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Microfinance and rural credit in India

Ms. Ashlesha A. Trivedi[1], Dr.Savita Trivedi[2]
[1] *Student, Department of Commerce and Management, AIMS, Bangalore*
[2] *Professor, Department of Master of Commerce, DSCASC, Bangalore.*

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Corresponding Author:
Dr.Savita Trivedi

Abstract:

Microfinance has emerged as a crucial instrument for promoting financial inclusion, alleviating rural poverty and empowering marginalized communities in India. Rural credit has historically been dominated by informal moneylenders, but microfinance institutions (MFIs), self-help groups (SHGs), and cooperative banks have transformed access to credit in rural areas.

Microfinance refers to the provision of financial services such as small loans (microcredit), savings, insurance, and money transfers to individuals and small businesses who lack access to traditional banking services. It is specifically designed for low-income households, informal workers, and micro-entrepreneurs who are excluded from the formal financial system due to lack of collateral, low income, or inadequate credit history.

As per the data from Credit Information Companies, which includes banks, small finance banks (SFBs), non-banking financial companies (NBFCs), NBFC-MFIs, and other lenders, shows that the Self-Help Group (SHG) Bank linkage programme registered positive growth in 2024-25, with overall outstanding reaching ₹3.04 lakh crore for 84.94 lakh SHGs. There were around 143.3 lakh SHGs with 17.1 crore households linked to savings under the SHG Bank linkage programme,(The Bharat Microfinance Report 2025) .This paper examines the evolution of microfinance in India, its significance, issues and future.

Keywords: Origin, Significance, Market Trends and Drivers, Issues/ Challenges, Recommendations, Potential Path Forwards

1. Introduction

MFIs started working from the 1970s in Bangladesh. Microfinance started growing with the creation of Grameen Bank in Bangladesh, in 1976, by Muhammad Yunus. Various microfinance institutions are broadly categorized into five types: NBFCMFIs, Banks, SFBs, NBFCs and Non-profit MFIs. All these institutions are regulated by RBI except Non-profit MFIs. Microfinance works with underserved populations who have poor livelihood means, low education and are very new to engaging in financial and banking transactions. NABARD is a key source of finance to many MFIs in the country. Due to insufficient funds, MFIs are facing challenges, so it is needed to search for other sources of funding.

The central government had introduced the MUDRA. This scheme aims to refinance loans which are collateral free (up to Rs 10 lakh). It is suggested that lending must be handled effectively then only financial inclusion for the poor in rural and urban areas will be achieved.

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This study is done to understand the concept, evolution and present status of microfinance in India.

Microfinance is a basis of financial services for entrepreneurs and small businesses deficient in contact with banking and associated services. Microfinance is any activity that includes financial services such as credit, savings, and insurance to under privileged people. It helps people who are below poverty line and aims to create social values. Creation of social values includes alleviation of poverty and proving employment opportunities to poor for a better standard of living.

Mr. Robinson in 2001 gave a very plausible definition of microfinance. According to him, "Microfinance refers to small scale financial services for both credit and deposit-that are provided to people who farm or fish or herd; operate small or microenterprises where goods are produced, recycled, repaired or traded; provide services; work for wages or commissions; gain income from renting out small amount of land, vehicle, draft animals, or machinery and tools; and to other individuals and local groups in developing countries in both rural and urban areas".

Asian Development Bank (ADB) defines microfinance as "the provision of a broad range of financial services such as deposits, loans, money transfers, and insurance to small enterprise and households."

Origin and growth of micro finance-

- Informal financial institutions in Nigeria dates back to 15th century
- Enormous increase in poverty was observed during European wars (1618-1648)
- In 1720 first loan fund was founded in Ireland
- The term **"micro financing"** was first used in the 1970s during the development of Grameen Bank of Bangladesh, which was founded by the microfinance pioneer, Muhammad Yunus.
- It was first introduced by the SEWA Bank (Self Employed Women's Association) in Gujarat in 1974.
- In 1976, Yunus institutionalized the approaches of microfinance, along with the foundation of Grameen Bank in Bangladesh.

Significance in present scenario

Microfinance plays a crucial role in promoting financial inclusion, poverty reduction, and economic development, especially in countries like India where a large population depends on informal credit. Its significance can be understood across social, economic, and developmental dimensions. MFIs are providing service to low-income people. Various microfinance institutions are-small finance banks, NBFC MFIs, non profit MFIs and Banks. Wide range of financial services are provided such as deposits, loans, payment services, money transfers & insurance.

