan repayments.

Overall portfolio quality is improving, and the sector is picking up again. However, lenders still need to pay attention to average ticket size and avoid the concentration of risk to ensure sustainable growth.

23 Sa Dhan, Bharat Microfinance Report 2025, https://www.sa-dhan.net/wp-content/uploads/2025/10/Bharat-Microfinance-Report_FY_2024-25_compressed.pdf, Sa Dhan, Quarterly Microfinance Report Q1 FY2026, https://www.sa-dhan.net/wp-content/uploads/2025/09/QMR-April-June25.pdf

> “One of the primary reasons for high NPAs in recent times is the prevailing macro-economic conditions. It is important to note that rural wages have not grown for last five years. Post-COVID credit growth led to increase in household obligations, and the situation was further aggravated because of persistent high food inflation, which has impacted the HH budget.”
>
> **Sadaf Sayeed**
> CEO, Muthoot Microfin

f. Shift in social equity

Microfinance is shifting from group-based solidarity to individual responsibility. The JLG once provided social collateral through peer monitoring and shared norms. As borrowers mature, many now prefer direct relationships with lenders and are comfortable managing repayments without centre meetings. Group sizes have reduced, and the centre has become a sourcing and collection channel rather than a client engagement mechanism. This transition changes how credit discipline is achieved, from reliance on collective discipline to transparent, individual assessment and service.

Three drivers underpin this transition. First, customer behaviour has evolved. Households are more experienced with formal credit are more likely to use digital payments, and expect faster, direct service. Second, regulation has widened eligibility and introduced clearer guardrails, including exposure caps and affordability expectations. Third, MFIs have improved their ability to assess borrower-level risk. Digital onboarding, business rule engines, and bureau integrations standardise KYC, exposure checks, and disclosures. This is further aided by advancements in financial inclusion, which have allowed customers to maintain formal financial records. Analytics draw on bank statements, UPI sales patterns, geo-tags, and even image analysis of micro-enterprises to estimate turnover and stability. Field knowledge of local markets and the relationships built by loan officers complement these tools, producing a more accurate view of an individual's cash flows and repayment capacity.

The traditional model of centre meetings, where repayments are prioritised and sourcing is achieved through collective gatherings, is gradually losing influence as households are engaged in various employment scenarios and face restrictions on hosting centre meetings outside regulated timings. MFIs are now more flexible in terms of repayment terms and sourcing, leveraging digital channels and personal customer connections.

3.2 Critical challenges faced by MFIs

Microfinance has emerged as the heartbeat of India's informal economy in the past few decades. The sector has made considerable strides in promoting financial inclusion in the nation through empowering the underserved communities, especially women entrepreneurs. The sector is also a good indicator of the financial health of the population at the bottom of the economy's pyramid. However, certain critical challenges still threaten the sector's stability and effectiveness, which need to be addressed to ensure its sustainability and maximise its social impact.

a. Increased investment in customer connections

Microfinance, which is principally underpinned by trust among its stakeholders (i.e. borrowers, field officers, and lending institutions), has become more transactional. Major setbacks, such as demonetisation and the COVID-19 pandemic, have further exacerbated the decline in group culture in microfinance, which has had a widespread impact on repayment discipline and public confidence. Rebuilding credibility and confidence remains a major challenge to achieving sustainable growth. Equipping and empowering customers with adequate information is crucial to regaining their trust. MFIs have also experienced declining support from external stakeholders, including investors, refinancers, and partners, over the past few years. This has resulted from increased caution amongst stakeholders for bottom-of-the-pyramid borrowers.

Financial literacy is the first step towards meaningful financial inclusion and building alternative channels to maintain connections with borrowers, beyond group-influenced channels. Capacity-building workshops, educational workshops, and financial literacy bootcamps can be conducted to inform customers of their rights, the products offered, various schemes for their benefit, and their responsibilities. Lenders also need to ensure fairness, clarity, consistency, and care across their communication, collection practices, customer support, and community engagement.

b. Customer acquisition

To improve asset quality, the industry has deliberately focused on serving low-risk, disciplined customers. The impact of this can be seen in the decline in disbursements (₹2,84,130 crore in FY2025 compared with ₹3,86,287 crore in FY2024) and loans outstanding (₹3,81,225 crore in FY2025 compared with ₹4,42,700 crore in FY2024).[24] At present, the industry prefers improved

24 Sa Dhan, Bharat Microfinance Report 2025, https://www.sa-dhan.net/wp-content/uploads/2025/10/Bharat-Microfinance-Report_FY_2024-25_compressed.pdf

portfolio health over aggressive growth in loan accounts and loan outstanding balances. However, despite this being a beneficial exercise to increase trust in the industry, it is not a sustainable approach in the long term, and the process of acquiring customers at the last mile requires extensive attention to balance growth with quality.

Currently, customer outreach faces longer, more complex, and more cost-intensive processes due to difficulties reaching customers who lack financial and digital literacy. More than half (56%) the respondents cited financial literacy among customers as a primary deterrent to customer acquisition, while 50% also highlighted the difficulty of group formation. Assembling reliable groups that meet eligibility criteria and attendance norms is taking longer in some areas, resulting in lower productivity per loan officer and the centre's viability. This shift might mean lenders now have to consider providing credit to individuals and explore new assessment and collection models.

