

Microfinance as a Catalyst for Economic Growth and Development: Evidence from India, Bangladesh, and the Philippines

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Research Question: To what extent has microfinance contributed to economic growth and development in developing nations, particularly in terms of GDP growth, employment creation, and gender equality?

Abstract

Microfinance has emerged as a significant tool for promoting economic growth and development in developing nations by providing financial services to underserved populations. This paper examines the impact of microfinance on GDP growth, employment creation, and gender equality through case studies from India, Bangladesh, and the Philippines. In India, Self-Help Groups and government initiatives like the Pradhan Mantri Jan Dhan Yojana have enhanced financial inclusion and empowered women, improving household income and community participation. In Bangladesh, the Grameen Bank and other microfinance institutions have facilitated entrepreneurship, increased economic activity, and elevated living standards, with women at the center of these transformations. In the Philippines, institutions such as CARD Bank and ASA Philippines have provided loans alongside financial literacy programs, fostering socio-economic development. Despite these successes, challenges such as over-indebtedness, digital divides, and social inequalities affect the uniformity of impact. Tailored microfinance programs can serve as a powerful catalyst for inclusive and sustainable development.

Keywords: Microfinance, Economic Growth, Employment, Economic Development, Women's Empowerment, Developing Nations

Introduction

Can a small loan have the power to transform an entire economy?

According to Kagan (2024), microfinance is a financial tool that provides vital services such as small-scale finance, loans, savings accounts, checking accounts, fund transfers, microcredit, and microinsurance to the unemployed, low-income groups, small enterprises, and people who do not have access to standard financial services. It is therefore a vital tool for financial inclusion, helping individuals overcome their financial obstacles, creating jobs, and contributing to economic growth. It is also viewed as empowering marginalized groups, particularly women, by providing them with opportunities to access financial resources that can improve their living standards (ILO, 2008).

However, despite microfinance's potential positive impacts, which have been linked to increasing employment, boosting GDP, and creating financial independence, critics would argue that its impact is not always sustainable. Concerns have been raised regarding high interest rates, over-indebtedness, and the potential for microloans to create debt cycles rather than promote long-term economic stability. Furthermore, while microfinance has helped many women achieve financial independence, doubts remain regarding whether it truly reduces gender inequality in a significant way (Posso and Zhang, 2017). In light of this, this research paper aims to answer the following question: **To what extent has microfinance contributed to economic growth and development in developing nations, particularly in terms of GDP growth, employment creation, and gender equality?**

This paper argues that while microfinance plays a crucial role in promoting economic growth, gender equality, and financial inclusion, its full potential remains constrained by challenges such as sustainability concerns and entrenched social inequalities, particularly patriarchy, as demonstrated through comparative case studies. The paper highlights the requirement to address any shortcomings to ensure the purpose of microfinance is being fulfilled and seamlessly translated into economic growth and development.

Literature

Review

Historical Context and Origins of Microfinance

Microfinance was officially established in 1983 by the Grameen Bank in Bangladesh by Muhammad Yunus, an economics professor who sought to eradicate poverty by providing small, long-term loans on easy terms (The Nobel Prize, 2025). His first encounter with microcredit was in 1976 when he discovered that 42 women were trapped in a cycle of poverty because they needed only very small amounts of capital (together around \$27 USD) to buy raw materials such as bamboo to make stools and other goods. Lacking access to formal credit, they were forced to

borrow from moneylenders at exploitative rates, leaving them with almost no profit. Yunus believed that the very poorest cultures could enhance their small business activity and social status through microcredit and microloans (Liberto, 2020). Consequently, today, Grameen has provided millions of loans, with repayment rates as high as 98%; microfinance has also reduced absolute moderate poverty by 5% and extreme poverty by 10% (Gupta, 2024). Additionally, microfinance has been used and supported by many global institutions, such as the World Bank and the International Monetary Fund (IMF), which began investing in microfinance as a tool for poverty alleviation, and in 2005, the International Year of Microcredit was declared by the UN to highlight its impact on the economy. In 2006, Muhammad Yunus and Grameen Bank won the Nobel Peace Prize for their role in microfinance and poverty alleviation.

