International Journal of Finance and Commerce
www.commercejournals.com
Online ISSN: 2664-715X
Received: 15-06-2026, Accepted: 15-07-2026, Published: 30-07-2026
Volume 8, Issue 3, 2026, Page No. 39-43

Does commercialisation of microfinance reinforce regional inequality in India? evidence from lender type, credit access, and risk profiles

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Abstract
The transition of the microfinance sector in India from a socio-developmental model to a commercialized, for-profit framework has sparked a critical debate regarding its impact on balanced regional growth. This research paper investigates whether the commercialisation of microfinance exacerbates existing regional inequalities in India. By analyzing contemporary data across various lender types—including NBFC-MFIs, Small Finance Banks (SFBs), and Commercial Banks—this study evaluates the geographical distribution of credit and its correlation with state-wise economic development.

The findings indicate a significant "mission drift," where commercial interests lead microfinance providers to gravitate toward economically active and infrastructure-rich regions, particularly in Southern India, while underserved regions like the North and North-East continue to face a credit vacuum. The study further examines how risk profiles and operational costs influence lender behavior, leading to higher interest rates and stringent credit access in lagging states. Through an empirical lens, the paper argues that while commercialisation has enhanced financial sustainability and scale, it has inadvertently reinforced a regional divide. The research concludes with policy recommendations, emphasizing the need for targeted regulatory interventions to incentivize lenders to expand into credit-deficient zones, ensuring that the goal of universal financial inclusion is not compromised by the pursuit of commercial profitability.

Highlights

- **Importance of Research:** To demonstrate how commercialisation of microfinance institutions contributes to regional disparities across Indian states.
- **Innovation:** Identifies concentration of microfinance institutions in economically viable regions.
- **Application:** Examines the role of MFIs and profit-driven models in shaping credit distribution.
- **Results:** Highlights implications for financial inclusion and equitable development.
- **Future Perspective:** Suggest policy measures to balance profitability with inclusive regional growth.

Keywords: Microfinance commercialisation, regional inequality, financial inclusion, NBFC-MFIs, credit access, risk profiling, Indian economy

Introduction

Background of the Study

The concept of microfinance in India has been changing over the last 30 years, whereby the existing system focused more on welfare to a more commercialised financial system. It was heavily the Self-Help Group (SHG)-Bank Linkage Programme that was launched in the early 1990s by the National Bank of Agriculture and Rural Development (NABARD) that led to the development of microfinance in India. Collective savings, employee monitoring, and marginalized population (especially rural women) monetary inclusion were the two key focus areas of this model. It was generally considered to be a socially responsible practice, which sought to reduce poverty and empower people, and not to make profits (NABARD, 2021) [10]. With time, the microfinance sector in turn experienced a structural change in the advent of the Non-Banking Financial Company-Microfinance Institutions (NBFCMFIs) which had grown in number and was expanding at a very rapid pace. These institutions have brought about more formalized and scalable lending model backed by the use of private capital, standardized operations and increased outreach ability. Commercialisation of microfinance facilitated the accelerated increase in the loan books and reach to borrowers and placed MFIs crucial to the financial inclusion aspect in India (Reserve Bank of India, 2022) [13]. This growth went in tandem with wider countrywide initiatives to encourage financial inclusion, including the Pradhan Mantri Jan Dhan Yojana, priority sector lending standards, and digital financial programs. These measures were used to make sure the underserved populations can have access to financial services, and microfinance is an important instrument in the mission of inclusive development (World Bank, 2022) [20]. Consequently, microfinance has through this turned out to become a part and parcel of the Indian financial ecosystem, reaching out to millions of low-income earner households. Although this is going on, there are still disparities in the delivery of microfinance services in India. In all empirical studies, it is indicated that microfinance is heavily restocked in the southern states of Tamil Nadu, Karnataka and Andhra Pradesh that contribute a heavy portion of total loan books. Conversely, there are still comparatively less penetration rates in microfinance within the northern and eastern parts, such as Bihar, Uttar Pradesh, Assam, and other states (MFIN, 2023).

Research Questions

- Does the process of commercialisation affect the way microfinance in India is distributed regionally?
- What are the variations in outreach by various categories of lenders (NBFCMFIs, SHGs, and banks) by region?

- How significant is risk-based lending towards the exclusion of certain areas to receive microfinance services?

