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Micro-Finance and Micro-Credit System in India: A Study of Financial Inclusion, Poverty Alleviation, and Inclusive Development

Dr. BOJJA. SRIDEVI

Associate Professor

Government Degree College

Yellandu Bhadradi Kothagudem Telangana

Abstract

Microfinance and microcredit have become central pillars of India's financial inclusion strategy, aiming to integrate economically marginalized populations into the formal financial system. The Self-Help Group–Bank Linkage Programme (SHG-BLP) has emerged as the backbone of microfinance delivery, while Microfinance Institutions (MFIs), NBFC-MFIs, and government-led initiatives have significantly expanded outreach. This research paper critically examines the evolution, institutional framework, delivery models, socioeconomic impact, regulatory mechanisms, and challenges of microfinance in India. It further explores the role of digital integration and financial literacy in enhancing the sustainability and effectiveness of microfinance as a tool for poverty alleviation and inclusive development. The study concludes that while microfinance is not a standalone solution to poverty, it remains an indispensable support system for inclusive growth when combined with appropriate regulation, capability building, and development linkages.

Keywords: Microfinance, Microcredit, Financial Inclusion, SHG-Bank Linkage Programme, MFIs, Poverty Alleviation, Inclusive Development, India

1. Introduction

Financial exclusion remains one of the most persistent challenges in India's development trajectory. A significant portion of the population, particularly in rural and informal sectors, lacks access to formal financial services due to low incomes, lack of collateral, irregular employment, and limited financial literacy. In this context, microfinance has emerged as an innovative mechanism to bridge the gap between the formal banking system and the economically marginalized.

Microfinance refers to the provision of small-scale financial services—including microcredit, savings, insurance, and remittance facilities—to low-income

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individuals who are traditionally excluded from conventional banking. Microcredit, a subset of microfinance, focuses specifically on providing small loans to support self-employment, micro-enterprise development, and consumption smoothing. In India, microfinance has evolved into a structured system supported by banks, MFIs, government institutions, and regulatory bodies.

2. Objectives of the Study

The main objectives of this research paper are:

1. To examine the evolution of microfinance and microcredit in India
2. To analyze the institutional and operational models of microfinance
3. To assess the role of microfinance in financial inclusion and poverty alleviation
4. To study regulatory frameworks governing microfinance in India
5. To identify challenges and limitations of the microfinance system
6. To explore future prospects through digital integration and financial literacy

3. Research Methodology

This study is **descriptive and analytical** in nature and is based on **secondary data** collected from:

- Academic journals and research papers
- Reports of NABARD, RBI, and Government of India
- Books and policy documents
- Published data from MFIs and financial institutions

The paper adopts a qualitative approach to analyze trends, impacts, and challenges in the microfinance sector.

4. Evolution of Microfinance in India

The origins of microfinance in India can be traced back to informal credit systems such as moneylenders and rotating savings groups. However, the formal microfinance movement began in the early 1990s with the launch of the **Self-Help Group–Bank Linkage Programme (SHG-BLP)** by NABARD in 1992.

The SHG-BLP aimed to link informal self-help groups with formal banking institutions, enabling poor households—particularly women—to access savings and credit services. Over time, the success of SHG-BLP encouraged the growth of Microfinance Institutions (MFIs), which expanded outreach using group-based and individual lending models. The sector witnessed rapid growth in the 2000s, followed by a regulatory overhaul after the 2010 Andhra Pradesh microfinance crisis.

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5. Microfinance Models in India

5.1 SHG-Bank Linkage Programme

The SHG-BLP is the largest microfinance model in India and one of the largest globally. SHGs typically consist of 10–20 members, predominantly women, who pool savings and access bank credit collectively. The group mechanism replaces collateral with social trust and peer accountability, resulting in high repayment rates.

The SHG model promotes:

- Savings discipline
- Women's empowerment
- Reduced transaction costs for banks
- Community-based financial inclusion

5.2 Microfinance Institutions (MFIs)

MFIs operate as specialized financial intermediaries providing microcredit to low-income borrowers. NBFC-MFIs, regulated by the RBI, constitute the dominant segment. MFIs use Joint Liability Groups (JLGs) and individual lending models to extend credit efficiently, particularly in underserved regions.

While MFIs have expanded outreach rapidly, concerns regarding high interest rates, over-indebtedness, and commercialization have attracted regulatory scrutiny.

5.3 Government-Led Microfinance Initiatives

Government schemes such as:

- **Deendayal Antyodaya Yojana – National Rural Livelihoods Mission (DAY-NRLM)**
- **Pradhan Mantri Jan Dhan Yojana (PMJDY)**
- **Pradhan Mantri MUDRA Yojana (PMMY)**

have strengthened microfinance by improving access to bank accounts, credit, and livelihood support services.

6. Role of Microfinance in Financial Inclusion

Microfinance plays a crucial role in advancing financial inclusion by:

- Providing access to formal credit
- Encouraging savings habits
- Reducing dependence on informal moneylenders
- Integrating marginalized communities into the banking system

SHGs and MFIs act as intermediaries between banks and the unbanked, enabling inclusive participation in financial markets.

7. Impact on Poverty Alleviation and Inclusive Development

7.1 Economic Impact

Microcredit supports income-generating activities such as small businesses, agriculture, animal husbandry, and self-employment. It helps households manage income volatility and cope with financial shocks.

7.2 Social Impact

Microfinance contributes to:

- Women's empowerment
- Improved household decision-making
- Increased participation in local governance
- Enhanced social capital

However, evidence suggests that microfinance reduces **poverty vulnerability** rather than eliminating poverty entirely.

8. Regulatory Framework

The Reserve Bank of India regulates NBFC-MFIs to ensure:

- Responsible lending
- Transparency in pricing
- Borrower protection
- Limits on household indebtedness

Post-2010 reforms have strengthened sector stability and restored public confidence in microfinance.

9. Challenges of Microfinance in India

Despite its achievements, the microfinance system faces several challenges:

- Over-indebtedness of borrowers
- Regional imbalances in outreach
- High operational costs
- Limited financial literacy
- Risk of mission drift among MFIs

These challenges highlight the need for balanced growth and ethical lending practices.

10. Digital Integration and Financial Literacy

The integration of digital technologies—such as Aadhaar-based KYC, mobile banking, and digital payments—has transformed microfinance delivery. Digitalization reduces costs and improves efficiency but also introduces risks related to data privacy and over-lending.

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Financial literacy is essential to ensure borrowers understand credit terms, manage debt responsibly, and use financial services productively.

11. Conclusion

Microfinance and microcredit are indispensable components of India's financial inclusion framework. The SHG-Bank Linkage Programme remains the backbone of the system, while MFIs and government initiatives have expanded outreach and efficiency. However, microfinance is not a panacea for poverty. Its success depends on responsible regulation, financial literacy, digital inclusion, and integration with broader development policies. When combined with skill development, market access, and social protection, microfinance can serve as a powerful instrument for inclusive and sustainable development.

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