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An Assessment of Group Lending Challenges Facing Microfinance Institutions in Mwanza, Tanzania

Evelyne F. Magambo
Department of Accountancy, College of Business Education
Email: evelyine.magambo@cbe.ac.tz
P .O. Box 3168, Mwanza -Tanzania

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ABSTRACT

The purpose of this study is to thoroughly evaluate the difficulties Tanzanian microfinance institutions (MFIs) encountered when putting group lending concepts into practice. It specifically aims to pinpoint the main obstacles associated with trust concerns, group dynamics, operational complexity, and legal limitations. The study uses a mixed-methods research methodology to collect data from borrowers and MFI staff through qualitative interviews and quantitative surveys. While semi-structured interviews were held with MFIs, surveys were given to clients taking part in group lending programs. For context and historical patterns, secondary data were also gathered from previously published studies, scholarly works, and regulatory papers. According to the study, trust and group dynamics are crucial to the success of group lending initiatives. There are issues with resolving conflicts, free rider issues, uneven participation, and eroding confidence. MFIs emphasized operational problems, such as the difficulty of complying with regulations, technological constraints, and the complexity of handling repayments. Capacity building, technological advancements, regulatory authority collaboration, risk management, and a client-centered approach are among the recommendations. The study admits its shortcomings, including the fact that it only focused on two MFIs in Mwanza and that survey results may have been biased. The results, however, lay the groundwork for future studies on the changing opportunities and difficulties in group lending and give useful insights for practitioners and policymakers in Tanzania's microfinance industry. This study fills a clear vacuum in the literature by offering a comprehensive analysis of the difficulties MFIs in Tanzania encountered when implementing group lending models. The study's uniqueness and practical worth are enhanced by the inclusion of theoretical frameworks, a mixed-methods approach, and practical recommendations. As such, it is a great resource for those involved in the microfinance and financial inclusion scene.

1. Introduction

Microfinance institutions (MFIs) play a pivotal role in expanding financial inclusion and fostering economic development, particularly in emerging economies. In Tanzania, as in many developing nations, these institutions have emerged as vital contributors to poverty alleviation and economic empowerment. A significant approach within microfinance that has gained prominence is group lending, a mechanism designed to enhance access to credit and financial services for marginalized communities and low-income individuals.

Group lending is built on the premise of collective responsibility, where small groups of borrowers come together, guarantee each other's loans, and often receive financial education and support from microfinance institutions. While this model has demonstrated considerable success in empowering the unbanked and underprivileged, its implementation is not without its challenges. This study delves into the multifaceted landscape of group lending in Tanzania, seeking to comprehensively assess the hurdles and obstacles faced by microfinance institutions in their efforts to extend financial services to the underserved.

Tanzania, endowed with a rich tapestry of cultures, landscapes, and economic diversities, faces the challenge of providing inclusive financial services to its vast and heterogeneous population. Microfinance institutions have stepped in as a potential panacea, facilitating access to credit, savings, and insurance for those who are typically excluded from mainstream banking. Group lending, often associated with concepts like solidarity lending and joint liability, holds promise as an efficient and sustainable mechanism to reach remote and economically vulnerable communities.

However, the implementation of group lending schemes is not without complexities. MFIs must navigate a myriad of issues that can impact the effectiveness and sustainability of their lending operations. These issues include but are not limited to: Group Dynamics, Loan Repayment Rates, Operational Challenges, Regulatory Framework and Sustainability.

This study aims to provide an in-depth exploration of these challenges, shedding light on the nuances of group lending in Tanzania's microfinance sector. By examining the real-world obstacles faced by MFIs, we endeavor to contribute to the ongoing dialogue on improving the effectiveness of microfinance in promoting financial inclusion, poverty reduction, and sustainable economic growth in Tanzania.

This research aims to achieve three specific objectives: First, to identify and analyze the key challenges that microfinance institutions encounter when implementing group lending models in Tanzania, including issues related to group dynamics, operational constraints, and regulatory barriers. Second, to examine the impact of these challenges on critical performance indicators, such as loan repayment rates and the financial sustainability of microfinance institutions in the Tanzanian context. Finally, to propose actionable recommendations and strategies that can enhance the effectiveness of group lending models within Tanzanian microfinance institutions, with a focus on improving group formation and management, operational efficiency, regulatory compliance, and overall program sustainability.

