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Financial Literacy, Regulation, and Borrower Rights: A Capability–Asymmetry Study of Rural Women's Microfinance in India- A Case Study in West Bengal

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Abstract

Objective: This study examines the impact of financial illiteracy on rural borrowers' ability to exercise their legal rights in microfinance transactions, with a focus on Self-Help Group (SHG) members in Kharagpur-II Block, West Bengal. While microfinance is widely promoted as a tool for poverty alleviation and financial inclusion, literacy gaps and institutional barriers constrain its effectiveness.

Methods: A descriptive design was employed using survey questionnaires and focus group discussions. Stratified random sampling selected 150 women borrowers associated with Bangiya Gramin Vikash Bank. Quantitative data were analysed through correlation, regression, and Chi-square tests, while qualitative insights were triangulated to capture structural aspects of borrower disempowerment.

Results: Findings reveal a modest positive correlation between financial literacy and loan performance ($r = 0.366$, $p < 0.01$), with regression analysis showing literacy accounts for only 13.4% of performance variance. Borrowers demonstrated stronger awareness of repayment schedules but weaker skills in interest calculation, reflecting compliance-oriented literacy rather than empowerment-oriented capability. Qualitative evidence highlights dependence on private MFI field agents, lack of vernacular documentation, and weak grievance redressal mechanisms, which reinforce information asymmetry and restrict borrower rights.

Conclusions The study proposes a Capability–Asymmetry Framework integrating financial capability theory, information asymmetry, and political economy critiques of microfinance. It argues that financial literacy is necessary but insufficient, calling for structural reforms such as vernacular loan documentation, independent grievance cells, and community paralegals. These measures can strengthen borrower empowerment and provide actionable insights for policymakers, regulators, and practitioners seeking to enhance rural financial inclusion in India.

Keywords: Financial literacy; Microfinance; Rural women; Capability–Asymmetry Framework; Information asymmetry; Borrower rights; India

1. Introduction

The aim of Micro-finance institutions in developing country like India is to serve the poor though availing financial services like providing small amount of loans, a place for saving some amount and insurance coverage. Financial inclusion is a mechanism where Microfinance is used as one of the most important tools to alleviate poverty. The United Nation's first and key agenda is "No poverty"[1] which is taken as most prior sustainable development goal worldwide and rural development through financial inclusion is one of the ways towards achieving this goal. Thus, Rural Regional Banks of India are working hard by reaching huge number of rural micro-finance beneficiaries especially through the help of Self-help group and Joint liability group model[2] since long. Every beneficiary of the group is trying to follow the framework of Micro-finance schemes and avoid risk of getting penalized with high rate of interest or tag of defaulter of the group. Proper monitoring and controlling are the strong basis of those MFIs which helps the long-term financial growth and sustainability of rural borrowers.

There are many social, legal and ethical issues which influence the growth and sustainability of Micro-finance beneficiaries as well as providers in terms of financial enrichment. The success or failure of an organization like Bangiya Gramin Vikash Bank, a leading Rural Regional Bank of India is also depending upon various ethical or

[1] United Nations, *Sustainable Development Goals*, https://sdgs.un.org/goals (last visited Feb. 2, 2026).
[2] National Bank for Agriculture and Rural Development (NABARD), *Annual Report*, https://www.nabard.org/annual-report/index.html (last visited Feb. 2, 2026).

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unethical practices. As example Latin America, Bolivia has faced microfinance crises in 1999–2001[3]. Over indebtedness due to competition among Micro-finance players[4] is one most important reason of increasing numbers of defaulters. Another example is "The Andhra Pradesh Micro-finance Crisis" in October 2010[5] due to the similar reason of multiple loans from multiple organizations against an individual borrower. All the MFIs are in need of holding the leading position among competitors; they are trying to increase their capital base. And this is one reason of MFIs to attract significant investment from various private equity players.

MICRO-FINANCE VS MICRO-CREDIT

Micro-finance is combination of more than one financial service which includes Saving Account, Credit Facilities and Insurance Coverage to the low-income group of society who are unable to access formal banking facilities due to lack of employability and collateral. The aim is to alleviate poverty by creating and activating income generation activities among those non-bankable populations of the society, so that the long-term financial growth and sustainability can reach to them[6]. On the other side "Micro-credit" is a facility to provide small amount of loans to the borrowers of any structured financial organization to meet certain purposes[7]. Hence Micro-finance is a wider concept than the Micro-credit. Therefore, microfinance encompasses savings and insurance alongside credit, borrowers face layered legal obligations, making literacy in regulatory frameworks essential for sustainable participation.

THEORETICAL FRAMEWORK

This research stands at the crossroads of three separate yet related theoretical streams of thought – financial capability theory, information asymmetry theory, and political economy of microfinance theory. The combination of these theories provides the required theoretical framework that will make it possible to analyse the structural reasons for the inability of rural borrowers in regions like Kharagpur-II Block to realize their legal right in microfinance transactions despite their possession of adequate financial literacy. Thus, measures should be taken to incorporate both the process of financial education and the process of implementation of structures such as vernacular lending papers and community paralegals into practice.

A. Financial Capability: Beyond Knowledge to Action

In previous literature, the mainstream theory that was considered for examining microfinance has always focused on the concept of financial literacy as the biggest hurdle that needs to be cleared by the borrowers in order for them to behave rationally. The purpose of this study is to challenge the notion through an application of the theory of financial capability by Johnson & Sherraden (2007) and further by Sherraden (2010).

Johnson and Sherraden (2007) draw a fundamental distinction between financial literacy — the possession of knowledge about financial products and concepts — and financial capability, which they define as the combination of financial literacy and the actual opportunity and ability to act on that knowledge. Their framework identifies four dimensions of financial capability: (1) financial knowledge and skills, (2) financial inclusion (access to appropriate financial products), (3) financial enablement (the structural conditions under which people can make and execute financial decisions), and (4) financial well-being outcomes. The critical insight for the present study is that financial literacy is only one component of financial capability, and is insufficient on its own to produce positive financial

Sherraden (2010) further develops this argument by demonstrating that structural access is often a more powerful predictor of financial behaviour than knowledge. In his analysis of Individual Development Accounts (IDAs) in the United States, Sherraden finds that when low-income participants are given automatic enrolment, matching incentives, and guided access to savings products, their savings behaviour improves significantly — independent of their level of financial literacy at enrolment. The implication is clear in its simplicity: financial literacy training will lead to minimal results unless efforts to remove barriers are considered at the same time.

