

Financial Empowerment and Inclusive Growth in India: An Examination of the Role of Microfinance and Financial Literacy

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Abstract

India's path to inclusive and sustainable economic growth requires empowering marginalized households not just through access to financial resources but also by equipping them with the skills to manage those resources effectively. Two mechanisms—microfinance and financial literacy—have emerged as crucial drivers in this process. While microfinance institutions (MFIs) provide loans and savings opportunities to underserved populations, financial literacy enables individuals to make informed and responsible financial decisions. This paper investigates the combined role of microfinance and financial literacy in fostering financial empowerment and inclusive growth, with evidence from rural Rajasthan. Primary data were collected from 500 respondents in nine districts of Rajasthan—Ajmer, Bhilwara, Udaipur, Jaipur, Alwar, Jodhpur, Bikaner, Bharatpur, and Barmer through surveys and interviews. Statistical analysis, including correlation and regression, was used to evaluate the influence of financial literacy on loan management, saving behavior, and entrepreneurial activity. Findings indicate that financial literacy significantly enhances the impact of microfinance by improving repayment discipline, encouraging savings, and promoting small-scale entrepreneurship. Women, in particular, displayed increased financial decision-making autonomy when literacy training was integrated with microfinance. The study concludes that microfinance alone is insufficient to achieve long-term development. When supported by financial literacy, however, it becomes an effective instrument of empowerment and inclusive growth. The paper recommends embedding financial education within all microfinance programs to align with India's sustainable development objectives under SDG 8 (Decent Work and Economic Growth) and SDG 10 (Reduced Inequalities).

Keywords: Financial Empowerment, Inclusive Growth, Microfinance, Financial Literacy, Rajasthan, Sustainable Development.

Introduction

India has emerged as one of the fastest-growing economies in the world, yet the benefits of this growth have not been evenly distributed. Deep disparities persist between rural and urban populations, across gender, and among socio-economic classes. While urban areas increasingly benefit from modern banking and digital finance, millions of rural households remain dependent on informal sources of credit such as moneylenders. This exclusion from the formal financial system undermines their ability to save, invest productively, and cope with financial shocks.

Financial empowerment is therefore considered an essential pillar for achieving inclusive growth. It extends beyond simple access to financial products and services; it also encompasses the capacity of individuals to make informed choices and to manage financial resources effectively. In India, the two most widely discussed enablers of empowerment are **microfinance** and **financial literacy**.

Microfinance refers to the provision of small-scale credit, savings facilities, and related services to individuals who are traditionally excluded from the formal banking system. Over the last three decades, microfinance institutions (MFIs), along with Self-Help Groups (SHGs) supported by the National Bank for Agriculture and Rural Development (NABARD), non-governmental organizations (NGOs), and commercial banks, have played a significant role in extending financial services to low-income households. These programs have enabled poor households to access credit for agriculture, livestock, and small businesses, thereby creating opportunities for income generation and poverty alleviation.

However, microfinance has faced criticism for its limited effectiveness in producing long-term developmental outcomes. Several studies point out that borrowers often utilize loans for consumption purposes rather than productive investments, which increases their debt burden without improving their economic resilience. Over-indebtedness, repayment stress, and lack of entrepreneurial training are recurring issues that undermine the transformative potential of microfinance.

This limitation underscores the importance of **financial literacy**. Financial literacy involves the ability to understand fundamental concepts such as interest rates, savings, budgeting, risk management, and investment options. More importantly, it cultivates the confidence and decision-making capacity required to use financial services effectively. Without adequate literacy, individuals may misuse loans, fail to save systematically, or fall prey to exploitative practices. In contrast, financially literate individuals are more likely to adopt responsible borrowing practices, create financial plans, and invest in productive ventures.