1. Literature Review

2.1. Microfinance in Tanzania

The provision of financial services to low-income people who are typically ignored by traditional banking institutions is known as microfinance. Several nations that employ microfinance attest to the fact that it is widely recognized and accredited for its contribution to the fight against poverty. The Government of Tanzania developed and approved the first National Microfinance Policy in 2000, realizing the potential of the microfinance subsector in reducing poverty and fostering economic progress (NMP, 2000). The National Microfinance Policy 2017 (NMP 2017) and its implementation strategy, which spans ten years from 2019/20 to 2029/30, were developed in response to a review of the policy in 2017. The primary goal of NMP 2017 is to advance financial inclusion by fostering an environment that will allow the nation's microfinance subsector to operate effectively and efficiently, meeting the needs of low-income individuals, households, and businesses and so promoting economic growth, job creation, and the reduction of poverty. Furthermore, the Government passed the 2018 Microfinance Act. It is the responsibility of the Bank of Tanzania (BOT) to license, oversee, and control the microfinance industry in Tanzania. According to the Act, microfinance service providers are divided into the following four tiers: Savings and Credit Cooperative Organizations (SACCOS) make up Tier 3, while Tier 4 consists of community microfinance groups; Tier 2, which consists of non-deposit-taking microfinance service providers like individual money lenders; and Tier 1, which consists of deposit-taking microfinance service institutions. According to the latest information made available by BOT (2022), there are in Tanzania 4 microfinance banks, (Tier 1 microfinance institutions), and 576 Tier 2 microfinance institutions.

2.2. Theoretical Review

2.2.1. Social Capital Theory

Social Capital Theory is highly pertinent to the study because it focuses on the role of social networks, trust, and social cohesion within groups, which are fundamental aspects of group lending in microfinance. This theory guides the current study in understanding how social capital within borrowing groups influences the success or challenges of group lending programs. It provides a framework for analyzing the dynamics of trust, reciprocity, and cooperation among group members, which are critical for collective responsibility and loan repayment rates. Examining how social capital is built, maintained, and leveraged within microfinance groups can shed light on the challenges faced and strategies employed.

2.2.2. Institutional Theory

Institutional Theory is relevant to your study as it helps explain how external factors, such as regulations and norms, shape the practices and behaviors of organizations, including microfinance institutions. This theory guides the current research by examining the impact of the regulatory environment on microfinance operations in Tanzania. It provides a framework for understanding how external institutional pressures influence MFIs' decisions regarding group lending and their responses to regulatory changes. By analyzing how regulatory constraints and norms affect the implementation of group lending models, you can gain insights into the challenges faced and strategies employed by MFIs to adapt and comply with institutional requirements.

These theories can serve as valuable lenses through which we can analyze the challenges and dynamics of group lending in Tanzanian microfinance institutions. They offer conceptual frameworks for understanding the social and institutional factors that influence the success or difficulties of group lending programs, and they can help structure your research and guide your data analysis.

2.3. Empirical Literature

Individual and group lending are the two types of lending. Individual lending gives financial stability to a microfinance institution, whereas group lending maximizes the reach of microfinance. Furthermore, group financing does not require collateral, freeing consumers from collateral and expanding the scope of microfinance (Abrar, 2016). According to Morduch (2010), group lending is a lending practice in which the "poor," who frequently lack access to conventional financial services, are compelled to come together as a group for the purpose of accessing financial services. It is a critical component of microfinance, allowing MFIs to reduce the costs of information, transaction, monitoring, and enforcement involved with lending to the poor.

Group lending models, characterized by joint liability and collective responsibility, have shown promise in addressing the financial needs of low-income individuals and communities in Tanzania. In their study (Akter et al., 2021) noticed that research in group lending has become prominent in the field of Microfinance. Berge and Garcia, (2021) posit that loan groups could be a valuable venue for the exchange of entrepreneurial resources. It further highlighted the effectiveness of group lending in fostering trust, reducing information asymmetry, and increasing loan repayment rates among borrowers. Trust, once built, can also be fragile. Negative experiences, such as defaults by group members, can erode trust within the group. When trust diminishes, it can lead to increased loan delinquencies and difficulties in maintaining group cohesion. However, despite the potential advantages, the implementation of group lending in Tanzania is not without its complexities.

