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The Backbone of Grassroots Finance: A Conceptual Study of Microfinance in India

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ABSTRACT

Microfinance is playing a very important role in the development of India. Microfinance is a very significant source of financial services for the poor people and small and medium enterprises that do not have easy access to banking and related services. Microfinance is the form of a broad range of financial services such as deposits, loans, payment services, savings, microcredit, etc. Microfinance in India has emerged as a significant tool for poverty reduction, empowering low-income individuals, particularly women. Micro financial instruments are very important for the economic development of India because 70 percent of its population lives in rural areas and 60 percent depends on agriculture (according to World Bank reports).

Keywords:

Microfinance, Financial Inclusion, Rural Economy, Microfinance Institutions (MFIs), Women Empowerment, Small Enterprises, Economic Development, Microcredit,

1. INTRODUCTION

The concept of microfinance refers to the provision of financial services to the poor people through credits & deposits. Microfinance in India is gaining momentum for sustainable development. **(Teena Varsini S2),2025**

The government has also played a crucial role in promoting microfinance through various schemes and policies. And several microfinance institutions emerged in both the public and private sectors, offering a range of financial services to the low-income population. In India, all loans that are below Rs. 1 lakh can be considered as microfinance loans. (Dr R Tyagi,),2024

There are some examples of microfinance institutions.

Example: - Bandhan Bank, BSS Microfinance, Grameen America Inc., Asmitha Micro fin Ltd., Equitas Small Finance Bank, rural banks, commercial banks, etc.

2. HISTORY

In India, SEWA BANK (Self Employed Women Association) was the first microfinance institution established in 1974 in the city of Gujrat for bringing microfinance into popularity.

The first organisation to receive attention was GRAMEEN BANK, which was started in 1976 by Muhammad Yunus in Bangladesh. After that, GRAMEEN BANK received the Nobel Peace Prize award in 2006 for their efforts in developing the microfinance system.

In the early 1980s, the existing banking policies, procedures, and systems were not suited to meet the requirements of the poor; then, the National Bank for Agriculture and Rural Development (NABARD) recommended several alternative policies and procedures for making aid to those poor populations of India.

After that, various banks have been offering financing services to many people who seek to grow their business in those rural areas. That time is when one of the female-owned community organizations of Neighbourhood Groups (NHGs) brings women from rural and urban areas together to fight for their rights and helps empower them. Through these NHGs, women work on a variety of issues like health, nutrition, and agriculture.

The main objective of microfinance in India should be promoting social and economic development at the grassroots level. (Jhanvi S),2020

Microfinance schemes are very beneficial for the middle- and lower-class people all over the world. We discussed some benefits of microfinance in the below: -

- Microfinance is providing small loans for small businesses and income-generating activities; microfinance empowers individuals and households to reduce poverty.
- Lower interest rates compared to local money lenders.
- Self-employment.
- Opportunity for the educational sector through various types of educational loans and student loans.
- Entrepreneurs who create a successful business create jobs, trade, and economic improvement.
- MFIs also help to empower women in particular, leading to more stability.

The World Bank estimates that more than 500 million people have directly or indirectly benefited from microfinance-related operations. (Kofi Annan), In 2021, the Consultative Group to Assist the Poor (CGAP) estimated that more than 120 million people had directly benefited from microfinance.

Regulatory Framework for Microfinance Institutions in India

The Micro Finance Institutions (Development & Regulation) Bill 2012 was introduced in the Lok Sabha by the minister of finance and referred by a consultative committee with representation from state government, regulators, banks, and development financial institutions. This committee was constituted by the Ministry of finance, Government of India.

The recent crisis of COVID-19 in 2020 has made the whole microfinance industry fall due to the economic crisis. Then RBI established new guidelines for microfinance, which were effective from 1st April 2022.

The microfinance sector in India is primarily regulated by the Reserve Bank of India (S.Saini),2024. The RBI has issued various guidelines and regulations, including the master direction on microfinance loans, to regulate the operations of microfinance institutions (MFIs). And NABARD provides financial and technical support to MFIs.