MFIs help in mobilization of savings & using the same for the welfare of its members. Finance is given on easy terms and low rate of interest. It promotes self-sufficiency. It empowers poor women economically & socially.

A large share of microfinance clients are women. Access to credit enhances women's decision-making power, financial independence, and participation in social and economic activities. Supports entrepreneurship and the growth of micro and small enterprises. Creates self-employment opportunities, especially in rural and semi-urban areas.

Helps fund basic needs like education, healthcare, sanitation, and home improvements. Improves the overall quality of life and enables upward mobility. Offers affordable credit with transparent terms. Protects low-income households from exploitation by moneylenders. Provides capital to rural producers, artisans, farmers, and small traders. Supports local markets and stimulates economic activity at the grassroots.

Many MFIs also promote micro-savings and recurring deposit products. Builds financial discipline and resilience against economic shocks. Aligns with national priorities like financial inclusion, women-led development, self-help group (SHG) promotion, and rural development. Complements schemes like NRLM, PMJDY, MUDRA, etc. Group-based lending models encourage community discipline, timely repayment, and responsible financial behavior.

Objectives of study

- To understand the concept of micro finance.
- To know current status of microfinance in India.
- To know about the beneficiaries and identify the challenges.
- To provide some suggestions.

Methodology

It is a conceptual paper. Secondary data are collected from NABARD report, websites, magazines, newspapers and various research articles.

2. Literature review

Zohir and Matin (2004) in their study state that MFIs not only help in poverty alleviation but the groups created for availing the microfinance facility also contribute beyond finance, such as, it brings in a sense of community, reliance and trust among the members.

Sekabira (2013) examine the impact of capital structure on the performance of MFI by studying a sample of 14 MFIs from Uganda and found that debt and donations have a negative impact on the both operational and financial sustainability of MFIs. He suggests that MFIs should consider capital markets for long term sustainability of MFIs

Chawla (2013) reviews Indian MFIs literature to see the impact of regulations on MFIs in India. This study is done post the Andhra crisis where many farmers in the state of Andhra Pradesh had committed suicide due to inability to pay the high interest rate charged by unregulated MFIs.

Bhanot and Bhapat (2014) tested the impact of gross loan portfolio, portfolio at risk, debt equity ratio, return on assets, borrower per staff and deposits on Indian MFIs for the year 2010 using panel data regression on a sample of 81 MFIs picked from MIX database and found four factors to be crucial to the sustainability namely; gross loan portfolio, return on assets, portfolio quality and staff productivity.

Helms (2006) states that the concern of welfarists is that when MFIs focus on financial sustainability there is a “mission drift”. In an endeavor to become financially sustainable, the MFIs try to change

their legal status from an NGO to NBFI and abandoning their poor clients in search of profits, which questions their reason for existence.

Bhole B. & Ogden S (2010) in their paper had compared the presence of strategic default between group lending & individual lending. Secondary data was considered for the purpose of the study.

Seibel and Torres (1999) in their study conducted on Philippines MFIs states that Grameen-type MFIs can be sustainable and can increase their outreach, only through subsidy.

Brijesh Rupa para & Jitendra Patoliya (2012) have written a book titled-Problems faced by Microfinance Institutions & measures to solve it. The book has been divided into seven chapters namely basics of microfinance, self-help group, microfinance institutions performance, urban & rural microfinance, micro insurance, technology & microfinance & lastly business models for microfinance. It gives deep insights about microfinance.

Quayes (2012) impact of depth of outreach on financial sustainability of MFIs by taking a sample of 702 MFIs operating in 83 countries and found that there is a positive relationship between financial sustainability and outreach.

3. Concept and market overview

Micro finance institution reduced dependence of SHGs on local money lenders fully or partially. Loans given by banks to the groups 1-3 times higher than the saving of the groups. It is an instrument to empower the poorest. Loans are of small amount. These are of short duration. Delivery is generally through SHGs. Loans are given without security. Loans to those people who live BPL (Below Poverty Line). Even members of SHG enjoy Micro Finance. Maximum limit of loan under micro finance 25,000/-. High frequency of payment. The terms and conditions given to poor people are decided by NGOs.