According to the research on group lending and group liability, group lending benefits both borrowers and institutions. Borrowers gain additional support and guidance from a network of people coping with similar challenges. Furthermore, the institutions can save money by relying on lending groups to supply services that would otherwise be provided by the institution itself. Group financing also aims to shift institutions toward a more client-centered approach, which has proven to be more effective in developing long-term development programs (Hailu, 2023).

Ensuring cohesion, trust, and effective group management can be challenging. Studies have discussed the significance of social capital and group dynamics in the success of group lending programs (Tegambwage and Kasoga,2022). In a study done in Sierra Leone (a case of BRAC) by (Gracia et al., 2019) found that Microcredit supplied through a group lending scheme boosts social interactions and exposes participants to role models during weekly meetings, potentially raising aspirations. Establishing trust among group members, especially in newly formed groups, can be challenging. Borrowers may be unfamiliar with each other, and building trust can take time. Trust is essential for ensuring that group members collectively assume responsibility for loan repayments. A group lending system with common liability serves as a vehicle for coordination. The women would be unable to borrow if this program did not exist. Furthermore, group lending is considered to reduce the probability of loan default by encouraging borrowers to feel a sense of solidarity and shared responsibility (Malamsha,2023).

MFIs grapple with logistical challenges in delivering financial services to remote and underserved areas. Issues related to infrastructure, outreach, and resource constraints are explored in the literature. The regulatory framework governing microfinance in Tanzania influences the practices and outreach of MFIs. Changes in regulations and compliance requirements have been discussed as factors impacting microfinance operations (Beck, 2015).

The challenges associated with group lending models can have significant implications for the financial sustainability of microfinance institutions. High repayment rates are crucial for the sustainability of lending programs. Research (Msuya et al., 2019) has explored the relationship between group lending challenges and loan repayment rates, shedding light on the potential consequences of these challenges on the financial health of MFIs. The outcomes suggest excellent repayment performance since they show very low levels of write-offs, portfolio at risk, and arrears. Sound institutional design which includes strict loan approval processes, frequent client visits, and payback plans is the reason for this accomplishment. Despite the successful loan recovery, there are still difficulties for the group members. They may occasionally be required to make contributions on behalf of other members in the event of defaults or delays. The quality members may start to disappear if this keeps up.
In response to the identified challenges, scholars have proposed various strategies and innovations to enhance the effectiveness of group lending programs in Tanzania. These strategies encompass improved group formation, risk management mechanisms, product diversification, and leveraging technology to reach remote clients (Khan et al.,2021). Parmeter et al., (2021) advocate for lending organizations to focus on borrower groups with more social capital to tackle existing group lending challenges.

A study conducted by (Chomen, 2021) in Ethiopia to assess the contribution of Oromia Credit and Saving Share Company microfinance institution on poverty alleviation in Welmera district surfaced various challenges facing MFI. Group lending was mentioned by 19.3% of respondents as one of the challenges that hinder them from accessing finance. However group lending model is the most preferred in the country.

Chaturvedi and Sharma, (2019) conducted a study in India to establish reasons for the diminishing importance of group lending. They noted various challenges including low trust and little knowledge on how to manage group loans. This suggests that if group lending challenges are not well addressed it is likely such lending model will diminish.

While there is a significant body of literature on group lending and microfinance in Tanzania, there is a noticeable research gap in the comprehensive assessment of the specific challenges faced by microfinance institutions (MFIs) when implementing group lending models in this context. Existing studies have explored the advantages and success stories of group lending, the impact on financial sustainability, and various strategies for enhancing microfinance operations. However, there is a lack of in-depth research that systematically investigates the multifaceted challenges associated with group lending and their implications for the effectiveness and sustainability of MFIs in Tanzania. Moreover, limited attention has been given to the dynamic regulatory environment and its influence on group lending practices. To address this gap, the current study seeks to provide a holistic assessment of these challenges and to offer practical recommendations for improving group lending operations in Tanzanian MFIs.

3. Research Methodology

3.1. Research Design

The study adopts a mixed-methods research design to provide a comprehensive assessment of group lending challenges facing microfinance institutions (MFIs) in Tanzania. This design combines quantitative and qualitative data collection and analysis to gain a holistic understanding of the research problem.

3.2. Source of Data

Surveys and interviews were conducted to collect primary data. Surveys was administered to clients of MFIs using group lending models to understand their perspectives. Semi-structured interviews were conducted with MFI staff, regulatory authorities, and other stakeholders to gather insights into operational challenges and regulatory constraints. Secondary data were collected from existing reports, academic literature, regulatory documents, and MFI financial records. This data provided background information, context, and historical trends related to group lending in Tanzania.