Over one-third (38%) respondents pointed to the challenge of retaining existing customers. This has a cascading impact on growth and contributes to rising customer acquisition costs. Reducing friction in renewal journeys, timely resolution of customer grievances, and flexible repayment options to tide over tough times can help in improving customer retention.

c. Operational friction

The challenges of serving the last mile are often highlighted in operational problems and high costs. 50% of the respondents ranked the high cost of operations as their most pressing operational challenge, followed by 25% ranking process efficiency as the greatest difficulty, and approximately 12% stating that technology adoption is a major operational challenge for MFIs in India.

Operational efficiency is often reduced by manual interfaces the field staff use for loan sourcing, manual KYC processes, and cash-based collections, especially when they run on legacy systems. Digitisation of onboarding journeys, automation of workflows, and overall technological adoption can help reduce operational costs, support business growth, enhance portfolio quality, and improve staff and customer experience.

d. Credit assessment

Credit underwriting remains one of the most complex challenges for the Indian microfinance industry. The first step in credit assessment—estimating true household income—is difficult as livelihoods are often seasonal, cash based, and derived from multiple sources. Credit histories are scarce or non-existent, and indebtedness in this segment may be fragmented across formal and informal lenders.

For new-to-credit customers, the distinction between the ability to pay and the willingness to pay remains unclear due to limited data. MFIs cannot rely solely on bureau data for credit assessment, as this would defeat the objective of financial inclusion, which is central to the microfinance industry.

In place of depleting group dynamics, proxies and alternative models are to be deployed to improve individual credit assessment. With the advent of AI and digital financial inclusion, efforts can be made to simplify assessment through smart data capture and transaction analysis, along with machine-learning-based scoring.

e. Over-indebtedness

The risk of over-indebtedness among borrowers is a critical challenge faced by institutions as they strive to expand their reach to diverse customer segments. This also poses a systemic risk to the microfinance sector, potentially leading to higher default rates and financial losses for institutions.

The sector's struggle with over-indebtedness is also affected by the ecosystem's evolving internal dynamics. The sector has become increasingly competitive with the emergence of multiple digital lending platforms offering collateral-free loans and BNPL products, fostering quick and easy access to credit. These platforms frequently target vulnerable populations without adequate assessment of their repayment capacities, exacerbating the problem.

This competition threatens traditional MFIs, which typically adhere to more stringent credit assessment procedures and ethical lending standards. The proliferation of unregulated lenders can lead to loan stacking and frequent top-ups by clients, exacerbating over-indebtedness and compromising the microfinance sector's credibility and sustainability. The RBI noticed this problem and released a list of 1,600 recognised digital lending apps in July 2025. This initiative aims to provide transparency in digital lending and protect customers from involvement with illegal lending applications.

3.3 Operating models and products

India's microfinance ecosystem uses a multi-channel approach that combines community-based savings (SHGs), group lending (JLGs), individual lending, and the bank agency model.

1. **SHG model:** The SHG bank linkage programme in India is the most prevalent and effective delivery channel, usually comprising 10–20 members from a homogenous social and economic background. The members contribute to the group's collective fund and facilitate the savings and lending activities within the group.

2. **JLG model:** Primarily recognised as a credit group, a JLG is an informal association of 4–10 members established to access bank financing through mutual guarantee. An important feature of JLGs is that loan amounts are not tied to savings, and group members can access credit without having to provide collateral.

3. **Individual lending model:** To address the demand for larger loan amounts from existing to bank/NBFC customers, an increasing number of MFIs are extending personal loans to long-term clients. These individual loans typically require more rigorous and frequent monitoring and often involve one or two guarantors.

4. **Bank agency model:** Banks avail themselves of the services of NGOs, MFIs, and co-operative societies, which act as business correspondents (BCs) to extend financial services to the unbanked rural population. Under this model, the MFI is responsible for preliminary customer evaluation, recommending and originating loans, facilitating disbursement, and subsequently monitoring and collecting repayments. In return, the MFI earns a service fee and typically provides the bank with a first-loss default guarantee. Banks are responsible for conducting credit evaluations and other due diligence and compliance checks as applicable to each lender. The BC model serves as an intermediary between financial institutions and end customers.

Each model caters to different borrower segments and operational needs, supported by regulatory frameworks and institutions.

Figure 2: Comparison of different microfinance operating models

Features	SHG-bank linkage model	JLG model	Individual lending models	Bank agency model (BCs)
Primary focus	Savings-first, social empowerment, capacity building	Credit-first, quick disbursement of credit	Borrowers with established relationships/credit scores; offering tailored loans suited to individual needs	Wider outreach of providing banking services
Operations	Group pools savings, lends internally, then borrows from banks	Group jointly liable for loans taken by group/individual	Direct lending to individuals; individual credit assessment	Agents evaluate borrowers, assist applications, collect repayments
Key drivers	NABARD-led SHG-bank linkage programme	Initially supported by SIDBI, it is now mostly bank driven	Micro enterprise loan products, such as Lakhpati Didi programme, PM SVANidhi, Prayaas Scheme by SIDBI	Corporate BCs, individual BCs, Bank Sakhi Model of DAY-NRLM
Strengths	Promotes financial discipline, social cohesion, empowerment	Scalable credit delivery, risk mitigated via social collateral	Quick scale-up, professional microfinance operations	Reduces bank transaction cost and risk, expands outreach
Scalability	Moderate, dependent on group formation and nurturing	Designed for rapid credit expansion	High scalability, especially NBFC-MFIs	Highly scalable via existing agent networks