Scope and Significance

This study presents Indian microfinance with special reference to regional differences; specifically, at the state level. It analyses credit distribution patterns, the presence of lenders and risk indicators in various regions based on secondary data covering reputable sources such as the Reserve bank of India, NABARD, MFIN, among others.

The context of the study is relevant as it has potential to contribute to academic and policy discourses on financial inclusion. In pointing out the correlation that exists between commercialisation and regional inequality, the study offers insights into the weakness of market-based approaches towards inclusive finance. It also provides evidence which could be used to make policy interventions that will enhance the accessibility of microfinance in low-served regions.

Policy-wise, the results could underpin the formulation of specific policies which could assist the government in pressurizing the financial institutions to extend their operation to the less developed regions. This can be in the form of incentives, reforms, and reinforcement of alternative frameworks like SHG-based lending. Finally, the research will have a role to play in ensuring that there is a more equitable and balanced Indian financial system.

Literature Review

The history of microfinance in India demonstrates how a shift has occurred towards a more organized and focused on commercial enterprise financial structure but initially in socially motivated development projects. Microfinance in India was initially established by the Self-Help Group (SHG)-Bank Linkage Programme set up by the National Bank of Agriculture and Rural Development [NABARD] in 1992. This model focused on collective saving, lending amongst peers, and as well as including marginalized citizens, especially women in rural regions. The SHG model was based on the principles of social capital and collective responsibility, and it was instrumental in broadening access to credit to those populations that do not have access to formal banking (NABARD, 2021) [10].

Financial inclusion has been one of the primary policy goals in India with the intention of accessing affordable financial services to all sectors of society. Microfinance has been well identified to be one of the essential tools of achieving this objective, especially to the low-income households and informal sector workers. The necessity to increase the availability of credit has been further supported by government policies like the financial inclusion push and priority sector lending standards (World Bank, 2022) [20].

Commercialisation of microfinance has been the focus of a lot of debate between academia and policy issues. Commercialisation is the rise in the activities, engagements, and investment of capitalism and profit-seeking organizations and market exchange practices in the microfinance industry. On the positive side, proponents believe that commercialisation leads to greater sustainability and scale of microfinance by limiting reliance on subsidies, as well as ensuring that institutional entities can access more clients (Cull *et al*., 2018) [4].

Risk-based lending may create access gaps in the financial services available in the regions. Microfinance institutions may pay less attention to areas that are considered as high-risk (poor income, poorly developed infrastructure or bad borrower repayment history). Concurrently, borrowers within the same regions can be charged an interest rate that is higher to reflect on the perceived risk (RBI, 2022).

Increased risk aversion, in turn, is brought about by profit orientation. When applied to microfinance, the risks are often or traditionally related to default by the borrowers or fluctuations in the income streams or institutional risk like poor infrastructure or lower financial literacy. To mitigate exposure, commercial MFIs utilize several risk evaluation instruments, such as credit scoring, portfolio management and geographic risk profiling. The practices relate to the risk management theory, which states that it is essential to reduce uncertainty in financial operations (Ledgerwood, 2013) [6].

Research Methodology

1. Research Design

In this study, a descriptive and analytical research design has been used, which is completely based on secondary data. The descriptive aspect is concerned with describing distributions of microfinance, lenders and inequalities within India. The analytical part takes a step further and seeks to interpret these trends in order to comprehend how commercialisation relates to the inequality between regions. This type of design would be suitable in research that has the goal of trying to generalize the current evidence and define patterns in the structure without using primary data collection. The evidence-based use of secondary research has been on the rise in studies of finance and development factors because of the presence of quality institutional data and reports. When applied in a systematized way, it helps researchers to make some meaningful inferences in large geographic regions and time (Johnston, 2017) [5].

2. Data Sources

The research is based on numerous sources of information that are credible and publicly available and they can be divided into three groups: institutional reports, international databases, and scholarly publications. The main source of the quantitative data is institutional reports. In the reserve bank of India (RBI) publications the banking trends, financial inclusion and credit distribution are thoroughly represented. NABARD reports provide in-depth information on the performance and target of Self-Help Group-Bank Linkage Programme whereas reports provided by the Microfinance Institutions Network (MFIN) show the NBFC-MFIs, including the loan portfolio and distribution by region. They are generally considered credible authoritative sources and frequently applied when making policies and as an academic subject (RBI, 2023). Other sources like international bodies like the World Bank and the International Monetary fund provide other data and analyses. These bodies present comparative indicators on financial inclusion, economic development and institutional performance. Their data sets come in especially handy in placing the sector of microfinance in India into a further international context (World Bank, 2021) [19]. Theoretical arguments and explanations of empirical results are supported with the help of academic literature (peer-reviewed journal articles). These works provide an understanding of the dynamics of microfinance such as commercialisation, risk assessment and disparities between areas. Utilizing more than one data source can make the research work more credible, since one is able to cross verify the information.

