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Microfinance as a Development Strategy for Rural India: A Case Study of Uttar Pradesh

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Abstract

The Indian microfinance (MF) sector, delivered via SHGs, JLGs and MFIs has evolved into a key policy tool for rural development in India by providing access to savings, credit and other financial services to excluded households from formal banking. Microfinance, this article argues, is a strategy that some consider viable for development in selected settings (with the state of UP taking refuge among those who do) and it employs the evidence from Uttar Pradesh (UP); a large predominantly agrarian state with high levels of poverty, seasonal incomes and limited access to formal finance where group-based models and microcredit are particularly pertinent. Leveraging secondary data from formal bank linkages, national rural livelihood mission (NRLM) dashboards and publications of NABARD and MFIN, the analysis assessed outreach, credit linkage and portfolio trends as well as pathways through which microfinance impacts on livelihoods: consumption smoothing; risk buffering; asset formation; women's agency and local enterprise development. We present evidence on the ability of such an institution to scale-up, with SHG-bank linkage expanding from ₹58,070.68 crore in 2020–21 to ₹2,09,285.87 crore in 2023–24 and improvement in portfolio quality (NPAs decreasing to ~2.05 percent in 2023–24). Uttar Pradesh has an enormous SHG base (more than 12 lakhs of SHGs are under NRLM eGov system), however, saving linkage to complete bank loan mapping is required to ensure enhanced absorption of credit, enterprise support and risk mitigation. The paper finds that it is credit coupled with capacity building, market ties, producer organisations

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and social protection that maximises microfinance impact in rural development; and when a policy focus on page volume gives way to one on income pathway and resilience outcomes.

Keywords: Microfinance, SHG-bank linkage, NRLM, Rural development, Women's empowerment, Uttar Pradesh, Financial inclusion

1. Introduction

Rural development in India has historically depended on the ability of households to invest in income-generating assets, to smooth seasonal volatility, the production seasonality of agriculture and to deal with shocks such as ill-health, bad harvests or short-term unemployment. But for many families, credit; formal credit in particular; has continued to be rationed by the need for collateral, the maze of paperwork and travel needed to access a loan through banks (which can take days or weeks and sometimes still not result in an approval), and banks' view of small loans as too risky. Microfinance came out as a practical answer to this denial. Microfinance does not require "conventional" forms of collateral (in the form of land, buildings, etc.) but often involves various forms of guarantees simply borrowing groups from each other. Within the Indian microfinance landscape, there have been two broad institutional pathways of the microfinance: (i) SHG-Bank Linkage Programme (SHG-BLP), which connects community managed groups with banks; and (ii) MFI as an approach to financing that includes MFIs as NBFC-MFIs and other regulated entities who provide credit using group methodologies such as JLGs. Micro-credit is typically justified on a development literature: small loans at an interest rate that is below extortionate can long consumption during hard times, allow for other emergency needs without having to sell assets in distress, finance agricultural inputs and vitalize microenterprises. With repeated exposure, finance and skills can lead to higher incomes, fixed assets ownership and enhanced bargaining power among women in households as well as in communities over a period of time. But the worldwide experience also contains a warning that microfinance is not transformative per se: results depend on loan use, market opportunities, complementary services and the risk of over-borrowing. Uttar Pradesh is a good case study in the development of poor through microcredit. With the largest population of any state in India, it features wide inter-district differences in agricultural productivity, non-farm employment opportunities, caste gender inequalities and provision of basic services. These elements lead to an enhanced demand for inclusive finance, as well as a high-pressure situation for credit discipline and productive investment. Thus, the guiding question of this investigation is: 'What are the extent and conditions of micro-credit's operation as a development strategy in rural UP -and thus also, what aspects of policy design might strengthen or undermine its effect?'

