THE ROLE OF MICROFINANCE IN INDIAN ECONOMY

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ABSTRACT:

Microfinance helps in lifting people out of poverty,empowering women, and promoting the overall economic growth. The success story of Bangladeshis a powerful example where poverty was reduced from 44% to 20% in 30 years. This paper explores the basics of finance of inclusion and microfinance focusing on their role in India's economic growth. This study explores the impact of microfinance on agriculture, fisheries, micro and small enterprises and also focuses on Self-Help Groups (SHGs) to empower women.However, microfinance faces various challenges such as limited employment, high operating costs, regulatory and social barriers. The importance of interventions in various forms such as, regulatory reform, and improved financial literacy have been discussed.This study focuses on the areas which ensures that microfinance remains a tool for financial inclusion and financial liberalization, enabling an inclusive and sustainable economy.

Keywords: Microfinance, Financial Inclusion, Self Help Groups, Sustainable Economic Growth

INTRODUCTION

As noted by the United Nations Press (2005), **Kofi Annan** rightly stated that"Microfinance is not charity. In some cases, it might have started out as philanthropy. But today it is real business**(United Nations, 2005).**"

Microfinance and financial inclusion are interconnected concepts and both are aimed at enhancing economic opportunities for marginalized populations. Microfinance provides small loans and savings options to people in developing areas who don't have access to traditional banks**(Sonam et al., 2024)(Lahiri, 2024).**Conversely, financial inclusionaims to ensure that all individuals and businesses have access to affordable financial products and services to meet their needs. (**Lahiri, 2024).** Together, these concepts work to empower disadvantaged groups, reduce poverty, and stimulate economic growth.

According to the Reserve Bank of India's Regulatory Framework for Microfinance Loans, 2022, a microfinance loan is defined as a collateral-free loan offered to households with an annual income of up to ₹3,00,000. A household is considered a single-family unit consisting of a husband, wife, and their unmarried children in this context**(Reserve Bank of India, 2022).**As per the guidelines any collateral-free loan, regardless of its end use, application method, or mode of disbursal (whether physical or digital), qualifies as a microfinance loan with the condition that it is extended to low-income households that meet the specified income threshold.

To maintain the collateral-free nature of such loans, they cannot be secured against a lien on the borrower's deposit account.The Reserve Bank of India mandates that regulated entities (REs) implement a governing framework that ensures adaptability in loan repayment schedules. This framework must also allow borrowers to choose a repayment plan which can aligns with their financial circumstances**(Reserve Bank of India, 2024).**

Muhammad Yunus, a Bangladeshi social entrepreneur, economist, and banker is best known for pioneering microfinance and founding Grameen Bank. His work in providing small, collateral-free loans to the poor, particularly womenhas helped millions escape poverty. For his contributions to economic and social development, he was awarded the Nobel Peace Prize in 2006**(Mohite, 2024).**His establishment of

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Indian Journal of Business Administration (IJBA)
(A National Peer Reviewed Refereed Journal)
ISSN: 0975-6825, Volume 17, Issue 2, July-December 2024, pp. 08-17
the Grameen Bank in Bangladesh was an innovative approach which significantly influenced poverty reduction by providing financial services to the underserved, and women. Yunus's model emphasizes social business principles with an integration of economic viability with social objectives. This fosters entrepreneurship and self-sufficiency among the poor. The concept of microcreditpioneered by Yunusoffers small loans without collateral, which has empowered millions to start businesses and improve their livelihoods **(Mwemezi, 2023).**Further his initiatives particularly target women to enhance their economic independence and social status, which is crucial for community development **(Pokharel, 2022).**

SIGNIFICANCE OF MICROFINANCE

Microfinance extends financial services to those individuals who are excluded from traditional banking systems. It helps in promoting entrepreneurship, increasing household incomesand thereby contributing to overall community development. The following sections outline its key contributions. Microfinance initiatives have been shown to increase household income by an average of 28% among beneficiaries **(Ashraf et al., 2024)**. Microfinance contributes to local economic growth by providing individuals with the means to establish and grow small businesses and thereby help in generating employment opportunities and enhancing productivity **(Lahiri, 2024).** It also plays a crucial role in empowering women by enabling self-employment and strengthening their household financial stability. Participation in Self-Help Groups (SHGs) further supports women’s entrepreneurial development and fosters community cohesion which leads to improved health and education **(Shrestha, 2024).**

