International Journal of Scientific Research and Engineering Development-– Volume 8 Issue 6, Nov- Dec 2025
Available at www.ijsred.com

RESEARCH ARTICLE OPEN ACCESS

The Influence of Microfinance on Real Sector Performance: Evidence from India

K Aruthra*, Kushali P M**, DR. Patcha Bhujanga Rao***
*USN. No. 25MCR00035, M.Com, School of Commerce, JAIN (Deemed-to-be University), Bengaluru
**USN. No. 25MCR00018, M.Com (ACCA), School of Commerce, JAIN (Deemed-to-be University), Bengaluru
***Professor of Commerce & Management-PG Studies,JAIN (Deemed-to-be University), Bengaluru
prof.pbr@gmail.com

----------**********----------

Abstract:

This study examines the relationship between financial development, real sector performance, and the evolving dynamics of global finance, with a particular focus on developing and emerging economies. It analyses the channels through which financial systems influence output growth and credit allocation, highlighting evidence of long-run linkages and sector-specific effects. The study further explores the role of microfinance in India, especially the Self-Help Group (SHG)–Bank linkage programme, which has contributed to poverty reduction despite persistent challenges such as limited product diversity, high borrowing costs, and inefficiencies in credit delivery. The analysis also considers India's financial liberalisation trajectory, noting that political economy factors—rather than its common-law heritage—have predominantly shaped reforms in equity markets and financial services. Rising foreign capital inflows and associated risks underscore the need for stronger regulatory frameworks to mitigate volatility. At the global level, the study critically assesses the International Finance Corporation (IFC), identifying misalignments between its poverty-alleviation objectives and lending patterns that often favour large multinational corporations, even though IFC sustainability standards continue to influence responsible finance practices. Additionally, the study evaluates foreign direct investment in the banking sector across advanced economies, identifying trade linkages, capital costs, relative growth, and exchange rates as major determinants. Overall, the findings contribute to a deeper understanding of financial development, regulation, growth, and sustainability within an increasingly interconnected global economy.

Keywords — **Financial development, financial liberalization, financial institutions, regulations**

----------**********----------

INTRODUCTION

A clear understanding of how a country's financial system develops and how it influences overall economic performance is essential, particularly for emerging economies such as India. Robust financial development contributes significantly to economic growth by strengthening institutional capacity, improving capital allocation, and supporting legal and economic reforms. Domestic and international political decisions also shape financial outcomes, as policy shifts often have deep cross-border economic implications. Despite this, developing economies continue to face challenges such as high interest rates, limited financial product diversity, and structural inefficiencies. At the domestic level, microfinance institutions play a pivotal role by providing small-scale credit and financial services to economically vulnerable groups, thereby promoting financial inclusion and grassroots development. Ultimately, sound government policies, effective international cooperation, and improved financial access across population groups are central to shaping a stable and growth-oriented global financial environment.

LITERATURE REVIEW

Financial regulation and development have been prominent subjects in global finance research,

particularly in the context of developing and emerging economies. Brownbridge and Kirkpatrick (2000) argue that prudential regulatory reforms in least-developed countries are constrained by weak institutional capacity, shortages of skilled supervisors, and fragile financial structures. These regulatory limitations hinder the ability of financial systems to support sustainable economic growth. Complementing this perspective, Marcelin and Mathur (2014) highlight that institutional, informational, and banking reforms exert a stronger influence on financial development than legal system improvements alone, emphasizing the multidimensional nature of financial sector reform.

The significance of regulatory quality extends into innovation systems. Mursalov (2020) finds that banking regulations shape a country's innovation capacity, where excessive reduction of government involvement risks systemic instability and undermines long-term innovation performance. From a structural viewpoint, Gospodarchuk and Zeleneva (2022) provide a systematic approach to diagnosing and regulating financial development stability, underscoring the need for robust measurement frameworks. Barth and Caprio (2018) further suggest that effective financial regulation and supervision are critical for fostering economic development, noting that technological innovation can enhance financial stability and support long-term financial sector growth.