For the current research, this theory can be used to resolve one of the major contradictions that appear in the data collected: Why, despite the moderate level of knowledge of repayment schedules and penalties on loans (as seen in Table 4), SHG members in Kharagpur-II Block do not benefit from their rights according to the 2022 RBI framework for microfinance. It is not only ignorance; it is a matter of capabilities. While borrowers can be aware

[3] Elisabeth Rhyne, *Commercialization and Crisis in Bolivian Microfinance* (2001), https://www.findevgateway.org/sites/default/files/publications/files/mfg-en-paper-commercialization-and-crisis-in-bolivian-microfinance-nov-2001.pdf (last visited Feb. 2, 2026).
[4] A. Constantinou & A. Ashta, Ethical Governance in Microfinance Institutions, 104 *J. Bus. Ethics* 1 (2011).
[5] H. Tadele & P.M.S. Rao, Corporate Governance and Ethical Issues in Microfinance Institutions (MFIs) – A Study of Microfinance Crises in Andhra Pradesh, India, 3(1) *J. Bus. Mgmt. & Soc. Sci. Res.* 21 (2014).
[6] Small Industries Development Bank of India (SIDBI), *Legal and Regulatory Framework*, https://www.sidbi.in/assets/front/pdf/Legal%20%26%20Regulatory%20Framework.pdf (last visited Feb. 2, 2026).
[7] *Supra* Note 5.

of the fact that the interest rate must be regulated, but they are unable to confirm this since they cannot get the information regarding the interest rate, nor file a complaint with the RBI Integrated Ombudsman Scheme due to the lack of proper knowledge.

The capability approach also helps reshape the research question. While posing the conventional research question such as "Do the borrowers know about their rights?", the approach demands the question be further extended to "In what structural conditions are the borrowers able or unable to act upon their knowledge?" The qualitative data obtained through focused group discussions in the Kharagpur-II Block is relevant to these structural conditions, which include the dependence on the private MFI field agents for all transaction support, lack of any block level campaign activities by the monitoring organizations, and social pressure in the joint liability groups against individual complaints.

B. Information Asymmetry: The Structural Power Imbalance Between Borrowers and Lenders

The second theory that informs this research comes from the economics of information asymmetry in credit markets, which was first established by Stiglitz and Weiss (1981). The work of Stiglitz and Weiss shows that credit markets with information asymmetries lack equality between the borrowers and lenders in terms of possession of relevant information regarding loan conditions and their risk and behavior of the other players in the market. Information asymmetries cause not only adverse selection and moral hazard but also, more importantly, create long-lasting power dynamics independent of regulatory intentions.

While Stiglitz and Weiss studied formal credit markets, the framework of information asymmetry has much explanatory power within the microfinance setting, and has been used extensively to analyse SHG-bank linkage programs in India (Armendáriz & Morduch, 2010; Ghosh & Van Tassel, 2011). Within the group lending system that applies to microfinance in Kharagpur-II Block, information asymmetries exist at several levels at once.

On this first level, there is an inequality between the lending entity and the borrower. The lending entity is aware of the terms and conditions of the lending process, i.e., the cost of the charge structure, the penalty clauses, the right to make repayments before the due date, and grievance processes involved; however, the borrower may not be aware of them. As seen in Table 4, which presents the descriptive statistics of the study, the mean score for "ability to calculate interest" is the least among all six financial literacy variables (mean = 3.00, SD = 1.129). This implies that the most basic information-processing skill needed to understand the cost of the loan transaction is missing. In addition to having more knowledge than the borrowers, lending entities have deliberately designed the information architecture of loans. They do not provide the loan documents in vernacular languages, nor is the information on the interest rates provided on display at the branches.

At the second level, there is an asymmetry within the group itself. SHG group leaders and private MFI field agents serve as information intermediaries between the lending institution and individual borrowers, and this intermediary role is itself a source of power. Focused group interviews conducted for this study reveal that borrowers in Kharagpur-II Block frequently rely entirely on the advice of MFI field agents for guidance on loan terms even where such agents have an institutional interest in maximising loan disbursals and may not faithfully represent the borrower's rights. This is consistent with Ghosh and Van Tassel's (2011) finding that information gatekeepers in group lending models can extract informational rents from borrowers, particularly in contexts where borrowers lack independent access to regulatory information.

In this sense, the information asymmetry theory provides an explanation for the existence of a collusive cycle of high-interest financing in the case of Kharagpur-II Block in spite of the existence of a complete framework of regulation. It should be noted that the issue of information asymmetry is not only a matter of ignorance that can be addressed through financial literacy but is a structural part of the credit transaction.

C. The Political Economy of Microfinance: Structural Constraints on Financial Inclusion

Thirdly, there is the pillar in the form of political economy framework in the field of microfinance, which has been developed most elaborately by Bateman (2010). The critique of the microfinance paradigm as a poverty reduction strategy has been advanced by Bateman, who claims that the institution of microfinance, the way it exists globally, especially in South Asia, has not merely failed in meeting the goals of transformational poverty reduction, but, more often than not, has created precarity of financial situation for those whom the microfinance institutions were meant to help.

The Bateman analysis is especially relevant for the Kharagpur-II Block case in three ways. First, the research shows that microfinance credit usage is commonly diverted from investments into consumption spending, such as marriage expenditures, house building, and domestic crisis management. It is exactly the point raised by Bateman (2010) and Dichter & Harper (2007): due to the lack of local markets where microbusinesses can grow, microfinance credit is essentially used for consumption rather than as investment capital. Thus, it is unlikely that the financial literacy program aimed at enhancing "loan performance" (the dependent variable in the research) would be effective in the absence of structural conditions allowing for investments.

Second, Bateman (2010) highlights the competitive nature of microfinance markets, which encourages over-lending and over-borrowing. The introduction of this research paper itself gives the example of the crisis in microfinance in the state of Andhra Pradesh in 2010 due to such dynamics. In Kharagpur-II Block, the pattern is reproduced at a smaller scale: private NBFC-MFIs compete with Bangiya Gramin Vikash Bank for the same borrower base, and the study finds that private MFIs attract greater borrower preference despite higher costs — a preference driven by processing convenience and field agent accessibility rather than by informed comparison of terms. This is the outcome that information asymmetry and inadequate financial capability together produce: borrowers make choices that are not in their financial interest, not because they are irrational, but because they lack the capability infrastructure to exercise meaningful informed choice.

Third, Bateman's examination of the political economy of microfinance regulation is directly relevant to the present study's findings on regulatory non-compliance. The RBI's 2022 framework is a sincere effort to require borrower-protective procedures – including vernacular loan cards, interest rate transparency, and forbidding prepayment penalties. However, the qualitative findings of this study show that the borrowers in Kharagpur-II Block are almost unaware of these protections. Bateman (2010) argues that regulatory frameworks for microfinance are structurally incomplete where the regulated entities control the information infrastructure through which borrowers would need to access their rights. Self-regulatory organisations such as MFIN and Sa-Dhan are subject to this critique: their member institutions are simultaneously the entities whose practices require regulation and the primary conduits through which borrowers receive information about their rights. Independent, state-funded legal literacy infrastructure — outside the MFI ecosystem — is therefore a structural prerequisite for meaningful regulatory compliance.

D. Theoretical Integration: A Capability-Asymmetry Framework for Rural Borrower Empowerment

Drawing these three traditions together, this study proposes a Capability-Asymmetry Framework for understanding the legal disempowerment of rural microfinance borrowers in India. The framework rests on three integrated propositions.