India Microfinance Market was valued at USD 7.72 Billion in 2025 and is expected to reach USD 13.78 Billion by 2031 with a CAGR of 10.20% during the forecast period. Microfinance continues to be a vital driver of economic growth, yet its conventional approach requires transformation. The future will be shaped by greater digital integration, enhanced risk management, and tailored credit solutions. While demand for microfinance remains robust, its delivery must evolve to meet the needs of an increasingly digital and fast-changing financial environment. The Reserve Bank of India (RBI) started regulating the microfinance sector in 2011, the industry has experienced tremendous growth. The gross loan portfolio expanded from around ₹17,000 crore in 2012 to over ₹3.93 lakh crore by 2024, marking an impressive 2,176% increase. Today, microfinance institutions serve nearly 8 crore borrowers across 723 districts, including 111 aspirational districts. The sector contributes about 2.03% to India's Gross Value Added (GVA) and supports approximately 1.3 crore jobs. (https://www.techsciresearch.com/report/india-microfinance-market/3210.html)

Microfinance has emerged as a cornerstone of India's socio-economic transformation, fostering financial inclusion and empowering women, small and marginal farmers, artisans, and other vulnerable communities. Millions have been able to access timely and collateral-free credit, enabling them to build sustainable livelihoods and enterprises. With data-driven insights, the Bharat Microfinance

Report deepens our collective understanding of microfinance and highlights its role as a catalyst in advancing our shared national vision of Viksit Bharat," (Shaji KV, Chairman, NABARD)

Rural India constitutes nearly 65% of the country's population and depends heavily on agriculture and allied sectors for livelihood. For decades, the lack of adequate and affordable formal credit constrained rural economic growth. Microfinance, introduced in the early 1990s, aimed to bridge this gap by offering small loans, savings products, and financial services to low-income households.

The microfinance movement gained momentum through the Self-Help Group–Bank Linkage Programme (SHG-BLP) initiated by NABARD and the rise of specialized microfinance institutions (MFIs). Today, microfinance plays a significant role in supporting entrepreneurship, women's empowerment, and poverty reduction.

4. Market Trends and Drivers

The India Microfinance Market is witnessing a significant surge in demand driven by the urgent need for financial inclusion among underserved populations. With a large portion of the Indian population still lacking access to traditional banking services, microfinance institutions (MFIs) have emerged as a vital bridge. These institutions cater primarily to low-income individuals and small businesses, providing them with essential financial products such as microloans, savings accounts, and insurance. The government's initiatives to promote financial literacy and inclusion, coupled with technological advancements like mobile banking, have further fueled this demand. As more people in rural and semi-urban areas become aware of the benefits of microfinance, the sector is expected to grow exponentially. This trend is not only empowering individuals but also contributing to broader economic development by fostering entrepreneurship and improving living standards.

Another dynamic influencing the India Microfinance Market is the rapid technological advancement and digital transformation within the sector. The rise of fintech companies has revolutionized how microfinance services are delivered, making them more accessible and efficient. Mobile applications and online platforms allow borrowers to apply for loans, manage repayments, and access financial education resources from the comfort of their homes. This shift towards digitalization has reduced operational costs for MFIs, enabling them to offer competitive interest rates and expand their customer base. Additionally, the use of data analytics and artificial intelligence is enhancing credit assessment processes, allowing institutions to make informed lending decisions. As technology continues to evolve, it is expected to play a crucial role in shaping the future of microfinance in India, driving innovation and improving service delivery.

The regulatory framework surrounding the microfinance sector in India is another critical dynamic influencing market trends. The Reserve Bank of India (RBI) has established guidelines to ensure the stability and sustainability of MFIs, which has helped to enhance trust among borrowers. Recent reforms aimed at improving transparency and protecting consumer rights are also contributing to a more favorable environment for microfinance operations. Furthermore, government support through schemes like the Pradhan Mantri Mudra Yojana (PMMY) is facilitating access to capital for micro-entrepreneurs. These regulatory measures and government initiatives are vital for the long-term growth of the microfinance market, as they not only boost investor confidence but also ensure that the needs of borrowers are met responsibly.

The India Microfinance Market is poised for significant growth, with various trends shaping its trajectory. One of the most notable trends is the increasing focus on diversification of financial products offered by microfinance institutions (MFIs). Traditionally, MFIs primarily provided microloans to women for income-generating activities. However, as of 2025, there has been a noticeable shift towards offering a broader range of financial services, including insurance, savings, and investment products. This diversification is aimed at meeting the evolving needs of clients and enhancing their financial resilience. Additionally, the integration of technology in service delivery, such as mobile banking and digital payment systems, is transforming how clients interact with MFIs. This trend not only improves access to financial services but also enhances customer experience. Furthermore, the growing awareness of social impact among investors is driving capital inflow into the microfinance sector, enabling MFIs to expand their reach and improve their service offerings.