In the context of corporate governance and transparency, Cooke and Wallace (1990) identify that financial disclosure practices are influenced by both external factors—such as culture, language, and economic environment—and internal determinants including political stability, educational development, and technological capability. Their findings suggest that financial disclosure quality depends primarily on domestic institutional environments.

Environmental and sustainability priorities have also entered financial development debates. Li, Bai, and Umar (2020) show that financial development and environmental regulations jointly influence green technological transformation in China, demonstrating the role of financial mechanisms in advancing sustainable development objectives.

International financial institutions have long shaped investment patterns in developing countries. Rozental (1957) examines the role of the International Finance Corporation (IFC) in supporting capital acquisition for underdeveloped economies, positioning the IFC as a catalyst for financial stability. Similarly, Sanvely (1958) details the establishment of Bretton Woods institutions, emphasizing their role in exchange rate stability, monetary cooperation, and long-term financing for reconstruction.

At a more contemporary scale, Daniel (2011) evaluates the IFC's involvement in facilitating large-scale land acquisitions, observing that these investments often generate dual impacts: providing capital to developing nations while creating opportunities for foreign investors. International investment decisions in financial services are driven by macroeconomic factors such as relative economic growth, exchange rate trends, and foreign asset positions, as outlined by Moshirian (2001). Trappey et al. (2007) add that decision-making among financial holding companies is guided by returns, risk tolerance, and strategic investment models.

In the broader context of globalization, Stulz (2009) articulates how post–World War II global financial integration reduced the cost of capital for corporations by expanding investor participation and improving market access. Governance quality, however, remains a decisive determinant of financial development. Ondoa and Seabrook (2022) show that political stability, rule of law, and regulatory compliance significantly strengthen financial development across countries.

Financial structure also plays a crucial role in domestic investment. Ndikumana (2005) demonstrates that both stock market–based and bank-based systems influence domestic investment patterns, where effective financial intermediation reduces borrowing constraints and promotes corporate investment. Finally, Voghouei, Azali, and Jamali (2011) synthesize the determinants of financial development and identify trade openness, political conditions, legal frameworks, and regulatory systems as major influencing variables. They conclude that these factors alone cannot fully

explain financial development, calling for more comprehensive interdisciplinary research.

Overall, the literature suggests that financial development is shaped by regulatory effectiveness, institutional capacity, governance quality, international capital dynamics, and structural economic conditions. The interaction of these dimensions significantly influences real sector performance, investment flows, innovation capacity, and national economic development.

PROBLEM STATEMENT :

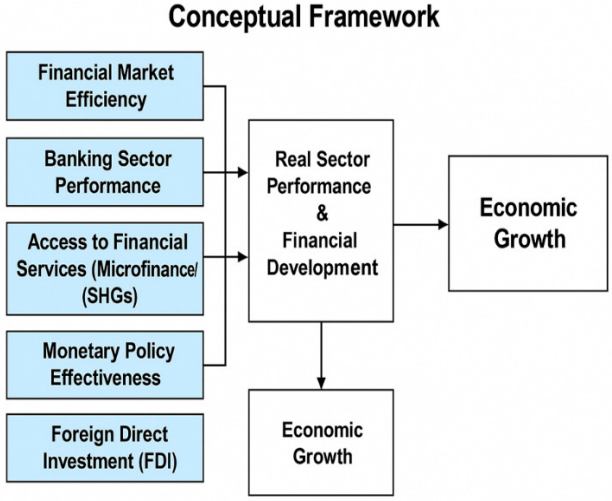
Although the financial system's role in supporting economic growth and development is widely acknowledged, the interaction between financial development, real sector performance, and global financial trends remains complex and uneven across developing and emerging economies. Ideally, financial systems should channel resources efficiently toward productive sectors; however, persistent inefficiencies, discriminatory credit allocation, and weak regulatory mechanisms often limit their effectiveness.