Recognizing this, the Reserve Bank of India (RBI), the National Centre for Financial Education (NCFE), and NABARD have launched numerous financial literacy campaigns over the past decade. These initiatives aim to educate households on financial planning, encourage savings habits, and build awareness of digital financial platforms such as Unified Payments Interface (UPI). Yet, despite these efforts, a significant proportion of India's rural population continues to lack adequate financial knowledge.

This gap has important implications for India's inclusive growth agenda. While microfinance has expanded the reach of financial services, the lack of financial literacy has prevented many households from realizing its full benefits. The real empowerment occurs when access (through microfinance) is combined with capability (through financial literacy). This integrated approach equips households to not only borrow and repay responsibly but also to save for the future, diversify income, and improve their quality of life.

The state of Rajasthan presents a particularly relevant case for studying this integration. Rajasthan has a long tradition of SHGs and microfinance programs, many of which are supported by NABARD, NGOs, and government schemes. At the same time, the state has witnessed growing efforts in financial literacy training, with special focus on women and rural entrepreneurs. Despite these initiatives, evidence regarding the combined effect of microfinance and financial literacy in Rajasthan remains limited.

Research Problem

Despite significant expansion of microfinance and financial inclusion initiatives in India, many rural households—particularly in Rajasthan—continue to face difficulties in loan repayment, savings mobilization, and productive utilization of credit. Microfinance alone has not been sufficient to bring lasting empowerment, and a lack of financial literacy often leads to misuse of loans, repayment defaults, and limited entrepreneurial growth.

Although various financial literacy programs exist, their combined impact with microfinance has not been systematically studied in the context of rural Rajasthan. This gap creates uncertainty about whether financial literacy truly strengthens microfinance outcomes and contributes to sustainable, inclusive growth.

Research Questions

- Does financial literacy significantly influence loan repayment behavior among rural households in Rajasthan?
- How does financial literacy affect saving patterns and debt management when combined with microfinance?
- What role does financial literacy play in promoting entrepreneurial activity among microfinance beneficiaries?
- Are there gender differences in the impact of financial literacy on financial empowerment?

Hypotheses

- H₀₁:** Financial literacy has no significant impact on loan repayment behavior among rural households in Rajasthan.
- H₁₁:** Financial literacy has a significant positive impact on loan repayment behavior among rural households in Rajasthan.
- H₀₂:** Financial literacy does not significantly influence saving patterns of microfinance beneficiaries.
- H₁₂:** Financial literacy significantly improves saving patterns of microfinance beneficiaries.
- H₀₃:** Financial literacy has no significant effect on entrepreneurial activities of microfinance participants.
- H₁₃:** Financial literacy has a significant positive effect on entrepreneurial activities of microfinance participants.
- H₀₄:** There is no significant gender difference in the impact of financial literacy on financial empowerment.
- H₁₄:** There is a significant gender difference in the impact of financial literacy on financial empowerment.

Objectives of the Study

The study is guided by the following objectives:

- To examine the role of financial literacy in enhancing microfinance outcomes.
- To study its impact on repayment, savings, and debt management.
- To evaluate the relationship between literacy and entrepreneurship.
- To assess gender differences in financial empowerment.
- To suggest policy recommendations for inclusive growth.

Scope of the Study

This study focuses on rural households in nine districts of Rajasthan—Ajmer, Bhilwara, Udaipur, Jaipur, Alwar, Jodhpur, Bikaner, Bharatpur, and Barmer. It examines the role of financial literacy in enhancing the outcomes of microfinance, particularly in repayment, savings, entrepreneurship, and empowerment. The analysis is limited to Self-Help Groups (SHGs) and microfinance beneficiaries, based on cross-sectional data. While the findings provide valuable insights, they may not fully represent all regions of India.

Significance of the Study

This research contributes both theoretically and practically. Theoretically, it adds to the growing literature on financial inclusion by analyzing the relationship between access and capability. Practically, it provides insights for policymakers, MFIs, and development practitioners on designing integrated programs that combine financial services with literacy training. Such insights are critical for aligning India's financial inclusion policies with its commitments to the Sustainable Development Goals, particularly SDG 8 (Decent Work and Economic Growth) and SDG 10 (Reduced Inequalities).