Microfinance has significantly impacted the socio-economic landscape of Bangladesh, particularly in poverty alleviation and women's empowerment. While it has fostered entrepreneurship and improved living standards, the effectiveness of microfinance initiatives is nuanced, with both positive outcomes and challenges.Microfinance has led to increased incomes, with studies indicating an average income rise of 14.6% among beneficiaries**(Sonia et al., 2024).** It has improved food security and housing conditions, contributing to overall better living standards**(Shah, 2024).** The Ansar-VDP Unnayan Bank's initiatives have had a notable impact on nutritional intake and financial well-being which highlights the importance of targeted microcredit programs**(Shahjahan et al., 2024).**Microfinance organizations have been instrumental in enhancing women's agency and enabling them to participate in decision-making and economic activities**(Bosu, 2024).** Women beneficiaries report improved household income and increased political participation, showcasing the transformative potential of microfinance for gender equity **(Bosu, 2024).**Microfinance has fostered social cohesion and community engagement, as beneficiaries often participate in group activities that enhance social capital**(Shah, 2024).** However, repayment pressures from MFIs can lead to mental stress and social stigma, indicating a need for more supportive repayment strategies **(Chowdhury, 2023).**By offering access to essential financial services, microfinance institutions empower individuals to participate in economic activities, thereby improving livelihoods and supporting community development. This approach reduces poverty and also promotes growth in developing regions such as India.**(Sonam et al., 2024)**.

MICROFINANCE IN INDIAN ECONOMY

Microfinance in India emerged as a response to the financial exclusion of economically weaker sections. It provides collateral-free loans to individuals, particularly women and rural entrepreneurs, helping them start small businesses and improve their livelihoods.Microfinance is integral to India's socio-economic framework especially in poverty alleviation and women's empowerment. By providing financial services to underserved populations, microfinance institutions (MFIs) facilitate economic growth and improve living standards.

GROWTH OF MICROFINANCE IN INDIA

Microfinance in India started with the establishment of SEWA bank in 1974 in Gujarat. Since its inception, microfinance has been instrumental in extending financial inclusion to individuals who have traditionally lacked inclusion in the formal economic system.

India Brand Equity Foundation (2022) discusses the evolution of microfinance in India. Regarding regulatory measures, the Malegam Committee proposed specific interest rate limits for Non-Banking Financial Company-Microfinance Institutions (NBFC-MFIs) based on the scale of their lending operations.It proposed a profit limit of 10% for NBFC-MFIs with loan portfolios over US$1 billion, while smaller institutions faced a 12% cap.Additionally, the committee suggested a 24% ceiling on individual loans. The final regulatory framework, issued on December 2, 2011, standardized the margin cap at 12% for all NBFC-MFIs and set a 26% cap on individual loan interest rates. However, recognizing the need for greater operational flexibility in response to fluctuating borrowing costs, the fixed interest rate cap of 26% was removed in 2012. Nonetheless, a regulatory constraint remained, ensuring that the variation between the highest and lowest interest rates charged on individual loans could not exceed 4%.**(India Brand Equity Foundation, 2022)**

The 1990s marked a period of rapid growth for microfinance in India. The establishment of the National Bank for Agriculture and Rural Development (NABARD) in 1982 played a pivotal role in promoting microfinance initiatives. Introduced in 1992, NABARD's Self-Help Group (SHG)-Bank Linkage Programme emerged as a fundamental component of India's microfinance strategy to promote the establishment of SHGs and also to incorporate them into the formal banking system.**(Chakrabarti & Sanyal, 2016).**

In 2010, the microfinance sector faced a significant crisis in Andhra Pradesh due to allegations of coercive recovery practices and high-interest rates. This resulted in the implementation of the Andhra Pradesh Microfinance Ordinance, imposing strict regulations on MFIs**(Saxena, 2014).**In response, the Reserve Bank of India (RBI) implemented a regulatory framework for Non-Banking Financial Company-Microfinance Institutions (NBFC-MFIs) to promote ethical lending standards and safeguard borrowers' interests**(Reserve Bank of India, 2024).** The Microfinance Institutions (Development and Regulation) Bill, 2012, was introduced to formalize governance mechanisms for the microfinance sector.

The Small Industries Development Bank of India (SIDBI) published the 19th edition of the Microfinance Pulse Report in March 2024. It presents an in-depth assessment of the microfinance sector's performance, covering data and trends up to September 30, 2023.

