



To cite this article: Seema (2026). IMPORTANCE AND CHALLENGES OF MICROFINANCE, International Journal of Research in Commerce and Management Studies (IJRCMS) 8 (3): 774-780 Article No. 790 Sub Id 1320

IMPORTANCE AND CHALLENGES OF MICROFINANCE

Seema

Assistant Professor, Department of Commerce, Govt College Sidhrawali, Gurugram (HR)

DOI: <https://doi.org/10.38193/IJRCMS.2026.8352>

ABSTRACT

Microfinance refers to providing financial services, including loans, savings, and insurance, to individuals or small businesses with low or moderate incomes. It helps in lifting people out of poverty, empowering women, and promoting the overall economic growth. This study explores the impact of microfinance on agriculture, fisheries, micro and small enterprises and also focuses on Self-Help Groups (SHGs) and Joint Liability Group (JLGs). However, microfinance faces various challenges such as limited employment, high operating costs, regulatory and social barriers. (MFIs) play a key role in supporting Micro, Small, and Medium Enterprises (MSMEs). Through this analysis, the paper highlights the importance of microfinance in fostering inclusive economic growth. Microfinance is important for more than just financial transactions. Access to microcredit has aided people in various areas in moving from subsistence to sustainable means of subsistence, which has boosted the economy as a whole. In terms of economic development, microfinance reduces poverty, encourages entrepreneurship, builds community resilience and removes long-standing obstacles to financial access. It also identifies obstacles and provides information on how microfinance may keep acting as a cornerstone of equitable growth

KEYWORDS: MFIs, MSMEs, SHGs, JLGs, SEWA, Microfinance, inclusive economy, equitable growth

INTRODUCTION

Introduction: Microfinance refers to the provision of financial services to low-income individuals who lack access to traditional banking facilities. These services include microloans, micro savings, and microinsurance. In India, microfinance institutions provide small loans to underserved populations and have expanded significantly over the past two decades. Microfinance institutions in India have expanded significantly over the last two decades and currently serve millions of low-income borrowers through various financial channels.

Objective: The objectives of this study are to examine the importance of microfinance and identify the major challenges associated with microfinance.

Material and Methods: This study is descriptive in nature and is based on secondary data collected

from journals, books, reports, government publications, and authenticated websites.

Review of literature: The origins of microfinance can be traced back to the mid-nineteenth century when theorists such as Lysander Spooner emphasized the importance of providing small loans to farmers and entrepreneurs as a means of alleviating poverty and promoting economic self-reliance. Although early forms of small-scale lending existed prior to this period, the concept gained greater prominence after the Second World War, particularly through initiatives such as the Marshall Plan, which demonstrated the potential of financial assistance in rebuilding economies and improving livelihoods.

The modern microfinance movement emerged during the 1970s, when institutions such as the Grameen Bank of Bangladesh, led by Muhammad Yunus, began shaping the contemporary microfinance industry. Another notable pioneer in this field was Akhtar Hameed Khan, whose community-based development initiatives significantly influenced participatory approaches to poverty reduction. During this period, several organizations experimented with extending credit to underserved populations, challenging the conventional belief that low-income individuals were not creditworthy. These initiatives demonstrated that poor borrowers could successfully repay loans and that financial services could be delivered sustainably through market-based mechanisms without heavy dependence on subsidies.

The development of community-oriented financial institutions further strengthened the microfinance movement. ShoreBank, established in Chicago in 1974, is often regarded as one of the earliest community development banks. Similarly, the Raiffeisen village banking movement in Germany, initiated by Friedrich Wilhelm Raiffeisen in 1864, highlighted the effectiveness of cooperative financial systems. Research by economic historian Timothy Guinnane documented that by 1901, Raiffeisen's cooperative banking network had expanded to serve nearly two million rural farmers, illustrating the long-standing significance of inclusive financial practices.

Global recognition of microfinance expanded considerably during the late twentieth and early twenty-first centuries. According to estimates by the World Bank, millions of individuals worldwide have gained access to financial services through thousands of microfinance institutions. The Consultative Group to Assist the Poor (CGAP) reported that hundreds of millions of families have benefited from small loans that facilitate entrepreneurship and income generation. The Microcredit Summit held in Washington, D.C., further emphasized the global commitment to extending credit facilities to the world's poorest populations. In recognition of the role of microfinance in promoting development, the United Nations declared 2005 as the International Year of Microcredit, encouraging the financial sector to support the entrepreneurial capabilities of disadvantaged communities. Subsequently, in

2006, the Norwegian Nobel Committee awarded the Nobel Peace Prize jointly to Muhammad Yunus and Grameen Bank for their efforts to promote economic and social development from the grassroots level.

