IOSR Journal of Economics and Finance (IOSR-JEF)
e-ISSN: 2321-5933, p-ISSN: 2321-5925, Volume 17, Issue 6 Ser. I (Nov. – Dec. 2026), PP 59-67
www.iosrjournals.org

Role of Microfinance Institutions in Fund Mobilization and Financial Inclusion of MSMEs: A Study in Kolhapur District

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Abstract
Micro, Small and Medium Enterprises (MSMEs) are central to employment generation, regional balance and inclusive growth in India, yet access to adequate and timely finance remains a persistent constraint. This study examines fund mobilization by MSMEs through microfinance in Kolhapur district, Maharashtra, a region with a long industrial and cooperative tradition rooted in the former princely state of Kolhapur. The study has four objectives. First, it assesses MSME awareness of government microfinance programmes, including policy and schemes, taxation, governmental stability, legal framework and subsidies. Second, it profiles the demographic characteristics of enterprises, namely nature and size of business, location, techniques and legal entity. Third, it identifies the challenges and factors influencing fund mobilization. Fourth, it critically evaluates the effect of government microfinance interventions on MSME growth. The review of international and Indian evidence indicates that awareness gaps, collateral and documentation requirements, informality, and variable institutional quality shape access to credit. It also indicates that the impact of microfinance is heterogeneous rather than uniformly transformative. The study offers policy-relevant insights for financial institutions, regulators and enterprise-support agencies.

Keywords: *MSMEs; Microfinance; Fund mobilization; Financial inclusion; Government schemes; Credit access; Kolhapur district*

I. Introduction

Kolhapur is a district of Maharashtra with a distinguished historical and cultural heritage. It was formerly the princely state of Kolhapur, linked to the legacy of Chhatrapati Shahu Maharaj. The district was formed in 1949 after the state merged with Bombay State, and it has been part of Maharashtra since 1960. It is known for foundries, engineering and agro-processing, and for a strong cooperative movement.

The Micro, Small and Medium Enterprises (MSME) sector is highly dynamic and vibrant. MSMEs strengthen rural and backward areas, create employment at low capital cost, and contribute significantly to India's social and economic growth. Their output, exports and entrepreneurship add to industrial dispersal and income generation (Ayyagari et al., 2007).

Under the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, enterprises were classified by investment in plant and machinery. A micro enterprise had investment up to ₹25 lakh, a small enterprise more than ₹25 lakh and up to ₹5 crore, and a medium enterprise more than ₹5 crore and up to ₹10 crore. The classification has since been revised to combine investment and turnover criteria (2020, and again from 2025).

Despite this importance, finance remains a major growth constraint for small firms (Beck & Demirgüç-Kunt, 2006). Microfinance, meaning small-scale credit, savings and related services delivered by microfinance institutions (MFIs), self-help group (SHG) linkages and non-banking financial companies, is a complementary channel for enterprises that formal banks under-serve. The government has promoted it through schemes and regulatory support.

Kolhapur offers a useful setting to study how MSMEs mobilize funds through microfinance, how aware they are of government programmes, and what constrains them. The study contributes evidence on awareness, enterprise characteristics, challenges and the effectiveness of government microfinance initiatives.

Problem Statement

MSMEs in Kolhapur district contribute significantly to employment, manufacturing and local economic growth, yet many cannot obtain adequate and timely finance from formal banking channels because of collateral requirements, documentation burdens and limited credit history. Microfinance has been promoted as a flexible alternative, and the government offers several supporting policies, schemes and subsidies. However, it is unclear how aware MSMEs are of these programmes, how enterprise characteristics such as size, location, technique and legal form influence fund mobilization, and which challenges prevent effective use of microfinance. Evidence also remains inconclusive on whether government microfinance interventions actually promote MSME growth. There is therefore a need for a district-level empirical study of fund mobilization through microfinance in Kolhapur.