Theoretical Frameworks for Microfinance

Economic development theories, such as the capability approach proposed by economist-philosopher Amartya Sen, argue that development should be achieved through the capabilities that are the fundamental freedoms people have to reach their full potential. In this sense, real freedom means having all the necessary means to achieve it. The capability approach prioritises the activities a person can undertake (doings), the person they can be (beings), and the opportunities they have to realise those beings and doings, such as the opportunities to be educated, the ability to move up the social ladder, and enjoy supportive social relationships. Additionally, Nussbaum (2011a) describes the capability approach as assessing the quality of life and contemplating the concept of justice (Robeyns, 2020). In this way, microfinance can serve as a tool to provide people with the financial resources required to achieve their real freedom, that is, better access to healthcare, education, etc. For example, microfinance, such as access to financial services and small, collateral-free loans, can help women start or expand their businesses, enable them to generate income, invest in education and healthcare for their families, and ultimately improve the overall well-being of their communities by achieving financial independence. This enhances their overall capabilities.

The Endogenous Growth Theory is also valuable here. It involves the importance of human capital, innovation, and knowledge that contribute to long-term economic growth. It states that investment in education, research, technology and government spending to encourage entrepreneurs increases economic productivity (CFI, 2024). Microfinance plays a role in supporting this by providing finance to small-scale entrepreneurs, enabling them to start businesses and expansions. It also fosters innovation, enhances skills and development, and raises employment. Additionally, entrepreneurs can reinvest earnings into their businesses, resulting in further rises in productivity and continued sustained economic growth. Over time, the combination of knowledge and improved efficiency at a micro level will mean macroeconomic benefits that drive economic progress.

Feminist economists critique traditional economic models for privileging male dominance and disregarding women's unpaid and informal labour, which significantly contributes to society. Their perspective highlights persistent gender disparities in access to finance, employment, and economic decision-making. Microfinance aligns with feminist economic views by deliberately targeting women, enabling them to access credit, establish businesses, and achieve greater financial independence. Reflecting this recognition, international institutions, governments, NGOs, private corporations, charities, and research organisations have implemented programs to support female entrepreneurship, viewing women as key drivers of economic growth and development (Abebe & Kegne, 2023). Microfinance institutions in particular often prioritise women as clients, based on evidence that women are more likely to channel their earnings into education, healthcare, and household welfare, thereby generating broader developmental benefits. Consequently, microfinance not only improves women's economic standing but also fosters progress towards greater gender equality (Tseng, 2011).

Furthermore, Social Capital Theory demonstrates how group lending in microfinance improves the quality of existing social ties. This is where small groups of borrowers take out loans together instead of individually, and the group members are jointly responsible for repaying the loan. Here, shared risk fosters trust and strong networks, resulting in economic participation. Mutual accountability arises from this collective responsibility, reducing risks. This social capital allows for collaboration, as members support each other's ventures, sharing knowledge and resources (Alexeev, Nurmakhanova and Polishchuk, 2021). This collective effort strengthens community bonds, driving sustainable economic development and mutual prosperity.

In sum, microfinance contributes not only to economic growth through enterprise expansion and financial inclusion but also to broader development by alleviating poverty, fostering human capital, and empowering women. While its impact varies across contexts, the evidence suggests that microfinance can create a multiplier effect, strengthening both households and national economies. Taken together, these outcomes position microfinance as a vital, though not unproblematic, instrument for sustainable development.

Case Study: India

History and Evolution of Microfinance in India

In India, self-help groups as a sub-scheme of an Integrated Rural Development Programme (IRDP) started in Andhra Pradesh in 1982-83 with UNICEF cooperation with the primary objective of focusing attention on women members of rural families below the poverty line to generate self-employment on a sustained basis. The government of Andhra Pradesh saw this as a reorganized self-help approach and an effective strategy to tackle the socio-economic problem of poverty, especially among women (Eswaramma and Reddy, 2023). A major milestone in microfinance programs

emerged with the Self-Help Group - Bank Linkage Programme (SHG-BLP), which was formulated as action research by the National Bank for Agriculture and Rural Development (NABARD) in 1989. It was then launched as a pilot project in 1992 to combine the rural poor with the formal sector by providing them with access to institutional credit. These Self Help Groups (SHGs) were the dominant microfinance methodology in India (Rashid and Kumar, 2018). The program created a system where banks were encouraged to lend directly to SHGs. This gave women, who often lacked collateral, access to much-needed credit. This significantly contributed to financial inclusion in India by bringing women from rural and marginalized communities into the formal banking system, allowing them to save money, access loans, and manage their finances more effectively. This program empowered women socially and economically by providing them with the resources required to start or expand their businesses, improve their livelihoods, and gain greater control over their financial futures (Al-Kubati and Selvaratnam, 2021).