Review of Literature

Singh, R., & Rao, P. (2023). Financial literacy and digital inclusion in rural India: An empirical analysis. Journal of Rural Development Studies, 39(2), 112–128. This study highlighted that households

with higher financial literacy were more likely to adopt digital financial services such as mobile banking and UPI payments. The authors emphasized that literacy not only improved digital adoption but also enhanced risk management and saving behavior in rural India.

Patel, K. (2022). *Microfinance and women's entrepreneurship: Evidence from Gujarat. International Journal of Development Economics*, 14(3), 201–219. Patel examined the role of microfinance in promoting women's entrepreneurship. The study found that while microfinance alone improved access to credit, its effectiveness was far greater when accompanied by financial literacy training. Literate women were more confident in starting enterprises, managing finances, and negotiating within households.

Kumar, S., & Sharma, V. (2021). *Effectiveness of NABARD's financial literacy initiatives in Rajasthan. Indian Journal of Finance and Banking*, 10(1), 45–59. This research evaluated NABARD's financial literacy programs in Rajasthan. Findings showed that training significantly improved repayment rates among SHG members and reduced cases of loan default. The authors argued that financial literacy is indispensable for sustaining the benefits of microfinance initiatives.

Organisation for Economic Co-operation and Development (OECD). (2020). *OECD/INFE International Survey of Adult Financial Literacy. OECD Publishing*. The OECD survey assessed financial literacy levels across multiple countries and revealed that Indian adults scored below the global average. The report stressed that low levels of literacy could undermine financial inclusion efforts, especially in rural areas where digital transactions were expanding rapidly.

National Bank for Agriculture and Rural Development (NABARD). (2018). *Status of microfinance in India 2017–18. NABARD Publications*. The report evaluated SHG-bank linkage programs across India and concluded that while these programs played a vital role in empowering women economically, lack of continuous financial training limited their long-term impact. Many SHGs struggled with effective loan utilization and sustainability.

Sarma, M., & Pais, J. (2011). *Financial inclusion and development: A cross-country analysis. Journal of International Development*, 23(5), 613–628. Sarma and Pais constructed a financial inclusion index for Indian states and found that inclusion positively correlated with development indicators such as income growth and poverty reduction. However, they cautioned that financial inclusion without financial literacy might fail to deliver sustainable empowerment.

Research Gap

The literature collectively suggests that both microfinance and financial literacy play significant roles in financial empowerment. However, most existing studies either focus on microfinance or financial literacy independently, overlooking their combined effect. Only a handful of studies provide empirical evidence on how literacy enhances the effectiveness of microfinance in achieving inclusive growth.

Additionally, while several studies have explored microfinance in states such as Gujarat and Andhra Pradesh, there is limited empirical research on Rajasthan, despite its strong presence of SHG programs and financial literacy campaigns. The integration of microfinance and financial literacy remains underexplored in this regional context.

This study addresses the gap by investigating how financial literacy influences loan management, savings, entrepreneurship, and women's empowerment among rural households in Rajasthan, thereby providing new insights into the pathways of inclusive growth.

Research Methodology

Research Design

The study adopts a mixed-methods research design, combining both quantitative and qualitative approaches to provide a holistic understanding of the role of microfinance and financial literacy in financial empowerment. While quantitative data helped in identifying measurable patterns and statistical relationships, qualitative insights offered contextual understanding of how respondents experienced and utilized financial services.

Study Area

The research was conducted in nine districts of Rajasthan—Ajmer, Bhilwara, Udaipur, Jaipur, Alwar, Jodhpur, Bikaner, Bharatpur, and Barmer. These districts were selected due to their strong

presence of Self-Help Groups (SHGs), active microfinance operations, and widespread implementation of financial literacy programs supported by NABARD, RBI, and non-governmental organizations. The choice of Rajasthan is significant because, while the state has been a major hub for microfinance activities, limited empirical studies have analyzed the impact of financial literacy within this framework.