Figure 3: Challenges faced in the current operating model

Challenges	Steps 1–6	Steps 7–12	Challenges
• Ensuring group solidarity • Existing interpersonal conflicts	**Step 1** **Group formation** 5–10 Members with a group leader should know each other and live in close proximity.	**Step 7** **Risk assessment** Conduct house visits and assessments.	• Visibility on complete borrower information • Assessment of overall indebtedness
• Challenges in obtaining genuine KYC details • Delays due to mechanical methods of KYC processing • Network availability issues for the KYC process	**Step 2** **KYC collection** Collect documents from primary applicant and nominee.	**Step 8** **Loan sanctioning** Back-end loan verification and sanction if all the criteria is met.	• Possibility of dropouts due to certain criteria • Delay in sanctioning loan for group due to data/ document challenges with one or few group members
• Loan eligibility issues leading to higher number of dropouts • Instances of inaccurate data tagged to the specific record	**Step 3** **Credit bureau verification** Instant credit information report of the members interested is generated.	**Step 9** **Loan disbursement** Cashless bank disbursement	• Dropouts post sanction due to loan received from other sources by customer.
• Ensuring 100% borrower engagement and participation • Ensuring 100% transfer of knowledge	**Step 4** **Adequate group training** Sales officer provides orientation and training.	**Step 10** **Loan utilisation check** Conduct utilisation checks within 60 days of disbursement.	• Visibility on actual utilisation of the loans disbursed • Availability of borrowers during this utilisation check period
• Network availability issues during online loan application	**Step 5** **Loan application** Apply digitally on tablet.	**Step 11** **Loan management** Repayment collected at branches can be remitted by any group member.	• Irregular repayment periods • Customer attendance in group meetings • Willful defaults by customers
• Ensuring 100% borrower engagement and participation • Ensuring 100% transfer of knowledge	**Step 6** **Group verification process by BM** Verify group understanding on all aspects of the loan.	**Step 12** **Loan closure** Borrowers have the option of pre-closure of loan with no prepayment charges.	• Documentation requirements for loan closure can be cumbersome for customers in certain instances.

3.4 Technology integration and innovation

The integration of technology into microfinance has significantly changed how financial services are delivered to underserved segments of the economy. By embedding digital solutions across the customer lifecycle, MFIs have enhanced operational efficiency and redesigned customer experience. From loan origination to repayment and customer management, technology has indeed been a cornerstone of innovation in the microfinance sector.

a. Empowering borrowers through digital access

1. Convenient loan applications: Technology has advanced to the point where borrowers can apply for loans online at their convenience—anytime, anywhere. This digital approach reduces the operational burden of physical visits and paper-based documentation, thereby reducing longer waiting times. If this can be adopted, for MFI institutions, then the borrower can submit the loan application online, and the MFI can conduct a backend eligibility check using technology, thereby streamlining the application journey.

2. Seamless digital repayments: Borrower repayments are now more convenient through digital channels offered by MFIs, such as mobile applications and UPI-based services. These digital channels offer borrowers a secure, user-friendly way to manage their loan obligations without cash transactions or branch visits.

3. Comprehensive mobile platforms: Many MFIs have developed front-end applications that enable borrowers to monitor their existing portfolio in real time. These applications offer insights into outstanding amounts, repayment terms, and other value-added services, empowering borrowers with greater financial control and transparency.

b. Enhancing institutional efficiency across the lifecycle

1. Digital credit risk assessment: Technology plays a critical role in the credit risk assessment process. MFIs now have access to centralised databases that capture detailed borrower histories, enabling data-driven credit scoring and risk assessment. This ensures accurate lending decisions and reduces the risk of default.

2. Cashless disbursements: Loan disbursements have transitioned to digital channels, with funds directly credited to borrowers' bank accounts. This not only enhances security and traceability but also aligns broader financial inclusion goals.

3. Data-driven post-disbursement engagement: Post loan disbursement, MFIs leverage technology to monitor repayment behaviour, send automated reminders, and offer personalised financial products. Data analytics also help identify patterns that inform cross-selling opportunities, top-up loans, and customer retention strategies.

3.5 Technological innovation in the MFI industry

Microfinance in India is shifting to a technology-led operating model across origination, underwriting, collections, and portfolio surveillance. Institutions are using digital rails to improve consistency, reduce errors, and enhance customer experience, while embedding regulatory guardrails into daily workflows. Many MFI organisations also consider mobile apps and UPI/BBPS, LOS/LMS modernisation, and data analytics/AI as the most impactful innovations, and measure the success of these applications based on faster turnaround times, higher customer satisfaction, and improved operational efficiency.

a. Digital onboarding and consent (eKYC/eSign with rule engines)

MFIs are standardising identity, affordability, and consent through CKYC/Aadhaar eKYC, OCR-based capture, face recognition, and eSign, with business rule engines enforcing eligibility, income templates, total obligations, and the lender cap via bureau APIs. This reduces field discretion, shortens turnaround time, and creates audit-ready trails for disclosure and pricing.

