International Journal of Science, Strategic Management and Technology
Volume **02** Issue **10** October-2026 | ISSN: **3108-1762 (Online)** | Impact Factor: 3.8
An International, Peer-Reviewed, Open Access Scholarly Journal Indexed in recognized academic databases

Role of Microfinance and Self-Help Groups (SHGS) In Rural Financial Inclusion

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https://doi.org/10.55041/ijsmt.v2i10.088

Cite this Article: Renuka, (2026). Role of Microfinance and Self-Help Groups (SHGS) In Rural Financial Inclusion. International Journal of Science, Strategic Management and Technology, *02*(10), 1-9. https://doi.org/10.55041/ijsmt.v2i10.088

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Abstract

Microfinance and Self Help Groups (SHGs) have emerged as significant tools for achieving financial inclusion in India's rural and economically weaker sections. These institutions provide opportunities to save, access credit and insurance, and access to livelihoods and support the needs of women, small farmers, and low-income households who face constraints with traditional banking systems. The paper reviews the academic literature, policy documents and institutional reports to critically analyse the role of microfinance and SHGs in financial inclusion in the rural areas. It examines its impact on enhancing access to formal credit, formalising the relationship with informal moneylenders, augmenting the economic engagement of women and rural entrepreneurship. But, the advantages are limited to unequal regional distribution, insufficient financial knowledge, institutional weaknesses and potential for overborrowing. Research also suggests that credit access does not necessarily lead to significant increases in welfare of households. The paper finds that key elements of sustainable financial inclusion include low cost credit, robust group governance, financial education, digital access, and financial institutions' accountability. Thus, microfinance and SHGs must be seen beyond the framework of credit delivery, but rather as part of a greater rural development approach.

Keywords: Microfinance, Self-Help Groups, rural financial inclusion, women's empowerment, SHG–Bank Linkage Programme, India.

1. Introduction

Financial inclusion is the right to use and access affordable financial services such as saving, credit, payments, insurance and other financial products and services by individuals and businesses. Financial exclusion in rural areas frequently goes hand in hand with irregular incomes, low amounts of collateral, geographical isolation, inadequate banking infrastructure and low financial literacy. These obstacles can hinder low-income households in accessing formal credit facilities and help them to rely more on informal money-lenders that might charge high interest rates and set poor terms for repayments.

To overcome these constraints, microfinance has become a popular alternative source of finance for providing relatively small financial services to the households and entrepreneurs who are unable to avail conventional bank loans. The Self-Help Groups (SHGs) are a very important institutional arrangement in India for providing microfinance to the rural

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population. These groups are typically organized by people who regularly save, coordinate their savings, make loans to each other, and – if they qualify – borrow money from banks.

The National Bank for Agriculture and Rural Development (NABARD) launched the SHG – Bank Linkage Programme (SHG – BLP) in the year 1992 to link informal savings groups with the formal banking system. The model later came to play an important role in the policy-making process for financial inclusion in rural areas and women's development. According to NABARD's Status of Microfinance in India 2024–25, there are currently 143.30 lakh savings-linked SHGs with an aggregate savings of ₹71,433.27 crore (as on 31 March 2025). While participation is not a measure of the quality or effectiveness of financial inclusion, these figures show the programme's deep reach within the institutions.

The paper looks at the role of microfinance and SHGs in financial inclusion of rural poor, reviews the results of some empirical studies on which role and the conditions for strengthening their developmental impact and identify institutional conditions.

2. Review of Literature

2.1 Microfinance as a financial inclusion tool

Microfinance rests on the principle that small financial services can be delivered to those traditionally considered "unbankable." Collateral, documentation of income and credit histories are the traditional methods used by conventional lenders to evaluate borrowers. This puts many rural households with informal or seasonal livelihoods at a disadvantage.

These barriers are addressed through the SHG model by promoting collective savings, further financial relationships and group accountability. Members may build up a financial history and show repayment discipline before applying for greater loans from the banks. The Reserve Bank of India (RBI, 2024) has identified the potential of SHGs to link rural poor households to formal banking institutions and enhance access to institutional credit.

However, financial inclusion should not be defined based only on the number of accounts opened and loans disbursed. Of course, affordable, reliable and relevant financial services are necessary for meaningful inclusion as well, and financially secure in the long-term for the borrower.

The household welfare and poverty reduction are the key outcomes of 2.2 SHGs.

