



Economics: Microfinance And Poverty Reduction – Assessing The Impact Of Microfinance Institutions On Small Businesses And Poverty Alleviation In Developing Economies

Student Name:Ahaana Nirav Shah

1 Chapter 1: Introduction

Microfinance has become one of the key approaches to economic development that focuses on delivering financial services to the financially excluded population and enterprises. Microfinance is rapidly becoming popular in developing countries as a poverty reduction and entrepreneurship finance strategy. This paper evaluates microfinance institutions' (MFIs) roles in small business and poverty reduction in developing countries.

1.1 Background and Context

Microfinancing only evolved in 1976 with the formation of the Grameen Bank in Bangladesh by Professor Dr. Muhammad Yunus. Since then, microfinance institutions have grown globally, offering credit, savings, other financial products and services, and training to excluded groups and communities. One of the significant constraints hindering the growth of small businesses in developing economies is the issue of capital, which results in the economy's slow growth and a high poverty index. MFIs endeavor to fill this gap by providing funds that enable business people to fund their businesses, make more income, and enhance living standards. On the one hand, some authors emphasized the overall benefits of microfinance for economic empowerment; on the other hand, some authors pointed to the negative impacts of high interest rates and repayment pressure for borrowers (Sulemana, Fuseini, & Abdulai, 2023). Hence, it is essential to critically examine microfinance's effect on small businesses and poverty alleviation in developing nations.

1.2 Problem Statement

Although microfinance has become one of the most popular tools, it is still questionable whether it helps to overcome poverty and develop small businesses. Though some beneficiaries have seen growth and/or their enterprise and living standards, others face issues of cyclic debt and poor enterprise sustainability. Due to the absence of a conclusive common perception of microfinance, it is pertinent to examine the part that microfinance plays in enhancing economic development. This paper seeks to establish whether microfinance assists the growth of small enterprises and poverty reduction/or it exposes borrowers to more risks in developing countries.

1.3 Objectives of the Study

- To analyze how these microfinance institutions, enhance the emergence and stability of small businesses in developing countries.
- To evaluate the effect of microfinance on poverty relief by analyzing the changes in the income and quality of life among borrowers.
- To identify issues small business owners encounter regarding microfinance loans' accessibility and repayment plans.

1.4 Research Questions

1. How do microfinance institutions affect small businesses' growth and sustainability in emerging economies?
2. How does microfinance influence poverty reduction in terms of income generation and living standards?
3. What are the significant obstacles to using and repaying microfinance loans for small business owners?

1.5 Hypothesis

- **Null Hypothesis (H₀):** Microfinance institutions do not considerably impact small business growth and poverty reduction in developing economies.
- **Alternative Hypothesis (H₁):** Microfinance institutions considerably contribute to small business growth and poverty reduction in developing economies.

1.6 Scope and Limitations

This study aims to establish the effectiveness of microfinance institutions on small businesses and poverty reduction in the selected developing countries. It looks into financial permeation, business longevity and economic prosperity of borrowers. Still, the study has some drawbacks, including data constraints, variations in regional economic activity and differences in the microfinance models (Roberts, 2025).

However, it fails to consider other factors, such as the microfinance policies that are in place and the world's economic conditions today.

1.7 Significance of the Study

The study will establish the impact of microfinance as an economic instrument for Empowerment in society. Policy makers, financial institutions and development organizations can benefit from the research by extending better microfinance models to enhance poverty reduction. Also, the study will be helpful for academic research as it will provide an empirical assessment of how microfinance affects the growth of small businesses and poverty levels. Additionally, the results will assist in the development of appropriate financial services for small business owners and in the creation of sustainable financial structures for economic growth in the long run. The study will also help in providing policies that enhance equal access to credit for marginalized groups (Khan, 2022). In this respect, the study will provide empirical evidence about the effectiveness of microfinance interventions in generating sustainable socio-economic impacts that will help to underpin the development of focused interventions aimed at elevating poverty levels and expanding business growth in developing countries.

1.8 Structure of the Paper

- Chapter 1 presents an overview of the context of the study, the research problem, purpose, questions, assumptions, scope, importance, and organization of the paper.
- Chapter 2 reviews existing literature on microfinance, small business development, and poverty reduction.
- Chapter 3 overviews the research methodology and how data was collected and analyzed.
- Chapter 4 gives an account of the study findings.
- Chapter 5 will give conclusions and policy insights from the work done.