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2. Conceptual and Policy Framework

The SL through following inter-weaved mechanisms influences the RD. One, credit and savings increase a household's liquidity, providing for consumption smoothing in response to seasonality of incomes. Second, the organization in groups can enhance social capital production by establishing habits of visits, information recording and collective action. Third, microcredit can finance productive investment; cattle, small commerce, farm inputs and tools; if markets and skills exist. Fourth, repeat transactions with formal institutions can lead to better 'financial capability' and ultimately inclusion over the longer term. The SHG-BLP clearly seeks to utilise peer pressure in lieu of collateral, with NABARD explaining that the programme 'lay emphasis on peer pressure within the group as an alternative to collaterals', as a measure to maintain credit discipline (NABARD, 2024); for measurement is also one means of control. Nationally, microfinance is related to financial inclusion and livelihoods objectives. National Rural Livelihoods Mission (NRLM) encourages women's SHGs, their federations and community institutions, credit linkage with banks and subvention on interest on the loans. In addition, government announcements also monitor macro-level development with regard to financial inclusion; for example, the Financial Inclusion Index (RBI) in India in 2025 has been reported at 67 indicative of continued improvement under access and usage dimensions (PIB, 2025). This piece regards microfinance as an enabler and not a solution in its own right. The appropriate evaluative lens, then, is of 'credit-plus'; microfinance pays off in development when part of a larger ecosystem of training, producer collectives, market access and social protection.

Figure 1. Microfinance-to-Development Pathway (Conceptual Framework)

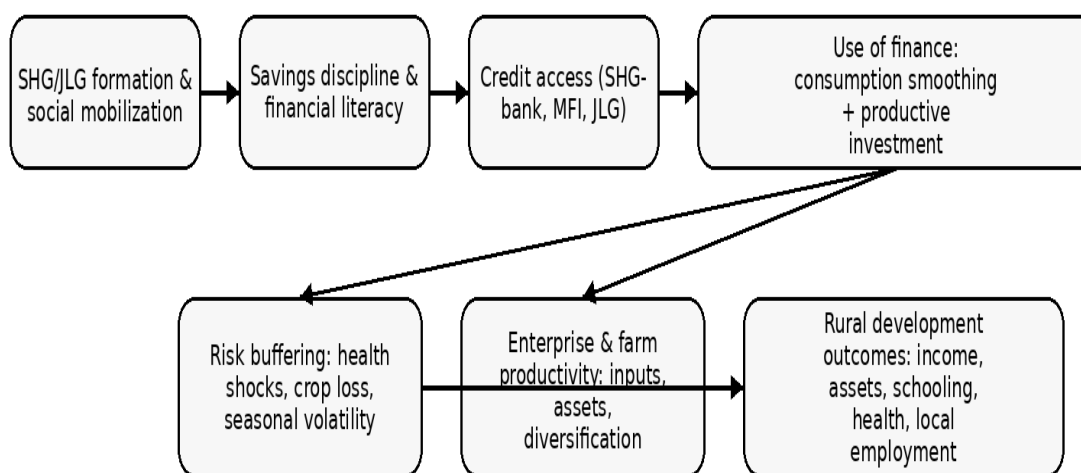


Figure 1. Microfinance-to-Development Pathway (Conceptual framework used in this study).

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3. Data and Methodology

Methods This is a descriptive-analytical study with secondary data sources, including policy documents. **Data** Three types of evidence are aggregated: (i) SHG-BLP national trends and portfolio quality indicators from NABARD; (ii) industry-level open-aggregates of the microfinance industry's aggregates (borrowers, portfolio size), reported by MFIN; and (iii) state-level outreach and bank-linkage fishbone-maps for Uttar Pradesh from official NRLM bank-linkage reporting portals. Since UP is a populous and heterogeneous state, the article takes UP as "strategic case" through which to understand how microfinance scales in contexts of high demand. The analysis is not making a claim for causal attribution, econometric style, but rather maps the plausible pathways; it checks whether scale and credit quality match those pathways; and it points to missing links in implementation (and policy levers). This includes variables reflecting: the quantity of SHGs set up and linked, bank-loan disbursement levels, non-performing assets (NPAs) in SHG loan portfolios; state mapping rates; and qualitative programme aspects reported on in official published material.