Microfinance has had a transformative impact on rural India by improving access to credit, reducing poverty, and promoting women's empowerment. Despite challenges like over-indebtedness and regional imbalance, the sector continues to evolve through regulatory reforms, digital innovation, and increased institutional support. To ensure sustainability, microfinance must balance social objectives with financial viability while expanding its reach to underserved regions.

Statistics 2024-25		
Category	**Latest Value (2024–25)**	**Details / Notes**
Total microfinance client base	8.28 crore	All lenders combined (NBFC-MFIs, banks, SFBs, NBFCs, others)
Total loan outstanding (microfinance sector)	₹3,81,225 crore	As of March 2025
Total microfinance loan accounts	13.99 crore	Number of active loan accounts
Loan portfolio: NBFC-MFIs	₹1,48,419 crore (39%)	Largest share in microfinance sector
Loan portfolio: Banks	₹1,24,431 crore (32%)	Includes PSBs, private banks, RRBs
Loan portfolio: Small Finance Banks (SFBs)	₹59,817 crore (16%)	SFBs are fast-growing lenders
Loan portfolio: NBFCs (non-MFIs)	₹45,042 crore (12%)	Diversified MF lenders
Loan portfolio: Other institutions	₹3,516 crore (1%)	Cooperatives, societies, NGOs
Share of rural microfinance loans	≈ 79–80%	Highest rural share in over 10 years
Rural disbursements (2024–25)	₹1.45 lakh crore	Out of total ₹1.86 lakh crore disbursed
Urban disbursements	₹41,000 crore	Slower growth compared with rural

Purpose of loans	91% for income-generation	Livelihood-focused lending
SHGs linked with banks (savings)	144.21 lakh SHGs	SHG–Bank Linkage Programme (SHG-BLP)
SHGs with outstanding loans	77.42 lakh SHGs	Credit-linked SHGs
Households covered (SHG-BLP)	17.75 crore households	Huge rural outreach
Total SHG savings	₹65,089 crore	Growth of ~10.5% over previous year

Issues/challenges

1.In FY 2024-25, the gross loan portfolio (GLP) of many microfinance institutions (MFIs) shrank significantly. GLP dropped from ₹442,700 crore to ~₹381,200 crore, a decline of about 13.9%.

2.Equity capital of "pure-bred" MFIs fell by 1.8%, and their annual borrowings dropped by 36% as banks and investors pulled back.

3. Loan disbursements have reduced. MFIs disbursed ₹1.12 trillion in FY25, down 25.4% from the previous year. Shrinking loan books and funding stress reduce the reach and impact of microfinance, affecting both lenders and borrowers who rely on small loans.

4. Non-performing assets (NPAs) and overdue loans surged. Loans overdue by 31+ days (PAR 30+) rose to 6.2% in FY25 from 2.1% in FY24; those overdue 90+ days (considered NPAs) climbed to 4.8% (vs 1.6% earlier).

5. Overdue microfinance loans ballooned to ₹43,075 crore in FY2025. Defaults reduce cash flows for MFIs, erode their financial health, and limit their ability to lend further threatening long-term viability and financial inclusion goals.

6. Many borrowers often low-income individuals borrow from multiple lenders (formal and informal), leading to excessive debt burden and increasing repayment stress.

7. High customer acquisition costs, low financial literacy and difficulty forming effective Joint Liability Groups (JLGs) have weakened borrower discipline and increased risks.

8. Many MFIs still rely on manual processes and legacy systems, combined with high cost of operations and overheads, this reduces profitability.

9. The structural model that once enabled widespread microcredit is being strained increasing risks for both lenders and vulnerable borrowers.

10. Microfinance Institutions Network (MFIN), a self-regulatory body, has tightened norms: for instance, MFIs are now discouraged from lending to borrowers with overdue loans > 60 days (vs 90 days earlier).

11. With rising credit costs and narrower margins, profitability for MFIs is under pressure. Rating agency ICRA projects a negative near-term outlook, given shrinking volumes and rising credit costs.

12. Many lenders have shifted to issue fewer, but larger-size loans possibly to reduce per-loan risk but that also means fewer low-size loans, which were the core of microfinance.