AI-enabled underwriting and income intelligence

Underwriting that combines bureau files, bank statements, UPI sales patterns, geotagging, and image analytics builds explainable risk scores and household affordability views, with early-warning triggers for emerging stress. Survey inputs show growing use of AI/ML for credit scoring and early warning, governed by data privacy, model explainability, and bias controls to protect customers and maintain portfolio discipline.

"Technology like image analysis has a transformational impact through which a basic input of establishment photos can provide output of approximate footfall and sales, enabling tailored products for dairy, petty retail, and e-rickshaw segments. These can be beneficial when ticket sizes approach ₹1 lakh."

Gautam Jain
MD, Vedika Capital

b. Predictive delinquency management and digital collections

Collections are increasingly cash light and data-led. Analytics segment risk and prioritise actions, while UPI/BBPS and mobile apps enable customer payments. Automated reminders, multi-lingual IVR, and bots improve access to agents as well as the speed of resolution.

"Looking ahead, with average loan size increasing, the sector is expected to see smaller and eventually dissolving group structures, a rapid transition to digital and UPI-based repayments, and real-time credit bureau reporting, all of which could fundamentally redefine the structure of the MFI and quality of credit underwriting. Yet, as leaders warned, technology alone cannot safeguard stability unless supported by borrower ethics and transparent practices by all the players in the ecosystem."

Natarajan R
South India Finvest, Chairman and MD

c. API-led core modernisation and interoperability

Institutions are upgrading their LOS/LMS to microservice architectures with APIs for exposure checks and lender caps, CKYC/Aadhaar for identity, account aggregators for consented data, and payment gateways for collections. Event-driven workflows, standard data models, and timestamped consent logs enable straight-through processing, branch-level dashboards, and reliable reporting.

> "Institutions are upgrading LOS/LMS to microservices architectures with APIs to bureaus for exposure checks and lender caps, Aadhaar for identity, account aggregators for consented data, and payment gateways for collections. Event-driven workflows, standard data models, and timestamped consent logs enable straight-through processing, branch level dashboards, and reliable reporting."
>
> **N Neeraja**
> MD, NABFINS

Technology adoption is increasingly viewed as both an operational necessity and a competitive differentiator. However, the survey underscored several challenges, including high adoption costs, integration with legacy systems, and digital literacy gaps among both staff and customers. Annual technology budgets remain modest for most institutions, forcing them to prioritise carefully. Compliance, risk monitoring, and customer service emerged as the top areas for technology investment. This point towards modular, phased technology adoption, ecosystem partnerships with FinTechs, and a sharper focus on measurable outcomes. Success in digital transformation is increasingly judged by improvements in compliance accuracy, efficiency gains, and collection performance.

> "MFIs are standardising identity, affordability, and consent through Aadhaar eKYC, OCR-based capture, face match, and eSign, with business rule engines enforcing eligibility, income templates, total obligations, and the lender-cap via bureau APIs. This reduces field discretion, shortens turnaround, and creates audit-ready trails for disclosure and pricing."
>
> **N Neeraja**
> MD, NABFINS

04

Current priorities and future outlook

The survey provides a comprehensive view of institutional priorities, operational realities, and long-term aspirations. These perspectives are also aligned to some of the key trends outlined in this paper—portfolio quality pressures, customer trust, funding constraints, regulatory guardrails, technology adoption, and workforce challenges—while also highlighting how institutions are preparing to evolve to the next phase of MFI's evolution in India.

4.1 Current priorities

a. Strategy and business direction

MFIs are recalibrating their long-term strategies to balance growth with resilience. With increasing competition from banks, NBFCs, and FinTechs, MFIs are considering how to evolve beyond traditional microcredit.

The survey highlights that many respondents are focused on diversifying into adjacent financial services, including but not limited to MSME lending, micro-insurance, and agricultural financing. They aim to transition into multi-product financial institutions shaped by cost of funds, repayment behaviour, customer analytics, and regulatory expectations.

The findings point to a gradual shift away from volume-led expansion towards insight-led strategy. Diversification, sustainability, and analytics emerge as the cornerstones of future business models.

b. Funding and capital access

Access to affordable, diversified funding remains one of the sector's defining challenges, driven primarily by reduced investor confidence. While some institutions expressed comfort with their current mix, others flagged high borrowing costs as a constraint on growth and customer affordability. Public listings are considered a medium-term strategy for credibility and scale, although most remain cautious about timing and market appetite. The role of SROs is critical for sustaining sectoral confidence and representing institutional interests.

Emerging trends include greater interest in market-based funding, securitisation, and impact-aligned capital pools. At the same time, investors are applying more rigorous due diligence around governance and transparency. The findings confirm that diversified liability strategies, coupled with strengthened reporting, will be essential for resilience and improved investor confidence.

c. Customer service and experience

Customer service and trust remain central for maintaining institutional stability. The respondents acknowledged persistent challenges in sourcing quality clients, particularly in saturated markets, and in addressing the risks of customer over-indebtedness.