The first proposition is that financial knowledge is a necessary but insufficient condition for the exercise of legal rights in microfinance transactions. Drawing on Johnson & Sherraden (2007) and Sherraden (2010), the study assumes that the conditions of structure which make capability possible – access to information, accessibility of grievance processes, social encouragement of individual action – must be met in addition to knowledge for there to be a possibility of using the legal rights.

The second proposition is that the information asymmetry is part of the structural conditions of group lending transactions rather than a gap in knowledge which can be corrected. Drawing on Stiglitz & Weiss (1981), the study argues that as long as the lending institutions and their field staff maintain near-monopoly over the information context of the rural clients, training on financial literacy alone will not redress the balance of power.

The third proposition is that the perpetuation of exploitative microfinance activities in places such as Kharagpur-II Block does not stem from individual ignorance or lender dishonesty, but rather from the inherent structure of the political economy of the market system in which borrowers have neither the power to speak collectively nor the institutions to realize their formally entitled rights. Based on the work of Bateman (2010), the study is grounded in the proposition that true financial inclusion involves not just increased access to credit, but also the creation of the legal and institutional framework within which such access is meaningful.

In total, these three propositions determine the dependent variable in the study to be "borrower empowerment" in addition to traditional loan performance.

REASONS BEHIND THE GROWTH OF MICRO-FINANCE ESPECIALLY IN RURAL AREAS

The traditional banking system does not provide financial services such as loans to the below poverty level clients as they don't have certain amount of continuous monthly income. But to maintain basic lifestyle and some urgent needs people need money. Tadele, H. et. el. (2014) finds that in an analysis of 28 studies in 14 Asian, American, and African countries the 76% rate of Moneylenders exceeds by 10% per month. Hence the mushroom growth of MFIs can be found in developing country like India is very normal due to high profitability[8].

This study has been identifying several reasons of small borrowing such as:

i) Personal emergencies: health issues, unemployment, theft, death etc.

[8] *Ibid*.

ii) Basic Livelihood needs: education, home construction and repair, wedding, social gathering and occasion, old age etc.

iii) Natural and man-made disaster management: cyclone, flood, war, dwelling etc.

iv) Securing future through investment: invest in business, buying land or equipment, invest in insurance or FD, asset creation etc.

There have been several changes in the regulatory landscape of microfinance in India, notably after the Reserve Bank of India (RBI) announced the new rules which came into effect from April 1, 2022. These rules are intended to strengthen the protection of borrowers, encourage responsible lending, and ensure uniformity in the operations of the regulated institutions (RBI, 2025). Such forces not only justify the need for microfinance but they also put borrowers at risk of legal vulnerabilities particularly when the loans are obtained under duress without full disclosure of rights. The RBI has set the effective date of the new regulatory framework as April 1, 2022, with a transition period until October 1, 2022, to allow for the implementation of the framework for entities that might face challenges in implementation, including in policy formulation or staff training (RBI, 2025). The scope of the framework is broad and comprises such entities as Non-Banking Financial Companies (NBFCs), cooperative banks, commercial banks (other than payment banks) and specialist micro financing institutions. Some criteria provide limited exemptions for not-for-profit microfinance enterprises (RBI, 2025).

One of the most remarkable aspects of this is that microfinance loans are defined as collateral-free financing to individuals from houses with an annual income of little more than ₹300,000. Loans made on hypothecation of physical assets e.g. gold, consumer products etc. are excluded. (RBI, 2026) This clarification fills the gaps in earlier guidelines and is consistent with best global practice on unsecured lending to low-income groups.

Borrower Evaluation and Repayment Cap: The guidelines highlight the need of responsible lending by considering income and overall debt at the family level. A ceiling of 50% is placed on the monthly repayment obligations (including both microfinance and non-microfinance loans) to prevent the borrowers from being excessively indebted (RBI, 2025). This provision is consistent with the findings in the microfinance literature that stresses repayment as a major risk factor in low-income sectors[9].

INCOME AND PRODUCT BUNDLING ESTIMATION

While assessing family income, RBI does not use estimated revenue from financed assets or activities thereby promoting conservative and accurate calculation of income (RBI, 2025). Furthermore, the purchase of non-credit items is absolutely optional, with clear disclosure and segregation from loan documents, addressing long-standing issues around product bundling and coerced sales (RBI, 2025; CGAP, 2014).

a) Transparency and Disclosure

Transparency is reinforced by requirements like facilitating borrowers with a credit card detailing identification, pricing, terms, repayment acknowledgments, and grievance redress mechanisms in a language of their understanding (RBI, 2025). Furthermore, regulated entities must publicly display minimum, maximum, and average interest rates, addressing critiques regarding opaque pricing in microfinance (RBI, 2025; Rosenberg et al., 2013)[10].

b) Charges, Penalties, and Fair Practices

Prepayment penalties are not allowed under the framework, while late-payment penalties should apply only to overdue payments. All fees should be disclosed in advance, and changes in interest rates and other conditions should be notified in writing and implemented prospectively (RBI, 2025). This is in line with international standards of treating customers fairly (Smart Campaign, 2011)[11].

c) Applicability to Legacy Loans

Most importantly, the new guidelines have a prospective nature. The loans that were approved before 1st April 2022 would still follow the earlier guidelines. However, the interest rates on the loans would be revised according to the earlier guidelines (RBI, 2025).

Conclusively, the RBI's new policy framework for the microfinance loans, as explained in its detailed FAQ, has made a significant step towards borrower-oriented, transparent and responsible microfinance activities in India (RBI, 2025). The policy framework also includes mechanisms to avoid the problem of over-indebtedness, calls

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[9] Beatriz Armendáriz & Jonathan Morduch, *The Economics of Microfinance* (MIT Press 2010).

[10] Richard Rosenberg, Adrian Gonzalez & Sushma Narain, The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?, in *Microfinance: Emerging Trends and Challenges* (CGAP 2013).

[11] Center for Financial Inclusion, *The Smart Campaign to Launch a Certification Program for Client Protection in Microfinance* (Feb. 8, 2011), https://www.centerforfinancialinclusion.org/the-smart-campaign-to-launch-a-certification-program-for-client-protection-in-microfinance/. (last visited Feb. 2, 2026).

for transparency, defines the obligations and responsibilities of the lender. This is expected to enhance the well-being of the borrower and institutional stability.

Role of Monitoring authorities of Microfinance activities

RBI: To oversee the micro-finance industry's practices and client protection in India, RBI always play the primary role. As the central regulatory authority for all financial sector activities in the India which includes commercial bank led MFIs as well as NBFC-MFIs. The RBI sets all guidelines such as fair lending practices and transparency in interest rate and also sets overall regulatory framework.