13. Risk-averse lending and stricter norms help stem defaults but may exclude some of the poorest borrowers who rely on small-ticket loans, undermining inclusion.

14. Slowdown in microfinance disbursements and tighter lending has resulted in many low-income borrowers being pushed out of the formal credit system.

15. For many rural and vulnerable borrowers, microfinance was often a fallback for emergency expenses, small business loans, or living costs. Reduced availability means they have to rely more on informal sources often costlier or riskier.

16. Widespread defaults, over-indebtedness and perceived instability may erode trust in MFIs. That can make people especially women and marginalized groups hesitant to borrow, reversing decades of financial inclusion progress. (Times of India, Free press, Insights IAS and Mint)

5. Findings

The NABARD supported Bharat Microfinance Report 2024-25, released in late 2025, highlights a growing microfinance sector with 8.28 crore clients & ₹3.81 lakh crore loans by March 2025, led by NBFC-MFIs, but notes stress from over-leveraging requiring new guardrails (July '24, April '25) to manage rising defaults, while NABARD also focuses on broader rural finance via funds like RIDF and promoting SHG marketing.

Key Findings for FY 2024-25 (from the Joint Report)

- There are 8.28 crore active clients. Loan outstandings are ₹3,81,225 crore as of March 31, 2025.
- Major players are NBFC-MFIs (39%), Banks (32%), Small Finance Banks (16%).
- Overleveraging and multiple loans caused stress, leading to new lending guardrails by industry bodies in mid-2024 and mid-2025.
- The Self-Help Group movement is a revolutionary initiative which connects group members, many of whom had never had a bank account before, to formal financial services in a sustainable and scalable manner.
- The SHG-BLP programme has transformed lives by mainstreaming women, and making them partners in our nation building process.
- “Microfinance” is also emerging as a fast-growing sector, although this segment is still underpenetrated.

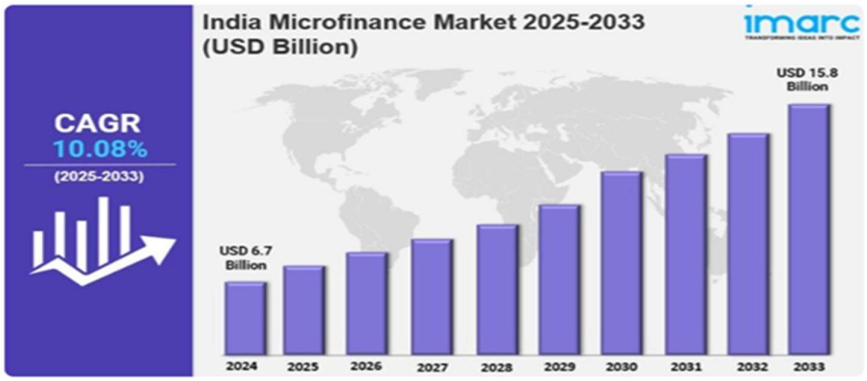
Recommendations

- There is a need for formation of a dedicated State level committee to oversee various aspects of the current welfare programs and to ensure end use by the eligible women.
- Existing SHGs need to be strengthen through capacity building and vocational trainings with the help of NGOs and other successful groups in the nearby regions for economic empowerment and financial independence of under privileged people.
- It is needed to instigate a massive social awareness movement from the grass root levels of the society.
- MFIs can come forward by providing smart phones, digital literacy training to their clients for

building a trust and habit on digital transaction. Entire digital value chain should be strengthened from MFIs to clients to improve MF services.