Grievance redressal processes, while present, are typically resource intensive, requiring modernisation through tech-based interventions to enhance efficiency and reduce dependency on manual interventions. The survey's findings suggest that customer service is evolving from a compliance requirement to a strategic differentiator. Building transparent, trust-driven service models will be essential for sustaining repayment discipline and building long-term relationships.

d. Regulatory landscape

The RBI's harmonised guidelines and the broader focus on responsible lending have created a new compliance paradigm in which institutions must balance operational flexibility with strict adherence. Frequent regulatory updates pose operational challenges, particularly in pricing transparency, interest rate policies, and customer protection standards. Respondents emphasise that aligning business operations with evolving regulations requires investment in compliance systems and staff capacity. Regulatory predictability is considered a critical enabler for long-term planning and product design.

The survey findings also highlight a growing emphasis on conduct regulation, greater reliance on RegTech interventions for monitoring and reporting, and expanding data-sharing requirements, including integration with credit bureaus and potential alignment with national platforms. The survey findings also reveal that proactive regulatory readiness both mitigates risk and enhances credibility.

e. Human resources and capacity building

Human capital remains one of the sector's most pressing challenges as many respondents reported difficulty in hiring skilled talent in Tier-3 geographies and beyond, with digital and risk management skills identified as the most challenging to source.

High attrition among frontline staff emerged as another systemic issue driven by workload stress, incentive structures, and limited career pathways. To address these concerns, institutions are experimenting with localised hiring, modular training programmes, and realigning incentives. Structured certifications and role-based career progression were also cited as emerging retention strategies.

These findings reinforce that workforce development is not a peripheral issue but a strategic imperative. Without a motivated, digitally skilled, and retained workforce, operational quality and customer engagement cannot be sustained.

4.2 The future of the MFI sector

The survey's findings highlight a transition from narrowly defined microlenders to comprehensive financial inclusion platforms. The respondents also discussed a model which is multi-product, digitally enabled, customer centric, resilient, and focused on:

- **Strategic evolution:** MFIs are now seeking ways to broaden their financial service offerings beyond micro-lending to cater to their evolved customer base and tap into unexplored markets through products such as MSME credit, insurance, and agriculture-linked products.
- **Customer-centric growth:** As the industry matures, so does the loyal customer base of these institutions, which has grown from microfinance households to a higher segment household, driving the need for updated operating model and product proposition of these institutions. Along with the existing customer base, the industry also has a responsibility to bring more underserved communities onto financial platforms; hence, there is a need to invest in financial literacy, transparent pricing, and robust grievance redressal systems, and to make them an integral part of the core operating model of MFIs.
- **Technology as an enabler:** Due to the low-ticket size and high volume of the transactions, it has become imperative for MFIs to invest in technology-based solutions to drive efficiency and cost-effectiveness. The inclusion of AI/ML/RPAs into operations through defined algorithms and BREs, through interventions such as AI-driven underwriting, automated collections, and data-led early warning systems, will increasingly shape operations.
- **Workforce of the future:** As the industry evolves, there is a need to create and harness specific skill-based resources for developing the market through collaborative efforts by industry players and market regulators.
- **Resilience and ESG alignment:** Climate and macroeconomic shocks are prompting MFIs to embed resilience and sustainability into long-term strategies, which will also be critical for attracting capital due to an increased focus on ESG norms by investors.

05

Survey insights

Survey methodology

To gain a deeper understanding of the evolving dynamics within India's microfinance sector, a comprehensive survey was conducted with leaders from the MFI industry. An online questionnaire was circulated which focused on future vision and strategy, customer satisfaction, key challenges, initial public offering plans, and the role of SROs. The survey aimed to capture the perspectives which are shaping the sector's trajectory amidst a rapidly changing landscape.

We received responses from 20 prominent microfinance leaders representing diverse geographies and institutions, including NBFC-MFIs, banks, and cooperative societies. These inputs provided nuanced insights into the opportunities and hurdles MFIs face as they navigate regulatory, operational, and market complexities. The insights drawn from this survey complement the broader analysis presented in this white paper, providing a real-time diagnosis of strategic priorities, customer engagement practices, and sectoral challenges.

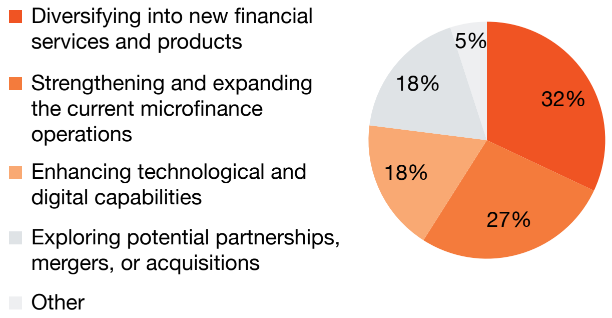
By integrating responses, the paper presents a data-led overview of the current mindset and future aspirations of the microfinance industry and also acts as a guide which offers recommendations for the future.

