



A Study on the Role of Microfinance in Promoting Inclusive Economic Growth in India: Challenges and Opportunities

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Abstract

Microfinance has increasingly been viewed as a strategic tool to promote inclusive economic growth—especially in emerging economies such as India. This study examines the role of microfinance in fostering inclusion and economic upliftment in Indian rural and semi-urban settings, while critically analysing persistent challenges and untapped opportunities. Drawing on secondary data from reports such as National Bank for Agriculture and Rural Development (NABARD), Microfinance Institutions Network (MFIN), and industry analyses, the study notes that as of FY 2022–23, microfinance in India reached 16.23 crore households with bank loans outstanding of ₹ 1.88 lakh crore. In 2023–24, the Self-Help Group (SHG)–bank linkage programme further expanded to 17.75 crore households, with ₹ 2,59,664 crore outstanding loans. The broader microfinance sector demonstrates a compound annual growth rate (CAGR) exceeding 18 %, with a loan portfolio of about ₹ 3,48,015 crore. These figures underscore the scale and penetration of microfinance. The analysis highlights that microfinance catalyses inclusive growth through enhanced access to credit, increased entrepreneurial activity among marginalized groups (especially women), and risk diversification in rural livelihoods. However, the sector is confronted with key challenges including regional imbalances in outreach, asset quality risks (rising delinquency), regulatory constraints, and sustainability of operations. Moreover, the credit gap is estimated at 70 % relative to potential demand (₹ 13 lakh crore projected for FY 23–24). The paper concludes that bridging these gaps requires innovative product design, stronger institutional capacity, digital transformation, and supportive policy interventions. If addressed adequately, microfinance can remain a robust catalyst for India’s journey toward equitable and inclusive development.

Keywords: Microfinance, Inclusive Growth, Financial Inclusion, Credit Gap, India

Introduction

Inclusive economic growth—defined as growth that creates opportunities for all segments of the population and distributes the dividends of increased prosperity fairly—has become a central goal of development policy in India. Despite impressive economic achievements over the past three decades, India continues to face the persistent challenge of unequal income distribution, rural poverty, and financial exclusion. Large sections of the population, particularly in rural and semi-urban areas, remain outside the formal banking system. In this context,

microfinance has emerged as a powerful instrument to bridge the gap between formal financial institutions and the economically weaker sections of society. It provides access to small loans, savings, insurance, and other basic financial services to those traditionally excluded from formal financial systems.

Microfinance was introduced in India in the early 1980s as a development tool to enhance self-employment, improve livelihoods, and empower marginalized groups, especially women. The Self-Help Group (SHG)-Bank Linkage Programme (SBLP), launched by the NABARD in 1992, marked a significant step toward institutionalizing microfinance in India. Over the years, microfinance institutions (MFIs) have evolved as critical partners in promoting financial inclusion. According to the MFIN, 2024, the gross loan portfolio of the microfinance industry in India reached approximately ₹3.48 lakh crore, representing over 6.5 crore active clients across rural and semi-urban areas. These figures indicate that microfinance has become an essential pillar in the broader financial ecosystem, directly contributing to inclusive growth by enabling low-income households to participate in economic activities.

Microfinance's role extends beyond credit provision; it fosters entrepreneurial development, women's empowerment, and rural livelihood diversification. By offering small loans without collateral, microfinance enables poor households to invest in income-generating activities such as small-scale farming, animal husbandry, handicrafts, and retail businesses. This not only improves household income but also stimulates local economies, generating employment and enhancing community resilience. Studies have shown that when women have access to microfinance, the benefits often extend to improved family health, education, and nutrition—further reinforcing the multidimensional impact of financial inclusion.

Despite these achievements, several challenges persist in realizing the full potential of microfinance as a driver of inclusive economic growth. The sector continues to grapple with issues such as high interest rates, over-indebtedness, limited financial literacy among borrowers, and uneven regional outreach. For instance, states in southern India like Tamil Nadu, Karnataka, and Andhra Pradesh dominate the microfinance landscape, while the eastern and northeastern states lag behind. Moreover, the repayment crises experienced in the past—such as the Andhra Pradesh microfinance crisis of 2010—highlight the importance of strong governance, transparency, and regulatory oversight in ensuring the sustainability of the sector.