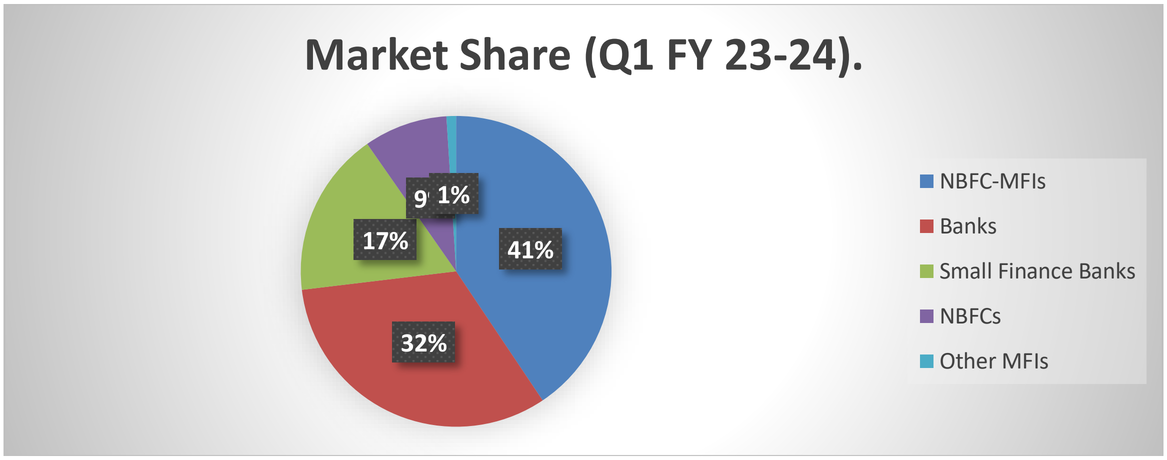
Table 1: Performance of the Microfinance Industry

Key Areas	Performance
Portfolio Outstanding	₹362,702 crore (as of Sep 30, 2023), covering 127 million active loans and 66 million unique borrowers.
Institutional Contributions	NBFC-MFIs accounted for the largest portion (41%) of the total portfolio.
Growth Trends	34% YoY growth in portfolio outstanding, 10% QoQ increase from June 2023.
Disbursement Patterns	₹93,232 crore disbursed (July–Sep 2023), up 21% in value and 6% in number of loans YoY.
Loan Ticket Sizes	₹40,000–₹50,000 loan bracket saw 48% YoY growth.
Aspirational Districts	₹49,073 crore portfolio outstanding (Sep 2023), 27% growth YoY. Loans worth ₹51,056 crore disbursed (Oct 2022–Oct 2023).
Roll Rate Analysis	Small Finance Banks (SFBs) showed lowest transition rates in delinquency, reflecting strong risk management.

Source: SIDBI (2024), Microfinance Pulse Report (Vol. XIX)

Dr. Alok Misra, CEO and Director of MFIN, underscored the steady expansion of the microfinance industry and emphasized the importance of responsible financial inclusion in sustaining this growth. He highlighted the notable rise in client outreach and the overall improvement in portfolio quality, reflecting the sector's increasing stability and impact**(Microfinance Institutions Network, 2023).**

Figure 1: Institutional Market Share in Microfinance (Q1 FY 2023-24)



Source: Microfinance Institutions Network. (2023)

The figure represents the institutional market share in India's microfinance sector for first quarterof financial year2023-2024. NBFC-MFIs hold the largest share at 40.6%, followed by banks (32.5%) and Small Finance Banks (17.2%). NBFCs account for 8.7%, while other MFIs contribute just 1.0%.The dominance of NBFC-MFIs reflects their extensive reach in microfinance lending, while banks and SFBs continue to play a vital role in financial inclusion. The smaller share of other MFIs indicates the sector's shift towards regulated financial institutions to enhance credit access and portfolio stability **(Microfinance Institutions Network, 2023).**

The expansion of India's microfinance sector is influenced by various interconnected factors that promote access to financial services and support economic development with especial focus ondisadvantaged group.The expansion of India's microfinance sector is driven by various interconnected factors that promote access to financial resources and support economic development. A considerable share of the people, especially in remote regions, lacks access to conventional banking services which highlight the need for alternative financial solutions.Key factors driving the expansion of India's Microfinance sector include the high demand for credit among rural populations, the effectiveness of Self-Help Groups (SHGs), and the necessity of financial services for economically underserved communities.**(Devi, 2024).** Regulatory measures have been implemented to ensure the sustainability and accountability of MFIs, which has bolstered confidence among borrowers **(Kauser & Zubairi, 2022).**

