

## **Evaluating the Impact of Microfinance on Socioeconomic Development in India: A Comprehensive Assessment**

Jaydeep Odhrani

Dubai International Academy, Emirates Hills

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### **ABSTRACT**

*Given that access to conventional financial services is rather limited, particularly in rural areas, microfinance serves as a significant driver of social and economic development. The purpose of this study is to analyze the effect of microfinance, with a focus on self-help groups (SHGs) and microfinance institutions (MFIs), in tackling poverty, women empowerment, and financial inclusion in India. This study, based on secondary sources and the analysis of such, shows that programs like the SHG-Bank Linkage Program have enabled low-income households to access credit and led to improved income generation and financial stability. Women, who comprise the majority of MFI clients, have particularly benefited, gaining greater empowerment and decision-making power within their households and communities. Despite these successes, however, challenges remain, such as regional differences in accessing microfinance resources and rising non-performing assets (NPAs), which were worsened by COVID-19. The study also highlights the immediate need for targeted interventions such as financial literacy programs, improved risk management, and digital financial solutions, in order to keep microfinance's role in inclusive growth.*

### **1. Introduction**

India's rural economy is mostly comprised of agricultural revenues, with approximately 70% of rural households that rely on farming as a primary source of income.<sup>1</sup> This dependence on agriculture, however, brings about a lot of challenges due to the fragmented nature of landholdings, limited access to modern farming technologies, and unpredictable weather patterns. According to the National Sample Survey Office, about 86% of farmers in India are

<sup>1</sup> "Contribution of Agriculture in GDP - Check Latest Data As Per 2023."

categorized as small, who hold less than 2 hectares of land.<sup>2</sup> These small-scale farmers face constant financial shortages, as they oftentimes lack the collateral needed to access formal banking services, which push them reside with informal lending at incredibly high interest rates.

The financial inclusion gap in rural India is noticeably large. And despite various governmental initiatives and banking reforms, a significant part of rural households is still underserved by traditional banking institutions. For example, the 2017 Global Findex Database shows that only around 80% of Indian adults have a bank account, but many of these accounts remain inactive due to limited financial literacy and irregular income flows.<sup>3</sup> In addition to that, the rural credit system appears to be dominated by informal credit sources, as estimates suggest that 40% of credit needs are still met through non-institutional lenders, contributing to a vicious cycle of debt and poverty for a lot of small-scale farmers.<sup>4</sup>

In this context, microfinance has emerged as an important tool for socioeconomic empowerment where it provides much needed financial services such as credit and insurance to low-income households. According to the 2023 Bharat Microfinance Report, the microfinance sector in India has grown substantially, with a gross loan portfolio USD41.8 billion as of March 2023, which is a huge jump of 21% from the previous fiscal year.<sup>5</sup> The number of microfinance loan accounts has also gone up, which further shows the increasing reach and impact of MFIs and SHGs in rural areas.

It appears that MFIs and SHGs are the main actors of this financial inclusion effort, who are working to bridge the gap between formal financial institutions and underserved populations. As of 2023, for example, India had over 213 microfinance institutions, 99 of which operate within a single state and 114 that provide services in a number of states.<sup>6</sup> These institutions are responsible for disbursing a staggering amount of USD39.3 billion in loans during fiscal year 2022-23, which is a 28% year-on-year growth in microfinance disbursements. And it important to note that the average loan per borrower increased to USD402 from USD358 in 2022. This, in essence, indicates a greater willingness among institutions to lend higher amounts to micro-entrepreneurs.

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<sup>2</sup> Gulati, Saini, and Roy, "Going Beyond Agricultural GDP to Farmers' Incomes."

<sup>3</sup> "India Moves Toward Universal Financial Inclusion | Blog | CGAP."

<sup>4</sup> BCG, "Credit Disrupted Digital MSME Lending in India"

<sup>5</sup> Sa-Dhan, "The Bharat Microfinance Report 2023"

<sup>6</sup> Sa-Dhan, "The Bharat Microfinance Report 2022"

Over the last two decades, microfinance programs have shown that providing small loans to low-income households can actually lead to significant improvements in their economic well-being, even in the absence of traditional collateral. The Self-Help Group - Bank Linkage Programme, launched in 1989 by the National Bank for Agriculture and Rural Development, is widely regarded as the largest microfinance program in the world, reaching over 160 million households across India. The SHG-BLP has helped mobilize over USD25.7 million in savings from SHGs, which not only helps in meeting the immediate credit needs of its members but also encourages a culture of saving among rural women.