Sampling and Respondents

A total of **500 respondents** were selected using stratified random sampling. Stratification was done based on gender, occupation, and income levels to ensure diversity and representation. Women constituted about 65 percent of the sample, reflecting their central role in SHGs and microfinance participation. The respondents mainly included small farmers, informal workers, and rural micro-entrepreneurs.

Data Collection Methods

- **Primary Data:** Collected through structured questionnaires and semi-structured interviews. The questionnaires covered areas such as income levels, savings behavior, borrowing patterns, repayment discipline, financial literacy levels, and entrepreneurial activities. Interviews provided qualitative insights into decision-making processes and gender dynamics within households.
- **Secondary Data:** Drawn from published reports of NABARD, RBI, NCFE, World Bank, and government ministries. These sources helped contextualize the findings and verify consistency with national trends.

Analytical Tools

Data were analyzed using **SPSS software**. Three primary techniques were employed:

- **Descriptive Statistics** – to summarize socio-economic characteristics and identify broad patterns in microfinance utilization and literacy levels.
- **Pearson's Correlation Coefficient** – to measure the strength and direction of relationships between financial literacy and financial outcomes such as repayment behavior, savings, and entrepreneurship.
- **Multiple Regression Analysis** – to examine the combined effect of financial literacy and microfinance access on indicators of financial empowerment, including income growth, loan repayment, and entrepreneurial activity.

Ethical Considerations

Participation in the study was voluntary. Respondents were informed about the purpose of the research, and confidentiality was maintained. Data collected was used strictly for academic purposes.

Limitations of the Study

While the study provides valuable insights, certain limitations must be acknowledged:

- **Geographical Scope:** Findings are limited to selected districts of Rajasthan and may not fully represent other regions of India.
- **Self-Reported Data:** Responses may include biases due to overestimation or underestimation of financial literacy or income.
- **Time Frame:** The cross-sectional nature of the data restricts assessment of long-term impacts. A longitudinal approach would provide deeper insights into sustained changes over time.

Data Analysis and Results

Socio-Economic Profile of Respondents

The socio-economic profile of the 500 respondents from nine districts of Rajasthan reflects the vulnerability of rural households in Rajasthan. A majority (65%) were women, consistent with the dominance of women in Self-Help Groups (SHGs) and microfinance networks. About 40% of the respondents were small farmers, 35% engaged in informal labor, and the rest were micro-entrepreneurs running small shops, livestock units, or home-based businesses. The average monthly household income was below ₹10,000, indicating limited financial capacity. Educational attainment was also modest, with nearly half of the respondents having only primary-level education. These characteristics suggest that respondents represent groups most in need of financial empowerment.

Table 1: Socio-Economic Profile of Respondents

Variable	Percentage(%)
Gender (Female)	65%
Gender (Male)	35%
Occupation – Small Farmers	40%
Occupation – Informal Labor	35%
Occupation – Microenterprise	25%
Monthly Income < ₹10,000	72%
Primary Education or below	48%

• **Utilization of Microfinance**

Most respondents reported using microfinance loans for income-generating purposes such as purchasing agricultural inputs, livestock, or starting petty trade businesses. However, approximately 15% admitted using loans for consumption-related expenses, including household ceremonies and health costs. While productive use of loans often contributed to improved household income, consumption-oriented borrowing created repayment pressures. About 18% of respondents reported difficulties in repaying their loans, underscoring the risks associated with inadequate financial planning.

