



ASSESSING THE IMPACT OF MICROCREDIT PRACTICE ON THE QUALITY OF THE RETAIL CREDIT PORTFOLIO

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Abstract: *The thesis systematises the modern theoretical and empirical evidence on the impact of microcredit practice on the quality of the retail credit portfolio of commercial banks. Microcredit is treated as a set of small-scale lending products characterised by short maturities, high frequency of repayment, alternative collateral arrangements and reliance on group or joint-liability mechanisms. Drawing on the works of Morduch, Karlan and Zinman, Banerjee, Duflo, Glennerster and Kinnan, Cull, Demirgüç-Kunt and Morduch, Bhutta and Keys, Berg et al., IMF and BIS reports, the paper analyses two competing hypotheses — the diversification hypothesis and the risk-substitution hypothesis — and summarises the empirical evidence. A summary table of the two hypotheses is presented. The paper concludes that the net impact of microcredit on retail portfolio quality is context-dependent and requires country-specific empirical assessment supported by credit-bureau data.*

Keywords: *commercial bank, microcredit, retail credit portfolio, non-performing loans, over-indebtedness, financial inclusion, joint liability, digital lending, credit scoring, Republic of Uzbekistan.*

Introduction

Microcredit — the practice of extending small loans to low-income households and micro-entrepreneurs — has expanded from a Bangladeshi social experiment in the 1980s into a globally significant segment of the retail credit market with more than USD 200 billion in outstanding loans as of 2024. Commercial banks have increasingly entered this segment either directly or through partnerships with microfinance institutions and fintech platforms, thereby diversifying their retail credit portfolio and expanding financial inclusion. However, the impact of microcredit on the quality of the retail credit portfolio has been the subject of intense theoretical and empirical debate.

The relevance of the topic is reinforced by three factors. First, the rapid growth of digital microcredit and Buy-Now-Pay-Later services has multiplied the number of concurrent credit relationships of individual borrowers, increasing the risk of over-indebtedness. Second, macroprudential policy is increasingly focused on the interaction of microcredit and traditional consumer credit, and several emerging-market countries have introduced coordinated regulation. Third, in the Republic of Uzbekistan the microcredit segment has expanded rapidly since 2019, and the systematic assessment of its impact on retail portfolio quality has become an important direction of banking supervision.

The aim of this thesis is to systematise the modern theoretical and empirical evidence on the impact of microcredit on retail credit portfolio quality and to identify directions for its coordinated regulation, with particular reference to the Republic of Uzbekistan. The methodology relies on scientific abstraction, comparative and structural analysis and content analysis of publications indexed in Scopus and Web of Science over the last decade.

Main body

Modern theory identifies two competing mechanisms through which microcredit affects the quality of the retail credit portfolio. The first — diversification — hypothesis, supported by Morduch (1999), Cull, Demirgüç-Kunt and Morduch (2007) and Ahlin, Lin and Maio (2011), holds that microcredit expands the borrower base into segments with idiosyncratic default risk that is imperfectly correlated with the default risk of traditional bank borrowers. The joint-liability and group-lending mechanisms further mitigate credit risk through peer monitoring. Under this hypothesis, the entry of commercial banks into microcredit should improve overall portfolio diversification and reduce concentration risk.

The second — risk-substitution — hypothesis, supported by Banerjee, Duflo, Glennerster and Kinnan (2015), Karlan and Zinman (2010) and Bhutta and Keys (2016), holds that microcredit borrowers often use new small loans to service existing debt, generating a debt-treadmill effect that increases the probability of default across the borrower's entire credit relationships. The rapid expansion of digital microcredit and BNPL services has amplified this concern by making it easy for a borrower to accumulate multiple concurrent small loans that are not visible in traditional credit-bureau data.



The empirical literature has attempted to reconcile these two hypotheses within a country-specific and product-specific framework. Banerjee, Karlan and Zinman (2015) surveyed six randomised evaluations of microcredit programs and documented that the average impact on household welfare and default is modest and heterogeneous. Karlan and Zinman (2010) demonstrated in a South African field experiment that microcredit reduces the probability of default when integrated with credit-bureau reporting and DSTI-type screening, but increases it when granted without such integration. Meager (2019) provided a Bayesian meta-analysis of 27 microcredit studies and confirmed the heterogeneity of results. Berg, Burg, Gombović and Puri (2020) demonstrated that digital-footprint data can substantially improve the default prediction of microcredit borrowers who lack traditional credit history.

The macroprudential dimension of microcredit has been increasingly emphasised by the Bank for International Settlements (2024) and the IMF (2023), which document that in several emerging-market countries — notably India (2010), Bangladesh (2011), Cambodia (2017) and Kazakhstan (2020) — over-lending by microfinance institutions and digital platforms produced sharp increases in over-indebtedness, mass default and social distress. The Reserve Bank of India in 2011 introduced a comprehensive package of borrower-based caps for microcredit (maximum indebtedness, DSTI cap, mandatory credit-bureau reporting), which substantially stabilised the segment. The comparison of the two hypotheses is summarised in Table 1.