4. National Evidence on Microfinance and SHG-Bank Linkage

NABARD's review of SHG-bank linkage performance indicates rapid scaling of formal credit to community groups over the last decade. As Table-based evidence in a NABARD policy booklet shows, SHG loans disbursed increased sharply from ₹58,070.68 crore in 2020–21 to ₹2,09,285.87 crore in 2023–24, and loans outstanding reached ₹2,59,663.72 crore in 2023–24. These volumes reflect the combined role of scheduled commercial banks, RRBs and cooperative banks in financing SHGs. Importantly, portfolio-quality trends have improved: NPAs in SHG loans declined from 4.73% in 2020–21 to 2.05% in 2023–24, suggesting stronger credit discipline and/or better credit management as the programme expanded. These national trends support two development claims. First, SHG-bank linkage has progressed beyond a niche inclusion experiment to a major flow of rural credit. Second, improving NPAs indicate that scale has not automatically compromised repayment quality; although disaggregated performance varies across regions and institutions. Alongside SHG linkage, the broader microfinance industry has also grown. MFIN's Micrometer press note for the quarter ending March 31, 2024 reported a total industry gross loan portfolio (GLP) of ₹4,33,697 crore serving about 7.8 crore unique borrowers (through 14.9 crore loan accounts). This scale implies that MFIs, banks and small finance banks together remain crucial in reaching households that may not yet be effectively served by SHG-based credit or that require faster turnaround and standardized products. Overall, national evidence indicates a 'two-pillar' microfinance ecosystem: SHG-BLP strengthens community institutions and women's collectives, while MFI-style microcredit expands the supply of standardized small loans. A development strategy for rural India must therefore coordinate these pillars to avoid duplication and over-lending, and to align credit with livelihoods.

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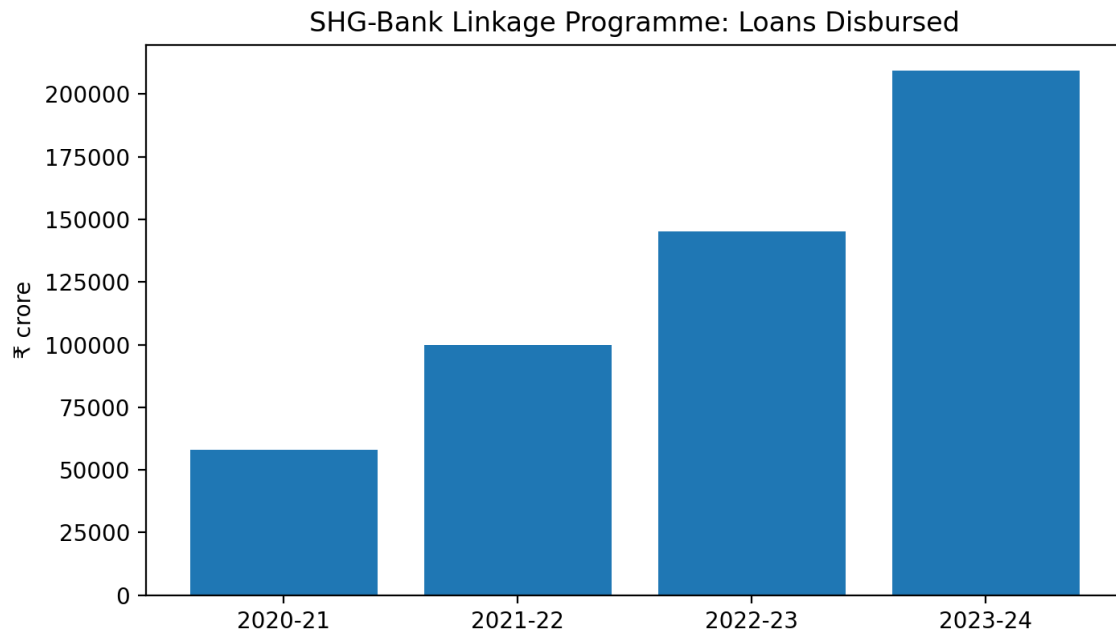


Chart 1. SHG-BLP loans disbursed (₹ crore), FY2020–21 to FY2023–24 (compiled from NABARD, 2024).