The idea of automatic poverty alleviation through micro credit has been called into doubt. An important study by Breza et al.? Specifically, Relief from usury: Impact of a self-help group lending program in rural India (Journal of Development Economics, 2021) analyzed a government-supported SHG credit programme. The researchers discovered that access to the SHG loan was high and some of the demand for loans was diverted from informal lenders. The programme also lowered borrowing rates, though the gains in other measures of household welfare were limited following two years of the programme. This implies that easy access to credit would be beneficial for households' financial decisions, but would not necessarily lead to an immediate and substantial rise in their standard of living.

Likewise, Tripathy and Jain (2011) studied the income consequences of the microenterprise finance in rural India. Their analysis revealed that internal savings and the group funds were positively related and statistically significant with beneficiaries' income growth but the bank credit failed to show similar significant relationship. The results indicate that the mobilization and productive utilization of savings can be as important as loans from outside sources.

The studies suggest that the most effective use of the microfinance occurs when it is used in conjunction with implementation of livelihood opportunities, savings discipline and capacity to manage financial resources.

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2.3 Women's participation and inclusion in society

An important role of SHGs is that they focus on social mobilization especially of rural women. Possibility to make efficient use of savings, to make decisions about borrowing, to attend group meetings and to become more confident when dealing with financial institutions.

Yadav et al. (2024) did a systematic review of 140 studies between 1992 and 2021 on SHGs in relation to women empowerment, poverty alleviation, rural development and entrepreneurship. They show the wide range of development outcomes linked to the involvement in SHG as well as identify areas for further research.

Maity (2023) adds to this research by examining the relationship between financial inclusion and social and institutional environment of disadvantaged communities in Assam. However, Baland, Somanathan and Vandewalle (2019) in eastern India have established that education is an important factor affecting SHG membership continuity and credit access. Their research suggests that group financing alone is not enough to overcome social inequalities; for this, education and prior inequalities are important variables to consider.

In general, the literature indicates that the empowerment of women through the SHGs is possible but the level of empowerment depends on empowerment elements such as decision-making power, membership, and economic opportunities for the women members.

3. Role of Microfinance and SHGs in Rural Financial Inclusion

3.1 Improving access to formal credit

One of the most significant contributions of SHGs is that they are able to link the rural households with the formal financial institutions. Many poor borrowers don't have conventional collateral or a credit history, which makes it hard for individual banks to lend to them. SHGs overcome some of these drawbacks by mobilizing collective saving and keeping records and establishing connections with banks.
As per the SHG–Bank Linkage Programme, the eligible groups can avail institutional loan based on their saving pattern, their attitude towards repayment and their financial management. The structure alleviates some of the barriers to providing credit to individual borrowers while also provides a route where households could incrementally access the formal financial system.
In the FY 2023–24, NABARD's report detailed loans disbursed to 54.8 lakh SHGs amounting to ₹2,09,285.9 crore. This shows the magnitude of the institutional lending supported by the programme, but does not indicate the extent of credit availability to the poorest households or the effectiveness with which borrowers have taken advantage of the credit availability.

3.2 Mobilising savings and strengthening financial resilience

Microfinance not only helps to achieve financial inclusion through loans but also through regular savings. In rural communities where income is not regular, small savings can go a long way to offsetting unexpected expenses, smoothing out seasonal income variations and eliminating risk of distress borrowing.

In SHGs members make small contributions to a common pool from which other members may borrow. This is a good way to ensure that people get into good money habits and have a comfortable environment to learn basic money management. It can also help them build the ability to determine their borrowing needs and make repayments plans.

The importance of savings is further supported by the findings of Tripathy and Jain (2011) indicating that the internal savings and group funds are positively related with the growth of income. The evidence indicates that saving-inclusion financial transactions needs to be given equal importance as credit expansion efforts.

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But, financial sustainability of SHGs depends upon the stability of income of their members, the extent to which they have saved money and whether their assets are safe from mismanagement. The individual bank accounts and an appropriate insurance product, therefore, should be used alongside group savings, not in place of it.

3.3 Supporting rural entrepreneurship and livelihood diversification

Small loans can be used to purchase agricultural inputs, livestock, food processing equipment, and tailoring and handicraft equipment, and to support petty trade and other micro enterprises, among other uses. This can offer a variety of income generating activities and decrease reliance on a single seasonal job.

SHGs can also provide an opportunity for members to share knowledge on production and marketing, and to share resources for the purchase of inputs. The role of groups in the context of livelihood programmes, training institutions and producer organisations can go beyond credit delivery.

However, there is no automatic linkage between credit and enterprise development. Borrowers must have viable business concepts, the necessary skills to implement the business, a market for their product, and enough time to realize a profit. Loans for consumption and/or emergency expenses can be made to meet short-term family demands and not result in the formation of an asset.