Table 1. Two hypotheses on the impact of microcredit on retail credit portfolio quality

Hypothesis	Key representatives (year)	Predicted impact on retail portfolio quality
Diversification hypothesis	Morduch (1999); Cull, Demirgüç-Kunt & Morduch (2007); Ahlin, Lin & Maio (2011)	Positive — microcredit adds idiosyncratic exposures, improves diversification
Risk-substitution hypothesis	Banerjee, Duflo, Glennerster & Kinnan (2015); Karlan &	Negative — over-indebtedness and debt-treadmill effects



	Zinman (2010); Bhutta & Keys (2016)	generate default contagion
Empirical synthesis	Meager (2019); Berg et al. (2020); BIS (2024)	Context-dependent; positive if integrated with credit bureau and DSTI screening, negative otherwise

For the Republic of Uzbekistan the coordinated regulation of microcredit and its integration with the traditional retail credit portfolio requires several coordinated measures. First, the mandatory reporting of all microcredit — bank, non-bank and digital — to the national credit bureau. Second, the introduction of a comprehensive borrower-based cap covering the sum of all microcredit and traditional consumer-credit obligations of the borrower. Third, the strengthening of DSTI screening at loan origination and the coordination with mandatory cooling-off periods for multiple concurrent loans. Fourth, the development of financial-literacy programs targeting low-income borrowers. Fifth, the systematic monitoring of over-indebtedness indicators and the publication of a national over-indebtedness report.

The role of joint-liability lending in the impact of microcredit on portfolio quality is a topic of particular theoretical importance. The original Grameen Bank model relied on joint-liability groups of five borrowers, in which the future access of the group to credit depended on the timely repayment of all members. Ghatak and Guinnane (1999) formalised the theoretical foundations of joint liability and demonstrated its comparative advantage over conventional individual lending in the presence of information asymmetries. However, Attanasio, Augsburg, De Haas, Fitzsimons and Harmgart (2015) empirically demonstrated that in a Mongolian field experiment individual-liability lending produced substantially better welfare outcomes than joint-liability lending, suggesting that the comparative advantage of joint liability depends on the specific institutional context.

The digital transformation of microcredit has qualitatively changed the risk profile of the segment. Bharadwaj, Jack and Suri (2019) documented the rapid expansion of mobile microcredit in Kenya through the M-Shwari platform and demonstrated both its financial-inclusion benefits and the emergence of new default risks associated with the low cost of application and the absence of face-to-face

interaction. Suri, Bharadwaj and Jack (2021) extended this analysis and demonstrated that the interaction of mobile microcredit with traditional bank credit generates complex spillovers that supervisors must monitor. In the Republic of Uzbekistan the emerging digital microcredit segment — including bank-fintech partnerships and standalone platforms — will require the coordinated development of the credit-bureau infrastructure and macroprudential regulation.

Conclusion

The conducted study leads to four generalising conclusions. First, the theoretical impact of microcredit on the quality of the retail credit portfolio is ambiguous, with the diversification and risk-substitution hypotheses generating opposite predictions. Second, the empirical literature — including six randomised evaluations synthesised by Banerjee, Karlan and Zinman (2015) and the Bayesian meta-analysis of Meager (2019) — confirms that the net impact is context-dependent and depends critically on the integration of microcredit with the national credit bureau and on the presence of borrower-based screening.

Third, the macroprudential experience of India, Bangladesh, Cambodia and Kazakhstan demonstrates that unregulated microcredit expansion can generate sharp increases in over-indebtedness, mass default and social distress, but that borrower-based caps combined with mandatory credit-bureau reporting can effectively stabilise the segment. Fourth, for the Republic of Uzbekistan the priority directions of further work are the mandatory reporting of all microcredit to the national credit bureau, the introduction of a comprehensive borrower-based cap, the strengthening of DSTI screening, the development of financial-literacy programs and the systematic monitoring of over-indebtedness indicators. The consistent implementation of these directions will strengthen the resilience of the retail credit portfolio and support the responsible expansion of financial inclusion.

In addition, the study identifies several institutional priorities for the Republic of Uzbekistan. First, the establishment of a unified regulatory perimeter covering all providers of microcredit — banks, microfinance institutions, digital platforms and Buy-Now-Pay-Later services — and their mandatory reporting to the national credit bureau. Second, the introduction of a comprehensive borrower-based cap covering the sum of all microcredit and traditional consumer-credit obligations of the borrower. Third, the development of financial-literacy programs targeting low-income

borrowers, in coordination with schools, employers and community organisations. Fourth, the systematic monitoring of over-indebtedness indicators through a dedicated national statistical exercise, in cooperation with the State Statistics Agency. The consistent implementation of these institutional priorities will support the responsible expansion of financial inclusion and strengthen the resilience of the retail credit portfolio.

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