3.3. Population and Sampling

The study population consists of customers in group lending at two selected microfinance institutions operating in Mwanza which are BRAC and FINCA. The two are chosen because are the largest MFIs in Tanzania (Maghina et al, 2023). The first MFI has 290 clients in group lending while the second MFI has 350 clients in the group lending program. Stratified random sampling was employed to select a representative sample from each MFI where each MFI represent a stratum. An estimated sample size of 246 customers in group lending was determined using the formula from Miller and Brewer (2003) as follows:

$$n = \frac{\mathrm{N}}{1 + \mathrm{N}(\alpha)^\wedge 2}$$

Where N= sample frame; n=sample size; ά=margin of error=(0.05).
Therefore

$$n = \frac{640}{1 + 640(0.05)^\wedge 2}$$

n= 246

This sample is allocated proportionally for each MFI in the ratio of {290:235} 246 resulting in a sample of 111 respondents and 135 respondents from BRAC and FINCA respectively.

Within each MFI, a purposive sample of clients MFIs staff participating in group lending programs was selected. Additionally, interviews were conducted with 6 (Six) MFIs staff (3 from each).

3.4. Data Collection

For Quantitative Data, Surveys were administered to clients participating in group lending programs using structured questionnaires. The survey gathered data on group dynamics and trust challenges. For Qualitative Data, Semi-structured interviews were conducted with MFI staff, regulatory authorities, and experts. These interviews explored operational challenges, regulatory constraints, and strategies employed by MFIs. Qualitative data were audio-recorded and transcribed for analysis.

3.5. Data Analysis

Quantitative data were analyzed using descriptive statistics (e.g., frequencies, percentages). These are employed to summarize survey responses and loan repayment rates. Further, qualitative data from interviews were analyzed thematically. Transcripts were coded and categorized into themes related to group lending challenges, operational issues, and regulatory constraints. Content analysis techniques is applied to identify patterns and insights.

3.6. Ethical Consideration

Ethical guidelines, including informed consent and confidentiality, were strictly followed during data collection and analysis. Necessary permissions were obtained from respondents.

4. Findings and Discussion

The results of this research are grouped into three major parts. The first part presents the characteristics of respondents while the second and third part presents the opinions of MFIs and group borrowers regarding group lending challenges.

4.1. Respondents Characteristics

Table 4.1 shows respondents' profiles. The table only includes the profiles of sampled MFIs customers. The study found that the majority of respondents were aged 36-60, with 51.6% having secondary school education and 26% having Tertiary/University education. Most customers were female (91.9%).

Table 4.1 Respondents Characteristics

Characteristics		**Frequency**	**Percent** (%)
Age	18-35	108	43.9
	36-60	128	52
	Above 60	10	4.1
TOTAL (n)		**246**	**100**
Education	Primary	55	22.4
	Secondary	127	51.6
	Tertiary/University	64	26
TOTAL (n)		**246**	**100**
Sex	Male	20	8.1
	Female	226	91.9
TOTAL (n)		**246**	**100**

Field Data (2024)

4.2. Findings from interviews (Qualitative)

The researcher asked the respondents from selected MFIs to surface their opinions and challenges that face them when dealing with group lending. The following are the answers given.

"Most of us (MFIs) face compliance burden. Adhering to evolving regulatory requirements can be resource-intensive, particularly for smaller MFIs. The cost of compliance and the need for regulatory advocacy are ongoing operational concerns. This affects all modes of lending including group lending."

Some of the interviewees pointed technology as a major challenge to them. One officer said that:

"Group lending is a very good model of lending as it reduces default possibilities. Sometime we wish to extend this service to remote areas but inadequate or unreliable internet connectivity hinders that. You need to use digital financial services to operate the group lending at minimal cost…"
Furthermore, repayments handling was also mentioned to be a challenge to MFIs when handling group lending schemes.
"….you know these group lending models often involve frequent loan repayment schedules. Coordinating and collecting repayments from multiple group members on time can be operationally complex. It's very different when one manages an individual lending portfolio".

"We are also faced with limited access to credit information, making it challenging to assess the creditworthiness of potential borrowers accurately. This can lead to higher default rates and increased credit risk as well."
These interview replies fundamentally demonstrate that technology, information asymmetry, regulatory environment and operational complexities are the main challenges facing MFIs in group lending models. These aligns with the institutional theory on the effect of external environment and regulations on organization's operations. These results validate the challenges that previous study noted in the literature.