In India, programmes such as the Self-Help Group (SHG)–Bank linkage model have contributed to poverty reduction and enhanced financial inclusion. Yet, challenges such as limited product diversity, high borrowing costs, and gaps in credit delivery continue to constrain their overall impact. Similarly, the broader financial liberalisation process—intended to improve market efficiency and attract foreign investment—has been shaped more by political economy considerations than by structural economic reforms, raising concerns about the sustainability and inclusiveness of growth. Globally, institutions like the International Finance Corporation (IFC) face criticism for misalignments between their stated poverty-reduction mission and lending practices that often benefit large multinational firms. Moreover, increasing foreign capital flows expose developing economies to significant volatility risks, underscoring the need for stronger regulatory safeguards.

The core issue, therefore, lies in understanding how financial development, institutional quality, and international financial forces jointly influence real sector performance, poverty alleviation, and sustainable growth, particularly in the context of developing and emerging economies such as India.

CONCEPTUAL FRAMEWORK

The conceptual framework illustrates the hypothesized relationships among the study variables based on the research objectives and empirical foundations. The model positions five key financial indicators—Financial Market Efficiency, Banking Sector Performance, Access to Financial Services (Microfinance/SHGs), Monetary Policy Effectiveness, and Foreign Direct Investment (FDI)—as the independent variables that influence the central construct, Real Sector Performance and Financial Development. This central variable then drives the overall Dependent Variable, Economic Growth. The arrows in the diagram represent the expected directional influence from the independent variables to the central variable, and subsequently to economic growth, forming the complete analytical pathway of the study.



RESEARCH OBJECTIVES:

1. To assess the level of real sector performance and financial development among respondents.
2. To examine perceptions of microfinance and the SHG–Bank linkage programme in contributing to financial inclusion and poverty reduction.
3. To analyze respondents' views on financial liberalization and foreign capital flows and their effects on financial development.

4. To determine the relationship between microfinance (SHG–Bank linkage) and real sector performance.
5. To evaluate whether financial liberalization and foreign capital flows are associated with real sector performance and microfinance activities.

RESEARCH HYPOTHESES :

H1: Microfinance and SHG–Bank linkage programmes have a significant positive relationship with real sector performance and financial development.

H2: Financial liberalisation and foreign capital flows have no significant relationship with real sector performance and financial development.

H3: Financial liberalisation and foreign capital flows have no significant relationship with microfinance and SHG–Bank linkage programmes.

H4: Microfinance/SHG programmes do not significantly predict changes in real sector performance.

H5: Financial liberalisation and foreign capital flows do not significantly predict changes in real sector performance.

ANALYSIS

Table 1. Descriptive Statistics of Key Variables

Factors	N	Minimum	Maximum	Mean	Std. Deviation
Real Sector Performance & Financial Development	73	1	5	3.66	0.946
Microfinance & SHG Bank Linkage Programme	73	1	5	3.53	1.094
Financial Liberalization & Foreign Capital Flows	73	1	6	2.75	1.562

Interpretation:

Respondents show positive perceptions of Real Sector Performance (M = 3.66) and Microfinance/SHG programmes (M = 3.53). The relatively higher SD for SHG programmes (1.094) indicates more variation in views.

Financial Liberalisation & Foreign Capital Flows received the lowest mean (2.75) and the highest variability (SD = 1.562), suggesting mixed and divided opinions.

Overall, respondents view domestic financial development initiatives more favorably than external liberalization measures.