In the Indian context, one of the earliest microfinance initiatives was undertaken by the Self-Employed Women's Association (SEWA) in Gujarat, which established SEWA Bank in 1974 to provide financial services to low-income women engaged in self-employment activities. Another noteworthy initiative is Kudumbashree, Kerala's Poverty Eradication Mission launched in 1998. This women-led community network operates through Neighbourhood Groups (NHGs) and focuses on empowering women through collective action and access to microcredit. Kudumbashree has facilitated income-generating activities and addressed issues related to health, nutrition, agriculture, and social development, thereby promoting financial independence among marginalized communities.

The literature suggests that microfinance has evolved from a simple credit mechanism into a comprehensive development strategy aimed at enhancing financial inclusion, reducing poverty, empowering women, and promoting entrepreneurship. However, despite its significant contributions, the implementation of microfinance programmes, particularly in rural India, continues to face challenges related to outreach, financial literacy, sustainability, and regulatory constraints. Addressing these challenges is essential to maximize the developmental potential of microfinance and ensure its long-term effectiveness.

Importance of Microfinance:

Reduction of Poverty: The primary goal of microfinance is to reduce poverty. If you are wondering how Microfinance can help you alleviate poverty here is the answer. Microfinance provides financial aid that helps people balance their finances. . Microfinance loans are often used for:

- Starting small businesses – such as local shops, farming, or handicrafts.
- Meeting essential needs – like food, housing repairs, and healthcare.
- Investing in education – to ensure better long-term opportunities for children.

According to studies, households that have access to microfinance have an average gain in income levels of 15–25% when compared to those that do not. Poverty headcount ratios have seen quantifiable decreases in areas with high microfinance penetration, especially among rural communities. Microfinance also promotes financial independence. Families are able to take charge of their income-generating activities rather of relying exclusively on seasonal or informal labour. Long-term impacts of this empowerment include lowering susceptibility to economic downturns and paving the road for upward mobility. Microfinance offers the first step to a long-term escape from poverty by tackling financial exclusion head-on.

Entrepreneurship Development: Microfinance contributes significantly to the growth of entrepreneurship in addition to reducing poverty. Even with little capital needs, people can turn ideas into successful businesses because of loan availability. Traditional loans are unavailable to many small business owners because they lack formal credit history or collateral. This gap is filled by microfinance, which encourages small business creation and self-employment. Among the results are:

Job Creation: Small businesses often employ local workers, generating income and reducing unemployment.

Local Economic Growth: By circulating money within communities, microfinance supported enterprises contribute to broader development.

Sustainable Income Streams: Entrepreneurship fosters independence, allowing households to rely less on seasonal or unstable income.

Example – a rural farmer can increase output and facilitate excess sales by using microcredit to buy better equipment, seeds or cattle. In addition to increasing home income, this shift from subsistence farming to small-scale agribusiness also fortifies community food security.

Social and Community Impact of Microfinance

Microfinance's impacts go beyond economics they also include community development and social empowerment like women's empowerment. Women, who frequently encounter structural obstacles to financial access, have benefited greatly from microfinance. Women who have access to credit are able to handle household finances, launch enterprises, and fund their children's education. According to research, women who borrow money are more likely to reinvest in their families' welfare, which increases the positive societal effects.

Improved Education and Healthcare

Households can pay for improved healthcare and education with the extra money they earn from microfinance-supported activities. This investment lowers poverty across generations by developing long-term human capital.

Stronger Communities

Cooperatives and lending groups encourage cooperation and accountability among members. Shared responsibility builds resilience, improves trust and fortifies social ties.

Strength to Sustain Shocks: Who would not want to be resilient to financial shocks? Microfinance

can enhance borrowers' resilience to economic shocks and disasters. It helps the debtors to get back on their feet without falling back to the poverty line. Microfinance not only provides financial support but also gives the self-confidence to stand against economic stability. Financially underprivileged people will gain the confidence to deal with their daily hustle without giving up on their life.