Literature Review

MSMEs and growth. Cross-country evidence shows that small and medium enterprises contribute substantially to employment and output, with a larger share in developing economies (Ayyagari et al., 2007). Studies of micro and small enterprises in developing countries show that most firms are small, grow slowly, and often remain at the start-up size, while a minority generates most of the employment growth (Mead & Liedholm, 1998). In India, firms are concentrated in small, informal units. Productivity and growth are held back by misallocation and by a missing "middle" of mid-sized firms (Hsieh & Klenow, 2014; Hsieh & Olken, 2014).

Access to finance. Theory explains why credit markets ration borrowers. Asymmetric information leads lenders to ration credit instead of raising interest rates (Stiglitz & Weiss, 1981). Small business finance relies on different lending technologies, such as relationship lending and transactions-based lending, which suit different kinds of firms (Berger & Udell, 1998, 2006). Empirically, firm size, financial development and legal quality determine financing obstacles (Beck et al., 2005; Beck et al., 2008). Barriers to bank use include costs, documentation and distance (Beck et al., 2008).

Microfinance as a response. Group lending and joint liability were designed to overcome information and collateral problems (Ghatak & Guinnane, 1999; Morduch, 1999). Early observational studies from Bangladesh reported poverty-reducing effects (Pitt & Khandker, 1998; Khandker, 2005). Later randomized evaluations found modest average effects on business profits and little evidence of transformative impact (Banerjee et al., 2015; Banerjee, Karlan, & Zinman, 2015; Karlan & Zinman, 2011). Returns to capital can be high for some micro-entrepreneurs (De Mel et al., 2008), but the benefits differ across borrowers.

Performance, sustainability and subsidy. Research on MFIs examines the trade-off between financial sustainability and outreach (Cull et al., 2007, 2009; Hermes & Lensink, 2011). It also covers mission drift (Mersland & Strøm, 2010), subsidy effects (Hudon & Traca, 2011) and the finding that most MFIs rely on subsidy or earn only modest profits (Cull et al., 2018). Macroeconomic and institutional context affects MFI performance (Ahlin et al., 2011).

The Indian experience. Directed lending in India influenced credit availability, although firms did not always seek more borrowing (Banerjee & Duflo, 2014). The Hyderabad randomized study showed gains for some existing businesses (Banerjee et al., 2015). Studies of the Andhra Pradesh crisis document over-indebtedness, coercive recovery and regulatory gaps (Shylendra, 2006; Taylor, 2011). Subsequent work finds that the crisis disrupted credit and local economic activity (Breza & Kinnan, 2021). Research on women's empowerment shows mixed results (Kabeer, 2001; Garikipati, 2008).

Gap. Few studies combine awareness of schemes, enterprise demographics, constraints and critical assessment of government programmes for a specific Indian district. This study addresses that gap for Kolhapur.