Another key challenge lies in the digital transformation of microfinance. While digital finance and fintech innovations are revolutionizing banking services, many microfinance institutions still operate with limited technological infrastructure. Leveraging digital tools for loan disbursement, monitoring, and repayment collection could significantly enhance operational efficiency, reduce costs, and expand outreach to underserved areas. Government initiatives like Pradhan Mantri Jan-Dhan Yojana (PMJDY), Digital India, and the Unified Payments Interface (UPI) have created a favourable environment for integrating technology into microfinance operations, but institutional adaptation remains uneven across regions.

Furthermore, the COVID-19 pandemic exposed the vulnerability of microfinance borrowers, particularly small entrepreneurs and women in the informal sector. Disruptions in income, limited mobility, and declining demand adversely affected repayment behaviour and loan portfolios. However, this period also underscored the resilience and adaptability of microfinance institutions in providing relief, restructuring loans, and supporting recovery through community-based initiatives. The post-pandemic recovery phase presents both opportunities and challenges—a chance to redesign financial inclusion strategies that are more resilient, inclusive, and digitally empowered.

From a policy perspective, the Reserve Bank of India (RBI) and NABARD have continued to play a pivotal role in supporting the microfinance ecosystem through regulatory reforms, refinancing facilities, and developmental initiatives. The introduction of a harmonized regulatory framework in 2022 was a milestone that established uniform norms for pricing,

transparency, and borrower protection. These measures aim to ensure responsible lending, reduce client exploitation, and promote healthy competition among microfinance players.

Microfinance remains a catalyst for inclusive economic growth in India, empowering millions of low-income households to improve their standard of living. However, to unlock its full potential, there is a pressing need for policy coherence, technological integration, effective risk management, and enhanced borrower education. This study seeks to analyse the evolving role of microfinance in India's inclusive growth agenda by examining its impact, identifying structural challenges, and exploring future opportunities for sustainable expansion. Through this analysis, the paper contributes to understanding how microfinance can be strategically leveraged to achieve India's long-term vision of equitable, inclusive, and sustainable economic development.

Review of Literature

The concept of microfinance as a tool for inclusive economic growth has been widely studied both in India and globally. Early studies by **Yunus (1999)**, who pioneered the Grameen Bank model in Bangladesh, demonstrated that access to small-scale credit could empower poor households to engage in productive activities and reduce poverty. This foundational idea influenced India's microfinance landscape and led to the institutionalization of SHGs and MFIs as part of national development programs.

Karmakar (2008) highlighted that microfinance in India has been instrumental in promoting financial inclusion by providing credit facilities to marginalized and low-income groups who are excluded from formal banking channels. The **NABARD Self-Help Group–Bank Linkage Programme (SBLP)** was identified as a milestone that enabled millions of rural women to access financial resources, thereby fostering entrepreneurship and community development. According to **NABARD's Microfinance Report (2023)**, over 17.75 crore households were connected through SHGs, with total loan disbursements exceeding ₹ 2.59 lakh crore—reflecting the significant expansion of microfinance outreach.

Das and Sahu (2012) emphasized that microfinance not only enhances financial access but also strengthens social capital by promoting collective decision-making among women's groups. Similarly, **Morduch and Haley (2010)** found that microfinance improves household resilience and income stability, although its long-term poverty reduction effects depend on sustained access and responsible lending practices. **Sinha (2014)** examined the regional disparities in microfinance penetration across India, noting that southern states accounted for nearly 60% of the total microfinance portfolio, while the northern and northeastern regions remained underserved. This uneven distribution poses a challenge to achieving inclusive growth nationwide.