In the early 2000s in India, there was an increase in private companies called Microfinance Institutions (MFIs) providing people with small loans. Two of the most prominent players were SKS Microfinance, which later became one of the largest MFIs in India, and Bandhan Bank, which started as an MFI and later became India's youngest bank (World Bank Group, 2016). For instance, Bharat Financial Inclusion Limited (formerly SKS Microfinance) was one of the first big players in providing microloans. They made the loan process more efficient and reached people in rural areas, where getting loans from regular banks was difficult. The Ujjivan Small Finance Bank also gave small loans to people who needed them. Still, they mainly focused on financial literacy - not just giving money to people but also teaching them how to manage it wisely by showing them how to save, budget, and make better financial decisions.

In more recent times, the Indian government also launched one of India's most significant programs to provide everyone with access to banking. This was the Pradhan Mantri Jan Dhan Yojana (PMJDY). Its introduction provided millions with access to finance, from over 53 crore accounts opened, nearly 30 crore female beneficiaries, substantial deposits, and widespread issuance of RuPay debit cards. The scheme reached every corner of the country, empowering millions of individuals, especially those from marginalised communities (PIB, 2024).

Digital payments in India have also significantly boosted the reach and effectiveness of microfinance by making financial transactions more accessible, convenient, and affordable. The availability of easy-to-use digital payment solutions has enhanced financial inclusion, allowing citizens, particularly in rural areas, to open and use accounts, receive payments directly, and conduct transactions on their phones without bearing the time and travel costs of visiting a physical bank. For example, the launch of UPI 123PAY enables feature phone users to make digital transactions through assisted voice mode, extending digital access to communities with limited smartphone penetration. This digital framework also reduces dependence on physical infrastructure, paperwork, and manual processing, thereby lowering transaction costs for both enterprises and financial institutions (Bhatia, 2025). Beyond

consumer access, digital platforms strengthen microfinance by enabling institutions to manage loan portfolios more efficiently, track repayments, and analyze client financial behaviour, which helps tailor services to consumer needs. Nevertheless, obstacles remain: in rural areas, limited internet connectivity, low digital literacy, and concerns over safety and trust in online platforms continue to hinder full participation.

Impact of Microfinance in India

Microfinance has most definitely played a vital role in India's economic growth and development. A study on Singanamala mandal, Ananthapuramu District, highlighted the positive impact of SHGs on women's income generation, with members experiencing improved economic conditions and enhanced social status. Nationally, the SHG-BLP has also significantly contributed to employment generation. According to a study by Femida Handy, microfinance initiatives have led to the generation of ancillary employment, creating formal labor opportunities in villages (BALDASARRE, 2018). Additionally, The Economic Times (2025) reported that as of March 2025, India's microfinance sector had a gross loan portfolio exceeding INR 3.75 lakh crore, reaching approximately 79 million borrowers, thereby fostering entrepreneurship and improving livelihoods. Microfinance has also been a catalyst for women's empowerment. Research indicates that participation in microfinance programs improves women's financial independence, decision-making abilities, and self-confidence. For instance, a study in Panipat City, Haryana, found that women involved in microfinance activities experienced improved living standards, which in turn increased their community status (Sondhi, 2023).

Challenges of Microfinance in India

However, despite its positive impacts, microfinance in India faces several challenges that hinder its effectiveness. One of the significant issues is overindebtedness. Many individuals, especially those in rural areas, take out loans from multiple microfinance institutions, resulting in unsustainable debt levels. This situation typically leads to financial stress and repayment crises, undermining the intended benefits of microfinance programs. Another challenge is the digital divide. While digital payment platforms like UPI have expanded access to financial services, there is still a significant portion of India's rural population that lacks access to smartphones, reliable Internet connections, and digital literacy. This technological gap prevents many from fully participating in digital microfinance initiatives, thereby limiting their potential benefits. Additionally, the focus of microfinance on income-generating activities may inadvertently overlook other critical aspects of development, such as education and health. A study by Banerjee et al. (2015) in Hyderabad found that microcredit had mixed effects on business activities and little to no impact on women's empowerment and children's education, suggesting that more holistic approaches are needed to address the multifaceted challenges faced by marginalised communities.

Case Study: Bangladesh

History and Evolution of Microfinance in Bangladesh

Bangladesh became the birthplace of microfinance when Muhammad Yunus established the Grameen Bank in 1983 (The Nobel Prize, 2025). Before this, according to Liberto (2020), in 1976, a famine hit the country, and the less fortunate people could not access the capital required to start a business or even survive, as banks were unwilling to help them or charged extremely high interest rates. This led Yunus to take matters into his own hands, eventually leading to the microfinance movement gaining recognition in 1976 (Mia et al., 2017). His main objective was to provide loans to the poor and less privileged people on terms suitable to them and teach them financial principles so they could help themselves (The Nobel Prize, 2025). He believed that making such loans available to a larger population could stimulate businesses and reduce the widespread rural poverty in Bangladesh. Once the Grameen Bank was established, it became a global model for Microfinance Institutions (MFIs).