Microfinance has also played a pivotal role in increasing access to formal financial services in some of India's most underserved regions. While Southern India continues to dominate the microfinance landscape in SHG savings-linked accounts, there has been significant growth in other regions as well. For instance, the Eastern region has seen an expansion of SHG activities, driven in part by government programs aimed at improving financial inclusion. However, regional disparities remain a challenge. The Northern and Northeastern regions continue to lag behind in terms of outreach, representing only a tiny fraction of savings-linked SHGs.

## **2. Literature Review**

Several studies have highlighted the positive effects of microfinance on socioeconomic development in India, particularly in addressing the financial needs of excluded households. Rajesh et al. (2019) examined the origins of microfinance in India and emphasized the various delivery models, including the Self-Help Group-Bank Linkage Program and the Microfinance Institution Model.<sup>7</sup> These models have been pivotal in expanding access to credit for rural and low-income households, with SHGs now encompassing over 13.4 million members as of 2023, showing a rise in outstanding loans from 2018. Sharif (2018) explored the performance of MFIs, noting increased loan portfolios despite a reduction in the total number of loans obtained from formal financial institutions.<sup>8</sup> As of 2023, the gross loan portfolio of MFIs had grown to USD24 billion, with 74% of the disbursements directed towards rural areas. However, certain marginalized groups, particularly SC/ST borrowers, have seen their representation slightly decline, indicating continued barriers in accessing microfinance services.

Hoda and Gupta (2015) and Sharma (2022) highlighted the importance of SHGs in promoting financial inclusion. Gupta et al. reported a steady rise in average SHG savings, which reached

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<sup>7</sup> Rajesh et al., "FINANCIAL AID SCHEMES AND ACCESS FOR THE UNDERPRIVILEGED."

<sup>8</sup> Mohd, "A Study on the Performance of Microfinance Institutions in India."

USD522 in 2023.<sup>9</sup> However, Sharma pointed to challenges in group functionality, such as dropout rates and regional disparities.<sup>10</sup> SHGs in Northern and Northeastern India face greater obstacles compared to their Southern counterparts, where microfinance is more established. The role of microfinance in women's empowerment has been widely acknowledged, with studies by Desai et al. (2022) affirming that access to credit has significantly improved the economic and social standing of women in rural India.<sup>11</sup> These women are not only engaging in income-generating activities but are also becoming more active in household decision-making and community leadership.

However, concerns about the sustainability of microfinance initiatives have been raised. Banerjee et al. (2015) found that while microfinance helps smooth household consumption and provides resilience to financial shocks, it has had limited impact on long-term income growth or business investment.<sup>12</sup>

### **3. Methodology**

This study is based on secondary data collected from various journals, reports, and surveys related to microfinance in India. The data has been analyzed to assess the performance of SHGs, MFIs, and other microfinance providers, with a focus on loan disbursements, savings, NPAs, and the regional distribution of services. Additionally, the study evaluates the impact of microfinance on key socioeconomic indicators, such as income generation, poverty reduction, and women's empowerment.

### **4. The Concept of Microfinance in India**

Microfinance in India operates through two main models: the SHG-Bank Linkage Model and the Microfinance Institution Model. The SHG-Bank Linkage Program was launched by the National Bank for Agriculture and Rural Development in 1989, and it has since become the most widely adopted microfinance model in the country. Through this program, SHGs, which consist of 10-20 members, primarily women, pool their savings and access loans from banks. This model has proven to be effective in reaching low-income households, particularly in rural areas.

MFIs, on the other hand, are non-banking financial institutions that provide microcredit to

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<sup>9</sup> Hoda and Gupta, "Faith-Based Organizations and Microfinance."

<sup>10</sup> Sharma, "AN ANALYSIS OF PERFORMANCE OF MICRO FINANCE IN INDIA."

<sup>11</sup> Desai and Garg, "Empowering Women to Make Strategic Life Choices."

<sup>12</sup> Banerjee et al., "The Miracle of Microfinance?"

individuals and groups. Unlike SHGs, MFIs operate on a for-profit basis and often rely on external funding from commercial banks and foreign donors. Both models have significantly contributed to financial inclusion in India, but they face distinct challenges, such as high NPAs and regional disparities in service provision.