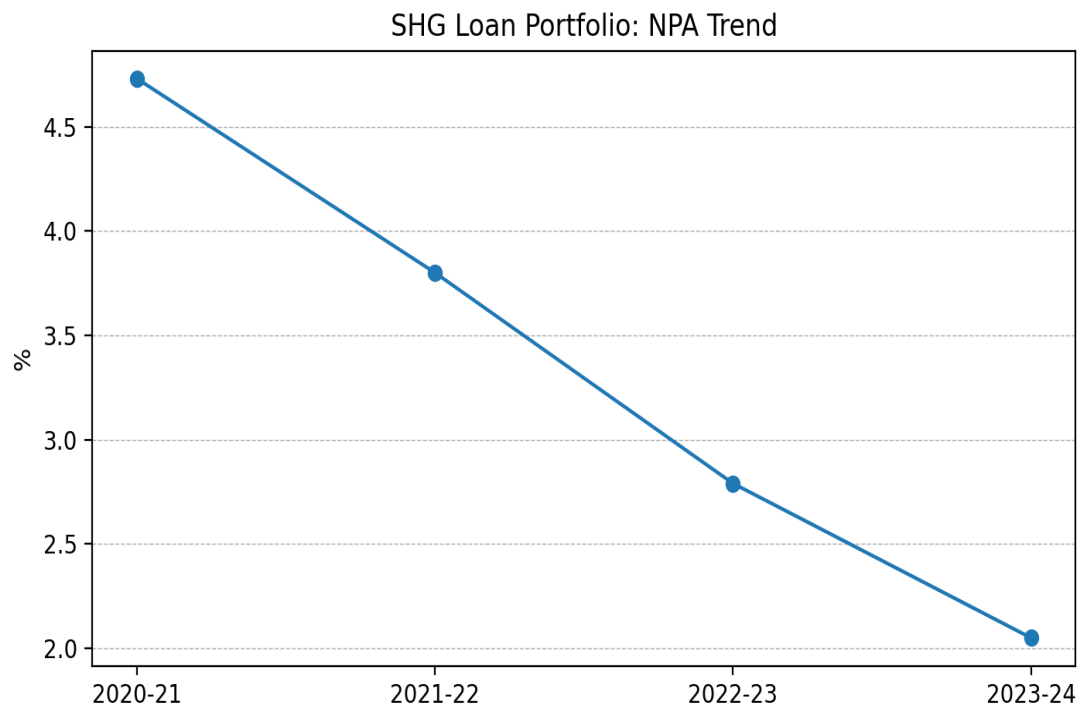


Chart 2. SHG loan portfolio NPAs (%), FY2020–21 to FY2023–24 (compiled from NABARD, 2024).

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5. Uttar Pradesh: Microfinance Landscape and Bank-Linkage Performance

Agricultural economy of rural Uttar Pradesh They are widely dispersed small and marginal holdings, The dependence on seasonal agriculture labour is high in nearly all the villages from a few weeks to six months. These characteristics sustain ongoing short-term credit needs (for input costs and consumption), as well as long-term finance for microenterprise growth and asset accumulation. SHGs and JLGs have a duality of functions in this regard: participatory inclusion (integrating households into savings-credit links) and developmental inclusion (binding finance with income streams).

Official NRLM bank-linkage mapping data show that Uttar Pradesh has one of the largest SHG bases in the country. The NRLM eGov system reports 12,02,779 SHGs in Uttar Pradesh, of which 11,99,884 have valid savings bank accounts (99.76% validity). However, only 3,19,601 SHGs are shown as ‘mapped’ (i.e., cumulatively availed loans); about 26.64% of total SHGs. In other words, UP exhibits a large savings-linked platform but a comparatively modest conversion into fully mapped credit-linked groups. This tendency admits of two explanations. Best case, a big savings base indicates successful social mobilization and financial penetration at the bottom end. More prudently, the low mapping ratio reflects a ‘credit absorption’, and maybe, more importantly for microfinance institutions (MFI), a ‘deepening’ problem: many groups are young or inactive, not yet credit-ready; bank underwriting and documentation may be slow; households may value informal finance or MFI product speed and flexibility. If so, a realistic development step for UP would then be to have in place an explicit ‘graduation’ pathway – indeed the central insight of Brune et al (2008b) was that there needed to be such a three-step process (i) stabilizing group quality and recordkeeping, (ii) ensuring timely repeat credit and the provision of loan sizes suitable for specific purposes – this would seem likely to involve some class of what GoJ/NABARD/RBI/RTF etc term different livelihoods interventions)skills, value chains, producer groups)that link borrowings into income.