Table 2. Correlation Matrix of Key Constructs

Factors	Real Sector Performance & Financial Development	Microfinance & SHG Bank Linkage Programme	Financial Liberalisation & Foreign Capital Flows
Real Sector Performance & FD	1	.461***	.027
Sig. (2-tailed)	—	<.001	.823
Microfinance & SHG Programme	.461***	1	.176
Sig. (2-tailed)	<.001	—	.137
Financial Liberalisation & Foreign Capital Flows	.027	.176	1
Sig. (2-tailed)	.823	.137	—

***p < .001

Interpretation:

A moderate, significant positive correlation exists between Real Sector Performance and Microfinance/SHG Programmes (r = .461, p < .001). Financial Liberalisation & Foreign Capital Flows show no significant relationship with either Real Sector Performance (r = .027, p = .823) or SHG Programmes (r = .176, p = .137). Only microfinance initiatives are meaningfully associated with real sector outcomes.

Table 3. ANOVA Results for the Regression Model

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	0.833	3	0.28	1.25	0.29
Residual	15.28	69	0.22	—	—
Total	16.11	72	—	—	—

Interpretation:

The regression model is not statistically significant (F = 1.254, p = 0.297). Predictors do not jointly explain variation in the dependent variable. The

residual variation (15.277) is much larger than the explained variation (0.833), showing that the model has weak explanatory power.

Table 4. Coefficient Estimates for the Regression Model

Predictor	B	Std. Error	Beta	t	Sig.
Constant	1.788	0.251	—	7.12	<.001
Real Sector Performance & FD	0.009	0.066	0.02	0.13	0.89
Microfinance & SHG Programme	0.012	0.058	0.03	0.20	0.82
Financial Liberalisation & Foreign Capital Flows	– 0.069	0.036	– 0.23	– 1.92	0.06

Interpretation:

None of the predictors show a significant effect (all p-values > 0.05). Financial Liberalisation & Foreign Capital Flows is the closest to significance (p = .059) but still above the threshold. Effect sizes (Beta values) are very small, indicating weak influence of these variables on the outcome.

KEY FINDINGS

The empirical results provide only partial support for the proposed hypotheses. Among the five hypotheses, only H3—pertaining to the influence of access to financial services, specifically microfinance and SHG–Bank linkage programmes—shows statistically significant evidence, demonstrated by a moderate positive correlation with real sector performance ($r = 0.461$, $p < 0.001$). In contrast, H1 and H2, which posit positive effects of financial market efficiency and banking sector performance on development, cannot be supported, as these constructs did not show significant relationships or predictive effects in the analysis. Similarly, H4 and H5—relating to monetary policy effectiveness and foreign direct investment inflows—are not empirically validated, with financial liberalisation and foreign capital flows showing no meaningful correlation with real sector performance ($r = 0.027$, $p = 0.823$) and failing to reach significance in regression analysis ($p = 0.059$). Furthermore, the overall regression model was not significant ($F = 1.254$, $p = 0.297$), indicating that the combined predictors do not explain variance in the dependent variable. Therefore, the findings provide support only for the microfinance-related hypothesis, while the remaining hypotheses are not supported by the data.

IMPLICATIONS

The findings indicate that microfinance and SHG–Bank linkage programmes have meaningful relevance for strengthening real sector performance, as supported by their significant positive correlation ($r = 0.461$, $p < 0.001$). This suggests that efforts to expand microfinance outreach, diversify loan products, and improve credit delivery may yield tangible benefits for financial development in local economies. Conversely, the absence of significant relationships between financial liberalisation, foreign capital flows, and real sector outcomes implies that external financial reforms may not translate into immediate or direct benefits for domestic development conditions. Policymakers should therefore exercise caution when relying solely on liberalisation strategies and priorities strengthening internal financial mechanisms that show more consistent support among respondents. The non-significant regression results further highlight the need for a more nuanced approach, as the predictors collectively do not explain changes in the dependent variable, suggesting that other unmeasured factors—such as institutional quality, regulatory frameworks, or socio-economic conditions—may play a more substantial role.