4.3. Borrowers' opinions on group lending schemes (Quantitative analysis)

This part explores the complex world of group lending programs, paying particular attention to the viewpoints of borrowers and their thoughts on the difficulties that these financial models present. Although group lending is frequently praised for its ability to increase financial inclusion and reduce risks, it is not without its difficulties. This study clarifies the complex difficulties borrowers confront in group lending arrangements by thoroughly examining their experiences.

4.3.1. Borrowers' opinions on group dynamics

Borrowing groups sometimes face internal conflicts related to loan distribution, repayment responsibilities, or disputes among members. These conflicts can disrupt group cohesion and impact the success of group lending programs. The purpose of the question was to determine which of the three group dynamic concerns are thought to be major challenge to group lending. The results of the survey are shown in Figure 1.

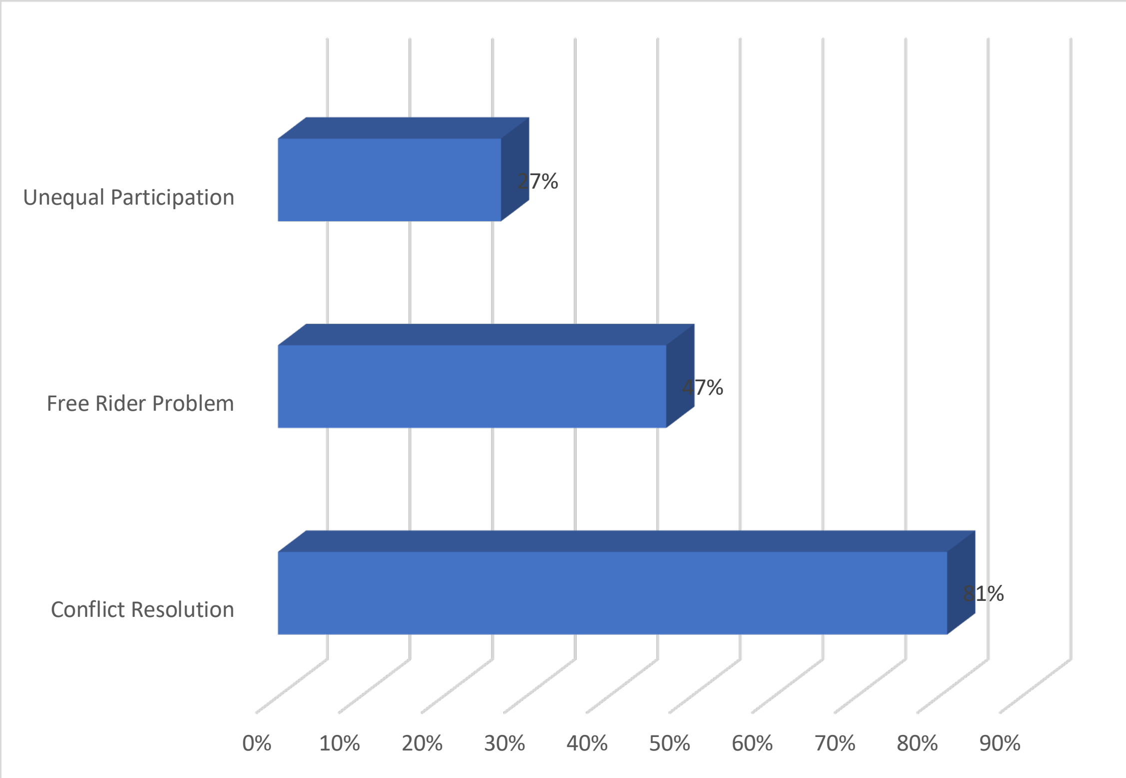

Figure 1: Group Dynamics

The results make it evident that 81% of respondents agreed that conflict resolution is a major challenge to group lending. This implies that efficient conflict resolution is essential for reducing problems like conflicts, arguments over loan terms, and shared duties. This is also found by Chaturvedi and Sharma, 2019 where they suggest to increase trust to reduce conflicts. Furthermore, 47% of respondents supported the free rider problem as a group lending challenge while 27%% of respondents believed that unequal participation is a challenge that faces borrowers in group lending. The Free Rider Problem refers to a group dynamic where certain members benefit from group lending resources without contributing enough. To improve group lending programs, measures like monitoring systems, fair contribution methods, and incentives can be implemented to prevent free rider behavior. Similarly, Unequal Participation is a problem in group dynamics where members don't participate fairly. This is supported by Malamsha, (2023) where he found that equal participation can reduce group lending challenges among borrowers. To improve group lending programs, strategies like monitoring participation levels, implementing fair decision-making processes, and providing support to underrepresented members may be necessary. These results concur with the findings obtained by (Tegambwage and Kasoga,2022).