NABARD: this organization aims to develop the rural India by facilitating with various schemes which may help people to find monetary resources like microfinance. It also is monitoring all developmental activities especially for SHG members and Joint Liability group members in rural areas. NABARD also actively refinances various microfinance initiatives which are publishes in annual report of "status of Microfinance in India"[12].

There are few recognized Self-Regulatory Organizations (SROs) to ensure compliances of all NBFC-MFIs with the regulatory framework and a mandatory code of conduct. MFIN[13], Sa-Dhan[14] are example of such SROs which monitor their members using various tools like field survey, self-assessment mechanisms and credit assessment frameworks. While Sa-Dhan, the largest association of community development finance institutions in India, focuses on enforcing codes of conduct and encouraging the sector to operate in a more professional, healthy, and ethical manner, MFIN's main objectives are consumer welfare and corporate governance.

STATEMENT OF THE PROBLEM

As per the financial status of rural community where maximum people suffer lack of social security, here the "Insurance" remains to be "sold" rather than a product "to be bought". Due to social customs, traditions, urgent health issues, losses, natural calamities etc, the poor communities are forced to borrow money from unorganized sector at high rate of interest. On the other hand, the leading RRBs like Bangiya Grammen Vikash Bank provide micro-lending facilities along with other secure financial services to those same rural populations at low rate. Because in 1975 the establishment of RRB happened with the intention of developing rural economy under the provisions of the Ordinance promulgated on 26th September, 1975[15].

As per the latest census data 66.64% area of West Bengal covered rural area where the leading RRBs are trying to provide micro-finance activities since long period for financial inclusion[16].

As per the Handbook of SHG, all microfinance beneficiaries can deposit and withdraw money from their savings account as members of the bank's Self-Help Group. This is clearly stated in point 6.3 of the Handbook of SHG, which states, "An account enables the SHG to conduct financial transactions with the bank and enhances the members' financial literacy;" and "it facilitates the introduction of all individual SHG members to the bank who may eventually become individual customers of the bank." However, the problem arises when self-help group account holders from various villages in the Kharagpur-II block face difficulty withdrawing their deposited money from the savings account. Microfinance fundamentally contrasts with traditional banking by utilising social collateral for the provision and recovery of loans through group lending and shared liability mechanisms. These asset alternatives are based on lending regulations and variable benefits that permit the loan amount to grow over time in response to required savings, regular payback schedules, and good repayment. Collective responsibility limits the group's capacity to borrow money as individuals; the consumer further suffers from interest, penalties, and charges on these loans. Therefore, studies indicate a rise in negligence in dealing with regional rural banks among SHG members for microfinance purposes. This may affect the financial performance in the long run of such organised banks like RRB. For these complexities, this study seeks to find the effect of financial illiteracy among rural borrowers, which limits their ability to exercise their legal rights in microfinance transactions.

This study therefore proposes a dual approach: strengthening borrower-side legal literacy through SHG training modules, and enforcing stricter compliance audits on MFIs to ensure transparency.

RESEARCH GAP

A notable research deficiency has been discovered from a survey conducted in a rural locality of Kharagpur-II Block in the district of West Medinipur, West Bengal. The results show that many women who get microfinance

[12] NABARD, *Status of Microfinance in India 2022–23* (2023), https://www.nabard.org/auth/writereaddata/tender/status-of-microfinance-in-india-2022-23.pdf. (last visited on Feb. 2, 2026).
[13] Microfinance Institutions Network (MFIN), *Self-Regulatory Organisation (SRO) for NBFC-MFIs*, https://mfinindia.org/about/sro (last visited Feb. 2, 2026).
[14] Sa-Dhan, *Association of Community Development Finance Institutions*, https://www.sa-dhan.net/ (last visited Feb. 2, 2026).
[15] The Regional Rural Banks Ordinance, 1975, Ordinance No. 9 of 1975 (India), promulgated Sept. 26, 1975.
[16] Office of the Registrar General & Census Commissioner, India, *Census Data Archive*, https://censusindia.gov.in/nada/index.php/catalog/6891 (last visited Feb. 2, 2026).

benefits can't get all the advantages they're entitled to because they lack knowledge about money and the law. Also, since they don't know their legal rights, they can't do anything about financial institutions when they have a problem or are being taken advantage of. This lack of information not only makes microfinance programs less successful, but it also puts women at risk of financial and legal problems. This shows how important it is to focus on financial and legal education in these areas. Existing literature has largely focused on financial literacy as knowledge acquisition, but has not adequately addressed the structural and legal disempowerment of rural borrowers. This study fills that gap by situating financial literacy within a capability-asymmetry framework and empirically examining borrower rights in Kharagpur-II.

RESEARCH QUESTION

How does financial illiteracy among rural borrowers limit their ability to exercise their legal rights in microfinance transactions?

OBJECTIVE

This study aims to identify issues faced by rural microfinance borrowers due to a lack of financial literacy and its impact on the research area i.e. Kharagpur-II block, a case of SHG microfinance borrowers who are account holders of local Rural Regional Bank.

- To investigate the connection between repayment of loans and knowledge of finances among rural microfinance recipients in Kharagpur-II block.
- To evaluate how understanding of finances affects loan achievement in the context of microfinance in rural Kharagpur-II block.

RESEARCH METHODOLOGY

The study is designed by researchers to find the objective through empirical evidence[17]. This study describes the behavior and characteristics of population or phenomenon. It is descriptive research which will be utilized as the most suitable method for collecting information about people's behavior, opinions, regular habits and a variety of other issues related to micro-lending activities[18]. The prospectus of this study is that authors are able to collect various forms of data through questionnaires and some focused group interviews. Also, information is collected and incorporated as experiences of people associated from various end with the Micro-finance providing organizations. It gives strength to the research design to look at the various aspects they are studying and provide a broad view from both sides, i.e. micro-finance providers and beneficiaries[19].

The Target population of this study is the Micro-finance beneficiaries i.e. rural women who belongs to various Self-Help groups since long period in this block. Primarily through Government scheme the Bangiya Gamin Vikash Bank, a leading RRBs covering this block to fulfill the purpose of financial inclusion and community development. This bank, with its 496 rural branches, serves 274649 SB linked SHGs and 232120 numbers of credit-linked SHGs as on 31st March 2024[20] throughout the West Bengal State.

Sample Design

This study adopted stratified random sampling as we know that sampling is a process of selecting a number of individuals for the study in such a way that they can represent a larger group from which they are selected from[21]. It involves 150 Micro-finance beneficiaries from various villages of Kharagpur-II block who are members of various SHGs and beneficiaries of Micro-credit facilities for more than 3 years.