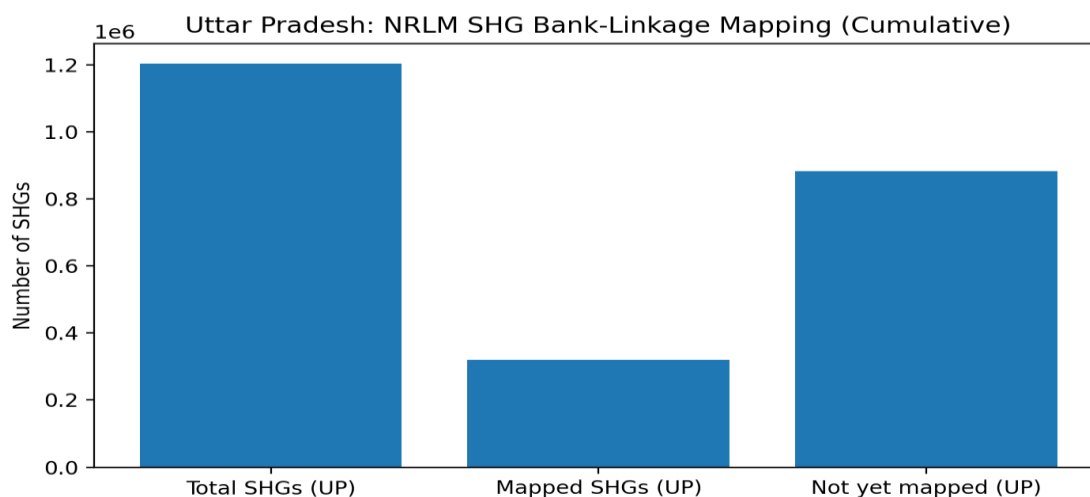


Chart 3. Uttar Pradesh NRLM SHG mapping snapshot (compiled from NRLM bank-linkage portal data).

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6. How Microfinance Contributes to Rural Development in Uttar Pradesh

Based on the conceptual framework (Figure 1) and the UP mapping evidence, microfinance contributes to rural development through five principal channels.

6.1 Smoothing consumption / Distress options 39 At the beginning of each period a household can decide how to allocate its resources between food consumption and distress coping strategies in order to smooth out variations in consumption over time. Rural households are confronted by lean seasons between harvests and occasional gaps in cash flow. Tiny loans and easily accessible savings enable households to avoid making distress sales of their animals, turning to high-cost informal financing or cutting back on food consumption. Hence the visibility of this liquidity effect when credit is rapidly available for predictable seasonal needs (inputs, school fees) and also in case on emergencies.

6.2 Resilience to shocks and risk buffering. Vulnerability is driven largely by health expenditure. Internal lending from pooled savings is often the starting point for SHGs, which can offer fast small loans for emergency use. Then, when bank-linked credit is layered on top, families can supplement smaller emergency loans with larger livelihood loans. Quality improvements in SHG loans at national level (NPAs at ~2.05% in 2023–24) indicate that group-based lending can be viable for repayment despite reaching the risk exposed population – if credit appraisal, follow up, and borrower cash flows are upheld adequate.

6.3 Productive investment and diversification. The greatest development effects occur when microfinance finances income-generating investment projects. In UP, these may involve dairying/small animal husbandry, petty trade, food processing and preparation, tailoring, small transport operations and farm input procurement. But the ‘credit-to-income’ transformation depends much on markets, capacities and infrastructure. This suggests that the success of the programme should not be measured only by disbursement ratios but also by loans as a share of stable income flows.

6.4 Agency and collective capabilities of women. In India, SHG models are generally women centric. NABARD (2024) records that SHG-BLP has reached out to households through an extensive network of groups, and points out that credit flows are linked to women’s collectives and the broader mission infrastructure. In UP, the magnitude of SHGs is a landscape where women are able to participate in local decision-making. Agency effects may be magnified when women are in charge of records, deal with banks and work in federations, there by increasing their mobility, confidence and bargaining power.