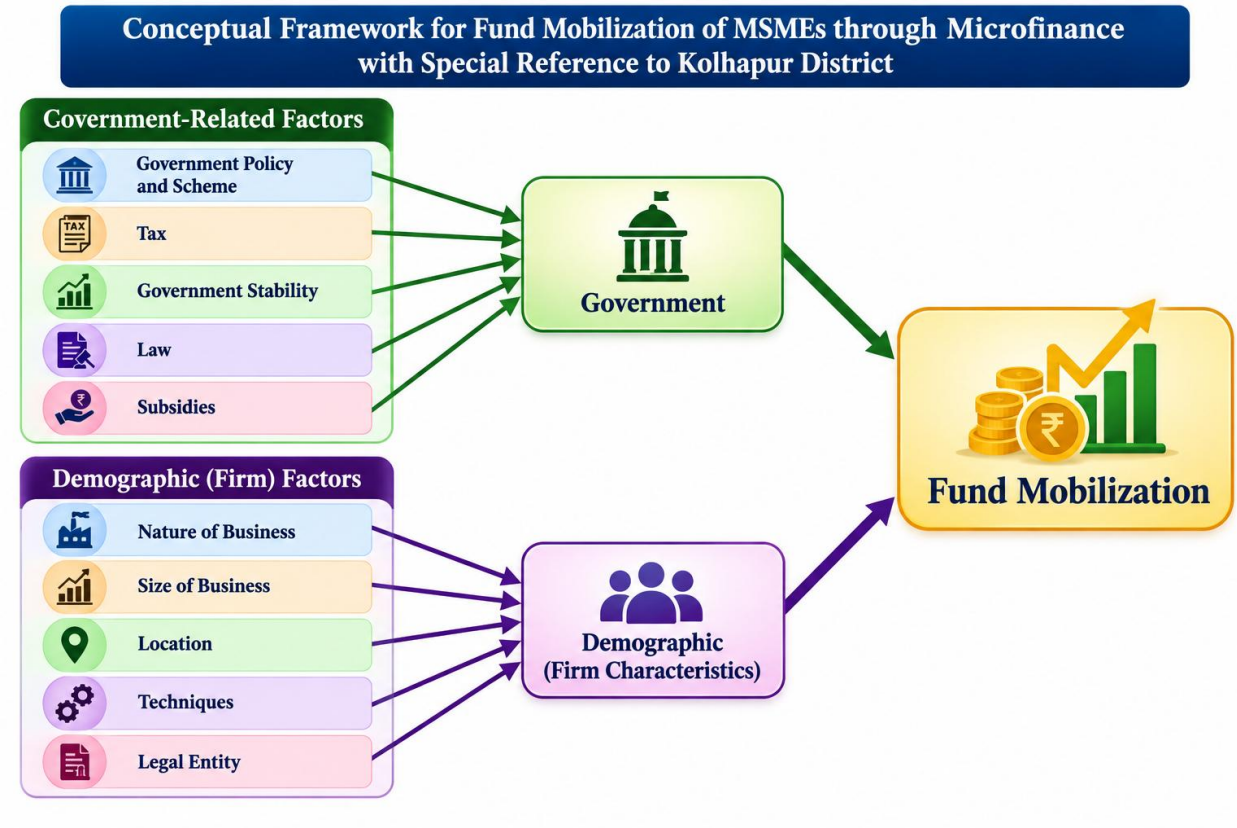

Fig 1. Conceptual framework Fund Mobilization on Microfinance Institutions with special reference through Kolhapur District, Source: Created by Research Scholar

Research Questions

1. How aware are MSMEs in Kolhapur district of government microfinance programmes,?
2. How do demographic characteristics of MSMEs relate to their fund mobilization through microfinance?
3. What challenges and factors influence MSMEs in mobilizing funds from microfinance?
4. To what extent have government microfinance programmes influenced the growth of MSMEs in Kolhapur district, and what are their limitations?

Research Objectives

1. To study the awareness about Microfinance programme of Government at Kolhapu District
2. To study the demographics of MSME's while mobilizing fund in Kolhapur District
3. To study the challenges for factors influencing MSME's while mobilizing fund from microfinance.
4. To criticizing Microfinance programme of Government with reference to its effect on the growth of MSMEs in Kolhapur District

Discussion of Objective 1: Awareness of Government Microfinance Programmes

Awareness determines whether policy reaches enterprises. Small firms face financing obstacles that depend on information, documentation and institutional quality (Beck & Demirgüç-Kunt, 2006; Beck et al., 2005). Lenders' lending technologies also affect who gets credit (Berger & Udell, 1998). Barriers such as distance, cost and paperwork reduce use of formal services (Beck et al., 2008; Beck et al., 2009), so awareness of schemes is a necessary first step.

Government policy has often targeted credit supply. In India, directed lending programmes altered credit availability, yet firms did not always want to borrow more (Banerjee & Duflo, 2014). Partial credit guarantee funds, comparable to India's credit-guarantee mechanisms, are a common instrument, though their design varies widely (Beck et al., 2010). Randomized studies show modest average effects of microcredit, so the awareness and fit of products matter (Banerjee et al., 2015; Banerjee, Karlan, & Zinman, 2015).