3. Data Selection Criteria

Clearly specified criteria are used to select the data to ensure that it is relevant, reliable and is comparable. First, the research lays special emphasis on recent data and that is generally within the past five to ten years. This will be used to make sure that the analysis has the trends in the microfinance sector and captures the recent changes in policy and institutional behaviour. Second, the data has to be able to make comparisons state-level or regionally. The data must be disaggregated and on a level that would allow a meaningful comparison among the different parts of the country since the study is about regional inequality. Only selectively are used sources providing only aggregate national figures, which are used mainly contextually. Third, factors that should be considered in selection of data are reliability and credibility. Only the information provided by the trustworthy institutions, peer reviewed articles and the established international bodies are provided. This minimizes chances of being biased and increases validity of the results. This focus on quality data corresponds to the best practices of secondary research, which argue the importance of considering the quality of sources and transparency of the methods (Johnston, 2017) [5].

4. Variables and Indicators

The study uses a range of wellchosen variables and indicators to examine the correlation between commercialisation and the inequality within the region. The commercialisation is evaluated with the help of the proxy variable that is lender type. The varieties of institutions including NBFC-MFIs, Self-help-groups as well as banks represent the different levels of commercialisation. NBFC-MFIs tend to be a better oriented profit-making company, whereas SHGs are more a social oriented company. This categorization will enable the research to study the impact that institutional factors have on lending behaviour. The indicators that are used to measure the levels of inequality within the region include credit penetration, the number of loan accounts and the total loan outstanding. The variables are used to give a quantitative access to the microfinance services in various regions. Non-performing assets (NPAs) and portfolio at risk (PAR) are some of the indicators that help in capturing the risk. This would be indicative of the quality of lending portfolio and amount of credit risk linked to various regions. Unless the level of risk is high, lending will be discouraged, which can lead to the differences between regions. Interest rates are used in the analysis of pricing as they represent clients of microfinance the price of a loan. The differences in the interest rates in different regions and types of lenders would offer information as to how the levels of risk and commercialisation would affect the pricing strategies.

5. Method of Analysis

The study uses both comparative analysis, trend analysis and cross-source synthesis. Instead of using higher levels of statistical modelling, the study is aimed at discerning patterns in the data and making associations between variables. The differences amongst the regions are analysed through comparative analysis especially where there are high penetrant and low penetration states. This method aids in finding out the trends of concentration and marginalization in the outreach of microfinance. Trend analysis will be used in the time-series of data. This is achieved by studying the trends over time to evaluate whether the disparities between regions are incremental or decreasing and the trends in respect to how commercialisation of microfinance is changing. Cross-source synthesis is the use of a variety of sources to synthesize data and knowledge towards a consistent meaning of the research problem. This approach makes the analysis even more solid, as it minimizes the dependence on any particular dataset and allows triangulating the data (Snyder, 2019) [17].

Data Analysis and Findings

1. Regional Distribution of Microfinance

The concentration patterns of the regional distribution of microfinance in India are high that is supported by all the three reports through quantitative evidence. MFIN review reports that microfinance sector had more than 80 million borrowers, and an outstanding portfolio of more than ₹4.3 lakh crore as on March 2024 (MFIN, 2024). Equally, the ORF report also affirms a similar level because an ORF loan portfolio of over ₹4.2 lakh crore and approximately 8 crore borrowers were reported as at June 2024 (ORF, 2025). This massive outreach is however not evenly spread. According to the Bharat Microfinance report, the operations of microfinance are geographically imbalanced with a lot of concentration being in particular areas. The entire state table will cover more than a couple of pages, although the report lists highest ranking states in terms of loan outstanding and borrower accounts, especially in southern India and western India.

It is also supported by the fact that the clustering also finds support in the district level outreach data that indicates that 722 districts, of the 108 aspirational districts, have coverage with some regions having greater strength than others do. This suggests geographic expansion but with regional concentration of depth of penetration (MFIN, 2024).