- Strengthen use of credit bureau data before every loan. Use AI-based early warning systems to flag risky borrowers. Impose stricter caps on household indebtedness, monitored across all lenders. Incentivize MFIs to prioritize repayment discipline over loan volumes.
- Shift from group-based pressure to ethical, personalized recovery models. Promote digital repayment methods (UPI, recurring mandates). Introduce special restructuring schemes for climate-affected regions or disaster-hit areas.
- Push for digitization (paperless onboarding, e-KYC, mobile agents). Reduce branch-based costs using hub-and-spoke models.
- Encourage MFIs to diversify into savings, insurance, pensions, not just credit. Provide interest-rate incentives for MFIs that maintain low NPA levels.
- Mandatory pre-loan counselling for new borrowers. Community-based programs teaching budgeting, debt planning, responsible borrowing. Use of local-language videos, street plays, SHG meetings, NGOs, etc.
- Allow real-time data integration between MFIs and credit bureaus. Introduce risk-based supervision, more audits for high-delinquency MFIs. Strengthen SROs like MFIN to enforce norms on lending and collection. Government-supported guarantee funds to reduce risk in poor states.
- Introduce longer-duration loans for income-generating activities. Create flexible repayment schedules for seasonal workers (farmers, fishers, etc.). Offer enterprise loans for micro-business expansion, not just consumption credit.
- Mobile-based loan origination, GPS based field monitoring. Biometric authentication to reduce ghost borrowers. Digital dashboards for real-time monitoring of arrears.
- Bundle loans with micro-insurance for health, livestock, crops, etc. Provide emergency credit lines to avoid multiple loans from informal sources. Support climate-vulnerable borrowers with resilience loans.
- State-wise zonal allocation or controlled expansion. Unified portal showing district-wise credit saturation to prevent overlap.
- Transparent communication about interest rates, fees, penalties. Quick grievance redressal mechanisms via toll-free numbers, WhatsApp lines. Public disclosure of recovery practices and social performance indicators.

Potential Paths Forward: What Could Drive a Strong Microfinance Future in India



Microfinance has had a transformative impact on rural India by improving access to credit, reducing poverty, and promoting women's empowerment. Despite challenges like over-indebtedness and regional imbalance, the sector continues to evolve through regulatory reforms, digital innovation, and increased institutional support. To ensure sustainability, microfinance must balance social objectives with financial viability while expanding its reach to underserved regions.

If managed well, here are the key growth levers and opportunities for microfinance: -

1.**Deeper rural & under-banked area penetration:** India has many remote/rural regions with limited access to formal banking. Microfinance can expand into those "credit dark" areas, offering small credit, micro-savings, and allied financial services.

2. New-to-credit (NTC) customers & financial inclusion push: As financial inclusion remains a priority (government, private sector, fintech), MFIs can onboard households and small entrepreneurs who have never used formal credit before.

3. Product diversification: Instead of only small loans, MFIs could expand to micro-savings, micro-insurance, livelihood financing, and small-enterprise loans making them comprehensive financial-services providers for rural/low-income segments.

4. Digital adoption and tech-enabled operations: Leveraging digital onboarding, mobile banking, credit-scoring algorithms, data analytics reducing costs, improving reach, and improving risk assessment.

5. Responsible lending and regulatory support: With guardrails, better supervision, transparency and borrower-protection norms, microfinance could regain credibility leading to better asset quality and sustainable growth.

6. Demand rebound if rural incomes recover: If rural economy improves (e.g. good monsoons, better Agri incomes, more non-farming employment), demand for small-ticket credit for working capital, consumption smoothing, small business could rise again, boosting microfinance demand.

6. Conclusion

Microfinance sector has grown rapidly over the past few decades. It has a significant impact on poor people's confidence, courage and skill development. Two development banks NABARD and SIDBI spearheaded the microfinance movement in the country with financial and promotional support. MUDRA also has had a part in the recent years. NRLM provided the financial and programmatic muscle to the SHG programme and it is poised to make a difference to livelihoods of the poor.

The inability of MFIs to get sufficient funds is a major challenge for the microfinance industry's growth, so these institutions should look for alternative sources of funding. The central government had introduced the Micro Units Development Refinance Agency (MUDRA) where the scheme aims to refinance collateral-free loans of up to Rs 10 lakh granted by lending entities to non-corporate small borrowers, for revenue growth actions in the non-farm sector. It is necessary to handle lending in an

effective manner then only India can achieve financial inclusion for the poor in rural and urban areas. Leveraging digital onboarding, mobile banking, credit-scoring algorithms, data analytics reducing costs, improving reach and improving risk assessment.

Promote financial literacy among rural and under-banked populations, to ensure borrowers understand credit and avoid over-indebtedness. Encourage digital infrastructure, including credit bureaus, digitized records, mobile banking, and fintech-MFI partnerships.

Maintain responsible-lending norms and borrower protection regulations, while allowing flexibility for MFIs to innovate (diversification of products). Support MFIs with access to stable, low-cost funding, perhaps via development finance institutions or concessional funds for livelihood-focused lending. Encourage MFIs to diversify products beyond just credit e.g. micro-savings, insurance, small-enterprise credit thereby offering a full suite of financial services and reducing risk.

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