5.1 Future vision and strategy

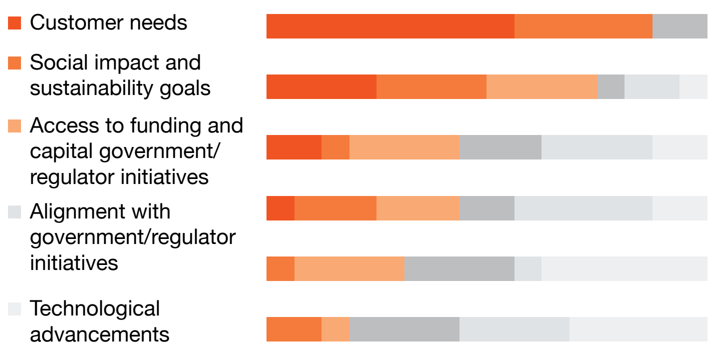
The survey results point to a measured reset and a clear path forward. The top strategic priorities of institutions are split between diversifying into new financial services and products (32%), strengthening core microfinance (27%), and enhancing technological capabilities (18%), with a similar share focused on exploring partnerships and M&As (18%). 33% of institutions plan to transition into a multi-product NBFC; 22% intend to remain NBFC MFIs; and 44% have no immediate plans to change form.

Figure 4: Future vision and strategy

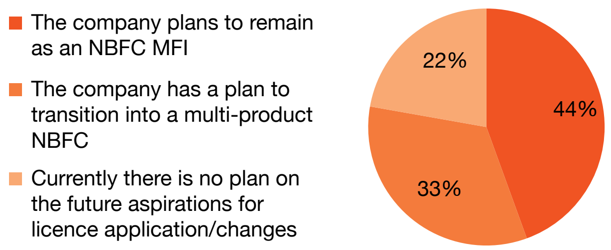
Long-term strategy



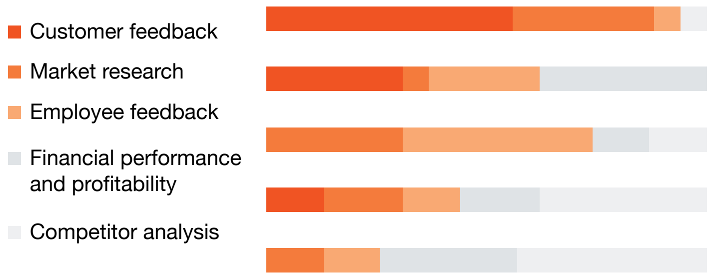
Strategic direction (in order of preference)



Decision to transform into a different licensed entity



Most valuable business insights (in order of preference)



Customer needs are the primary driver of strategic direction, followed by social impact and sustainability, access to funding, and alignment with regulatory initiatives. The respondents primarily rely on customer feedback and market research to shape priorities, alongside financial performance, while employee feedback and competitor analysis play supporting roles.

5.2 Customer satisfaction

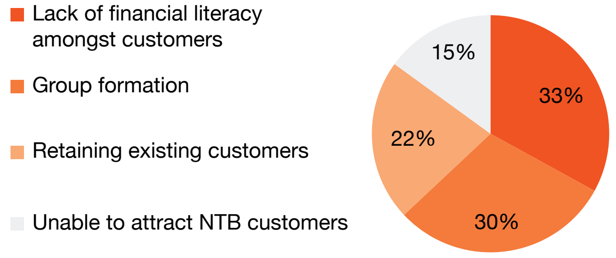
Customer service is now a frontline lever in the sector's efforts to rebuild trust. Survey responses show increased operational costs as the dominant constraint, with inconsistent staff behaviour and customer accessibility close behind. Institutions are responding by deploying dedicated customer service teams and conducting regular staff training. A smaller set of institutions is establishing customer advisory boards and providing online guides, with early use of digital review platforms. The emphasis on structured service aligns with the sector's quality-first reset and the need to stabilise early-bucket delinquency while containing ageing stress.

Figure 5: Customer satisfaction

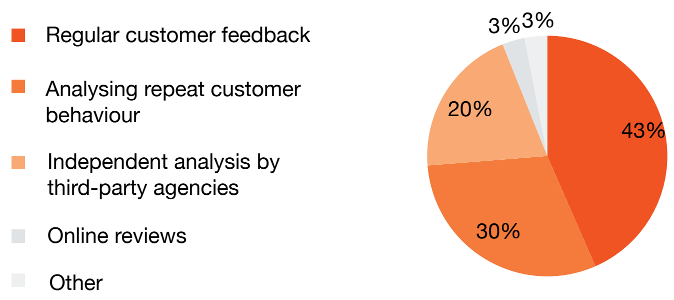
Challenges faced in providing customer service