4.3.2. Borrowers' opinions on trust challenges

The term "trust erosion" describes the gradual deterioration of trust within a group. From the findings, it is evident that 78% of the respondents agreed that trust erosion is a major trust challenge facing borrowers in group lending. From a practical standpoint, this means that group financing programs cannot succeed long-term unless Trust Erosion is addressed and prevented. Berge and Garcia, (2021) found that when trust is eroded in groups it increase group management complexities.

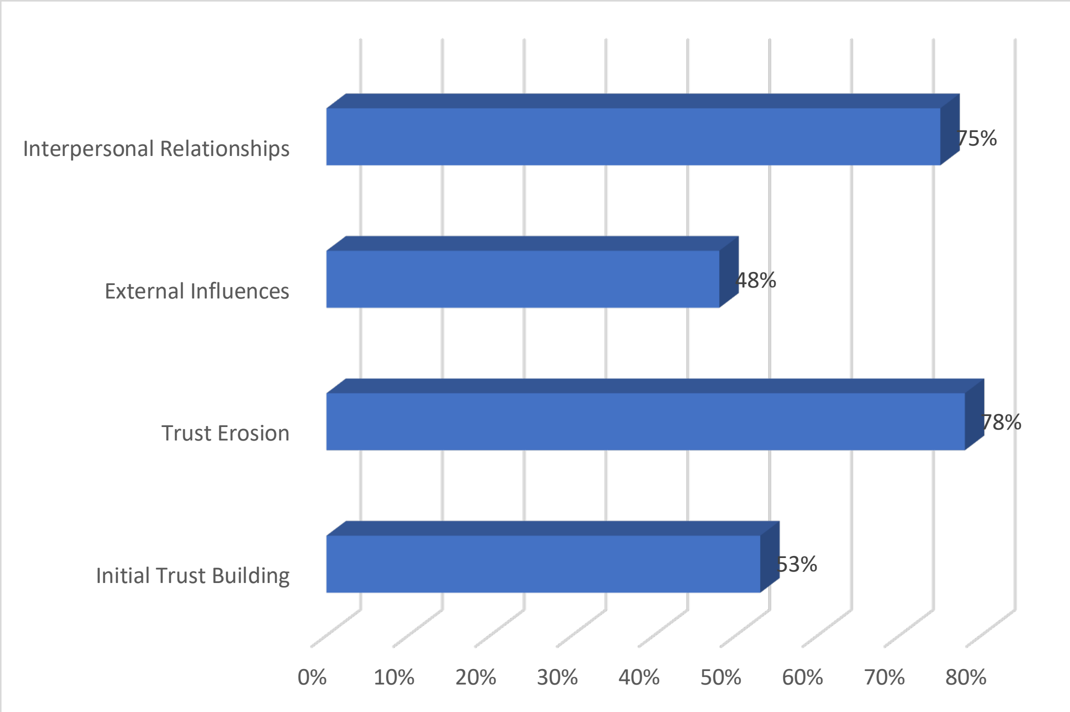

Figure 2: Trust Challenges

Interpersonal relationships have been identified as a second major trust challenge facing borrowers in group lending. This has been supported by 75% of the respondents. The term "interpersonal relationships" describes the nature and dynamics of bonds between individuals in a group. From a practical standpoint, this emphasizes how crucial it is to cultivate positive interpersonal relationships within the group in order to ensure that group lending programs succeed. Trust within borrowing groups is often closely tied to interpersonal relationships. Differences in social, cultural, or economic backgrounds among group members can impact trust dynamics. Building trust requires addressing these differences sensitively.

The variable "Initial Trust Building" pertains to the building of trust among group members at the onset of the lending process, specifically in relation to borrowers involved in group lending. 53% of the respondents pointed out that Initial Trust Building is one of the trust challenges facing borrowers in group lending. From a practical standpoint, this means that building trust between group members at the outset of the lending relationship is essential to reducing difficulties in group financing. Open communication, clear expectations, and group cohesion can enhance trust, support borrowers, and ensure the sustainability of group lending initiatives.