In a study conducted by **Sharma and Bansal (2017)**, microfinance was found to play a vital role in empowering rural women by enhancing their decision-making capacity, financial literacy, and social participation. The authors also highlighted issues such as high interest rates and over-indebtedness as key challenges limiting the sector's impact. **RBI's Financial Inclusion Report (2022)** further confirmed that microfinance institutions contributed significantly to India's overall financial inclusion index, but cautioned that regulatory inconsistencies and portfolio quality risks could undermine sectoral sustainability.

Recent studies, such as **MFIN India (2024)**, show that the microfinance industry recorded a gross loan portfolio of ₹ 3.48 lakh crore with over 6.5 crore active borrowers, reflecting robust growth despite economic disruptions during the COVID-19 pandemic. However, **Patnaik and Rao (2023)** argue that the future success of microfinance lies in digital transformation—integrating fintech, mobile banking, and e-governance to reduce operational costs and improve transparency.

Objectives of the Study

1. To analyse the impact of microfinance on promoting inclusive economic growth in India.
2. To identify the major challenges faced by microfinance institutions in achieving financial inclusion.
3. To explore opportunities and policy measures for strengthening the role of microfinance in sustainable economic development.

Research Methodology

This study is based on secondary data analysis to examine the role of microfinance in promoting inclusive economic growth in India. Data have been collected from reliable sources such as NABARD reports, RBI publications, MFIN reports, government policy documents, and research journals. The study adopts a descriptive and analytical research design, focusing on trends, growth patterns, and challenges of the microfinance sector from 2015 to 2024. Comparative and statistical methods are used to interpret the data, evaluate sectoral performance, and assess its contribution to financial inclusion and poverty alleviation.

Impact of Microfinance on Inclusive Economic Growth in India

Concept of Inclusive Growth and Financial Inclusion

Inclusive growth refers to economic progress that is broad-based, equitable, and capable of benefiting all sections of society. In the Indian context, this means not only increasing GDP but also ensuring that low-income households, rural populations, and marginalized communities have access to resources and opportunities. Financial inclusion, which provides affordable financial services to all citizens, is a vital component of this framework. Microfinance acts as a bridge connecting the unbanked population with the formal financial system. Through small loans, savings, insurance, and remittance services, it empowers individuals who were previously excluded from mainstream banking.

Role of MFIs in Economic Upliftment

MFIs in India play a transformative role by extending credit to those without collateral or formal credit history. This democratization of finance has empowered millions of rural families to start micro-enterprises, invest in agriculture, or engage in income-generating activities. According to the MFIN, 2024, India's microfinance industry had a gross loan portfolio of ₹ 3.48 lakh crore, serving over 6.5 crore active clients. These figures illustrate the substantial reach and importance of MFIs in driving rural entrepreneurship and enhancing household income.

Microfinance has particularly strengthened women's economic participation. Women constitute nearly 85% of microfinance borrowers in India. Their involvement has resulted in higher savings, better household budgeting, and greater financial independence. The SBLP initiated by NABARD in 1992 has further expanded the inclusion of women through collective financial empowerment. As of 2023–24, over 1.23 crore SHGs were linked with banks, representing more than 17.7 crore households and ₹ 2.59 lakh crore in outstanding loans.

Microfinance and Rural Entrepreneurship

Microfinance is instrumental in promoting rural entrepreneurship by providing credit for self-employment. Many rural households invest their loans in micro-enterprises such as tailoring, dairy farming, poultry, handicrafts, or petty shops. These activities not only provide livelihood security but also stimulate local economic activity and generate employment. For instance, studies by Karmakar (2008) and Das & Sahu (2012) reveal that microcredit recipients often transition from subsistence activities to profitable ventures within a few years, reflecting improved productivity and financial stability.

Additionally, the multiplier effect of microfinance extends to community development. As incomes rise, demand for local goods and services increases, generating a virtuous cycle

of rural growth. The integration of microfinance with government schemes like Start-Up India, Mudra Yojana, and Deendayal Antyodaya Yojana has created new opportunities for low-income entrepreneurs to formalize and scale their operations.