Approaching customer service

Challenges in customer service



Metrics analysed for enhanced customer service



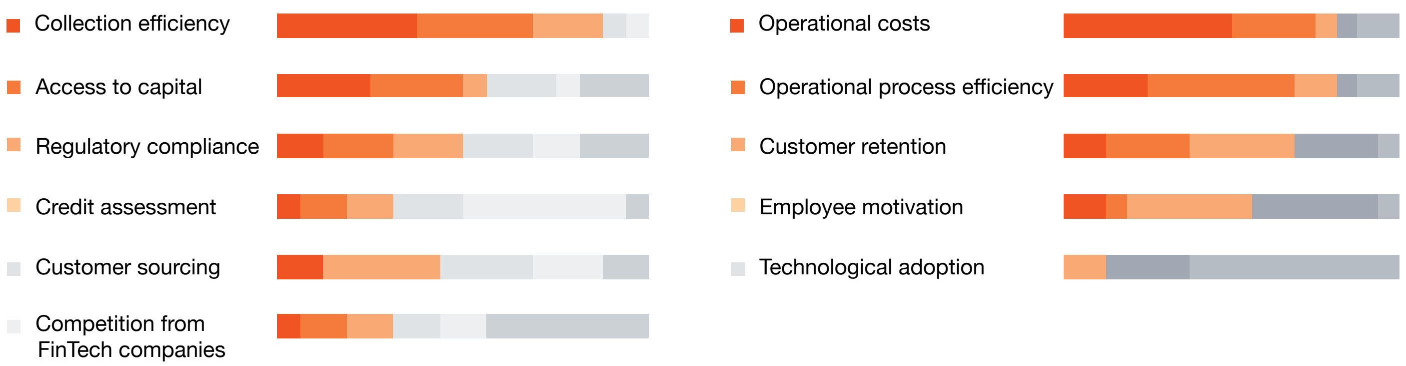
5.3 Key challenges faced by microfinance players

The survey highlights a clear set of pressure points in the sector. Collection efficiency and access to capital emerge as the most critical challenges, with regulatory compliance and credit assessment close behind. Customer sourcing and competition from FinTechs also feature prominently, indicating a crowded market and tighter underwriting requirements.

Figure 6: Key challenges faced by microfinance players

Most critical challenge for MFIs (in order of preference)

Biggest operational challenge for MFIs (in order of preference)



On the operations side, institutions identify high operational costs and process-efficiency gaps as the most significant hurdles, followed by customer retention, technological adoption, and employee motivation.

Taken together, these indicate for a quality-first approach which can stabilise collections, improve affordability assessment, streamline processes, and attract affordable funding.

5.4 IPO

The survey shows muted capital market ambitions in the near future. 13% of the respondents are already listed; 50% of the respondents do not plan to go public in the next 12 months, while 38% have no clarity yet. This aligns with a quality-first approach as MFIs prioritise portfolio health, conduct, and operating discipline before considering listings. Bank lines remain the practical funding anchors while institutions work to stabilise early-bucket stress and contain ageing delinquency.

Figure 7: IPO Plans

Plans for IPO

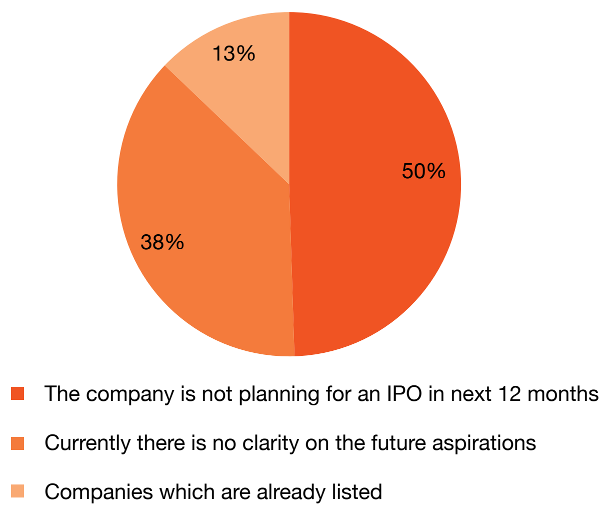
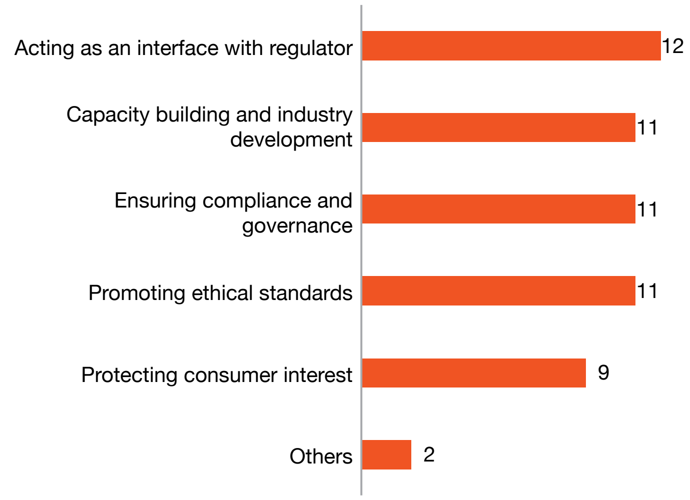


Figure 8: The role of SROs

Role of SRO



5.5 Role of SROs

Based on the survey insights (Figure 9) expectations from SROs are clear—acting as an interface with the regulator ranks first (12 mentions), followed by ensuring compliance and governance, capacity building, and promoting ethical standards (11 each). Protecting consumer interest is also prominent (9). The industry seeks more rigorous enforcement of governance standards related to income capture and exposure checks, and a more proactive public narrative to rebuild confidence.