Regarding External Influences, 48% identified it as a challenge in group lending that relates to trust issues. This suggests that other variables, such as the state of the economy, modifications to regulations, or other outside influences, may have a big impact on the difficulties borrowers face when using group lending. Gracia et al., (2019) found that trust is essential for ensuring that group members collectively assume responsibility for loan repayments. This supports the findings of this study.

Challenges related to group dynamics and trust relate to social capital theory as it highlights the role of social networks, trust, and social cohesion within groups, which are fundamental aspects of group lending in microfinance.

5. Conclusion and Recommendations

5.1 Conclusion

Group Dynamics and Trust: The study revealed that group dynamics and trust among members play a pivotal role in the success of group lending programs. Trust-building mechanisms, regular communication, and shared responsibility are essential for maintaining high loan repayment rates. Group dynamics may be affected by unequal participation levels among members. Some individuals may be more engaged and committed to the group's success, while others may contribute less effort, creating disparities in responsibilities and contributions. Addressing these challenges related to group dynamics and trust is crucial for the success of group lending programs. Also, trust can be influenced by external factors, including perceptions of the microfinance institution's transparency and fairness. If group members perceive that the MFI or its staff are not acting in their best interests, it can undermine trust in the lending process. Microfinance institutions should consider implementing training programs and conflict resolution mechanisms to strengthen group cohesion and trust among members. Additionally, ongoing communication and support from MFIs can help prevent trust erosion and maintain a positive lending environment within borrowing groups.

Operational Challenges: MFIs face significant operational challenges in reaching remote and underserved areas, which often result in increased costs and logistical difficulties. Innovative solutions, including mobile banking and agent banking, are emerging as effective ways to address these challenges.

Regulatory Environment: The regulatory framework governing microfinance in Tanzania exerts a considerable influence on MFI operations. Changes in regulations and compliance requirements can pose challenges, particularly for smaller MFIs. Advocacy for a conducive regulatory environment that balances client protection with operational flexibility is essential.

5.2 Recommendations

The study found that challenges related to group lending can impact the financial sustainability of MFIs. Addressing these challenges requires a combination of strategies, including investing in technology, expanding training programs for staff, collaborating with regulatory authorities, and exploring alternative delivery channels. MFIs should consider tailoring their operational approaches to the specific challenges faced in each region and continuously monitor and adapt their strategies to improve efficiency and effectiveness. Based on the research findings and conclusions, the following recommendations are offered to enhance the effectiveness of group lending models in Tanzanian microfinance institutions:

Capacity Building and Training: MFIs should invest in training programs for staff and clients to enhance group dynamics, communication, and trust-building. Training should focus on financial literacy, entrepreneurship, and conflict resolution within borrowing groups. In the context of loans, strategies to uphold and deepen trust over time, such as consistent communication, dispute resolution procedures, and continuous relationship-building initiatives, may be crucial to reducing difficulties and promoting a supportive and cooperative atmosphere among group members.

Innovative Technologies: Embrace innovative technologies, such as mobile banking and digital financial services, to overcome operational challenges in remote areas. This can expand outreach and reduce operational costs.

Collaboration with Regulatory Authorities: MFIs should engage proactively with regulatory authorities to advocate for a regulatory environment that supports responsible microfinance practices while allowing operational flexibility. Regular dialogue can foster a better understanding of the sector's needs.

Risk Management: Develop comprehensive risk management strategies to mitigate loan default risks and protect the financial sustainability of MFIs. This includes diversifying loan portfolios and implementing effective credit risk assessment mechanisms.

Research and Continuous Improvement: Continuously monitor and evaluate the impact of group lending programs. Invest in ongoing research to identify emerging challenges and opportunities. Use research findings to adapt and improve lending models.

Client-Centered Approach: Place clients at the center of program design and implementation. Tailor group lending models to meet the unique needs and preferences of clients, ensuring that they remain at the forefront of financial inclusion efforts.

This study underscores the importance of addressing group lending challenges to enhance the effectiveness and sustainability of microfinance institutions in Tanzania. By implementing the recommended strategies and fostering a supportive regulatory environment, MFIs can navigate these challenges and continue to play a vital role in promoting financial inclusion and economic empowerment in the region.

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