Long-Term Sustainability: Long-term sustainability indicates whether the borrowers can lead a happy and meaningful life even after the repayment. The main objective of microfinance is achieved only when the borrowers can achieve their economic goals.

Microfinance keeps track of their client's financial aid so that the repayment should not burden the borrower's lifestyle. The main agenda is to make life better and not worse. Therefore, they verify every aspect of borrowers' records to help them lead a normal life even after the repayment of the loan.

Social Return on Investment (SROI):

All the above-discussed points can be evaluated with a practical methodology called social return on investment. It collectively considers both financial and social outcomes to measure the effectiveness. Solely relying on the financial evaluation would not reveal the effectiveness of the financial service, as they do not show the social outcome after consuming the financial service. However, a mix of qualitative and quantitative evaluation can show how the financial service has impacted the lives of the borrowers.

Microfinance has a noticeable effect on communities in many areas, as seen by increased gender equality, better health outcomes and higher literacy rates in addition to economic growth.

Challenges and Limitations of Microfinance

Although microfinance has several advantages, a number of obstacles and restrictions need to be overcome to guarantee long-term effects,

Higher interest rates: The Interest rates are quite higher as compared to the banks making it difficult for loan seekers to avoid MFI loans.

Dependence on banking system: There is substantial dependence on the Indian banking system, presenting challenges that fintech solutions, like Pennant, aim to address.

Risk of bad debts increases: As these are collateral-free loans, there is no security involved and at times the risk of having bad debt increases.

Accessibility issues: Rural borrowers may not be aware of MFIs and their benefits, leading to a lack of support. Accessibility remains a challenge. End user reports can be digitised and discussed while onboarding any repeat customers.

Lack of information: Information of rural borrowers changing centres or Groups while defaulting payments in one group.

Over-Indebtedness: Repayment issues may arise from having easy access to several modest loans. Insufficient financial literacy can lead to debt cycles for borrowers.

Financial Literacy Gaps: A lot of borrowers require instruction in budgeting, company planning and money management. Without education, microfinance's potential might go untapped.

Sustainability: Sustainability of Institutions Financial viability and outreach must be balanced by microfinance providers. Poor management or exorbitant interest rates might erode efficacy and confidence.

Limited Scale: Structural problems including access to healthcare, education and infrastructure cannot be resolved by microfinance alone. For optimum effect, it needs to be incorporated into more comprehensive development policies.

Understanding these difficulties guarantees that microfinance expectations are reasonable while emphasizing the necessity of supplementary tactics like training, education and governmental assistance.

Conclusion: Microfinance has shown itself to be an effective instrument for fostering economic growth, especially in areas with limited access to regular banks. Its impact on community development, women's empowerment, entrepreneurship support and poverty alleviation highlight its worth as a social and financial innovation. Microfinance promotes self-sufficiency, resilience and inclusive growth by providing credit and savings to marginalized groups.

However, there is no one size fits all approach to microfinance. It is imperative to properly address issues including excessive debt, gaps in financial awareness and sustainability concerns. Integration with larger development measures, such as infrastructure, legislative reforms and education. Is necessary for effective microfinance.

Future prospects for microfinance depend on striking a balance between opportunity and

accountability. Making sure that microfinance acts as a means of achieving long-term stability rather than temporary respite will be crucial as financial inclusion grows. Providing small loans is only one aspect of microfinance's involvement in economic development other goals include empowering people, fostering community growth and laying the groundwork for equitable and sustainable prosperity.

REFERENCES:

1. Newoon Articles (<https://newoon.com/>)
2. <https://www.cgap.org/sites/default/files/CGAP-Donor-Brief-The-Impact-of-Microfinance-Jul-2003.pdf>
3. <https://ijisem.com/journal/index.php/ijisem/article/view/231>
4. <https://www.chaitanyaindia.in/microfinance-and-social-impact-measuring-success-beyond-financials/>
5. <https://jchr.org/index.php/JCHR/article/view/6765>
6. <https://finca.org/our-work/microfinance>
7. <https://www.unesco.org/en/dtc-finance-toolkit-factsheets/microfinance>
8. https://www.serialsjournals.com/abstract/37143_13.pdf