The study findings by Tripathy and Jain (2011) and the study of rural SHG lending undertaken in 2021 have raised some concerns on the use of bank credit as a proxy of poverty reduction. Financial services and productive opportunities and viable repayment ability must be linked to provide effective livelihood support.

3.4 Promoting women's economic participation

SHGs led by women are especially significant in rural India due to the linkages between financial exclusion and unequal access to household assets and to formal economic institutions. Members have the opportunity to gain hands-on skills in saving, borrowing, record-keeping and negotiating with banks through regular meetings and joint financial decision making.

These activities can foster financial confidence and opportunities for household and community involvement in decision making. Group membership could also be a medium through which information about government programmes, health, education & livelihood development can be shared.

The SHG–Bank Linkage Programme has, therefore, been adopted as a powerful means to achieve women's economic inclusion. But, a group does not mean that each member has meaningful control on borrowed funds. Other family members may affect or be responsible for use of the loan and its repayment in some households.

Therefore, measures of women's empowerment, like control over income, involvement in financial decision making, mobility, entrepreneurial activity and representation in community institutions should be used not only to measure membership.

3.5 Reducing dependence on informal moneylenders

Although formal credit access is important, informal credit access is also crucial in rural areas as the local moneylenders and other providers of informal credit may be able to provide immediate credit access when formal credit is not accessible or available. However, this borrowing can be very expensive for households in terms of interest rates, and can lead to frequent refinancing.

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The findings of the study on "SHG lending in rural India" from the Journal of Development Economics (2021) are especially relevant: some of the informal credit used by women was replaced by SHG loans, with the effect being to lower interest costs. But there has been limited overall improvement in household welfare during the study period. This is significant because, even if it won't eliminate poverty directly, it is a valuable financial transaction to be able to replace high cost debt with lower cost institutional credit.

One of the development potential of SHGs is to enhance the conditions under which loans are obtained by households. They are effective if institutional loans are delivered in time, at an appropriate rate and are in keeping with the borrowers real capacity to repay.

4. Challenges and Limitations

Microfinance institutions and SHGs have played a vital role in financial inclusion but are faced with a number of structural and operational hurdles.

First, credit does not assure productive investment of loans or poverty reduction. Households can use money borrowed to cover medical costs, or to buy necessities or pay off outstanding loans. While this can be a vital source of financial stability, it can also create a financial burden that is hard to manage in the long term as it may not produce extra income to pay off the loan.

Secondly, there may be regional and social inequalities within group-based programmes. Baland et al. (2019) concluded that education made a difference in SHG continuity and loan size. This suggests that if no extra measures are taken to support less educated and socially disadvantaged members, then collective lending mechanisms can create inequalities that already exist.

Third, weak governance and poor financial literacy can have a negative impact on the sustainability of SHGs. Ineffective bookkeeping, lack of knowledge about how to calculate interest, poor meeting attendance and lack of transparency can cause conflicts or financial losses for the members. Therefore, a good system of supervision, capacity building and sound accounting is essential.

Fourthly, the proliferation of digital financial services presents opportunities and risks. Digital payments and banking apps can cut costs and provide easier access for financial services. But, some of the rural users may not be able to take full advantage of the benefits because of low levels of digital literacy, weak connectivity, cybersecurity threats and reliance on intermediaries.

Last but not least, there is over-indebtedness and unfavourable loans conditions. Borrowing on more than one arrangement can lead to a pressure of repayment when income is unpredictable, or when agricultural enterprises are impacted by weather conditions, illness or market conditions. Thus, financial inclusion should focus on responsible lending, on transparent pricing, and on borrowers' repayment capacity, as well as on credit expansion.

5. Data Analysis and Interpretation

5.1 Research methodology and data sources

The present analysis is by adopting quantitative descriptive approach with secondary data published by NABARD. The financial year 2023–24 is compared with 2024–25 to study the changes in SHG savings linkage, credit disbursed and outstanding bank loans.

Absolute changes, percentage changes and comparisons of financial indicators are used to analyse the data. These are suitable for detecting financial activity and scale changes in programmes. The results of the aggregate annual data,

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however, do not demonstrate whether SHG participation directly leads to any improvement in household income, poverty reduction or women empowerment.