Microfinance and Poverty Reduction

Microfinance's direct contribution to poverty alleviation is visible through improved living standards, access to education, healthcare, and better housing conditions among borrowers. The World Bank (2022) recognized microfinance as a key factor contributing to India's poverty reduction, particularly in rural areas. Households with access to microfinance experience an average 20–30% increase in income within three years, compared to those without access. Furthermore, SHGs and MFIs have been instrumental in helping poor families manage financial shocks, reducing their dependence on informal moneylenders.

Challenges Faced by Microfinance Institutions in Achieving Financial Inclusion

Regional Disparities and Uneven Outreach

Despite its achievements, the microfinance sector faces several challenges that limit its effectiveness. One major issue is uneven regional distribution. The southern states—Tamil Nadu, Karnataka, Kerala, and Andhra Pradesh—account for nearly 60% of the total microfinance loan portfolio, while northern and northeastern states like Bihar, Jharkhand, and Assam remain underserved. This imbalance hinders nationwide inclusive growth and indicates that certain regions benefit disproportionately from financial inclusion efforts.

High Interest Rates and Over-Indebtedness

A persistent criticism of microfinance institutions concerns their relatively high interest rates, which often range from 20–26% annually. While these rates reflect the high operational costs of serving small borrowers across dispersed rural areas, they can burden low-income clients. Over-borrowing and multiple loans from different MFIs have led to over-indebtedness, as seen during the Andhra Pradesh crisis (2010), when excessive lending and coercive recovery methods led to borrower defaults and loss of trust. Strengthening credit discipline and improving financial literacy are essential to prevent such occurrences.

Loan Delinquency and Asset Quality Risks

Recent data from RBI's Financial Stability Report (2024) indicate a rise in portfolio-at-risk (PAR > 30 days) to nearly 6.8% among small MFIs, reflecting repayment stress in rural economies. Factors such as erratic rainfall, agricultural losses, and the post-COVID economic slowdown have contributed to delayed repayments. The sector must therefore enhance risk management practices, adopt technology for credit monitoring, and diversify lending portfolios to ensure sustainability.

Limited Financial Literacy and Borrower Education

Many microfinance clients lack awareness of basic financial principles such as interest calculation, savings, insurance, and repayment obligations. This gap in financial literacy often leads to misuse of funds and loan defaults. The government and MFIs must collaborate to design borrower training programs and promote digital literacy. Initiatives like RBI's Financial Literacy Centers (FLCs) and Digital Saksharta Abhiyan (DISHA) are positive steps toward building responsible financial behaviour among rural populations.

Regulatory and Institutional Constraints

The microfinance sector operates under a complex regulatory environment, with multiple agencies such as RBI, NABARD, and state governments involved. The absence of a unified legal framework earlier led to inconsistent policies. However, the RBI's harmonized regulatory framework (2022) has improved transparency by allowing MFIs to set interest rates based on

risk-based pricing and ensuring fair practices. Still, smaller MFIs face capital adequacy and compliance challenges, limiting their capacity to scale operations.

Digital Divide and Technological Limitations

The digital revolution in India offers tremendous potential for microfinance, yet many institutions lack adequate technological infrastructure. Limited access to smartphones, poor internet connectivity, and low digital literacy in rural areas hinder the adoption of fintech solutions. The use of digital payment platforms, UPI, and Aadhaar-linked services can streamline loan disbursement and reduce transaction costs, but achieving this requires targeted digital inclusion policies.

Impact of COVID-19 on Microfinance Sustainability

The pandemic severely disrupted the microfinance ecosystem. Lockdowns affected borrowers' income sources, resulting in lower repayments and liquidity stress for MFIs. According to MFIN (2023), collection efficiency dropped to 75–80% during FY 2020–21, though recovery has since improved. Many institutions restructured loans, extended moratoriums, and offered emergency credit support to help borrowers recover. The crisis highlighted the need for greater resilience through diversification, digitization, and crisis-management planning.