Tax regimes influence investment and entrepreneurship (Djankov et al., 2010), and political stability supports investment (Alesina & Perotti, 1996). A sound legal environment improves creditor protection and credit depth (La Porta et al., 1998; Djankov et al., 2007). Subsidies can raise outreach but may affect efficiency (Hudon

& Traca, 2011), and most MFIs depend on enduring subsidy or earn modest profits (Cull et al., 2018; Morduch, 2000). Regulatory gaps in India, notably in Andhra Pradesh, show why scheme awareness and regulation must advance together (Shylendra, 2006; Taylor, 2011). Microfinance can create opportunity, but outcomes depend on institutional context (Khavul, 2010), and cross-country evidence confirms the size-related nature of constraints (Ayyagari et al., 2007).

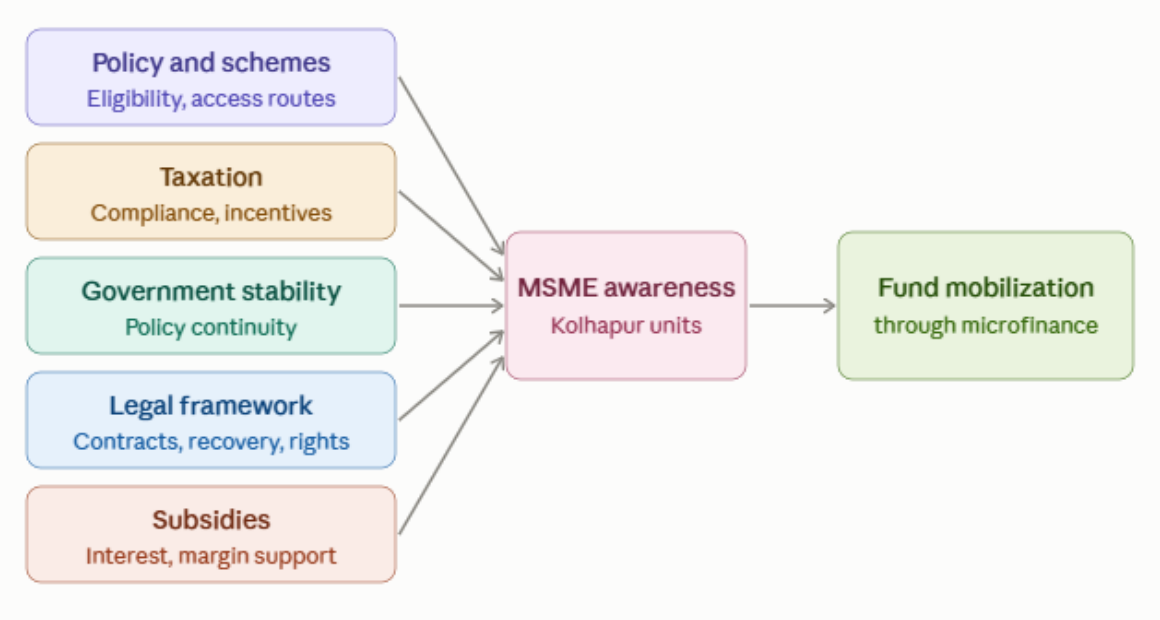

Figure 2 (Objective 1): Five government factors feed MSME awareness, which leads to fund mobilization., Source: Created by Research Scholar

Discussion of Objective 2: Demographics of MSMEs while Mobilizing Funds

Enterprise characteristics shape both the demand for and supply of microfinance. The nature of business matters because micro and small firms differ in growth patterns, and most remain small (Mead & Liedholm, 1998). Size is critical, since small firms face greater financing obstacles (Beck et al., 2005; Beck et al., 2008). India's firm-size distribution is skewed toward small plants with limited growth over the life cycle (Hsieh & Klenow, 2014; Hsieh & Olken, 2014).