Data Collection

The study has adopted a mixed approach, i.e. both primary and secondary data have been collected to meet the objective. As recommended by Mugenda & Mugenda (2003), a sample size of more than 30 or at least 10% is usually appropriate for social sciences[22]. The primary data will be collected with the help of structured questionnaire which tested the relationship between the financial literacy and loan performances of rural micro-finance beneficiaries of the respective organization. And Eight focused group interviews were conducted in Kharagpur-II Block—four with SHG members linked to Regional Rural Banks and four with borrowers from NBFC-MFIs. This design ensured institutional diversity and allowed comparative analysis between bank-led and

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[17] Donald R. Cooper & Pamela S. Schindler, *Business Research Methods* (McGraw-Hill 2006).
[18] J.A. Orodho, *Techniques of Writing Research Proposals and Reports in Education and Social Sciences* (Maseno Univ. Press 2008).
[19] C.R. Kothari, *Research Methodology: Methods and Techniques* (New Age Int'l 2004).
[20] Bangiya Gramin Vikash Bank (BGVB), *Annual Report 2023–24* (2024).
[21] Alan Bryman, *Social Research Methods* (Oxford Univ. Press 2008).
[22] O.M. Mugenda & A.G. Mugenda, *Research Methods: Quantitative and Qualitative Approaches* (Acts Press 2003).

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private-sector models. The sample size was guided by thematic saturation, providing robust qualitative insights to complement the quantitative findings.

Secondary data helps to identify the micro-finance loan performances of the organization and helps to understand the actual goal of Micro-lending towards financial inclusion is satisfied or not.

MODEL SPECIFICATION

Study Variables

- **Independent Variable:** Financial Literacy
- **Dependent Variable:** Loan Performance
- **Control Variables:** Age, education level, income, loan size, and loan tenure

The following regression model was employed to investigate how financial literacy affects loan performance:

$$LP = \alpha + \beta(FL) + \epsilon$$

Where:

LP = Loan Performance

FL = Financial Literacy

α = Constant

β = Regression coefficient

ε = Error term.

Format of the structured questionnaire used to fit the model

Table-1

Section A: Socio-Economic Profile of Respondents

1. Age (in years): ☐ Below 25 ☐ 25–35 ☐ 36–45 ☐ Above 45
2. Gender: ☐ Male ☐ Female
3. Educational Qualification:
☐ Illiterate ☐ Primary ☐ Secondary ☐ Higher Secondary ☐ Graduate & above
4. Occupation:
☐ Agriculture ☐ Self-employed ☐ Wage labour ☐ Small business
☐ Others (Specify): ___________
5. Monthly Household Income:
☐ Below ₹10,000 ☐ ₹10,001–₹20,000 ☐ ₹20,001–₹30,000 ☐ Above ₹30,000
6. Number of years associated with micro-finance institution:
☐ Less than 1 year ☐ 1–3 years ☐ 3–5 years ☐ More than 5 years

Financial Literacy Index = Mean of FL1 to FL6

Table-2

Section B: Financial Literacy (Independent Variable)

(Please indicate your level of agreement using the following scale)
1 – Strongly Disagree | 2 – Disagree | 3 – Neutral | 4 – Agree | 5 – Strongly Agree

Sl. No.	Statement	1	2	3	4	5
1	I understand the interest rate charged on my loan					
2	I am aware of the loan repayment schedule					
3	I understand the penalties for late repayment					
4	I maintain a household budget regularly					
5	I have knowledge about savings and insurance schemes					
6	I can calculate interest on loans and savings					
7	I clearly understand loan terms and conditions					

Loan Performance Index = Mean of LP1 to LP5

Table-3

Section C: Loan Performance (Dependent Variable)

(Please indicate your level of agreement using the following scale)
1 – Strongly Disagree | 2 – Disagree | 3 – Neutral | 4 – Agree | 5 – Strongly Agree

Sl. No.	Statement	1	2	3	4	5
1	I repay my loan instalments on time					
2	I have never defaulted on my loan repayment					
3	I use the loan amount for the intended purpose					
4	My income has increased after availing the loan					
5	I find the loan amount sufficient for my needs					
6	I feel confident in managing loan repayment					

HYPOTHESES FORMULATION

The following hypotheses were formulated for the study:

H_{01} (Null Hypothesis): The loan performance of rural microfinance recipients and financial literacy do not significantly correlate.

H_{11} (Alternative Hypothesis): There is a strong correlation between financial literacy and the loan performance of rural microfinance clients.

H_{02}: The performance of loans is not much impacted by financial knowledge.

H_{12}: The performance of loans is significantly impacted by financial literacy.

ANALYSIS

Statistical Tests: Validity and Reliability: Cronbach's alpha (0.538) was lower than the conventional cut-off of 0.70 but still acceptable[23] for exploratory research in rural heterogeneous settings in which a range of socioeconomic backgrounds affects internal consistency (Galapan et al., 2025). Triangulation of qualitative focus group interviews enhanced reliability. Correlation analysis showed a significant positive relationship between financial literacy and loan performance ($r = 0.366$, p 0.01), which is in line with previous studies[24] that have found the literacy to be a factor in the repayment success of microfinance organisations (Kiran & Mayya, 2024).

Further, regression analysis (R2= 0.134) showed that literacy accounts for a small portion of the variance in loan performance, indicating the need for structural supports.

Finally, Finally, Chi-square tests showed significant relationships between borrower type and awareness of penalties, and between literacy level and ability to calculate interest ($p < 0.05$)[25]. These results are consistent with recent systematic reviews that identify education, gender and age as categorical predictors[26]of financial literacy (Zaimovic et al., 2023). The trials strongly support the mixed-methods approach and reconfirm the Capability–Asymmetry Framework for borrower empowerment.

Table -4 A

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.366[a]	.134	.128	.46085

a. Predictors: (Constant), Financial Literacy Index

[23] Galapin, R. G., Ibieza, D. B., & Vergara, J. T. (2025). Assessing financial literacy levels among small-scale farmers. *International Journal of Research and Innovation in Social Science, 9*(10), 2059–2068. https://doi.org/10.47772/IJRISS.2025.914MG00157 (doi.org in Bing)
[24] Kiran, K. B., & Mayya, S. (2024). Review of literature on determinants of loan repayment performance in microfinance institutions. *International Journal for Multidisciplinary Research, 6*(4). https://doi.org/10.36948/ijfmr.2024.v06i04.24399 (doi.org in Bing)
[25] Zaimovic, A., Torlakovic, A., Arnaut-Berilo, A., Dedovic, L., & Meskovic, M. N. (2023). Mapping financial literacy: A systematic literature review of determinants and recent trends. *Sustainability, 15*(12), 9358. https://doi.org/10.3390/su15129358
[26] C.R. Kothari, *Research Methodology: Methods and Techniques* (New Age Int'l 2004); Alan Bryman, *Social Research Methods* (Oxford Univ. Press 2008); O.M. Mugenda & A.G. Mugenda, *Research Methods: Quantitative and Qualitative Approaches* (Acts Press 2003); Donald R. Cooper & Pamela S. Schindler, *Business Research Methods* (McGraw-Hill 2006).