## **5. Impact of Microfinance on Socioeconomic Development**

- **Poverty Alleviation and Income Generation**

Microfinance has been pivotal in addressing poverty in rural India by providing marginalized populations with access to essential financial services, primarily credit. Traditionally, low-income households, particularly those dependent on agriculture, lacked access to formal banking institutions due to factors like low creditworthiness, lack of collateral, and geographical isolation. MFIs and SHGs have helped bridge this gap by offering small loans tailored to the needs of rural communities, enabling these households to invest in income-generating activities.

A report from the National Bank for Agriculture and Rural Development reveals that, between 2018-2023, the total number of SHGs with savings accounts linked to banks increased by over 33%, from 10 million SHGs in 2018-19 to 13 million SHGs in 2023. This growth has led to significant improvements in household income levels and financial stability. Many SHG members use microloans to start or expand small businesses, such as tailoring, livestock farming, handicrafts, and retail shops, which in turn creates employment opportunities within the community.

A study by the Institute of Rural Management Anand also supports these findings, showing that microfinance programs have resulted in a 10-15% increase in household income for many rural families. This additional income helps not only in improving living standards but also in building household assets, reducing vulnerability to financial shocks such as medical emergencies or crop failures. By allowing families to access affordable credit, microfinance significantly reduces their dependence on informal moneylenders who often charge exorbitant interest rates.

- **Women's Empowerment**

One of the most transformative impacts of microfinance in India has been its role in empowering women, particularly in rural areas where societal norms often restrict women's access to formal employment and financial independence. Women constitute approximately 98% of all MFI clients in India, according to the Bharat Microfinance Report 2023.<sup>13</sup> Through microfinance, women are able to access credit without the need for collateral, giving them the opportunity to

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<sup>13</sup> Sa-Dhan, "The Bharat Microfinance Report 2021 BMR-2021"

engage in income-generating activities that were traditionally dominated by men or were out of reach due to financial constraints.

SHGs, in particular, have played a critical role in fostering women's empowerment by creating platforms for collective action. According to NABARD, SHGs have not only increased women's access to financial services but also fostered leadership and organizational skills among rural women. These groups allow women to pool resources, share experiences, and participate in decision-making processes both within the group and in their households. Studies have shown that women who are part of SHGs are more likely to take on leadership roles in their communities, participate in local governance, and advocate for their rights, contributing to improved gender equality in rural areas.

A study by the United Nations Development Programme found that women who had access to microfinance were more likely to invest in their children's education and health, breaking the cycle of poverty across generations.<sup>14</sup> For example, a 2018 survey of SHG members in Tamil Nadu revealed that 82% of women reported an increase in household decision-making power, particularly in areas related to finances and investments, as a result of participating in microfinance programs.<sup>15</sup>

- **Financial Inclusion and Regional Disparities**

While microfinance has expanded its reach significantly across India, there remain stark regional disparities in the distribution of services. The Southern and Eastern regions of India dominate the microfinance landscape, accounting for the majority of SHG savings and credit linkages. As of 2023, the Southern region accounted for 30.8% of SHG savings-linked accounts, followed closely by the Eastern region at 29.3%.<sup>16</sup> This reflects the historical success of microfinance programs in Southern states like Andhra Pradesh, Tamil Nadu, and Karnataka, where SHGs and MFIs have been more active and better supported by local governments and financial institutions.

In contrast, the Northern and Northeastern regions of India lag behind in terms of microfinance outreach. For instance, only 5.9% of SHG savings-linked accounts were found in the Northern

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<sup>14</sup> UNDP, "Women's Economic Empowerment and Financial Inclusion."

<sup>15</sup> Sivakami et al, "Women Self-Help Groups and Climate Change in the Grassroots: Evidences from Thiruvavur District, South India"

<sup>16</sup> Pandey, "Status of Microfinance In India: A Review of Growth And Current Perspective of SHG-Bank Linkage Program In India."

region, and an equal 5.9% in the Northeastern region as of 2023.<sup>17</sup> The reasons for this disparity are complex and include factors such as political instability, geographic isolation, lack of infrastructure, and lower levels of financial literacy in these regions. Consequently, these underserved regions still rely heavily on informal lending practices, further exacerbating the financial exclusion of vulnerable populations.

Efforts to address these disparities have been made in recent years, with NABARD and MFIs increasing their focus on expanding outreach to underrepresented regions. NABARD's SHG-Bank Linkage Program, which grew by 25% between 2018 and 2023, aims to bring financial services to more households in the Northern and Northeastern regions. Additionally, there has been a concerted push to improve financial literacy in these areas, with NGOs and governmental initiatives providing training to SHG members to ensure they can effectively manage their savings and investments.