ROLE OF MICROFINANCE IN INDIAN ECONOMY

Microfinance in India operates through diverse models, each tailored to enhance financial inclusion and cater to the credit needs of underserved populations. Introduced by NABARD in 1992, the Self-Help Group (SHG)-Bank Linkage Programme (SBLP) remains a highly impactful model which allows small groups, primarily composed of women, to accumulate savings and access bank credit as a collective unit. The SHG-Bank Linkage Program has been pivotal, enabling households to secure loans, thereby improving income and financial stability**(Odhrani, 2024).**

Similarly, the Joint Liability Group (JLG) model facilitates group-based lending, particularly benefiting small and marginal farmers, by fostering collective responsibility for loan repayment. The Grameen Model, inspired by Bangladesh's Grameen Bank, relies on peer accountability, reducing default risks through group-based lending practices. Additionally, cooperative models, such as the SEWA Cooperative Bank, ensure democratic decision-making and profit-sharing among members. Another important approach is the NBFC-MFI model, in which Non-Banking Financial Company-Microfinance Institutions (NBFC-MFIs), overseen by the Reserve Bank of India (RBI), offer collateral-free microloans to low-income borrowers.They provide tailored financial products to underserved populations, addressing the gap left by traditional banks**(Kauser & Zubairi, 2022).**The Banking Correspondent (BC) model extends microfinance services to remote areas by appointing agents to facilitate loan disbursal and financial literacy initiatives. They are instrumental in connecting formal banking services with unbanked communities.**(Balasubramanyam, 2022).**

In recent years, the digital microfinance model has gained prominence by utilizing FinTech innovations such as smartphone-based financial services, artificial intelligence, and online credit platforms to facilitate seamless and paperless access to microcredit. Together, these models have been instrumental in expanding financial services, promoting entrepreneurship, and reducing poverty. The integration of digital technologies has significantly reshaped India's microfinance sectorin rural and underserved regions.The increasing affordability of smartphones and improved internet access have enabled Microfinance Institutions (MFIs) to streamline their services through digital platforms, leading to greater efficiency in loan origination, improved customer service, and the development of more flexible financial products.

Policy measures like the Pradhan Mantri Jan-Dhan Yojana (PMJDY) and the Digital India program have been instrumental in driving this transformation by advancing digital banking and enhancing financial literacy. The PMJDY has enabled the establishment of over 417 million bank accounts, significantly expanding banking access across the country.Furthermore, the widespread issuance of Aadhaar numbers has facilitated electronic Know Your Customer (e-KYC) processes, simplifying client onboarding and verification procedures **(KPMG, 2021).**

As a result, MFIs are now better equipped to serve an increasingly digitally literate clientele, ensuring greater accessibility, efficiency, and transparency in microfinance operations. The integration of FinTech solutions into microfinance has thus contributed significantly to India's overarching goal of financial inclusion and economic empowerment **(KPMG, 2021).**

NABARD has worked to bridge the gap between banks and SHGs by supporting Village-Level Programmes (VLPs). In FY2024, 15,794 VLPs were conducted, bringing the cumulative total to 66,357, facilitating account openings, credit linkages, and loan repayment regularity. Additionally, NABARD has collaborated with Anniyam Solutions to introduce the Money Purse (MP) App, a digital financial service platform aimed at providing real-time, paperless banking for SHG members in rural areas.Furthermore, NABARD has actively promoted Joint Liability Groups (JLGs) to expand credit access for marginal and small-scale borrowers, encouraging collateral-free lending. As of March 31, 2024, 331.3 lakh JLGs have been financed, with 73.3 lakh new JLGs added in FY2024 alone. The institution also prioritizes capacity building, having trained 3.15 lakh stakeholders in FY2024, contributing to a cumulative total of 50.2 lakh individuals under financial inclusion initiatives**(NABARD, 2024).**