SROs are considered the sector's liaison with regulators and are best positioned to identify early signals of stress and practices that require timely intervention. These roles would also further investor confidence in the sector.

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The road ahead

The future of the microfinance sector depends on achieving balanced growth anchored in trust and operational efficiency. Key priorities include adopting advanced technology at the right time for proper use cases, strengthening risk management frameworks, addressing talent shortages, and enhancing governance with clear accountability. Enhancing transparency and customer-centric practices will be central to rebuilding stakeholder confidence. Collaboration between industry players, regulators, and SROs is also essential to drive sustainable, inclusive, and resilient expansion. By focusing on the following areas, the sector can effectively navigate challenges and seize new opportunities in India's evolving financial landscape:

- **Scaling sustainably:** Building and expanding the market by focusing more on new-to-credit customers from existing and unexplored geographies, and analysing the existing database to re-evaluate the risk profile of customers previously earmarked as high-risk customers.
- **Stronger core systems:** Incorporate affordability and exposure limits directly into LOS workflows using detailed household cash-flow assessment, leveraging technology combined with bureau risk checks. Ensure local-language disclosures, digital consent records, and weekly grievance tracking dashboards to foster transparency and resilience.
- **Leverage technology for operational efficiency:** Integrate eKYC and consented data pulls through account aggregators, eSignatures, and transition collections to digitise all rails, such as UPI and BBPS, to reduce cash handling risks while enhancing accountability. Deploy agent apps featuring geotagged visits, standardised scripts, and workflow controls to reinforce conduct and operational efficiency.
- **Implement explainable risk analytics and early-warning systems:** Use transparent AI models to segment borrower risk profiles and deploy tailored interventions—from digital nudges to field restructuring efforts and focused recoveries—to improve portfolio quality and reduce defaults. Improved database accuracy can help CICs reduce data asymmetry.
- **Recalibrating to improve customer maturity:** As the ecosystem and the customers it serves continue to mature, institutions must evaluate adopting an individual-based lending model for enhancing customer service for financially literate and experienced customers with tailored credit solutions and flexible repayment options. At the same time, group lending remains the cornerstone for new-to-credit customer segments and developing markets. This balanced approach enables MFIs to improve portfolio quality by gradually transitioning mature

customers to individual lending products and driving financial inclusion through group lending models.
- **Development through financing:** Development institutions and policymakers should support the funding needs and requirements of MFIs to support the growth of the MFI ecosystem.
- **Strengthen the ecosystem with data-based predictions:** SROs can implement a comprehensive dashboard mechanism that aggregates key performance metrics from all member institutions on a historical basis. By systematically collecting and analysing this data, SROs can develop meaningful ratios and indicators, identify sector-wide patterns, and enhance forecasting capabilities. This data-driven approach can enable early detection of emerging risks through timely warning signals, supporting proactive interventions. Furthermore, integrating these insights into SRO quarterly publications could promote transparency, enhance stakeholder confidence, and strengthen the overall resilience and governance of the microfinance sector.
- **Elevate industry perception through SROs:** SROs can highlight the role of MFI in advancing financial inclusion by promoting data-backed success stories and ethical lending practices. Transparent communication from SROs can boost public trust and reinforce the sector's positive social impact, ultimately benefiting lenders. The capacity building programmes need to be conducted at multiple levels across the member institutions to enhance the role of MFIs in the country's economy.

MFIs are increasingly prioritising portfolio quality and rebuilding customer trust as foundational pillars for sustainable growth. The sector's renewed focus on meaningful financial inclusion seeks to empower underserved communities without compromising affordability or the borrower's financial well-being. While external shocks and economic uncertainties will continue to affect vulnerable populations with limited financial buffers, the microfinance industry must strive to be a source of resilience—not a burden. By fostering responsible lending, transparent practices, and supportive engagement, the sector can become an important enabler for improving the financial services for low-income households and strengthening India's path to inclusive development. SROs could also play a pivotal role in rebuilding public trust and highlighting the grassroots-level impact of the MFI sector.

By enhancing inclusion and fostering entrepreneurship through improved lending practices, microfinance could lead the way for the financial services sector to extend financial support to low-income families.

About Sa-Dhan

Sa-Dhan, an association of community development finance institutions, was formed in 1999. Over the last 27 years, Sa-Dhan has moved into various areas of impact to the poor, through direct interventions and through its member institutions. With more than 200 members, Sa-Dhan plays an important role in impact financing. Hence it has been rebranded as an Association of impact finance institutions. Among its members, Microfinance institutions are the major chunk, which include NBFC MFIs, non NBFC MFIs, SFBs, Banks, NBFCs etc. Also, it has BC partners who work with microlenders as its members. Together, Sa-Dhan members have reached more than 60 million households in the country and extended nearly ₹2.5 trillion loans.

Sa-Dhan is also recognised by RBI as a Self-Regulatory Organisation (SRO) for MFIs and has been working for over ten years as a SRO. It is also considered as a National Support Organisation and Technical Support Agency for NRLM and SRLMs. Sa-Dhan is engaged in various developmental and promotional activities such as promotion of climate-resilient agriculture, WASH financing, microenterprise development, financial literacy, digital literacy, affordable housing, rural health loan products, etc.

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