This is because the work is systematically outlined in a structured format to capture all the significant effects of microfinance institutions on small businesses and poverty in developing nations.

2 Chapter 2: Literature Review

Chikwira, Vengesai, & Mandude (2022) state that microfinance institutions (MFIs) have empowered people experiencing poverty by extending financial services to disadvantaged groups. According to their study, micro-finance empowers the minor business persons to undertake more business, increase production efficiency and thus provide employment opportunities. Some assert that microfinance reforms society, particularly women and other deprived groups, allowing them to engage in income-generating activities. They also state that microfinance institutions enhance asset accumulation and increase household welfare, leading to long-term economic stability. However, they also acknowledge that despite this, microfinance

has positive implications for poverty reduction, and problems such as high interest rates, poor financial management, and inability to repay may hamper the sustainability of microfinance. It implies that microfinance institutions can only be sustainable if their policies on borrowers' protection are harmonized with institutional viability (Chikwira, Vengesai, & Mandude, 2022).

El-Nasharty (2022) has pointed out that the efficiency of microfinance for poverty decrease depends on the region of some countries, and in others, there are some issues with its application. This paper reveals that microfinance has enhanced living standards in many developing countries, especially in the African and Asian regions, from 2000 to 2018. El-Nasharty found that favorable government policies, financial literacy, and policies that govern the microfinance operations are some of the key conditions that enhance the effectiveness of microfinance operations. This research also shows that microfinance institutions are much more effective in areas where there is political support for entrepreneurs and a sufficient demand for the products of small enterprises. However, it also shows in the following points that microfinance has sometimes resulted in debt burdens to the borrowers, negating the spirit of economically empowering them. Therefore, it suggests that authorities step up micro-finance regulation to prevent it from deepening subprime lending (El-Nasharty, 2022).

In the opinion of Adnan and Kumar (2021), the advancement of microfinance is highly relevant to economic development due to its ability to provide financing for businesses. They argue that microfinance institutions took the role of a bank to give credit to the borrowers who lack formal security or credit score. According to their findings, such microfinance helps to enhance business activity, increase household income, and ensure financial sustainability. They also point out that microfinance promotes innovation and entrepreneurship since small businesses can fund new technologies and equipment and expand their products to markets. While they admit that microfinance is a good concept, they also stand to testify that the idea can only be a success if sound loan management practices are considered coupled with financial conduct and responsibilities demonstrated by the borrowers and the general economic practices. It notes that a lack of proper training and support to the borrowers may reduce the benefits of microfinance since poor management leads to loan default. Instead, they suggest that sound microfinance institutions should be developed to support microfinance businesses while ensuring that financial literacy programs are incorporated in microfinance institutions for maximum outcomes with due consideration of policymakers involved in facilitating them (Adnan & Kumar, 2021).

Ayoo (2022) has opined that microfinance in developing countries must be fashioned in line with other poverty reduction and social and economic development programs. The study concludes that while microfinance funds offer much-needed capital to the needy, poverty eradication can only be effective through a combination of finance, education, health, and infrastructure development. Ayoo thus admits that microfinance cannot eliminate poverty per se but can help spur growth and development, especially if other

approaches to development complement it. The study also supports the view that for financial resources to benefit small entrepreneurs, they must be complemented by business training, mentorship, and markets. The study also highlights that the programs that focus on gender issues as a strategy for microfinance have effectively uplifted women's status economically. It also emphasises assessing and controlling microfinance programs to empower small business people and other needy groups. Finally, the study underlines the necessity of considering microfinance as one of the ways to combat poverty without leaving it as the only solution, the primary tool of economic and social development that would guarantee inclusive economic growth (Ayoo, 2022).