MFI AND AGRICULTURE

Microfinance improves agricultural productivity and strengthen the socio-economic well-being of rural farmers in India.By extending financial services to individuals marginalized by the banking system, microfinance institutions empower farmers to invest in agricultural inputs, improve their livelihoods, and contribute to rural development. Agriculture continues to be the foundation of the Indian economy, providing a primary source of livelihood for a significant portion of the population. Microfinance plays a critical role in supporting small and marginal farmers by providing them with access to credit for purchasing seeds, fertilizers, and equipment. Self-Help Group–Bank Linkage Programme (SHG-BLP) has played a pivotal role in providing financial services to farmers who have limited access to conventional banking systems**(NABARD, 2024).**Microfinance institutions (MFIs) offer agricultural loans to small farmers, reducing reliance on informal moneylenders. With the Kisan Credit Cards (KCCs)credit facilities are provided to SHG members for short-term agricultural needs.Training and Support through LEDP (Livelihood and Enterprise Development Programme) for organic farming, horticulture, and animal husbandry are supported through financial assistance and capacity-building programs **(NABARD, 2023).**

FINANCIAL INCLUSION

Microfinance has been a crucial catalyst for financial inclusion, enabling marginalized and low-income communities to access important financial services.This is especially significant in rural and semi-urban areas, where access to formal banking networks is constrained. Access to credit and savings facilities enables individuals to secure small loans for investment in micro-enterprises without the need for collateral. Microfinance programs promote financial literacy by providing training on digital transactions and banking processing order to foster greater engagement with formal financial services.

With access to social security schemes, microfinance beneficiaries are included in government initiatives such as the Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY) and Pradhan Mantri Suraksha Bima Yojana (PMSBY) **(NABARD, 2024).**

While microfinance penetration is high in southern India, efforts are being made to extend services to the northeastern, central, and northern regions, which remain underserved **(BIRD, NABARD, 2024).**

WOMEN’S EMPOWERMENT

Women represent a substantial share of microfinance beneficiaries in India, with the sector playing a transformative role in enhancing their socio-economic well-being.Programs such as NABARD’s Micro Enterprise Development Programme (MEDP) and LEDP focus on skill-building and entrepreneurship among women **(NABARD, 2024).**Under MEPD women are trained in skills such as tailoring, food processing, and handicrafts, enabling them to start micro-businesses.The establishment of women-centric Self-Help Groups (SHGs) strengthens women's financial independence and promotes their involvement in decision-making processes.Initiatives like the MUDRA loan scheme provide financial assistance to women entrepreneurs.

Availability of financial resources and credit empowers women to overcome traditional socio-cultural barriers, promoting both economic and social advancement.Engagement in microfinance initiatives enables women to manage financial assets more effectively and enhance their influence in household decision-making and improving their overall well-being.**(Devaraju et al., 2024).**The Self-Help Group–Bank Linkage Programme (SHG–BLP), led by the NABARD, has played animportant role in promoting financial inclusion and fostering rural development.As of FY2024, the programme has extended affordable and sustainable credit to 17.8 crore rural households, strengthening their access to mainstream banking. During FY2024 alone, ₹2,09,285.9 crore was disbursed to 54.8 lakh SHGs, demonstrating the increasing scale of the initiative. The programme has significantly empowered rural women, enabling them to save, borrow, and build social capital, reducing dependence on informal lenders **(NABARD, 2024).**

Kudumbashree, the Kerala State Poverty Eradication Mission, has been a pioneering initiative in promoting women's empowerment through microfinance since its establishment in 1998. It functions through a structured three-tier organizational framework, consisting of Neighbourhood Groups (NHGs) at the grassroots level, Area Development Societies (ADS) at the ward level, and Community Development Societies (CDS) at the local governance level. With a membership exceeding 4.6 million women, Kudumbashree provides financial support and facilitates socio-economic development, enabling women to enhance their livelihoods, participate in decision-making, and engage in local governance.Unlike conventional poverty alleviation programs, Kudumbashree adopts a multi-dimensional approach to empowerment. It combines microfinance with skill development, entrepreneurship support, and social welfare initiatives that enable women to achieve financial independence. It also helps in enhancing their health, nutritional status, and overall well-being. The initiative underscores the importance of enabling women to understand and exercise their rights, recognizing this as a fundamental prerequisite for sustainable poverty alleviation. By fostering financial inclusion and enhancing women's participation in economic and community development, Kudumbashree serves as a model for inclusive growth and empowerment **(Kudumbashree,2024).**