Location influences access through distance, density of lenders and local institutions, and macroeconomic and institutional context affects MFI performance (Ahlin et al., 2011). Technique and technology affect returns to capital, which can be high for micro-entrepreneurs (De Mel et al., 2008) but limited by entry costs and other constraints (McKenzie & Woodruff, 2006). The lending technology used by lenders also depends on firm opacity (Berger & Udell, 2006), and young or small firms may be debt-rationed (Cressy, 1996).

Legal entity and formality affect eligibility. Informality is widespread in developing economies (La Porta & Shleifer, 2014), and regulatory entry costs and formalization have implications for entrepreneurship (Klapper et al., 2006; Bruhn & McKenzie, 2014). Owner characteristics, particularly gender, also matter. Lending to women shows mixed empowerment effects (Kabeer, 2001; Garikipati, 2008), and women are often better repayers (D'Espallier et al., 2011). Evidence from Bangladesh and Thailand links microfinance to household and enterprise outcomes (Pitt & Khandker, 1998; Khandker, 2005; Kaboski & Townsend, 2011). In India, the classic microfinance model may discourage some forms of entrepreneurship (Field et al., 2013), and microlending in emerging economies requires context-specific inquiry (Bruton et al., 2011).

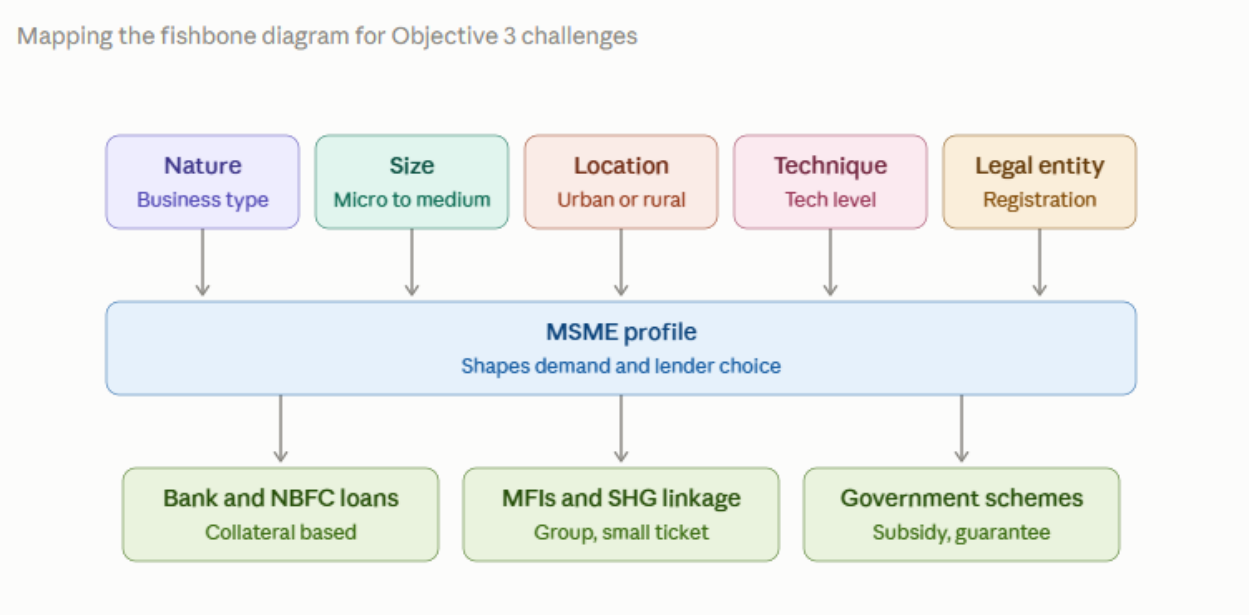

Figure 3 (Objective 2): Five enterprise characteristics form the MSME profile, which routes firms to bank, MFI/SHG or government-scheme funding., Source: Created by Research Scholar

Discussion of Objective 3: Challenges and Factors Influencing Fund Mobilization

Information asymmetry is the root challenge. Lenders ration credit when they cannot distinguish good from bad borrowers (Stiglitz & Weiss, 1981). Group lending with joint liability was designed to mitigate this (Ghatak & Guinnane, 1999; Armendáriz de Aghion & Morduch, 2000), but its repayment pressure and rigidity impose costs on borrowers (Morduch, 1999; Field et al., 2013 in the Objective 2 list).

