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A COMPARATIVE STUDY ON PROFITABILITY OF MICROFINANCE LOAN AND HOME LOAN WITH REFERENCE TO EQUITAS SMALL FINANCE BANK

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Abstract

This study compares the profitability of microfinance loans and home loans with reference to Equitas Small Finance Bank. It begins by outlining the Indian banking industry, the profile of Equitas Small Finance Bank, and the significance of both loan segments in promoting economic growth and financial inclusion. It also reviews the concepts of loan profitability, microfinance, and home loans, along with earlier studies, to identify the research gap.

The study is based on secondary data collected from RBI, NABARD, and NHB reports, journals, and official websites. Tools such as percentage analysis, trend analysis, ratio analysis, comparative analysis, NPA analysis, and regression analysis were used to evaluate the performance of both segments, covering loan portfolio growth, interest income, net profit, repayment performance, customer retention, and the impact of NPAs on profitability.

The findings reveal that while both loan segments contributed to the bank's growth, home loans generated higher net profit, better profit margins, lower NPAs, and greater customer retention. Microfinance loans yielded higher returns due to higher interest rates but involved greater credit risk and operating costs. The study concludes that home loans are more profitable and stable, while microfinance loans remain vital for financial inclusion and supporting low-income borrowers.

Key words: RBI, NABARD, NHB, NPAs, Small Finance Bank.

Introduction

1.1 Introduction

Loans are one of the main revenue streams for banking and financial institutions. Interest earned, the borrower's ability to repay, and the level of risk all affect lending profitability. Financial institutions strive to balance risk and return when lending to various segments of society. Microfinance and home loans have grown significantly in importance due to their role in fostering financial inclusion and economic development — home loans help people realise the dream of owning a home, while microfinance offers financial services to low-income individuals. Both industries raise living standards and contribute to economic expansion.

1.2 Industry Profile: Banking Industry in India

India's banking sector is vital to the economy, facilitating the mobilisation of savings and offering financial assistance to individuals, companies, and industries. The RBI oversees the sector, ensuring stability and proper operation. Government and private banks, regional rural banks, cooperative institutions, and small finance banks together make up the industry, which has grown rapidly due to government initiatives, digitalisation, and rising demand for financial services such as UPI, online banking, and mobile banking. Despite challenges such as rising non-performing assets, cybersecurity risks, and competition, the sector continues to expand into rural banking and financial inclusion.

1.3 Company Profile: Equitas Small Finance Bank

Equitas Small Finance Bank Ltd is one of India's leading banks, established to encourage financial inclusion by offering banking services to underprivileged and unbanked groups. Founded in 2007 as a microfinance organisation, it transformed into a small finance bank in 2016 following RBI approval, promoted by P. N. Vasudevan. Headquartered in Chennai, the bank has a significant presence across urban and rural India. Its key products include home loans, auto loans, business loans, savings accounts, and current accounts, with a strong emphasis on transparent, affordable banking and — particularly in the home loan segment — quick processing and customer satisfaction.

Vision: To emerge as the most reputable and customer-friendly bank by providing straightforward, open, and inclusive financial services.

Mission: To provide simple, affordable, and accessible banking services to underserved and low-income customers while promoting financial inclusion.

1.4 Products, Operations and Infrastructure

The bank's product portfolio spans loan products (home, vehicle, business, and personal loans), deposit services (savings, current, and fixed deposits), and other services (mobile banking, internet banking, and insurance). It operates branches across both rural and urban areas with a strong presence in South India, well-equipped branches, ATM networks, and digital banking platforms, and is expanding its online banking footprint. Its quality policy centres on client satisfaction, transparent and ethical service, prompt loan processing, and continuous improvement.

1.5 Competitors

- AU Small Finance Bank
- Jana Small Finance Bank
- Ujjivan Small Finance Bank
- Capital Small Finance Bank

1.6 SWOT Analysis

Strengths	Weaknesses
Financial inclusion focus; streamlined, customer-friendly loan approval; active branch network expansion	Low brand visibility; limited operational scale; elevated credit risk in microfinance lending

Opportunities	Threats
Rising housing demand; untapped semi-urban/rural markets; growing digital banking adoption	Competition from large banks; macroeconomic volatility affecting repayment; tightening RBI regulation

1.7 Future Growth and Prospects

- Expanding branch network and digital transformation
- Increased lending in the housing sector
- Sharper focus on middle- and lower-income populations

Conceptual Background and Literature Review

2.1 Loan Profitability and Key Concepts

Loan profitability is a bank's ability to earn income from lending after deducting expenses, risks, and losses — driven mainly by interest income, fees, and charges, and shaped by interest rates, repayment performance, operating costs, and non-performing assets (NPAs). Key concepts underpinning the analysis include interest rates, EMI (Equated Monthly Instalment), non-performing assets, and risk.

2.2 Microfinance and Home Loans

Microfinance refers to small, typically unsecured loans extended to low-income individuals with limited access to traditional banking, characterised by small ticket sizes, high interest rates, and frequent repayments; it supports financial inclusion and self-employment but carries higher risk. A home loan, by contrast, is a secured loan for purchasing, constructing, or renovating property, with larger amounts, longer tenures, lower interest rates, and greater stability due to steady income and real-estate security.