RBI plays a crucial role in regulating the microfinance sector. Here are some key regulations:

- **NBFC-**MFIs: Non-banking financial companies—microfinance institutions must meet certain criteria regarding the size of the loan portfolio, customer outreach, and interest rate charged.
- **Loan Size and Borrowing** Limits: The RBI has set a maximum loan amount for individual borrower's households with an annual income of Rs 1.25 lakh in rural areas and Rs 2 lakh in urban and semi-urban areas on a collateral-free loan.
- **Loan repayment**: The framework limits the monthly loan repayment obligation to 50% of a household's monthly income **(Zampini, Bruecker and Mia Elliott), 2025**
- **Loan terms**: Loans must have a tenure of at least 24 months if the loan amount is more than Rs 15000.
- **Interest rates**: The interest cap for individual loans is 26% per annum on a reducing balance basis.
- **Processing** fee: The processing fee cannot exceed 1%.

3. LITERATURE REVIEW

Although microfinance has played a significant role in promoting financial inclusion and supporting small-scale entrepreneurs, several scholars and researchers have highlighted the limitations and challenges associated with its implementation. These concerns are particularly important when considering the human and social impact of microfinance on vulnerable communities.

One of the most commonly discussed issues is the problem of over-indebtedness. **According to Zampini, Bruecker, and Mia Elliott (2025)**, many low-income borrowers take multiple loans from different microfinance institutions (MFIs) without a clear understanding of repayment responsibilities. This leads to a cycle of debt and financial distress, especially when the borrower's income is irregular or unstable. Such pressure can cause emotional and mental stress, weakening the very empowerment that microfinance aims to provide.

Loan repayment obligations have also been a matter of concern. Many MFIs require frequent repayments, sometimes on a weekly or bi-weekly basis. As noted by **Dr. R. Tyagi (2024**), this tight schedule often forces borrowers to use new loans to pay off existing ones, rather than using funds to grow their businesses. This practice not only reduces the effectiveness of microfinance but can also undermine trust in the system.

Another significant issue is the lack of financial literacy among borrowers (Marcelle),2025. Many microfinance clients are not well-versed in managing credit or understanding interest rates and repayment terms**. S. Saini (2024**) emphasizes that the absence of basic financial education can lead to mismanagement of funds, pushing individuals further into poverty rather than lifting them out of it. This gap highlights the need for support systems beyond just loan disbursement.

The small size of loans also limits the long-term impact of microfinance. While they may be helpful for starting a business or addressing immediate needs, such loans are often not sufficient for expansion or diversification**. Teena Varsini S2 (2025**) argues that without access to larger credit and capital, micro-entrepreneurs remain stuck in a cycle of subsistence rather than growth.

In addition, high operational costs in rural and remote areas often result in MFIs charging relatively high interest rates and service fees. Though still lower than traditional moneylenders, these costs can be burdensome for borrowers. This operational challenge raises ethical concerns about the sustainability and fairness of the microfinance model, especially in underserved regions.

Moreover, external shocks such as the COVID-19 pandemic have exposed the vulnerability of microfinance borrowers. Many individuals lost their sources of income, making it nearly impossible to meet repayment deadlines. As a result, the entire sector faced a significant setback, emphasizing the need for stronger crisis-response mechanisms and social safety nets.

Lastly, unequal access to microfinance services remains a barrier. Despite its widespread adoption, many interior rural areas and marginalized communities are still excluded. The goal of inclusive development cannot be fully realized until microfinance.

4. CONCLUSION

Microfinance has become a powerful tool for empowering India's rural and low-income populations, especially women, by providing access to credit, promoting self-employment, and reducing poverty. It supports grassroots development by enabling small businesses and enhancing financial inclusion.

However, challenges like over-indebtedness, lack of financial literacy, high interest rates, and limited reach in remote areas hinder its full potential. The COVID-19 crisis further exposed its vulnerabilities, stressing the need for stronger support systems and financial education.

To truly make a lasting impact, microfinance must adopt a more human-cantered approach—focusing not just on lending, but also on empowering individuals with knowledge, resilience, and opportunities. When inclusive, ethical, and sustainable, microfinance can serve as a foundation for equitable development across India.

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