Thai-Ha (2021) affirms that microfinance is important in social development as it addresses the need for financial services in marginalized groups. The work discusses the role of microfinance as the key driver for business development since it allows the latter to obtain funds. Thai-Ha (2021) analyses the role of microfinance institutions (MFIs) in financial inclusion, social uplift, and entrepreneurship by scrutinizing different literature sources. The study states that although microfinance has helped eradicate poverty, its effects are not similar in all regions and socio-economic statuses. Therefore, micro-finance efficiency depends on factors such as credit availability, micro business financial literacy and market factors. Thus, while microfinance has the potential for improving the economic status of the populace, there is a need for other support policies, such as financial literacy and improvement of the physical infrastructure, to complement this. In addition, the study proves how technology is incorporated in microfinance, given that more and more lending firms and mobile banking are making financial services available to underbanked populations (Thai-Ha, 2021).

In the view of Modu and Maina (2024), microfinance banks play a noticeable role in small and medium enterprises (SMEs) performance in Maiduguri Metropolis, Nigeria. Their research discusses microfinance's work delivering capital, enhancing business growth, and increasing financing support for SMEs. This paper's findings show that microfinance helps SMEs to have an improved profitability, better cash flow management and a sound financial management. However, some of the limitations include high interest rates, credit risks, and low financial literacy levels among the owners of the SMEs. In their view, policymakers should lower the lending rates and increase efforts to promote the financial literacy of the microfinance beneficiaries. It also recommends that mentorships, financial services, and structures for the repayment of loans be established, depending on the cash flow patterns of the SMEs. This paper, however, asserts that proper economic development and sound governmental policies are crucial in facilitating the steady growth of businesses and subsequently eradicating poverty in developing regions (MODU & MAINA, 2024).

Chali et al. (2022) posit that microfinance institutions help alleviate poverty by availing funds for funding activities in households in rural Ethiopia. It aims to evaluate whether microfinance can enhance the income

of the families and the economic status in general. This study, therefore, establishes that microfinance service has brought better incomes, improved agricultural output and better living standards among the borrowers. Still, the study finds that not everyone has equal access to microfinance since it is unavailable to women and vulnerable groups as much as hoped. The study shows that although microfinance plays a vital role in poverty reduction, the following factors: lack of collateral security, high interest rates and lack of training of the microfinance managers hamper its efficiency. In addition, the study shows the necessity of developing government policies and policies to control microfinance operations and protect consumers of such services from exploitation by lenders. The authors also pointed out the need for policies to promote access to micro-credit, build capacity among the beneficiaries, and place adequate checks on the microfinance institutions. They also point out the need to consider micro-finance services complementary to poverty alleviation with other reasons, such as employment opportunities and vocational training (Chali, Gelalcha, Gelaye, & Tyagi, 2022).

Mayang (2022) confirmed that microfinance institutions strongly influence poverty reduction in South Sudan, particularly in Juba County. Only recently have microfinance effects on income generation, employment, and business sustainability been inspected from the people's perspective. The financial services within the microfinance sector include loan products, saving products and other credit facilities through which the low-income persons are empowered to undertake income-generating activities. Still, it reveals some weaknesses such as high levels of loan default, lack of adequate business management knowledge and skills, and political risk that impacts microfinance operations. These findings suggest that MFI has to be supported by enterprise creation, policies, and a sound economy to impact poverty levels positively. Furthermore, it is recommended that MFIs should extend their financial education practice a step further to ensure that the borrowers are equipped with the knowledge in handling their finances. This study also confirms that micro-finances and small business growth require cooperation between all relevant actors, including the micro-finance institutions and the non-government and government organisations. The researcher recommends that Union Bank develop loan products sensitive to customers' economic status and introduce measures that would help share the problems related to loan delinquencies (Mayang, 2022).

Mengstie (2022) has pointed out that microfinance affects women's economic status by availing financial capital and promoting business skills and financial security for the women of the household. This paper seeks to discuss the role of microfinance in women's socio-economic development and in starting and enhancing business ventures. According to the existing data, most female microfinance users show an improvement in their overall financial literacy, better levels of savings, and enhanced decision-making power in their households. Nonetheless, barriers including gender bias, low education in finances, and culture limit women's effectiveness within microfinance schemes. It develops the argument that gender-sensitive policies, capacity-building programs, and supportive community structures should be developed to increase the effectiveness of micro-financing for empowering women. Also, the study focuses on

exploring women-oriented microfinance programs, which include peer group lending with added features of group meetings for motivation and knowledge enhancement. It, therefore, emerges that when microfinance is complemented with education, skill development, and appropriate policies and laws, poverty and lack of gender equity can be fought effectively in developing nations. The author also recommends that microfinance institutions extend appropriate product offering services that can help women in terms of repayment flexibility and business management skills, making them stronger financial roles in the future (Mengstie, 2022).