Table -4 B						
Coefficients[a]						
Model		Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	2.137	.286		7.475	.000
	Financial Literacy Index	.412	.086	.366	4.784	.000
a. Dependent Variable: Loan Performance Index						

The table-5 shows descriptive statistics of six financial literacy factors amongst 150 respondents which indicate some important trends regarding borrower capabilities. There is no missing value in any of the variables which make the dataset reliable. High mean scores for knowledge of repayments schedules (mean=3.50, SD=0.673) and knowledge of penalties (mean=3.43, SD=0.718) clearly indicate that the respondents have better grasp about the transactional aspect of borrowings. Average scores for budgeting practices and knowledge of savings and insurances (mean=3.30 for both) clearly indicate average levels of skills in long term financial literacy. On the other hand, lower scores for knowledge of interest rates (mean=3.20, SD=0.948) and ability to calculate interest (mean=3.00, SD=1.129) clearly indicate low level of competency with highest variations for calculating interest.

Table-5

Statistics

		understandin g interest rate	knowledge of repayment schedule	awareness of penalty	budgeting habit	knowledge of saving & insurance	ability to calculate interst
N	Valid	150	150	150	150	150	150
	Missing	0	0	0	0	0	0
Mean		3.20	3.50	3.43	3.30	3.30	3.00
Std. Deviation		.948	.673	.718	.642	.975	1.129

This is because the finding shows an important point of asymmetry whereby the borrowers are well versed on the payment aspect but are unable to understand certain financial aspects such as interest rate computations. In other words, this finding confirms the theory put forth in the study that it is not enough to have financial literacy; additional mechanisms are required in order for this to happen.

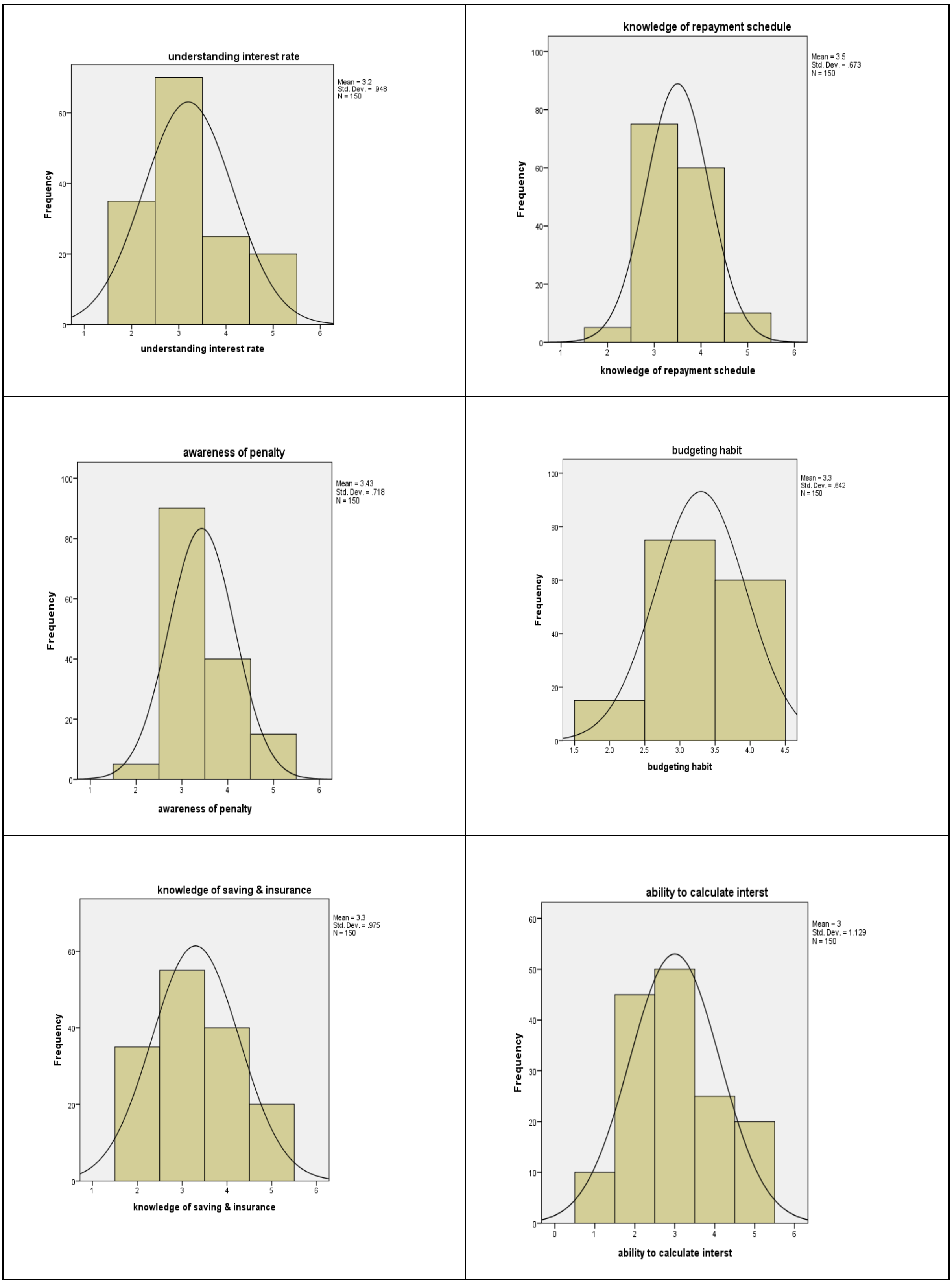
Table-6: Distribution of Responses on Six Financial Literacy Aspects, Referencing

Frequency Table													
		understanding interest rate		knowledge of repayment schedule		awareness of penalty		budgeting habit		knowledge of saving & insurance		ability to calculate interest	
		Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent	Frequency	Percent
Valid	Strongly Disagree	0	0	0	0	0	0	0	0	0	0	10	6.7
	Disagree	35	23.3	5	3.3	5	3.3	15	10	35	23.3	45	30
	Neutral	70	46.7	75	50	90	60	75	50	55	36.7	50	33.3
	Agree	25	16.7	60	40	40	26.7	60	40	40	26.7	25	16.7
	Strongly Agree	20	13.3	10	6.7	15	10	0	0	20	13.3	20	13.3
	Total	150	100	150	100	150	100	150	100	150	100	150	100

From the above table, we can see that rural borrowers display a pattern of being cautious about themselves. Most of the respondents had chosen 'neutral' for their knowledge about repayment schedules, fines, budgeting, saving and insurance, and interest rates. It is clear from this that the borrower has a fair amount of knowledge, but also has doubts about applying the same to the practical aspects. However, the biggest deficiency is related to calculating interest, where 30% of the respondents said that they did not agree, and 6.7% disagree very much with the fact that they possess the knowledge about the same.

The Frequency Distribution of All Six Key Aspects were made, and the pattern comes as follows:

Fig-A: Frequency distributions



These results highlight the fact that there is a gap that exists in structure in this case, where financial literacy is mostly reactive and not proactive in nature. The inability of borrowers to comprehend interest calculation or loan terms makes them vulnerable to manipulative pricing and practices. This is further buttressed by the main thrust of the study, which highlights how financial literacy needs to be accompanied by structural interventions to make it functional in nature.