Financial sustainability and outreach pull in different directions. MFIs must balance cost recovery against serving poorer or riskier clients (Cull et al., 2007, 2009; Hermes & Lensink, 2011; Hermes et al., 2011). Mission drift can reduce access for small enterprises (Mersland & Strøm, 2010). Interest rates and loan terms also matter, although demand may be only moderately sensitive to price (Dehejia et al., 2012).

Over-indebtedness and multiple borrowing are growing concerns (Schicks, 2014), and the Indian microfinance crisis shows how credit contraction can depress local economic activity (Breza & Kinnan, 2021). Loan size and product rigidity limit growth for enterprises that need larger or longer-term finance, and impacts differ by country and design (Crépon et al., 2015; Augsburg et al., 2015; Attanasio et al., 2015; Tarozzi et al., 2015). Reviews find limited and uneven evidence of impact (Rooyen et al., 2012; Karlan & Zinman, 2011), and early assessments cautioned about measurement and selection problems (Copestake et al., 2001). Finally, firms that depend on external finance grow faster where finance is deeper (Rajan & Zingales, 1998), so weak financial development in a region is itself a binding constraint.

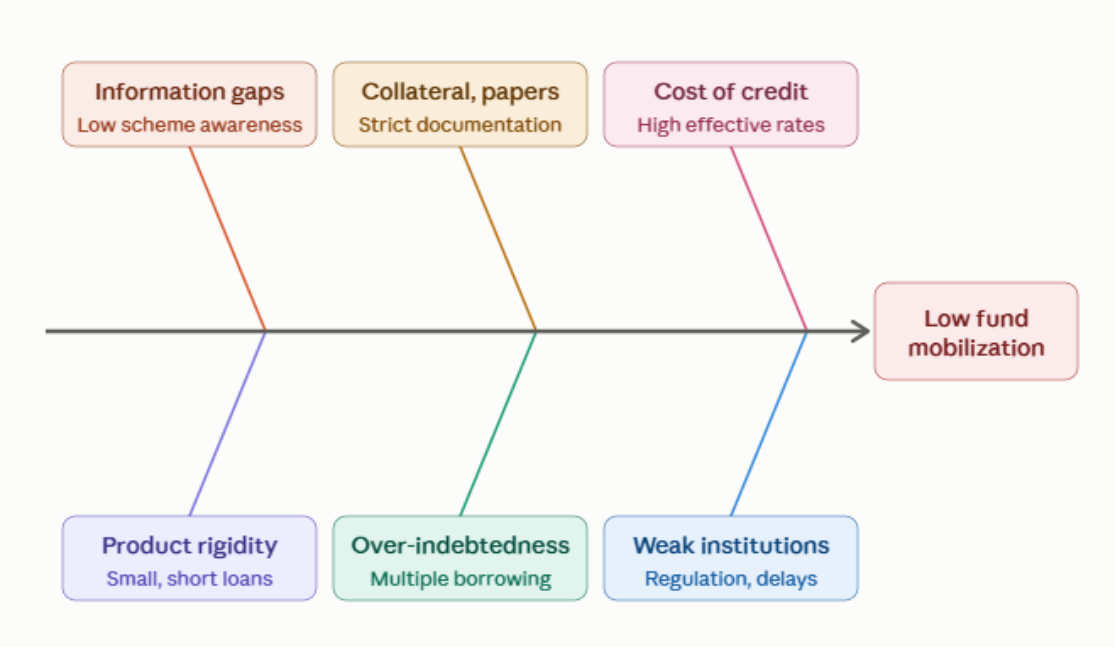

Figure 4 (Objective 3): A fishbone of six challenges converging on low fund mobilization., Source: Created by Research Scholar