3 Chapter 3: Research Methodology

This chapter presents the method used in the study to determine the effect of microfinance institutions in enhancing the performance of small business establishments and poverty reduction in the developing world. The adopted research methodology is qualitative, where participants in ten were interviewed using open-ended questions, and thematic analysis was used to evaluate the results.

3.1 Research Design

The research employs a qualitative approach to capture a detailed understanding of MFIs' effects on small businesses and poverty reduction. Qualitative design is most suitable for the present research. It would help to understand small business owners' and individuals' experiences and perceptions of microfinance services (Sonia, Hasan, Sultana, Akter, & Ullah, 2024). It allows the analysis of the financing opportunities, the viability of micro businesses, and the impact of microfinance on social and economic transition.

3.2 Research Approach

Due to the nature of the impact caused by microfinance and because of their influence, the context is chosen to use a qualitative research approach. The study adopts an interpretivist research approach since it acknowledges the social world as socially constructed through people's actions. It does not rely on the positivistic mode of hypothesis testing; it tries to unveil the viewpoint of the Microfinance users. Interviews reveal detailed information on the impact of microfinance on business development, financial security, and, in general, participants' quality of life (Elsherif, 2023).

3.3 Data Collection Methods

Data collection for this study is primary and the data will be collected with the sample of 10 participants, which are owners of small-scale businesses and microfinance borrowers. The interview questions aim to understand the participants' experiences, difficulties and/or perceptions of microfinance services. The five key questions explore how access to microfinance has influenced the growth and sustainability of their businesses, what changes they have observed in their income and quality of life since obtaining microfinance assistance, what challenges they face in accessing and repaying microfinance loans, how microfinance services have impacted their ability to create employment or expand their business operations, and what improvements they would suggest for microfinance institutions to enhance their support for small businesses

(Muhammad, Hameed, Saboor, & Hanif, 2024). The interviews can be face-to-face or online based on the participants' preference. The interviews take about 30-45 minutes on average and are conducted with the participant's permission, where an audio recording is made to ensure the most accurate transcription.

3.4 Data Analysis

The qualitative data collected from the participants' responses is then subjected to thematic analysis to ascertain general trends. Five broad topics are identified based on the effects of microfinance on business development, employment, loan acquisition and repayment difficulties, attitude towards microfinance, and suggestions for enhancement. Opportunities include business growth, higher and fixed income, employment creation and revenue from interests, whereas the constraints include high interest rates and inflexible repayment schedules. Microfinance is considered an essential solution for promoting small businesses and combating poverty, but questions appear regarding its sustainability if further training services do not accompany it. Challenges include bureaucracy when accessing loans and poor knowledge of financial matters. Participants' recommendations include offering lenient repayment terms, lowering interest rates, and financial literacy programs (Mwita, 2021). Based on the respondents' accounts, this analytical perspective affords an understanding of microfinance's positive and negative aspects for small businesses and economic steadiness.

3.5 Ethical Considerations

To this end, it is pertinent that ethical considerations are observed during this research to protect participants' rights and welfare. Voluntary and informed consent is sought from all the participants; participants are read and made to understand the research proposal's aim, processes, and possible risks to get their consent. To protect the participants' privacy, their identity is concealed by assigning them pseudo names during transcription and in all the reports. Informed consent is obtained from the participants, indicating that the study's participation is voluntary and that the participants are free to withdraw (Alam & Azad, 2021). Data involving research interviews is protected by adequately storing the recordings and transcripts; only authorized users can access the data.