2. Lender-Type Distribution

There are two models that dominate microfinance model; SHG-bank linkage and JLG-based NBFC-MFI model. The Bharat Microfinance Report gives definite statistical data:

- **SHG Bank Linkage portfolio:** ₹2.60 trillion.
- **Microfinance portfolio:** ₹4.42 trillion based on JLG

This shows that the JLG model (insurance dominated mostly by NBFC-MFIs) has the biggest share of the lending in microfinance, indicating a shift in the dominance of commercialised institutions (Sa-Dhan, 2024) [15].

The rise of NBFC-MFIs signifies a change in structure to commercialisation. These banks are governed by the standardized lending models and are more focused on scalability that affects their geographic choices. On the other handSHGs have a wider reach into regions of less development given their social orientation.

3. Credit Access Patterns

The trend of accessing credit shows growth and lockout. The MFIN report reveals that only the regulated entities reach out 7.8 crore low-income customers, which is a lot of outreach. However, access remains incomplete. Data shows that:

- There are still 25-31% rural households that depend on informal sources of credit.
- The cost of informal lending is 10 times the cost of formal credit.

These numbers point to the fact that despite the massive increase, microfinance has not surpassed informal credit systems yet. The existence of informal credit implies unequal participation, especially in the areas where micro-institutions are less operative.

4. Interest Rate Patterns

The interest rates of microfinance are based on the operational costs as well as the risk factor. Regulatory concern in the MFIN report is about pricing, that there are still debates relating to the interest rate structures and that transparency is needed. The financial model of the sector entails higher interest rates as opposed to the normal banking activities because of:

- High transaction costs
- Small loan sizes
- Field-based operations

Bharat Microfinance Report also mentions the financial costs and operating costs as significant parts of the pricing varying among the institutions and regions (Sa-Dhan, 2024) [15]. The introduction of the weighted average calculation of interest rates in most institutions though with varying rates will be a good sign that price has a systematic relationship with cost structures and risk exposure.

5. Risk and NPAs

Indicators are vital risk factors that show the lending behaviour. Bharat Microfinance Report reports the growth of stress in some areas caused by heightened exposure to credit and local repayment issues.

According to the MFIN report, it has been noted that (MFIN, 2024):

- Fears of the quality of the portfolio and delinquency.
- Adequacy of external disruptions to repayment behaviour.

The ORF report also details the types of risks as (ORF, 2025):

- Credit risk (default risk)
- Operational risk
- Regulatory risk

Increased risk in some areas cause institutions to become cautious in their lending policies, such as lower exposure and more restrictive selection criteria.

6. Synthesis of Findings

A distinct pattern can be seen when all the variables are looked at in combination. This sector of microfinance has already reached a large scale, loan and credit of more than ₹4 lakh crore and borrowers of 8 crore which is however not evenly spread. The sector is dominated by commercialised institutions, especially NBFC MFIs which have a ₹4.42 trillion portfolio implying the existence of a big shift toward profit orientated lending. These institutions prioritize:

- High borrower density
- Strong repayment history
- Lower operational costs

Meanwhile, more at-risk areas and fewer infrastructures are under served. The improbability of extraction with 25%-31% of total reliance on informal credit emphasizes the missing links with formal inclusion. The combined factor results in the creation of a system where commercialisation promotes selective reaching out, where credit is concentrated in the favourable areas and access to it is restricted in other areas.

7. Hypothesis Evaluation

This research hypothesis insinuates that microfinance institutions that are commercialised focus on the low risk areas and this causes inequality in financial inclusion on a regional basis. This hypothesis is confirmed by the evidence. The pre-eminence of NBFC-MFIs with ₹4.42 trillion has been in the firstplace signifying that the commercial institutions also play the key role in the distribution of credit. Second, outreach is unevenly distributed with clustering in certain regions although it covers the whole country. Third, the presence of risk signals and unofficial reliance on credit proves that there are still obstacles in underserved areas.

The hypothesis is however tested to be true and not completely confirmed as:

- Absolutes have increased in microfinance.
- It covers 722 districts (underserved districts).

In this way, although commercialisation does not fully disregard poorer regions it simply demonstrates a focus on more viable markets strengthening regional inequalities.