Discussion of Objective 4: Critical Evaluation of Government Microfinance Programmes and MSME Growth

A critical reading of the evidence suggests that microfinance helps some enterprises but is not a universal growth engine. Randomized evaluations find modest average effects on business outcomes and little transformation in poverty or income (Banerjee et al., 2015; Banerjee, Karlan, & Zinman, 2015; Karlan & Zinman, 2011). Systematic reviews reach similar conclusions (Rooyen et al., 2012). Earlier non-experimental studies were more optimistic (Pitt & Khandker, 1998; Khandker, 2005), and structural evidence points to gains through better risk-sharing and occupational choice (Kaboski & Townsend, 2011).

In India specifically, the standard repayment model may deter risk-taking and entrepreneurship (Field et al., 2013). Directed lending raised credit but not always real investment (Banerjee & Duflo, 2014). The Andhra Pradesh crisis exposed regulatory weakness, over-indebtedness and coercive recovery (Shylendra, 2006; Taylor, 2011; Schicks, 2014), with measurable economic costs (Breza & Kinnan, 2021).

Subsidies raise further concerns. They can improve outreach but may reduce efficiency (Hudon & Traca, 2011), and MFIs frequently remain dependent on subsidy (Cull et al., 2018). Mission drift weakens the targeting of small enterprises (Mersland & Strøm, 2010). Sustainability and outreach need to be balanced (Hermes & Lensink, 2011). Credit-guarantee instruments can broaden access but vary in design and performance (Beck et al., 2010). Entrepreneurship is a promising pathway out of poverty only when supported by the right institutions and complementary services (Bruton et al., 2013; Khavul, 2010). A critical assessment for Kolhapur should therefore examine scheme coverage, loan adequacy, repayment burden and enterprise growth, not only disbursement figures.

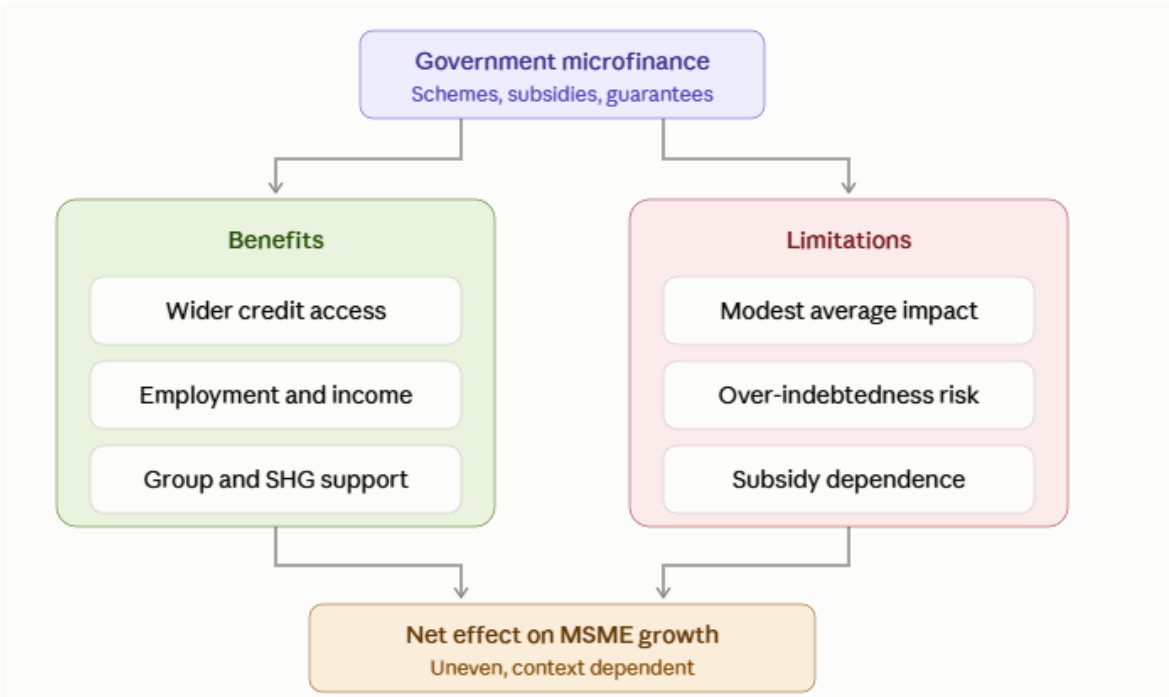

Figure 5 (Objective 4): **Benefits and limitations of government microfinance, weighed into the net effect on MSME growth, Source: Created by Research Scholar**