Despite these efforts, challenges remain in ensuring that SHG savings translate into productive investments and sustainable income generation for all members. A study by the World Bank found that while SHGs have significantly increased access to credit, many groups in underdeveloped regions face difficulties in turning these loans into long-term economic gains due to a lack of market access and entrepreneurial skills.<sup>18</sup>

- **Non-Performing Assets (NPAs)**

A significant challenge facing the microfinance sector is the issue of non-performing assets, which have worsened in recent years, particularly during the COVID-19 pandemic. Many borrowers, especially those in rural areas dependent on agriculture, struggled to repay their loans due to the economic disruptions caused by lockdowns and the subsequent loss of income. The NPA ratio for MFIs rose sharply from 4% in 2020 to 11.60% in 2021, reflecting the widespread financial distress among borrowers.<sup>19</sup>

However, there has been some recovery since the peak of the pandemic. By 2023, the NPA ratio had improved slightly to 10.31%, according to NABARD's status report on microfinance.<sup>20</sup> While this is an encouraging trend, the NPA levels remain a concern for the sustainability of microfinance programs, particularly for smaller MFIs that lack the financial resilience of larger

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<sup>17</sup> "Inclusive-Finance-India-Summit-Report-2022"

<sup>18</sup> World Bank, "Sustainability of Microfinance Self Help Groups in India."

<sup>19</sup> MFIN, "India Microfinance Review FY 2022-23"

<sup>20</sup> NABARD, "Status of Microfinance in India 2022-23."



institutions. The high levels of NPAs in certain regions, particularly in the Northern and Northeastern regions, further compound the challenges of expanding microfinance in these areas.

The pandemic revealed the need for more robust risk management practices within the microfinance sector. Many experts argue that MFIs need to diversify their client base and product offerings to mitigate risks associated with over-reliance on specific income sources, such as agriculture, which is prone to seasonal and environmental vulnerabilities. Furthermore, there is a growing emphasis on improving financial literacy among borrowers to ensure that they can manage their debt effectively and avoid defaulting on loans.

While the microfinance sector has demonstrated resilience in the face of economic challenges, addressing the issue of NPAs is critical for ensuring the long-term sustainability of microfinance programs in India. Strengthening risk management practices and providing more targeted support to the most vulnerable borrowers will be key to maintaining the progress made in poverty alleviation, women's empowerment, and financial inclusion.

## **6. Conclusion**

Microfinance has undeniably been a cornerstone in India's pursuit of inclusive socioeconomic development, with tangible progress made in poverty alleviation, women's empowerment, and financial inclusion. Programs like the SHG-Bank Linkage Program and the efforts of Microfinance Institutions have transformed millions of lives by extending financial services to underserved populations, fostering entrepreneurship, and promoting economic self-reliance. The sector has been particularly successful in empowering women, who make up the majority of microfinance clients, enabling them to break free from traditional constraints and become key contributors to their families and communities.

However, while microfinance has shown immense potential, the sector is not without its challenges. Persistent regional disparities, particularly in Northern and Northeastern India, continue to limit the full potential of microfinance in addressing financial exclusion. Furthermore, the rising issue of non-performing assets, exacerbated by the COVID-19 pandemic, poses a significant threat to the long-term sustainability of microfinance programs. The high default rates highlight the fragility of many borrowers' economic conditions and call for more robust financial literacy programs and risk management practices to safeguard both the institutions and the individuals they serve.

To fully harness the transformative power of microfinance, policymakers and stakeholders must take decisive action. Addressing the regional imbalances requires targeted interventions to extend the reach of microfinance services to underserved areas, particularly through infrastructure development, digital finance solutions, and localized financial literacy initiatives.



Strengthening the capacity of SHGs and MFIs to manage risks, diversify their financial products, and enhance borrower education will be crucial in reducing NPAs and ensuring sustainable growth. Moreover, integrating technology into microfinance operations—such as mobile banking and digital payment systems—can further enhance the efficiency, transparency, and reach of these services.

Ultimately, the future of microfinance in India rests on its ability to evolve and adapt to changing economic landscapes while remaining focused on its core mission of uplifting the poorest and most vulnerable populations. With the right support, including strong regulatory frameworks, continuous innovation, and capacity-building initiatives, microfinance can continue to play a pivotal role in achieving India's broader goals of inclusive growth and sustainable development, making financial empowerment a reality for all.

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