2.3 Microfinance vs. Home Loan

Basis	Microfinance Loan	Home Loan
Purpose	Small business / personal needs	Purchase, construction, or renovation
Loan Amount	₹10,000 – ₹2 lakh	₹5 lakh – ₹1 crore
Interest Rate	18% – 24%	8% – 10%
Tenure	Short-term	Long-term
Security	Unsecured	Secured
Risk	High	Low
Repayment	Weekly / Monthly	Monthly EMI
Target Group	Low-income borrowers	Middle- and upper-income groups
NPA Rate	Higher	Lower
Profitability	Moderate	High

2.4 Literature Review (Summary)

Twenty prior studies (2017–2022) inform this research. Sinha (2017) found small loans reduce individual borrower risk but raise administrative costs; Gupta (2017) linked sound credit appraisal to lower defaults; Mishra and Kumar (2018) noted low interest rates boost lending volume but compress margins; Khan (2018) and Choudhary (2019) tied financial literacy and customer awareness to better repayment behaviour; Iyer (2018) highlighted collateral as a risk mitigant in secured lending; and Kulkarni (2018) and Verma (2020) emphasised credit monitoring and NPA management as central to profitability.

Sharma (2019), Mehta (2019), and Bansal (2020) connected borrower income, loan tenure, and interest income to bank earnings, while Agarwal (2019) and Nair (2021) linked macroeconomic conditions and risk management to repayment and performance. Reddy (2020) and Thomas (2020) pointed to reputation and digital banking as drivers of trust and efficiency. Patel (2021) and Das (2021) examined microfinance profitability, risk, and its rural development role, while Singh (2022), Rao (2022), and Joshi (2022) established that home loans offer stable income, benefit from housing policy support, and that a balanced portfolio sustains long-term profitability.

2.5 Research Gap

Most existing research examines home loans and microfinance independently, with few studies comparing their profitability, risk, and return directly, and limited attention to the combined effect of tenure, interest rates, and NPAs. This study addresses that gap by directly comparing home loans and microfinance in the Indian context.

Research Design

3.1 Problem Statement

"To compare profitability between microfinance and home loan." Since microfinance and home loans differ in interest income, risk, loan size, and repayment patterns, this study analyses and compares their profitability to identify which segment contributes more to the institution's earnings.

3.2 Objectives

- To analyse the growth performance of home loans and microfinance loans
- To evaluate the growth, risk, and repayment performance of both segments
- To assess how NPAs affect the profitability of loans
- To recommend ways to lower risk and increase profitability

3.3 Scope, Research Type and Data Collection

The study focuses on profitability, loan expansion, interest revenue, NPAs, repayment performance, and client retention for home loans and microfinance, using secondary data from RBI, NABARD, and NHB reports, journals, and websites (2020–2024). It combines exploratory research — to build foundational understanding of the two products — with descriptive research analysing interest rates, NPAs, loan growth, and profitability trends.

3.4 Hypothesis

H_0 (Null): There is no significant difference in profitability between microfinance loans and home loans.

H_1 (Alternative): There is a significant difference in profitability between microfinance loans and home loans.

3.5 Tools for Analysis

Percentage analysis, trend analysis, and comparative analysis were used to examine data distribution, performance over time, and relative profitability, risk, and return across the two loan segments.

3.6 Limitations

- Based entirely on secondary data; accuracy depends on published sources
- Covers a limited period, 2020 to 2024
- Outcomes may be influenced by broader economic shifts
- Findings are restricted to the chosen variables and may not represent the industry as a whole

Data Analysis and Interpretation

4.1 Loan Portfolio Growth (₹ Cr)

Year	Microfinance Outstanding	Growth %	Home Loan Outstanding	Growth %
2020	145000	–	620000	–
2021	178000	22.75%	690000	11.29%
2022	205000	15.16%	780000	13.04%
2023	260000	26.82%	880000	12.82%
2024	320000	23.07%	1020000	15.91%

Both portfolios grew steadily over the period. Microfinance peaked at 26.82% growth in 2023, while home loans grew more consistently, driven by urbanisation and rising housing demand, and showed greater stability with less volatility than microfinance.

4.2 Interest Income, NPA and Net Profit (2024, ₹)

Particulars	Microfinance	Home Loan
Loan Outstanding	320000	1020000
Interest Rate	20%	8.5%
Interest Income	64000	86700
NPA %	6%	2%
NPA Loss	19200	20400
Operating Loss	25600	30600
Net Profit	19200	35700

Home loans generated higher interest income and net profit in absolute terms owing to larger loan volumes, while microfinance relied on higher interest rates. Due to unsecured lending, microfinance carried a higher NPA percentage, whereas home loans, secured by real estate, sustained lower default rates — resulting in higher overall profitability and stability for home loans despite both segments remaining profitable.