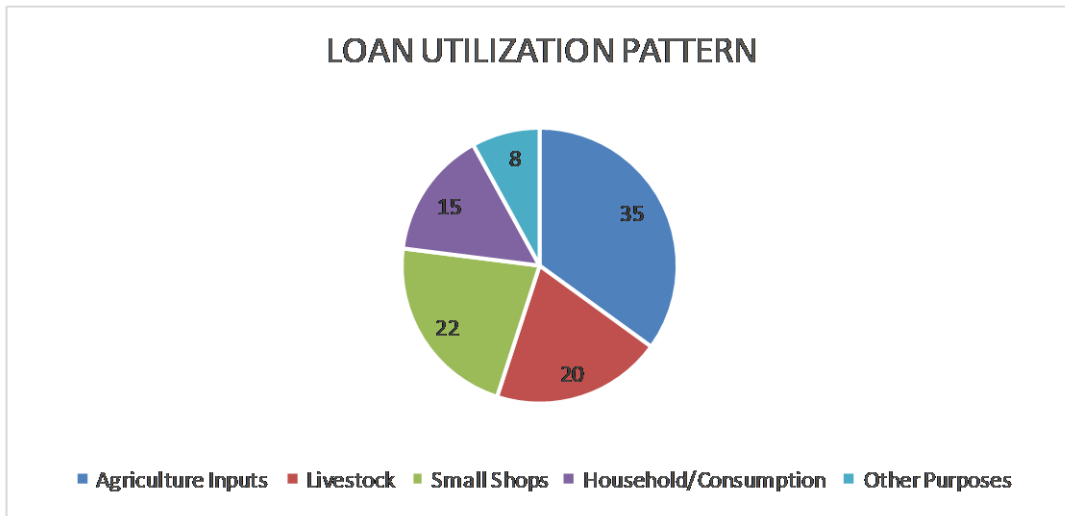


Figure 1: Loan Utilization Pattern

• **Financial Literacy Levels**

The assessment of financial literacy revealed that only 30% of respondents correctly answered basic questions related to interest calculation, savings planning, and budgeting. Respondents who had undergone literacy training through NABARD or RBI-supported programs demonstrated significantly better knowledge and skills. For example, trained participants were more likely to understand the difference between productive and non-productive borrowing and to adopt systematic savings practices. A key finding was the gender difference: women who participated in literacy programs displayed stronger confidence in managing household finances compared to men.

• **Correlation Analysis**

To test the relationship between financial literacy and microfinance outcomes, Pearson's correlation coefficient was applied. The results revealed strong positive correlations.

The findings suggest that financial literacy substantially improves savings and repayment behavior, while its effect on income is moderate, implying that income growth also depends on other structural factors such as market access and infrastructure.

Table 2: Correlation between Financial Literacy and Financial Outcomes

Financial Outcome	Correlation Coefficient (r)	Strength of Relationship
Savings Behavior	0.61	Strong
Loan Repayment Discipline	0.55	Strong
Entrepreneurial Activities	0.48	Moderate
Income Levels	0.29	Weak

- **Regression Analysis**

Regression models were applied to examine the combined effect of microfinance and financial literacy on empowerment indicators. Key results included:

- Respondents with higher financial literacy were **38% more likely to repay loans on time** compared to those with limited knowledge.
- Financially literate households saved **33% more regularly**, often setting aside small amounts even during lean seasons.
- Literacy increased the likelihood of entrepreneurial engagement by **27%**, as individuals were better able to calculate risks, manage accounts, and reinvest profits.
- Women with literacy training demonstrated greater decision-making autonomy in household financial matters and in investment choices for small enterprises.

- **Gender-Specific Insights**

The data revealed significant gender dimensions in financial empowerment. Women participants who combined access to microfinance with literacy training not only improved household savings but also gained a stronger voice in financial decision-making. Many reported increased independence from male family members in managing loans and deciding how to use profits from enterprises. Women-led SHGs showed better repayment rates and higher sustainability compared to mixed-gender groups. These findings confirm the transformative role of literacy in strengthening women's empowerment through microfinance.