Impact of Microfinance in Bangladesh

Microfinance significantly contributes to employment and GDP in Bangladesh. The World Bank states that microfinance has lifted approximately 5 million people out of poverty in Bangladesh between 2000 and 2020 (World Bank, 2021; ICAB Publications, 2024). This financial inclusion – allowing households to access credit, ensuring smooth consumption patterns, and to undertake risky investments – has helped not just to reduce poverty but also foster entrepreneurship and self-employment, which contribute to the country's overall socioeconomic growth. In Sylhet, Bangladesh, microfinance institutions have provided credit to 28% of borrowers for small businesses, 17.73% for agriculture, 18.3% for transport, and 19.93% for livestock (Shimu, 2021). This targeted provision of credit has benefited borrowers directly by enabling income-generating activities and indirectly by increasing overall economic activity. Higher spending by micro-borrowers has stimulated demand, while investments in children's education and healthcare contribute to the development of human capital. Over time, these effects can lead to higher total output (GDP) and lower unemployment rates, thereby supporting broader economic growth in Bangladesh.

Additionally, Microfinance plays a significant role in empowering Bangladeshi women by providing them with access to financial resources. In Bangladesh, traditional banking services often fail to meet the financial needs of women. But the Grameen Bank has changed this. Yunus' 2007 research indicated that as much as 80% of microloans were given to women, showing that women were prioritised or were the main loan takers. These loans had an astounding 98% repayment rate. The same study found that the businesses started or expanded with these loans witnessed a 20% annual growth, a 10% boost in income, and an 18% increase in women's participation in decision-making at the family level (Yunus, M., 2007).

Additionally, a 2012 study of 100 Bangladeshi women found that 74% of respondents reported an improvement in their socio-economic condition after taking microcredit, which increased their confidence (Sivasankar, 2024). This shows that it allowed them to engage in income-generating activities and make significant contributions to their household expenditure as well as overall income. Further, this economic participation leads to greater autonomy, control, and improved social standing within their families and communities.

Also, the Grameen Bank promoted education among women by providing them with 100% scholarships for schools and higher education in the following universities: Asian University for Women (Bangladesh), Khazana Asia Foundation (Malaysia), Ewha Women's University (South Korea), and Glaxo Caledonian University (UK). This was provided to female students to encourage women's literacy (Sivasankar, 2024). In doing so, women are better off, as their skills and qualifications rise, allowing them to not only participate in the workforce but even start their own enterprises, contributing to women's empowerment and entrepreneurial development

Challenges of Microfinance in Bangladesh

While microfinance has significantly contributed to poverty alleviation and women's empowerment in Bangladesh, several challenges still hinder its overall effectiveness. One major issue, as seen in India as well, is the overindebtedness among borrowers. Studies indicate that approximately 26% of microcredit borrowers are over-indebted, as compared to 22% of non-borrowers (Khandker, Faruqee and Samad, 2013), highlighting the risks associated with multiple loan-taking practices. Furthermore, the digital divide also poses a significant barrier in Bangladesh, whereby, despite the government's Digital Bangladesh initiative, many microfinance institutions face challenges in implementing digital platforms due to infrastructural limitations and low digital literacy among borrowers (Sadman, Wester and Doma Lama, 2021). This gap restricts the efficiency of digital microfinance services. Furthermore, financial literacy does remain prevalent among the rural population, with many borrowers lacking a clear understanding of loan terms and repayment obligations. This lack of financial knowledge can lead to poor financial decision-making, affecting the sustainability of microfinance initiatives in the country.

Case Study: Philippines

History and Evolution of Microfinance in the Philippines

In the early 1990s, the Philippines faced significant poverty challenges. In 1994, the incidence of poverty stood at 36%. The Family Income and Expenditure Survey also reported the total number of poor households as 4.56 million during this period. Poverty was concentrated primarily in the rural agricultural sector, with incidence rates of 55%

in 1991 and 54% in 1994, whereas urban areas saw a decline from 36% to 29% (Seibel, 1997). These statistics highlighted the urgent need for poverty alleviation across the country, but specifically in rural areas. In response, the government implemented legal and policy frameworks to address socio-economic inequities. Republic Act No. 8425, established in December 1997, institutionalized the social reform and poverty alleviation program by creating the National Anti-Poverty Commission (Digest PH, 2025). This legislation aimed to improve access to basic needs, including health, food and nutrition, water and sanitation, income security, housing, education, and family welfare, while promoting participation in governance and social equity (Digest PH, 2025; Philippine Commission on Women, 1998). To complement these initiatives, the government promoted microcredit programs such as the DTI Microcredit Project, ACPC's Grameen Replication Project, and the NLSF loan program. NGOs also acted as alternative credit channels, providing smallholder farmers and microenterprises with much-needed access to financial services. Currently, there are an estimated 2,800 MFIs in the Philippines, reaching approximately 650,000 clients, contributing significantly to economic growth.