5.2 Descriptive analysis of SHG–Bank Linkage Programme data

Table 1. Performance of the SHG–Bank Linkage Programme in India

Indicator	2023–24	2024–25	Change (%)
SHGs savings-linked with banks (lakh)	144.22	143.30	−0.64%
Aggregate savings (₹ crore)	65,089.15	71,433.27	+9.74%
SHGs credit-linked during the year (lakh)	54.82	55.57	+1.37%
Bank credit disbursed during the year (₹ crore)	209,285.87	208,282.67	−0.48%
SHGs with outstanding bank loans (lakh)	77.42	84.94	+9.71%
Outstanding bank loans (₹ crore)	259,663.73	304,258.74	+17.17%

Source: Compiled from NABARD (2024, 2025),

Growth in savings even though there was a small drop in savings related SHGs. The decline of 0.64% in the number of SHGs incorporated with the banks is offset by an increase in aggregate savings of 9.74%. The overall savings from the programme did not decrease with the slight reduction in the number of groups linked, suggesting this trend. It is consistent with an increase in the aggregate savings base, but for the moment it is not possible to determine if there has been an increase in the level of saving of current members, or whether the composition of the group has changed or other factors have influenced the level of saving.

Increase in the level of outstanding institutional credit. The number of SHGs having good loans grew by about 9.71% and the total loan amount outstanding grew by 17.17%. The increase in the aggregate stock of bank lending (i.e. outstanding credit) was faster than the growth in the number of groups with outstanding loans, suggesting the programme had a positive effect on growth in the volume of lending.

The average loan outstanding per SHG can be estimated by dividing the total loans outstanding by the number of SHGs with loan outstanding. This shows an approximate average outstanding loan per SHG of ₹3.35 lakh in 2023-24 and ₹3.58 lakh in 2024-25. It is in line with NABARD's average outstanding loan balance per SHG of ₹3.58 (2024–25). The rise could be due to bigger loans, more borrowing or variations in repayment habits, but the data is aggregated and does not allow to differentiate among these possibilities.

Credit disbursement continued to be broadly unchanged. The credit disbursed to SHGs declined by around 0.48% in the year while the number of credit disbursed to the SHGs rose by 1.37%. The programme, therefore, had a slightly greater impact on the groups, though without a corresponding rise in disbursement per group per year.

This distinction also emphasizes the importance of not measuring financial inclusion solely based on credit linked SHGs. The amount and affordability of credit, the timing of disbursement, repayment obligations and borrowers' ability to use loans productively are also important.

Overall, the figures indicate that the savings mobilization and expansion of the outstanding institutional credit under the SHG – Bank Linkage Programme remained on. Despite this, however, they set changes in programme-level financial indicators instead of direct improvements in household welfare. The results should thus be examined and understood in conjunction with empirical research on borrowers' experience and economic outcomes.

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6. Recommendations for Strengthening Rural Financial Inclusion

The findings indicate five priorities to enhance the effectiveness of microfinance and SHGs.

1. Embed financial literacy into credit provision. The financial aspects of training should include budgeting, saving, calculating loan interest, agreements to loans, digital payments and managing debt. This education should be based on practical application and suited to the literacy level of the members.

2. Link finance to sustainable livelihood opportunities. SHGs need assistance with enterprises, training, marketing, product quality and enterprise planning. A realistic opportunity to earn income increases the likelihood that loans will result in permanent changes.

3. Enhance group governance and accountability. Mismanagement and the loss of members' savings can be minimized through regular audits, clear records, participatory decision-making and effective grievance-redress processes.

4. Promote inclusive and responsible digital finance. Digital services as well as assisted banking services should be made available to banks and development agencies. Financial products should be clear, safe and accessible to customers who may not be technologically savvy.

5. Assess results after the loan is given. The evaluation of any programme should focus on the impact on the terms of borrowing, household saving, income security, business survival and attitudes to excessive indebtedness among women. Special focus should be placed on low income households, and areas with less institutional support.

All of these steps would help to shift the focus of SHGs from saving and lending to broader institutions promoting financial capability, livelihoods and social inclusion.

6. Conclusion

Microfinance and Self-Help Groups are important instruments in promoting financial inclusion in rural India and have helped bring the excluded households into the formal credit market, promoting savings, livelihood activities and increasing women's access to financial decision making. The SHG – Bank linkage programme shows that collective financial institutions can be operated at a large scale and establish linkages between the rural masses and conventional financial institutions.

But the facts suggest that granting more credit does not automatically do away with poverty. Empirical evidence from rural India suggests that SHG loans can help households cut down on their informal borrowing habits, and may have a generally small impact on consumption, income and other household welfare outcomes in the short term. Education, social disadvantage, institutional quality and productive economic opportunities are also important factors in determining who gets what benefits.

The longterm viability of microfinance is therefore more dependent on the growth of the amount of loans than anything else. It needs financial products that are cheap, good governance of the groups, financial education, responsible lending, inclusive digital services, and good linkages with markets and livelihood programmes. Under these circumstances, the role of microfinance and SHGs in making the rural financial system more accessible, resilient and equitable is possible.

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