Table 3: Gender-Specific Impact of Literacy

Indicator	Women with Literacy	Women without Literacy	Men with Literacy	Men without Literacy
Loan repayment rate (%)	89	72	84	70
Regular saving habit (%)	76	51	68	46
Entrepreneurial engagement (%)	42	25	38	21
Decision-making autonomy (index)	0.78	0.52	0.65	0.48

- **Key Observations**

- **Microfinance without literacy** often led to misuse of loans, repayment stress, and limited long-term benefits.
- **Microfinance with literacy** produced better outcomes in terms of savings, debt management, and entrepreneurship.
- **Women benefited disproportionately** when literacy was integrated, reinforcing the gender-equality dimension of financial empowerment.
- **Income effects were moderate**, suggesting that while microfinance and literacy improve financial practices, structural constraints such as limited market access also influence income levels.

Policy Implications and Recommendations

The findings of this study carry important implications for policymakers, financial institutions, and development agencies working toward inclusive growth in India. Evidence suggests that access to credit alone does not guarantee empowerment; rather, the integration of financial literacy with microfinance initiatives is essential for sustainable outcomes.

First, institutionalizing financial literacy within all microfinance programs is critical. Training modules should be made mandatory for members of Self-Help Groups (SHGs) and borrowers of microfinance institutions. Such modules should cover basic budgeting, responsible borrowing, savings management, and digital financial tools.

Second, women-focused interventions must be prioritized. Given that women demonstrated stronger improvements when literacy was combined with microfinance, programs should specifically target women's groups, enhancing their confidence and decision-making autonomy.

Third, with the expansion of digital finance platforms such as UPI, digital financial literacy has become essential. Awareness campaigns should address not only the opportunities of digital transactions but also the risks of fraud, misuse, and cyber vulnerabilities.

Fourth, collaborative partnerships between government agencies, banks, NGOs, and private institutions can improve both outreach and effectiveness. Leveraging technology and local institutions can enhance the scalability of literacy programs.

Finally, a monitoring and evaluation framework should be built into financial inclusion policies. Tracking how literacy affects repayment rates, savings, and entrepreneurial outcomes will help refine programs and ensure accountability.

By embedding literacy into financial inclusion strategies, India can ensure that access to financial services translates into genuine empowerment and long-term inclusive growth.

Findings, Discussion and Conclusion

Findings

The study reveals the following key points:

- Microfinance alone is not enough for sustainable empowerment.
- Financial literacy significantly improves loan repayment discipline.
- Literate respondents maintain stronger saving habits than others.
- Literacy moderately boosts entrepreneurial activities.
- Women with literacy training gain higher decision-making power.
- Women-led SHGs show better repayment and sustainability.
- Income impact is modest due to external market and structural constraints.

Discussion

The findings confirm that financial literacy strengthens the effectiveness of microfinance. Literate participants showed better repayment and saving behaviors, consistent with Singh & Rao (2023), who reported that literacy promotes responsible saving. Similarly, women's empowerment outcomes in this study align with Patel (2022), showing that literacy enhances entrepreneurship and financial autonomy.

However, the weaker impact on income suggests that **structural barriers**—such as limited market access, inadequate infrastructure, and seasonal dependence on agriculture—reduce the potential of microfinance and literacy to raise household earnings. This supports Sarma & Pais (2011), who emphasized that financial inclusion requires complementary development measures.

Overall, the discussion highlights that literacy transforms microfinance into a sustainable development tool by improving repayment, encouraging savings, and empowering women.

Conclusion

The study concludes that microfinance, when combined with financial literacy, leads to stronger financial behaviors and greater empowerment. Access (microfinance) and capability (literacy) together create real financial empowerment.

Key impacts were observed in repayment, savings, and women's autonomy, while income effects were weaker due to structural challenges. Policymakers should therefore embed financial literacy into all microfinance initiatives and address infrastructure and market barriers to achieve long-term inclusive growth.

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