4 Chapter 4: Results and Discussion

4.1 Thematic Analysis

Theme 1: Influence of Microfinance on Business Growth and Sustainability

The participants described the importance of microfinance in developing and expanding enterprises. Participant 1 described that microfinance helped them grow the type of retail business by increasing stocks and the consumer base. Participant 2 explained that the loans enabled them to purchase better equipment for the shop, which cut down the time they took to complete a particular order or job bid, as well as helping in conquering larger tenders. Participant 3 reported that the loan they secured helped them open another branch of a small restaurant, meaning that two more people were employed. Participant 4 noted that although

microfinance helped her start a poultry farm, the repayment period had short periods that forced them not to be able to reinvest the profits earned. Participant 5 revealed that microfinance was necessary to start their mobile phone accessories shop because they offered the capital the participants did not have.

Theme 2: Effects of Microfinance on Household Income and Quality of Life

The effectiveness of microfinance in improving household income and quality of life among the participants was mixed. Participant 1 observed that the household income increased, enabling her to afford better education for her children and good health facilities. According to Participant 2's interview, extra income was used for home remodeling and acquiring household necessities. Participant 3 also believed that although their business expansion saw an increase in the household income, loan repayments may sometimes reduce their disposable income. However, they could keep their financial records in check and ensure they did not overspend. Participant 4 said that through accessing the microfinance loan, they were in a position to support their family without the need for contracting casual employment. Participant 5 reported a slight increase in the household income, most of which is channeled back into the business.

Theme 3: Challenges in Accessing and Repaying Microfinance Loans

These challenges include the ability of the participants to access the microfinance loans and how they manage to repay the microfinance institutions to meet their business needs. Participant 1 mentioned that the application of the loans was tedious and time-consuming due to the numerous documents required for loan granting. They opined that this may extend the chances of gaining financial assistance following a reduction of the complicated procedures involved. High interest rates challenged Participant 2 since he used many of the profits to compensate for the rates. During off-peak business seasons, Participant 3 had challenges paying back the borrowed funds within the agreed time. They also said this flexible repayment was appropriate because the structures available for repayments did not factor in fluctuating revenues throughout the year. Participant 4 complained about the loan officers who confused him with the repayment periods. Participant 5 also noted the absence of security as another challenge that hinders one from obtaining a significant loan.

Theme 4: Perceptions of Microfinance in Supporting Entrepreneurship and Poverty Reduction

This is why the participants had different opinions concerning the position of microcredit in stimulating the development of business and eradicating poverty. Participant 1 considered microfinance an essential source of funding that can help many people start their own businesses or expand their existing businesses since other options would not be available. Microfinance was considered by Participant 2 as a tool that has positive effects in giving capital needed to support business while having adverse effects in offering very high interest, which may not enable the business to remain sustainable. According to Participant 3, microfinance institutions were credited with poverty reduction because they provided employment opportunities.

Participant 4 was concerned that while microfinance assists people in starting businesses, it does not substantially eradicate poverty. Participant 5 appreciated microfinance but argued it was helpful mainly to those with business skills.

Theme 5: Recommendations for Improving Microfinance Institutions

Respondents came up with some recommendations that would help increase the efficiency of microfinances to support small businesses and reduce poverty. As for the explanation of the problem, Participant 1 suggested the following: Interest rates should be brought down, and repayment terms should be lengthened, especially for owners of small businesses, to make credit more accessible. Participant 2 further proposed having financial literacy training, enabling borrowers to make the right decisions in managing their loans and businesses. Participant 3 suggested more flexible loan repayment to capture companies' changing cash flows with the amount they can pay to the lenders, changing depending on their revenue cycles. Participant 4 also insisted on the need for easy procedures involving borrowing with many formalities that discourage people from accessing credits. Participant 5 insisted that MFIs should be able to offer other financial services, such as grants and business incubation services, to the entrepreneurs apart from loans.

4.2 Discussion

From the insights of this research study, it could be deduced that MFIs are a crucial contributing factor to the growth of small businesses and poverty alleviation in the developing world. Everyone interviewed stated that the source of micro finance proved very useful in enhancing their businesses by offering funds needed to restock and expand both the stock and employment. This study also reveals that microfinancing has brought positive changes to the income and the quality of living of the microfinance beneficiaries as they have improved their access to education, health care and better shelters. However, some borrowers experienced a tough time repaying the loan based on these conditions, which sometimes outweighed the capacity to boost business revenues (Roberts, 2025). This is in line with other studies that have indicated that while microfinance enhances the economic capability of the borrowers, other factors, such as the borrower's financial literacy and policy environment, determine the effectiveness of microfinance in the long run. Nevertheless, microfinance can reduce poverty, but it should be understood that it is not a panacea. Some respondents also pointed out that for microfinance to have the intended impacts, it has to be accompanied by financial literacy, mentorship and a rational loan repayment schedule.