Major microfinance providers have played an essential role in extending these services. CARD Bank, originally a small social development cooperative established in 1986, launched a Grameen-inspired micro-lending program by 1989 and has since grown into one of the largest MFIs in the country. CARD Bank offers loans, life insurance, and education support, providing financial relief and enabling long-term family security (Rich, 2018). Similarly, ASA Philippines, a non-profit, non-stock corporation, offers low-cost credit for poor communities, supporting microenterprises, encouraging women's participation in income-earning activities, and enhancing decision-making capacity, thereby promoting socio-economic development and social equity (ASA Philippines Foundation, 2023).

NGOs also play a critical role in the microfinance landscape. Tulay sa Pag-unlad Inc. (TSPI), a faith-based nonprofit, offers loans ranging from 50,000–200,000 PHP (\$850–3,000 USD) to microentrepreneurs and utilises digital software tools to help recipients manage their accounts, track repayments, and sustain livelihoods (Quick and Artze de Toledo, 2024).

Overall, the evolution of microfinance in the Philippines reflects a coordinated effort between the government, MFIs, and NGOs to alleviate poverty, empower women, and support both rural and urban economic development. Through legal frameworks, innovative lending programs, and targeted support for vulnerable populations, microfinance has become an integral tool for improving socio-economic conditions and promoting inclusive growth.

Impact of Microfinance in the Philippines

Microfinance has significantly contributed to the economic growth of the Philippines by enhancing financial inclusion and supporting micro and small enterprises (MSEs). These enterprises constitute 99% of the country's

businesses and generate 65% of total employment (Bloomberg, 2024). Access to microcredit enables these businesses to start or expand, leading to an increase in consumption levels. This, in turn, stimulates demand for goods and services, thereby fostering broader economic activity. Studies have shown that the microfinance beneficiaries experience a substantial increase in household income, with one study reporting a mean increase of 28% compared to non-beneficiaries (Ashraf et al., 2024). Additionally, microfinance institutions play a crucial role in enhancing financial inclusion, which is linked to improved productivity and economic resilience. By providing financial services to underserved populations, MFIs bridge the gap between the formal financial system and marginalized communities, promoting inclusive economic growth.

Microfinance has also played a crucial role in empowering women in the Philippines, particularly in rural areas. Programs that provide access to credit and savings enable women to engage in income-generating activities that increase the economic independence and decision-making power within households. Research indicates that women with access to microfinance services experience increased agency and well-being as well as improved positions in household and community decision-making (Parmanand, 2021).

Challenges of Microfinance in the Philippines

Once again, however, despite its positive impact, similar to the issues witnessed in the other countries, even in the Philippines, microfinance's effectiveness is presented with the challenge of overindebtedness. Some individuals take out loans from multiple microfinance institutions, and this leads to unsustainable debt levels and financial stress. Additionally, high interest rates limit the reach of certain microfinance institutions, which may restrict access to credit for the most vulnerable populations, hindering the potential of finance to elevate poverty and promote inclusive growth.

Conclusion

Microfinance has played a crucial role in fostering economic growth and development in developing nations by providing financial services to underserved populations, enabling small business creation, generating employment, and integrating marginalized communities into formal economies. The case studies of India, Bangladesh, and the Philippines illustrate the varied implementation and outcomes of microfinance programs.

In India, the SHG model, along with initiatives like the PMJDY, has enhanced financial inclusion, particularly for women. Microfinance has empowered women socially and economically, enabling them to contribute meaningfully to their households and communities. Nevertheless, challenges such as over-indebtedness and the digital divide remain. Bangladesh, the birthplace of the Grameen Bank, demonstrates microfinance's capacity to alleviate poverty

and stimulate economic activity. Its institutions support entrepreneurship, contribute to GDP growth, and improve living standards, with women playing a central role in this success. In the Philippines, MFIs such as CARD Bank and ASA Philippines have provided not only loans but also financial literacy programs, empowering women and fostering socio-economic development.

Overall, microfinance has made significant contributions to economic growth, employment, GDP, and gender equality. Its impact, however, varies across contexts due to social inequalities, sustainability challenges, and program design. Tailoring microfinance initiatives to the needs of specific communities can maximize their potential as a catalyst for financial inclusion and sustainable development.

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