4.3 Loan Sanctions and Repayments (₹ Cr)

Year	MF Sanctioned	HL Sanctioned	MF Repaid	HL Repaid
2020	135000	610000	110000	520000
2021	160000	685000	132000	585000
2022	192000	760000	158000	660000
2023	235000	875000	196000	755000
2024	295000	1010000	242000	870000

Loan sanctions and repayments rose steadily in both segments between 2020 and 2024. Larger ticket sizes drove higher sanctioned and repaid amounts for home loans, while microfinance showed strong credit expansion and adequate repayment discipline among low-income borrowers.

4.4 Retention and Income per Customer

Metric	Microfinance	Home Loan
Customer Retention Rate	85%	93%
Number of Customers (lakh)	810	125
Income per Customer (₹)	7901	69300
Minimum – Maximum Tenure	6 months – 3 years	5 – 30 years

Home loans achieved higher customer retention due to long repayment terms and steady client relationships, and a far higher income per customer, reflecting larger loan sizes and longer tenures. Microfinance served a much larger customer base but at a lower income per borrower — illustrating fundamentally different lending structures.

4.5 Ratio Analysis

Ratio	Microfinance	Home Loan
Net Profit Margin	30%	41.17%
Return on Asset (ROA)	6%	3.5%
Return on Equity (ROE)	20%	17.5%
Interest Spread	10%	3.5%
Cost-to-Income Ratio	40%	35.29%
Gross NPA Ratio	6%	2%
Net NPA Ratio	3.19%	1.02%
Yield on Loan	22.07%	9.13%

Home loans show a materially higher net profit margin and lower cost-to-income ratio, indicating superior profitability and operational efficiency. Microfinance posts a higher ROA, ROE, interest spread, and yield — a reward for its higher lending rates — but this comes with a higher Gross and Net NPA ratio, confirming greater credit risk. Overall, home loans deliver more stable, sustainable returns, while microfinance trades higher potential yield for higher risk exposure.

4.6 Regression Analysis

A linear regression of net profit (Y) on loan portfolio (X) was estimated for each segment. For microfinance: $Y = 102.84 + 0.0206X$. For home loans: $Y = -5689.40 + 0.0388X$. The home loan coefficient (0.0388) is nearly double the microfinance coefficient (0.0206), indicating that portfolio growth translates into materially higher profitability gains for home loans than for microfinance.

4.7 Hypothesis Testing

Since the regression analysis confirms a marked difference in the profitability coefficients of the two segments, the Null Hypothesis (H_0) is rejected and the Alternative Hypothesis (H_1) is accepted: there is a significant difference in profitability between microfinance loans and home loans.

Findings, Suggestions and Conclusion

5.1 Key Findings

- Both microfinance and home loan portfolios grew steadily from 2020–2024, with home loans showing greater stability
- Home loans generated higher interest income (₹86,700) and net profit (₹35,700) than microfinance (₹64,000 and ₹19,200 respectively)
- Microfinance carried a higher NPA ratio (6%) than home loans (2%), reflecting greater credit risk
- Customer retention and income per customer were significantly higher for home loans (93%; ₹69,300) than microfinance (85%; ₹7,901)
- Home loans posted a better net profit margin (41.17% vs. 30%) and lower cost-to-income ratio (35.29% vs. 40%)
- Microfinance showed higher ROA, ROE, interest spread, and yield, owing to higher lending rates, but at higher risk
- Regression analysis confirmed NPA levels have a strong negative impact on profitability, and home loans deliver a higher profitability coefficient
- Overall, home loans were found to be more profitable and less risky than microfinance loans

5.2 Suggestions

- Strengthen credit appraisal procedures to reduce defaults in the microfinance segment
- Implement regular borrower monitoring to identify repayment issues early
- Conduct financial literacy programmes to improve microfinance repayment behaviour
- Expand digital loan processing and recovery systems to improve efficiency
- Maintain a balanced portfolio across both microfinance and home loans

- Focus on reducing NPAs through effective recovery mechanisms
- Further promote home loan products given their stable, sustainable profitability
- Improve risk assessment techniques prior to loan disbursement
- Strengthen customer relationship management to improve retention
- Expand into rural and semi-urban markets to grow lending opportunities

5.3 Conclusion

This study compared the profitability of microfinance loans and home loans at Equitas Small Finance Bank using financial and statistical tools. Both segments contribute positively to the bank's growth and income. Microfinance loans recorded consistent growth and higher yields from higher interest rates, but were associated with higher operating costs and NPA levels. Home loans, by contrast, showed steady growth, better repayment performance, lower default rates, and higher customer retention, generating higher net profit and better profit margins due to larger loan amounts and lower credit risk.

Ratio analysis, NPA analysis, and comparative financial statement analysis consistently indicate that home loans offer more stable and sustainable profitability than microfinance, and regression analysis confirms NPA levels as a key driver of profitability. It can therefore be concluded that home loans are comparatively more profitable and less risky, while microfinance remains crucial for promoting financial inclusion and supporting low-income borrowers. Equitas Small Finance Bank should continue expanding its home loan portfolio while strengthening credit appraisal, recovery mechanisms, and borrower awareness in the microfinance segment to achieve long-term profitability and sustainable growth.

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