Discussion

The results of the present paper prove that the growth of microfinance in India is characterized by a high level of regional concentration and not evenly distribution. Even though the sector has been able to reach out the masses, serving millions of borrowers and significant credit disbursement, the spatial distribution of financial services is a preference of institutions basing their decisions on the economic and operational factors. Microfinance institutions (MFIs), especially those that are commercially modeled like NBFC-MFIs are likely to focus on areas that provide good lending conditions.

Infrastructure is one of the major factors that influence this preference. Well developed physical and financial infrastructure in regions leads to effective provision of microfinance services. The smallscale borrowing (microfinance) business model is characterized by a very high frequency of interaction between the borrowers, operational field visits and collection of repayment where good transportation and communication infrastructure is essential. Regions that are better in terms of infrastructure, lower transaction costs and result in more efficient operations, which is more conducive to MFIs. Conversely, a poorly established infrastructure causes the cost of service delivery in the areas to be high and makes the areas less profitable, which will deter the institutional expansion (ORF, 2025).

The other major determinant is the density of the borrowers. Microfinance banks are small credit institutions, which survive when they have large numbers of small loans. Hence, high population regions enable the institutions to have economies of scale in that they serve many clients within the same geographical region. This lowers the operation costs per client, and enhances efficiency. Reports in the sector suggest that the geographic concentration is reinforced by MFIs being more likely to cluster in areas with concentration of borrowers, strengthening geographic concentration (MFIN, 2024).

Influence of repayment culture in the formation of institutional preferences is crucial as well. Microfinance models, especially group lending mechanisms rely on social collateral, and peer monitoring in order to help attain repayment. Areas where microfinance eco systems are well established tend to be well disciplined on repaying their loans, thereby minimizing risks of default and increasing the quality of their portfolios. Such regions are more likely to have more institutions due to predictable behaviour in terms of repayment, which leads to financial stability. In contrast, areas with less track record of repayment or areas with a low exposure to formal credit are perceived to be riskier and as such, institutional presence is lower (Sa-Dhan, 2024) [15].

These patterns are further supported by the risk considerations. Microfinance institutions are micro financial institutions, which face restrictions on financial sustainability and hence vulnerable to credit risk. Areas with volatile income or economic uncertainty as well as areas with social instability are morerisky to lend. Consequently, the institutions are likely to become cautious, with an exposure that is minimal in other places. This would be in line with general financial performance in which lenders encourage low risk conditions in order to sustain the quality of their portfolio and confidence of investors (Ledgerwood, 2013) [6].

Along with these structural factors, the competitive factors also affect the regional distribution. There has been evidence that MFIs tend to be situated around the same areas, with different borrower segments. This causes cluster effects by already established micro finance markets with the less served areas being left relatively unserved. This may also lead to several lending and over-indebtedness in some regions which makes the financial inclusion dynamics even more difficult (Reserve Bank of India, 2023) [14].

In general, results interpretation shows that a mixture of the availability of infrastructure, density of borrowers, culture of repayments, and risk estimation determines the regional distribution of microfinance. All these contribute to the institutional behaviour, leading to the marginalization and concentration of microfinance operations in certain areas, thereby marginalizing others.

Conclusion

This research indicates that although financial inclusion indicators have steadily increased over the years, such as access to and use of financial services, there is still a gap in credit supply and access. As commercialised institutions, particularly NBFC-MFIs have come to dominate the sector, their preference for low-risk, infrastructure-rich, and high-density regions has created a pattern of selective outreach that leaves underserved states comparatively behind. To overcome these difficulties, a set of policy actions like targeted incentives, strengthening SHG models, regulatory reforms and risk sharing reforms can be implemented. Moreover, institutional innovations and additional studies have to be combined. Addressing these structural tendencies requires a balanced approach one that combines regulatory intervention, strengthened SHG-based lending, and blended finance models to ensure that the benefits of microfinance reach all regions equitably, not merely the most profitable ones. Through providing a more inclusive and fair financial system by matching market forces with social goals, a fairer and more inclusive system can be established which will be beneficial in all regions.

Declarations

Funding Source: No funding received.

Acknowledgement: I would like to express my sincere gratitude to my supervisor, Dr. Sumant Meena and my co-mentors Dr. Saurabh Kumar Srivastava and Dr. Amit Rohilla for their invaluable guidance and support throughout the research.

Data Availability: Available on request

Authors' Contribution: Sole Author

*Use of AI and AI-Assisted Technologies: No AI-Assisted Technologies were used in writing

*Conflict of Interest: No conflict of interest

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