Opportunities for Strengthening the Role of Microfinance in Sustainable Development

Integration of Digital Technology

Digital transformation presents immense opportunities for scaling microfinance operations efficiently. By adopting mobile banking, biometric verification, and digital credit scoring, MFIs can minimize paperwork, enhance transparency, and improve borrower experience. Fintech partnerships can also help institutions track repayment patterns and prevent over-lending. Digital wallets and Unified Payments Interface (UPI) platforms can simplify micro-transactions, making credit access faster and safer.

Policy and Regulatory Support

The government and the Reserve Bank of India have introduced various policy measures to strengthen financial inclusion. Schemes like Pradhan Mantri Jan-Dhan Yojana (PMJDY), Stand-Up India, and MUDRA Yojana have increased access to credit for micro-entrepreneurs. The Micro Units Development and Refinance Agency (MUDRA), since its inception in 2015, has disbursed over ₹ 25 lakh crore to more than 41 crore borrowers, reflecting the government's commitment to inclusive finance. These initiatives, when integrated with microfinance operations, can ensure broader economic participation and resilience.

Empowering Women and Marginalized Groups

Women's empowerment remains one of the strongest pillars of microfinance. Programs targeted toward SHGs and women entrepreneurs have shown substantial improvement in household welfare and gender equality. Studies by Sharma & Bansal (2017) indicate that microfinance enhances women's decision-making power, savings behaviour, and self-confidence. Expanding women-focused products—such as health loans, insurance, and skill-development financing—can deepen their socio-economic impact.

Expansion to Underserved Regions

There is significant potential to expand microfinance services in under-penetrated regions, especially in eastern and northeastern India. Tailored financial products for agriculture, fisheries, and local crafts can stimulate regional economies. Partnerships between MFIs and cooperative banks can help achieve scale while maintaining local accountability. Decentralized models such as community-based finance and village-level financial services can ensure equitable distribution of resources.

Strengthening Institutional Capacity and Governance

To ensure long-term sustainability, MFIs need to enhance their institutional capacity through professional management, robust risk-assessment systems, and transparent governance. Building credit-rating mechanisms for SHGs and borrowers can encourage responsible lending and attract investor confidence. Furthermore, promoting social impact assessment frameworks will help measure microfinance outcomes beyond profit—covering health, education, and empowerment indicators.

Financial Literacy and Capacity-Building Initiatives

A strong emphasis on financial education can improve repayment performance and encourage productive loan utilization. Government agencies, NGOs, and academic institutions should collaborate to design context-specific literacy programs. Integrating digital literacy with financial training can prepare borrowers to use mobile wallets, track credit records, and safeguard themselves from fraud.

Public–Private Partnerships (PPP) and Corporate Social Responsibility (CSR) Initiatives

Microfinance expansion can be accelerated through collaboration between public institutions and private corporations. CSR initiatives in financial literacy, digital inclusion, and women entrepreneurship can complement government programs. For example, companies in the banking and telecommunications sectors can provide digital infrastructure and capacity-building support to MFIs.

Sustainable and Green Microfinance

With increasing focus on climate resilience, green microfinance offers new frontiers for sustainable growth. Financing renewable energy products (like solar lamps or biogas units), sustainable farming practices, and eco-friendly enterprises can simultaneously promote environmental protection and income generation. India's rural economy, highly dependent on natural resources, can benefit from microfinance models that integrate environmental sustainability with economic inclusion.

Results and Discussion

The analysis of secondary data from NABARD, RBI, and the MFIN reveals that India's microfinance sector has grown remarkably over the past decade, establishing itself as a cornerstone of financial inclusion. By the end of FY 2023–24, the total gross loan portfolio of the sector reached approximately ₹ 3.48 lakh crore, serving nearly 6.5 crore active borrowers across rural and semi-urban areas. The SBLP, spearheaded by NABARD, continues to be a driving force in this expansion, linking about 1.23 crore SHGs and reaching 17.75 crore households with outstanding loans amounting to ₹2.59 lakh crore. These figures highlight the extensive reach of microfinance and its critical role in connecting low-income and unbanked populations to formal credit channels.