II. Findings

The evidence indicates that awareness of government microfinance schemes is a key gateway to credit, and that gaps in information, documentation and institutional trust restrict uptake. Enterprise size, formality, location and legal form strongly influence who obtains funds, with smaller and informal units most constrained. Major challenges include information asymmetry, collateral demands, repayment rigidity, high effective cost, limited loan size and the risk of over-indebtedness. Impact on enterprise growth is real but heterogeneous. Average gains are modest, and benefits depend on product design, regulation and complementary support. Subsidy dependence and mission drift weaken long-term effectiveness. These patterns suggest that Kolhapur's MSMEs would benefit from better-targeted and better-publicized microfinance.

III. Conclusion

Microfinance is a valuable but partial solution to the financing problem of MSMEs. In Kolhapur, a district with strong entrepreneurial and cooperative traditions, fund mobilization depends on awareness of government schemes, enterprise characteristics and the quality of institutions. Persistent challenges such as information gaps, collateral requirements, repayment pressure and weak product fit limit its effect. Evidence suggests that microfinance supports some enterprises but is not uniformly transformative. Policy should therefore move beyond disbursement targets and focus on awareness, flexible products, sound regulation, borrower protection and complementary services such as training and market linkage. Empirical verification through primary data from Kolhapur is needed to confirm these patterns locally.

Recommendations

1. **Strengthen awareness campaigns.** District industries centres, banks and MFIs should run regular camps in local languages and through digital channels. Content should explain eligibility, documents and subsidies in simple terms.
2. **Simplify documentation.** Lenders should adopt standard, minimal paperwork for micro and small units. Single-window or assisted application desks would reduce delays and informal intermediaries.
3. **Design flexible products.** Loan size, tenure and repayment schedules should match enterprise cash flows. Seasonal and growth-stage products would suit foundries, agro-processing and service units.
4. **Promote credit guarantee use.** Awareness of existing guarantee mechanisms should be raised among both borrowers and lenders. This would reduce collateral dependence for first-time and informal borrowers.
5. **Protect borrowers.** MFIs should assess repayment capacity and share credit information to prevent multiple borrowing. Grievance redressal and fair recovery practices should be monitored.

6. **Support formalization.** Registration should be made easy and linked to tangible benefits such as cheaper credit. This would bring informal units into the formal lending system.
7. **Target women and small units.** Dedicated outreach and mentoring should help women-led and very small enterprises. Targets should be tracked to prevent mission drift.
8. **Pair credit with capability building.** Financial literacy, technical training and market-linkage services should accompany loans. Credit alone yields limited growth without these supports.
9. **Make subsidies efficient.** Interest and other subsidies should be transparent, time-bound and outcome-linked. Periodic evaluation should check that subsidies improve outreach without weakening repayment culture.
10. **Create a district monitoring system.** A shared dashboard should track disbursement, repayment and enterprise growth in Kolhapur. Findings should feed back into scheme design.

Limitations

This study is limited by its reliance on secondary literature, most of which comes from other countries and regions, so its direct applicability to Kolhapur is uncertain. Microfinance impact studies differ in method, context and measurement, which complicates comparison. Self-reported awareness and financial data from MSMEs may be subject to recall and response bias. The sample, if drawn from one district, limits generalization to other regions. Changes in MSME classification and government schemes over time may affect comparability. Finally, causal inference about the impact of government programmes on growth requires longitudinal or experimental data.

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