In addition, it was realised that microfinance institutions' (MFIs) effectiveness is not the same for all the small businesses and borrowers. Some respondents reported higher returns in businesses and revenue status, while others were burdened with the repayment of the loans due to high interest charges and low business turnover. This situation calls for MFIs to be flexible in loan offerings as small businesses are diverse and so is the economy in developing countries. For example, you may need to include seasonal trade credit periods for some purchases. For businesses that sell ice cream, making payments with an extra grace period during

the off-season may take a long time. One significant finding of the study is that financial literacy significantly helps generate the most optimism from microfinance. Some borrowers complained of challenges in adequately managing their loans, hence facing some forms of loan over-borrowing. This concurs with similar findings positing the need for borrower education as a key course for loan sustainability and business expansion (Shaheen, Babar, & Taj, 2025). The key components of microloans include budgeting, investment, and business planning to help clients have an adequate educational background to manage money effectively.

Mentorship and business development support appeared to be the other factors that may improve the efficacy of microfinances for their beneficiaries. Some respondents observed that they got valuable information on managing resources, marketing their products, and expanding their business ventures apart from capital. It is evident that some microfinance institutions have embraced training and mentorship, but not all have, and the available programs are not very effective. These and other similar innovations mean that widening the scope of such programs and guaranteeing their relevance for various business segments might yield more efficacious results in the context of small entrepreneurship. Nevertheless, the possibility of supporting poverty eradication through microfinance is beyond doubt (Heriyanto, Mariyanti, & Barat, 2022). The importance of microfinance in entrepreneurship was evidenced by the response of many respondents who pointed out that without microfinance, they could not have ventured into business or expanded their business. It is recommended that the government and other financial organizations should work in a way that will allow small business organizations to grow without having to worry about getting themselves into too much debt

5 Chapter 5: Conclusion and Recommendations

Conclusion

The paper also emphasizes the importance of microfinance institutions (MFIs) in contributing to the growth of small businesses and poverty eradication in the developing world. The study indicates that microfinance brings capital that would otherwise not be available to those who cannot obtain credit from traditional sources to business people, thus leading to the need to expand business, to increase income of households and, therefore, the level of living. Some of the study's findings include that microfinance was used to buy equipment, expand stock, and generate employment. However, it was established that microfinance had pertinent challenges, including high interest rates, unfavorable repayment terms, and cumbersome loan procedures, which hindered its usefulness in achieving sustainable economic development. It is worth mentioning that microfinance has been an effective instrument in poverty reduction but focuses on different segments of clients homogeneously.

Recommendations

The following policy recommendations will help improve microfinance's effectiveness for small businesses and poverty alleviation. First, microfinance institutions should set lower interest rates and incorporate flexible repayment schedules reflecting business seasonality. Repayment of loans has always been a problem for many business people, particularly those in businesses characterized by seasonal income. Second, it is required to offer financial literacy as part of value-added services that microfinancing institutions provide to the borrowers to manage the loans and business money. The third and final aspect is to develop and improve more flexible and efficient procedures in microfinance loan granting (Sonia, Hasan, Sultana, Akter, & Ullah, 2024). Reducing the burden of paperwork and the time it takes to secure a loan would help more businessmen and businesswomen, including those in rural areas, access the financial resources they need to start their businesses without much delay. Finally, policymakers should ensure that they put measures in place to check the excesses of some loan sharks who exploit vulnerable borrowers.

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Appendix

Interview Questions

1. How has access to microfinance influenced the growth and sustainability of your small business?
2. In what ways has microfinance affected your household income and overall quality of life?
3. What challenges have you encountered in accessing and repaying microfinance loans, and how have they impacted your business operations?
4. How do you perceive the role of microfinance institutions in supporting entrepreneurship and reducing poverty in your community?
5. What improvements would you suggest for microfinance institutions to better support small businesses and contribute more effectively to poverty alleviation?