FISHERIES AND ALLIED SECTORS

Fisheries contribute significantly to India's economy, particularly in coastal and inland rural areas. Microfinance has supported this sector by providing financial aid for infrastructure development and livelihood support. The impact of microfinance on the livelihoods of small-scale fish farmers in India is significant, particularly in enhancing financial stability, reducing indebtedness, and promoting socio-economic development. Microfinance industry has emerged as crucial players in supporting farmers, leading to improved living standards and economic empowerment. MFIs have been effective in decreasing the level of indebtedness among marine fisherfolk, with a reported reduction of up to 75% after joining an MFI**(Vipinkumar et al., 2013).**

NABARD's Fisheries and Aquaculture Infrastructure Development Fund (FIDF) has facilitated financial Support for Fishermen's Cooperatives. It allowed access to microcredit which enabled fishermen to purchase boats, nets, and cold storage facilities to improve productivity. With the expansion of inland aquacultureSmall-scale fish farmers receive funding to develop inland fisheries as an alternative livelihood source **(NABARD, 2023).**Integration with Rural Credit Mechanisms helped Fishermen and aquaculture entrepreneurs to benefit from low-interest loans and microfinance support through SHGs.

MICROFINANCE AND ASSOCIATED CHALLENGES

Microfinance in India serves as a key driver for expanding financial access and empowering underserved communities.However, it faces several key challenges that hinder its effectiveness. These challenges include high interest rates, inadequate infrastructure, and regulatory issues, which collectively impact the sustainability and reach of microfinance institutions (MFIs).

Many MFIs charge exorbitant interest rates, which can lead to borrower exploitation and increased debt cycles**(Kumar & Singh, 2024).** This practice undermines the intended benefits of microfinance, particularly for low-income individuals.Insufficient infrastructure hampers the efficient delivery of services, especially in rural areas**(Monish, 2024).**The COVID-19 pandemic intensified these challenges, as mobility restrictions disrupted conventional lending processes.**(Sangwan et al., 2021).**A lack of effective regulation allows for practices like multiple lending, leading to credit pollution**(Devi, 2024).**Financial illiteracy among borrowers further complicates their ability to manage loans effectively**(P, 2024).**

Regulatory constraints also strain MFIs, that compliance requirements consume a significant portion of their budgets, challenging their sustainability. Moreover, capital constraints lack of skilled workforce and over indebtedness of borrowers aggravate the issue further. Traditional norms and gender roles restrict women from participating in financial In India, borrowing often carries a social stigma, which hinders the effectiveness of MFIs in certain communities. Geographical barriers & regional inequalities also restrict the outreach of MFIs.

CONCLUSION AND SUGGESTIONS

Microfinance has been pivotal in expanding financial access and enhancing the economic empowerment of underserved communities in India.It has enabled individuals, women and rural entrepreneurs by providing small, collateral-free loans and improved their livelihoods. Government initiativeshave further strengthened its impact to encourage economic growth.High interest rates,indebtedness, policy and regulatory constraints persist and resist its growth. In order to address these issues responsible lending, financial literacy, and the integration of technology is required. Further to enhance accessibility and efficiencysustained policy support and innovation will be essential.

Regulatory frameworks for microfinance institutions (MFIs) need to be made more flexible to promote their sustainable growth. To accomplish this, the government should work in partnership with the RBI to streamline compliance requirementsfor smaller MFIs.Additionally, engaging in discussions with policymakers to advocate for more supportive regulations is essential. Bangladesh provides a relevant example, where the adoption of a "tight but light" regulatory approach has led to a more dynamic and resilient microfinance sector.

Addressing capital constraints is equally important, and this can be achieved by diversifying funding sources, as demonstrated by Ujjawal Financial Services (MFIN). The recommendations of the Y.H. Malegam Committee (2010) also offer valuable guidance for enhancing the financial sustainability of MFIs. The committee emphasized that interest rates should remain reasonable and affordable, with a margin cap—defined as the difference between the cost of funds and the lending rate—not exceeding 10%. Furthermore, adhering to the *Panchsutra* principles of Self-Help Groups (SHGs) can help maintain the financial integrity of MFIs.

Beyond financial reforms, creating a more supportive social ecosystem for microfinance is crucial. Financial literacy initiatives play a key role in this process, with NABARD's financial literacy centers and various NGOs working to improve financial awareness. Promoting gender inclusivity is also essential, and institutions such as Mahila Udyan Nidhi have been instrumental in supporting women entrepreneurs in rural areas through targeted loans and capacity-building programs. Additionally, addressing the regional disparities in MFI distribution can be effectively managed through the extensive network of Primary Agriculture Credit Societies (PACS), which operate at the block level across the country.

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