The significance of the association of the Financial Literacy Index and the Loan Performance Index can be seen through the positive Pearson correlation coefficient value of 0.366 ($p < 0.01$, two-tailed). There is, therefore, a statistically significant positive association between the level of financial literacy and the loan performance of rural people. Even though the association is weak, the significance points out financial literacy as one of the factors for the success of loans.

Table-7

Correlations

		Financial Literacy Index	Loan Performance Index
Financial Literacy Index	Pearson Correlation	1	.366**
	Sig. (2-tailed)		.000
	N	150	150
Loan Performance Index	Pearson Correlation	.366**	1
	Sig. (2-tailed)	.000	
	N	150	150

**. Correlation is significant at the 0.01 level (2-tailed).

However, the relatively low magnitude of the correlation indicates that there is more to loan repayment behavior than just financial literacy. As pointed out by Armendáriz and Morduch (2010), microfinance borrower outcomes depend on much more than knowledge, including, for example, information asymmetries, institutions, and enforcement of laws.[27]. Consistent with the Sherraden (2010) approach to financial capability, the current research indicates that alongside the need for literacy there is also the need for enabling structures: vernacular borrowing paperwork, disclosure, and complaint procedures.[28].

Therefore, although the finding indicates the importance of financial literacy, the rather small value of the coefficient further emphasizes the central point of this study that the loan performance is dependent not only on the level of individual knowledge but also on system capability support. The finding thus illustrates the Capability-Asymmetry Framework.

Table-8

ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	4.861	1	4.861	22.886	.000[b]
	Residual	31.433	148	.212		
	Total	36.293	149			

a. Dependent Variable: Loan Performance Index

b. Predictors: (Constant), Financial Literacy Index

[27] Armendáriz, B., & Morduch, J. (2010). *The economics of microfinance* (2nd ed.). MIT Press

[28] Sherraden, M. (2010). Financial capability: What is it, and how can it be created? *Journal of Social Work*, 48(1), 63–80. https://doi.org/10.1177/0040874010370795 (doi.org in Bing)

The logistic regression model analyzing the connection between loan repayment rates and knowledge of finance is tested for overall significance using the ANOVA table. With an F-value of 22.886 and a matching significance level (p-value) of 0.000, the results demonstrate that the model is statistically significant. This suggests that the Loan Performance Index is strongly predicted by the Financial Literacy Index. Further evidence that the model explains a significant amount of the variance in loan performance comes from the regression sum of squares (4.861) in comparison to the residual sum of squares (31.433). Therefore, our study confirms that financial literacy is a strong predictor of loan performance.

Table-9

Coefficients[a]						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.137	.286		7.475	.000
	Financial Literacy Index	.412	.086	.366	4.784	.000
a. Dependent Variable: Loan Performance Index						

The Loan Performance Index is significantly positively impacted by the Financial Literacy Index, according to the correlations table. The Financial Literacy Index's unstandardized coefficient (B) is 0.412, which indicates that, when all other variables are held equal, loan performance should rise by 0.412 units for every unit increase in financial literacy. A modest effect size is indicated by the standardized coefficient (Beta) of 0.366. The quantitative importance of this link is confirmed by the t-value of 4.784 and the corresponding significance level (p = 0.000). The constant term (intercept) is 2.137, representing the estimated loan performance when financial literacy is zero. Based on these findings, the regression equation for the model is:

Loan Performance Index = 2.137 + 0.412 (Financial Literacy Index)

Overall, our findings show that loan performance is significantly and favourably predicted by financial literacy.

FINDINGS AND SUGGESTION

From the above discussion the researcher concludes that there is a moderate positive relationship between microfinance initiatives and empowerment of rural women. Other factors are self-confidence, changing attitude of clients and supervision and guidance. The activities also have an impact on women's empowerment. Other factors have considerable influence to help the poor rural women. Microfinance initiatives for self-employment are not sufficient. Although participation in the microcredit scheme is found to have a small direct impact on improving women's access to resources, it is more successful as a tool to improve women's ability to act as intra-household processes.

Additionally, utilising microfinance facilities improves household education, family welfare, and women's empo werment while increasing employment options and a range of economic activities.
Furthermore, based on the aforementioned findings, it can be inferred that microfinance for education and skill d evelopment for selfemployment plays a major role for rural women and is the most effective means of empoweri ng lowincome rural women.

According to the research's outcomes, the majority of the impoverished have access to microfinance because they are impacted by unpredictable events like drought or unproductive land. For those individuals, microfinance help is crucial in this situation. However, certain respondents have also stated that because microfinance increases their reliance on it, it does not help them succeed in their endeavours. By reviewing the collateral requirements and lowering interest rates, microfinance organizations should encourage the impoverished to take out loans. Despite the existence of a legal and administrative safety valve, there is a widespread collusive vicious cycle of high-interest financing in this block. They may be more susceptible to this type of microcredit scheme due to their poverty and lack of education. It is also noticed that the purpose of credit is not fulfilled, but they have taken this for household work or for domestic help, mainly for marriage or for making a pucca house. In Kharagpur II block, RRBs' acceptance of microfinance is lower than that of private MFIs. Kharagpur-II block rural women's acceptance of microfinance initiatives is not monitored. The researcher is of the opinion that Ignorance of one's legal rights is a huge set back, increasing the unnecessary credit facility, Lack of financial literacy. MF monitoring organisations have not launched an awareness campaign in this block. Seeking a hassle-free way to pay for urgent expenses. There is a Lack of knowledge of digital systems and constant help from private MFI employees.

Financial Capability: Knowledge Without Structure Remains Inert

Evidence towards this argument is provided by descriptive statistics of Table 4. The respondents have moderately high levels of repayment schedule (mean = 3.50) and penalty awareness (mean = 3.43). On the other hand, interest calculation, which is necessary for independent determination of cost of credit, has the lowest mean score (3.00) and the highest variability (SD = 1.129) of all six dimensions of financial literacy. The result is congruent with financial capability framework provided by Johnson and Sherraden (2007), which states that the presence of rule-based knowledge does not imply the presence of necessary skills for application of this knowledge in transactional environments. Sherraden (2010) also showed in the case of IDA that structural access to products through mechanisms such as automatic enrolment and guided product access is better predictor of financial behaviour than scores of literacy alone. Empirical data from Kharagpur-II Block also confirm this conclusion in microfinance environment. Although the respondents are well aware of the fact that the interest rates are controlled by RBI, they are not able to verify compliance with these requirements independently. Without the existence of awareness campaigns at the block level, vernacular loan cards, or access to grievance redressal procedures, the information goes unused, just as would have been predicted within the theory. In addition to this, the results from the regression analysis (R^2= 0.134) provide further evidence for this interpretation since financial literacy emerges as a statistically significant variable for loan performance but accounts for merely 13.4% of the variance.