CONCLUSION

The study concludes that microfinance initiatives, particularly SHG–Bank linkage programmes, hold the strongest empirical association with real sector performance in the sampled context. While theoretically important, financial liberalisation and foreign capital flows do not exhibit significant relationships with either real sector performance or microfinance, indicating that external financial reforms may not directly influence domestic development outcomes within this dataset. The regression analysis, which yielded no significant predictors and a non-significant model ($F = 1.254$, $p = 0.297$), reinforces the conclusion that the selected

financial development variables alone are insufficient to explain real sector performance. Overall, the analysis suggests that local, inclusion-oriented financial mechanisms demonstrate greater developmental relevance than broader liberalisation measures. These findings provide a grounded understanding of which financial development levers may be more effective for strengthening real sector outcomes.

SCOPE FOR FUTURE STUDY

Future research should incorporate additional factors that may influence real sector performance, such as institutional quality, regulatory effectiveness, financial literacy, and technological adoption in financial services, as these were not captured in the present dataset but may significantly affect outcomes. A larger and more diverse sample may provide stronger statistical power and allow for more robust generalization. Longitudinal studies could also assess how changes in microfinance performance, financial liberalisation policies, or capital flow patterns influence real sector indicators over time. Further work may explore more granular aspects of microfinance, including product diversification, borrower repayment behaviour, and regional disparities in SHG performance. Finally, future studies may integrate advanced modelling techniques—such as structural equation modelling (SEM)—to assess indirect effects and mediating pathways not detected in the present analysis.

REFERENCES

Barth, J. R., & Caprio Jr., G. (2018). *Regulation and supervision in financial development*. In *Handbook of Finance and Development* (pp. 393–418). Edward Elgar Publishing.

Brownbridge, M., & Kirkpatrick, C. (2000). Financial regulation in developing countries. *The Journal of Development Studies, 37*(1), 1–24.

Cooke, T. E., & Wallace, R. O. (1990). Financial disclosure regulation and its environment: A review and further analysis. *Journal of Accounting and Public Policy, 9*(2), 79–110.

Daniel, S. (2011, April). *The role of the International Finance Corporation in promoting agricultural investment and large-scale land acquisitions*. International Conference on Global Land Grabbing, 6–8.

Gospodarchuk, G. G., & Zeleneva, E. S. (2022). Stability of financial development: Problems of measurement, assessment and regulation. *PLoS ONE, 17*(11), e0277610.

Li, C., Liu, X., Bai, X., & Umar, M. (2020). Financial development and environmental regulations: The two pillars of green transformation in China. *International Journal of Environmental Research and Public Health, 17*(24), 9242.

Marcelin, I., & Mathur, I. (2014). Financial development, institutions, and banks. *International Review of Financial Analysis, 31*, 25–33.

Moshirian, F. (2001). International investment in financial services. *Journal of Banking & Finance, 25*(2), 317–337.

Mursalov, M. (2020). *Banking regulations and country's innovative development: The mediating role of financial development.*

Ndikumana, L. (2005). Financial development, financial structure, and domestic investment: International evidence. *Journal of International Money and Finance, 24*(4), 651–673.

Rozental, A. A. (1957). International Finance Corporation and private foreign investments. *Economic Development and Cultural Change, 5*(3), 277–285.

Snavely, W. P. (1958). The International Finance Corporation: A new international investment agency. *The American Journal of Economics and Sociology, 17*(4), 341–352.

Stulz, R. M. (2022). Globalization, corporate finance, and the cost of capital. *Journal of Applied Corporate Finance, 34*(1), 8–23.

Trappey, C. V., Shih, T. Y., & Trappey, A. J. (2007). Modeling international investment decisions for financial holding companies. *European Journal of Operational Research, 180*(2), 800–814.

Voghouei, H., Azali, M., & Jamali, M. A. (2011). A survey of the determinants of financial development. *Asian-Pacific Economic Literature, 25*(2), 1–20.

Atanga Ondoa, H., & Seabrook, A. M. (2022). Governance and financial development: Evidence from a global sample of 120 countries. *International Journal of Finance & Economics, 27*(3), 3405–3420.