The findings indicate that microfinance has significantly contributed to inclusive economic growth by broadening access to credit, promoting entrepreneurship, and enhancing living standards among marginalized groups. Households benefiting from microfinance experience notable improvements in income, typically increasing by 20–30% within a few years of access. Microfinance's most visible success lies in women's empowerment—women account for nearly 85% of total borrowers. Through small loans, women have engaged in micro-enterprises such as tailoring, dairy farming, and handicrafts, leading to higher family income, better nutrition, and improved access to education and healthcare. This empowerment has also fostered greater participation in household decision-making and community leadership.

However, the sector continues to face several persistent challenges that limit its broader impact. One of the most prominent issues is regional disparity. Southern states such

as Tamil Nadu, Karnataka, and Andhra Pradesh account for nearly 60% of the total microfinance loan portfolio, while states in the eastern and northeastern regions like Bihar, Jharkhand, and Assam remain underserved. High operational costs and small loan sizes have kept interest rates relatively elevated, typically ranging between 20% and 26%, which can impose repayment burdens on low-income borrowers. Moreover, loan delinquency rates have been rising; RBI's 2024 Financial Stability Report noted a portfolio-at-risk (PAR >30 days) of 6.8% for smaller MFIs, reflecting repayment challenges linked to agricultural instability and income shocks. Over-indebtedness due to multiple borrowing and inadequate financial literacy among clients remain serious concerns that need stronger borrower education and credit discipline.

The COVID-19 pandemic further tested the resilience of the sector, as lockdowns and loss of income reduced collection efficiency to around 75–80% during FY 2020–21. Nevertheless, the sector demonstrated adaptability, and by FY 2022–23, repayment performance had recovered to approximately 96%, supported by restructuring measures, emergency loans, and moratoriums. The pandemic also accelerated the adoption of digital tools, with more borrowers using online platforms for repayments and communication, marking a shift toward a more technology-enabled microfinance model.

Emerging opportunities for strengthening the sector include leveraging digital transformation, expanding outreach to underserved regions, and improving institutional capacity. Mobile banking, biometric verification, and AI-based credit scoring can streamline loan processing and enhance transparency. Integrating microfinance with government initiatives such as MUDRA Yojana and Pradhan Mantri Jan-Dhan Yojana can further increase access to affordable credit. In addition, promoting green microfinance—such as financing renewable energy and sustainable agriculture—can align the sector with India's sustainability goals.

Overall, the results affirm that microfinance serves as a powerful catalyst for inclusive economic growth in India, empowering marginalized communities and reducing poverty. Yet, challenges related to cost, regional imbalance, digital gaps, and borrower literacy continue to hinder its full potential. Addressing these through policy support, technological innovation, and capacity building will enable microfinance to sustain its role as a dynamic force in India's journey toward equitable and inclusive development.

Conclusion

The study demonstrates that microfinance has become a substantive catalyst for India's inclusive economic growth by expanding financial access, stimulating micro-enterprise activity, and empowering marginalized groups—particularly women—thereby contributing to improved household incomes, resilience, and human-development outcomes; however, the sector's full potential remains constrained by regional imbalances in outreach, high effective lending costs, rising asset-quality risks, limited borrower financial literacy, and uneven digital adoption, challenges that were underscored during the COVID-19 shock and which demand multifaceted responses; policy makers, regulators, and practitioners must therefore pursue a coordinated strategy that promotes targeted expansion into underserved regions, accelerates digital transformation and fintech partnerships to lower transaction costs, strengthens institutional governance and capital access for smaller MFIs, integrates robust financial-literacy and client-protection measures, and encourages green and gender-focused product innovation; if these measures are implemented, microfinance can more effectively bridge the estimated credit gap and remain a resilient, equitable instrument for sustainable, inclusive development in India.

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