Information Asymmetry: The Field Agent as Information Gatekeeper

The second theoretical approach that sheds light on the reproduction of the process of structural disempowerment through individual transactions is that of the information asymmetry model proposed by Stiglitz and Weiss (1981). Interviews in focus groups held in the Kharagpur-II Block demonstrate that borrowers depend heavily on private MFI field workers for information concerning loan conditions, repayment conditions, and the choice of products. This intermediary dependency is not an accidental phenomenon but rather a structural feature of the credit relation in this specific context. Information gatekeepers in the group lending approach, as proved by Ghosh and Van Tassel (2011), can charge information rent from borrowers who do not have independent access to regulatory information. This situation holds true based on the results of the study as loan documentation is rarely given in vernacular language, interest rate information is not available to borrowers publicly, and the loan card is not issued according to RBI guidelines of 2022.Thus, borrowers of Kharagpur-II Block operate in an informational environment where institutions manage the products and the information architecture surrounding the products. The preference of private NBFC-MFIs to Bangiya Gramin Vikash Bank by borrowers despite the cost disadvantage inherent in the choice of the private institutions is clearly a reflection of the asymmetry. Borrowers are not opting for high-cost credits because of irrationality but simply based on which institutions have agents who are more available and processes that are better known to them. In an informational environment where information is scarce, accessibility substitutes for informed comparison. The correlation coefficient of 0.366 between the Financial Literacy Index and the Loan Performance Index, although significant, shows a relationship that is largely intermediated by the information quality available to borrowers during transactions.

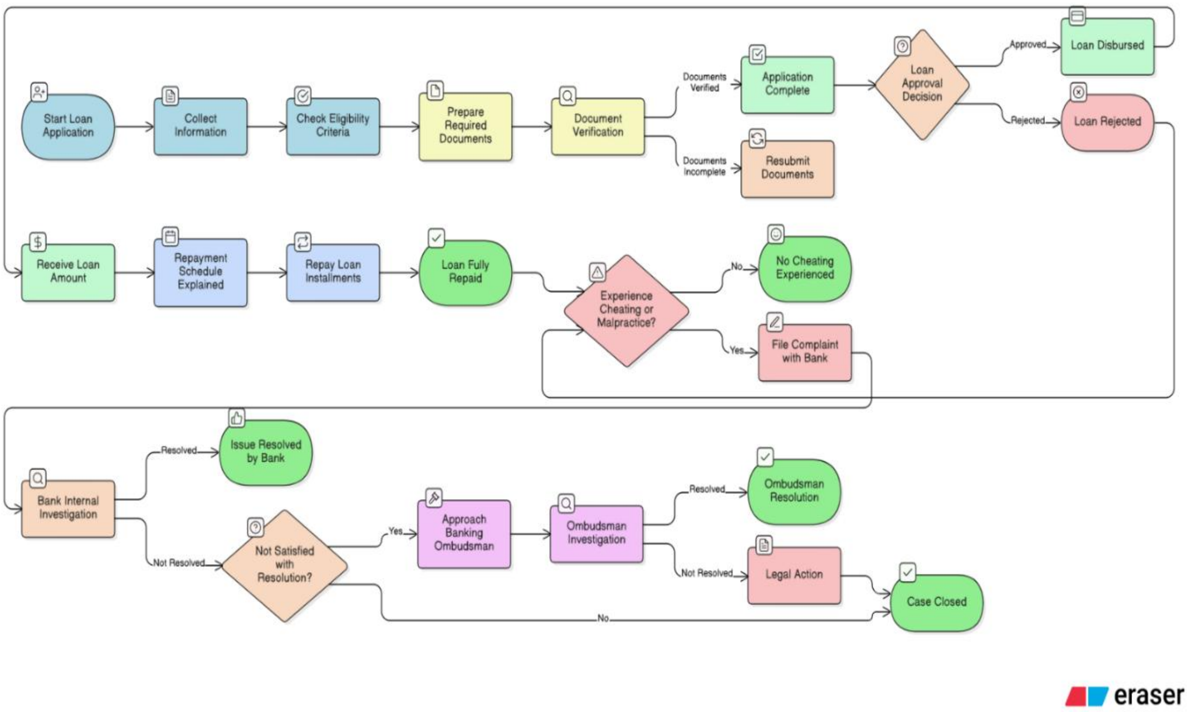
Political Economy of Microfinance: Regulatory Frameworks Without Enforcement Infrastructure

Thus, borrowers of Kharagpur-II Block operate in an informational environment where institutions manage the products and the information architecture surrounding the products. The preference of private NBFC-MFIs to Bangiya Gramin Vikash Bank by borrowers despite the cost disadvantage inherent in the choice of the private institutions is clearly a reflection of the asymmetry. Borrowers are not opting for high-cost credits because of irrationality but simply based on which institutions have agents who are more available and processes that are better known to them. In an informational environment where information is scarce, accessibility substitutes for informed comparison. The correlation coefficient of 0.366 between the Financial Literacy Index and the Loan Performance Index, although significant, shows a relationship that is largely intermediated by the information quality available to borrowers during transactions. It is exactly the kind of consumption smoothing pattern seen by Dichter & Harper (2007), and predicted by Bateman (2010) as the inevitable result of the use of credit tools in the absence of the more comprehensive institutional framework that could make those tools developmental in nature and not simply palliative. This interpretation is bolstered by the results from the Chi-Square analysis (Cramer's V = 0.542, $p < 0.001$) and the fact that there is a strong correlation between the categories in the analysis being examined.

Theoretical Synthesis: The Capability-Asymmetry Gap

In total, the three dimensions point to one diagnostic finding, which is termed as the capability-asymmetry gap in this study, defined as the difference between the rights granted by the RBI in its 2022 policy and the actual capability of rural borrowers in Kharagpur-II Block to use these rights in practice. While financial literacy reduces this gap at the margin – the regression results prove that it is a predictor of loan performance – this measure alone cannot resolve the issue. It can be done only through addressing the structural drivers of capability, including independent information intermediaries operating outside the MFI industry; legal literacy at the level of blocks; adequate grievance mechanisms that are truly accessible; and enforcement of regulations that is not reliant on the initiative of borrowers. It means that the study's results have a very clear policy implication, which is elaborated in the Recommendations chapter: for successful financial inclusion in rural India, it is not enough to provide access to credit but also the right environment for it.

Fig- B: Loan process flowchart (institutional structure, complaint resolution)



Finally, it is suggested that marketing and transportation facilities be provided to these people to sustain and increase their income generating activities. The study results will be useful to policy makers, planners and concerned organisations in strategy and policy formulation.

The empirical results of this study, interpreted within the Capability-Asymmetry Framework developed in the theoretical section, suggest a pattern of borrower disempowerment that cannot be explained solely by individual ignorance. Instead, the data suggest structural conditions that limit the abilities of rural women in Kharagpur-II Block to exercise their legal rights mandated in law, even if they have some financial knowledge.

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