6.5 Local economic multipliers. Microenterprise credit may create local employment and demand linkages (inputs, transport, services). These effects are probably larger when groups establish producer collective arrangements, access shared infrastructure and services or link into long-term buyers. In the absence of such linkages, local credit can be absorbed principally as consumption finance by the local economy, with welfare gains but not much structural change.

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7. Constraints, Risks, and Implementation Gaps in Uttar Pradesh

Despite large-scale mobilization, three constraints frequently limit microfinance impact in UP.

(i) The credit linkage gap. UP's mapping share (~26.64% of SHGs mapped to loans) indicates that many savings-linked groups are not yet integrated into the formal credit cycle. Bridging this gap requires improving group maturity, documentation workflows, and banker incentives.

(ii) Livelihood quality constraints. Just credit does not make for profit-making organisations. In the presence of poor market access, low skills, or local markets that are saturated, loan use may drift towards consumption or low-return after investment activities. That, in turn, can have some effect increasing welfare without necessarily lifting durable income.

(iii) Over-indebtedness and multiple borrowing. As the microfinance sector grows families have potential to borrow from both SHG and MFI. However, diversified sources of credit can also generate more stress due to repayment, and further amplify repayment stress particularly during covariate shocks. Sharing of information among lenders, honest use of the credit bureau and counseling borrowers will mitigate this risk.

It may also be cumbersome for the lender to administer interest subvention, data mapping and monitoring. It is important to reinforce digital workflows and enhance field level financial literacy in order to grow without sacrificing inclusion.

8. Policy Recommendations for a 'Credit-Plus' Microfinance Strategy in Uttar Pradesh

1) Strengthen SHG exit pipeline. UP should focus on a graduated path from savings-linked SHGs to repeat bank credit, with clear demarcation for bookkeeping, meeting regularity and repayment performance. Banks and SRLMs can collectively pursue 'mapped share' as an indicator of performance.

2) Scale up of enterprise support and market linkages. Credit needs to be accompanied by skills training, producer groups and buyer linkages so that a greater proportion of borrowing is used for productive investment. Livelihood planning on-and off-farm (dairy, food processing, handicrafts and farm services) by way of clusters can minimize the risk of multiple small yet unconnected plans: clusters are far better than scores of trivial individual projects fighting for minced spoonfuls in swarms markets.

3) Enhance borrower risk management. Facilitate micro-insurance, convergence of health coverage and contingency plan at group and federation. This decreases the probability that health shocks lead to loan default or distress borrowing.

4) Responsible credit and data sharing. Dovetailing of SHG lending and MFI financing with CMR queries to be conducted in credit bureau checks as well and by way of local lender forums for restraining multiple borrowings and preventing the overall indebtedness to remain within repayment capacity.

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5) Measure outcomes beyond credit. Programme dashboards need to follow income pathways (enterprise survival, asset creation, diversification) and resilience outcomes (the ability to withstand shocks) not just disbursement volumes.

6) Invest more in financial literacy, and girls' and women's leadership. Training should focus on household financial planning, enterprise costing and digital payments. Women-led community cadres can offer continued support and less reliance on external facilitators.

9. Conclusion

Microfinance can be considered to be a strategically important tool for rural development in India as it overcomes intrinsic structural barrier existing through the exclusion of low-income population from access to affordable and timely credit. The national evidence demonstrates that SHG-bank linkage has grown exponentially and portfolio quality improved as the amount of SHG credit disbursed grew to ₹2,09,285.87 crore and NPAs fell to about 2.05% in 2023–24. Uttar Pradesh, by contrast, is a showcase of both the potential – and the challenge – of scaling: it boasts an extremely large base of SHGs, but there is still substantial distance to travel in converting savings-linked groups into fully-mapped bank-credit users. As a development strategy for UP, microfinance is best handled as designed “credit-plus”: a package containing both that credit as well as trainings, livelihoods support, market linkages and risk coping. Where these complements exist, microfinance can transform household strategies from coping to investing and can produce wider impacts on rural development; raised incomes, increased resilience and increased agency for women. Without them, microfinance is likely to provide a reduction in vulnerability at best, rather than transformative and lasting development.

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