STUDYING MICROFINANCE IN AFRICA: THEORETICAL CONSIDERATIONS

Victor Otieno Ogada – Ondřej Dvouletý

Abstract

Microfinance in Africa has emerged as a key tool for financial inclusion, poverty reduction, and women's empowerment, yet its impact remains contested. Furthermore, the scholarly discussion on the topic remains fragmented into several theoretical approaches, which are not systematically studied and placed into a single conceptual framework. This research identified several previously published studies dealing with microfinance in Africa. The article reviews their theoretical approaches and highlights their relevance to the microfinance literature. The study describes various theoretical approaches, including social capital, group lending theories, poverty alleviation theory, financial inclusion theory and women's empowerment theory. Besides, the article reflects upon the positive experience with the mobile money platforms like M-Pesa and M-Shwari in Kenya, which have reduced transactional costs for accessing money from lenders, and at the same time, they have extended financial services to the remote rural areas. Overall, it is argued that the widespread use of financial technological innovations can serve as a chance to further reduce poverty in Africa.

Key words: microfinance, Africa, financial inclusion, poverty alleviation

JEL Codes: O18, L26

Introduction

The idea of microfinance became popular after the achievements of the Bangladesh Grameen Bank, which Muhammad Yunus established in 1976. It started to provide small loans to marginalized groups of individuals (such as poor women) with the aim of reducing their poverty. This model showed how a well-thought-out financial service could transform a vulnerable community by empowering them to access finance and improve their well-being through income generation.

In this ideological way, microfinance in Africa serves as a tool to promote financial inclusion, it helps to reduce poverty and supports women's economic activity through business start-ups and jobs creation. Founding microfinancial institutions (also called MFIs) in the African context was supported by both public institutions, international investors and non-governmental institutions to bring access to the financial services of the widest possible range of individuals and enhance their economic self-sufficiency. In this way, MFIs have both economic and social objectives, and they need to be economically sustainable in the long term to follow their socially beneficial missions. The scholarly community became interested in the topic, trying to understand MFIs, their day-to-day operational challenges, and conflicts among the members of the MFIs, and identify strategies to foster economic efficiency and deliver examples of best practices to the attention of stakeholders and policymakers.

However, a complex theoretical framework of microfinance is missing up to date, and the existing theories are fragmented. This research aims to systematically study the previous works, identify the key theories and highlight their relevance to the microfinance literature.

1 Methodology

This study employs a systematic literature review methodology to synthesize existing theories on microfinance in Africa. The methodology draws on established protocols for systematic reviews (Elsbach and van Knippenberg, 2020) from peer-reviewed articles, books, institutional reports, and case studies published between 2000 and 2023. The authors discovered more than 50 essential references in Web of Science and Google Scholar databases through targeted keyword searches like "microfinance Africa," "poverty alleviation," "microcredit in Africa," and "financial inclusion". Out of the studied articles and research reports, the authors narratively outline the most frequently used theoretical approaches and describe their relevance for the microfinance literature in the African context.

2 Main theoretical approaches and findings from previous studies

We begin this narrative overview by emphasizing social capital and group lending theories, which explain how microfinance institutions (MFIs) leverage social relationships to provide financial access to borrowers without traditional collateral (Chmelíková et al., 2019). These concepts assume that trust, mutual accountability, and social networks are vital in ensuring loan repayment and strengthening the financial discipline of borrowers. Cassar et al. (2007) or, more recently, Babajide et al. (2022) explain that this is crucial in the African context because the poorest inhabitants fail to have access to formal banking, especially in rural areas. In this way, microfinance institutions present an opportunity to enhance their financial inclusion.

However, despite the strong social ties within and outside of the microfinance organizations, there are issues with free riding, as some individuals do not repay the loans and rely on others to make sure/pay so that the institution does not go bankrupt as a whole. This behaviour also goes hand in hand with the moral hazard issue and undermines the social ties among the community, which needs to respond by increasing monitoring of the borrowers and, alternatively, requesting more collateral, which results in the institution becoming less efficient. In this way, the original goals of the organization are diminished, and those without collateral or a financial history would remain excluded from access to the financial capital. The role of trust in Rotating Savings and Credit Associations (ROSCAs), mutual collaboration and discipline among the community members represent thus a critical success factor (Tadele et al., 2021; Zambrano et al., 2023).

Buchenrieder et al. (2019) explain the application of the poverty alleviation theory in the context of Cameroon small farm households. Poverty alleviation theory is basically the theory of change for enhancing the poor's ability to generate their own income, thus leaving poverty, improving food security and income and in the long-term, becoming financially sustainable, building upon the Grameen Bank's successful model from the Bangladesh context. However, the results are not always positive, because in many cases, the poor households still struggle, especially when the loans are too small to meet the requirements, and the repayment terms are too short. Furthermore, households often lack fundamental financial literacy and prior market information. In addition, climatic conditions like drought and floods significantly influence the success of farming productivity and its economic outcomes. This clearly shows that, as much as microfinance can be a tool for poverty reduction, its successful implementation is moderated by several factors such as training, financial literacy and education, infrastructure availability, market access, and climate development (Buchenrieder et al., 2019).

A specific approach towards poverty reduction in rural Africa is adapting financial inclusion theory, which fosters economic participation of socially or culturally underrepresented groups of individuals, such as women, through the provision of loans, education and insurance, thus reducing inequality. The current literature revolves around combining microcredit initiatives with modern financial innovations such as Fintech (Banna et al., 2022). An example of good practice is the low-cost transactions project M-Pesa (money transfer platform), which was acknowledged even in the prestigious *Science* journal as an example of a good initiative to reduce poverty, as noted by Bateman et al. (2019). Though this has been celebrated as an invention that enables faster and easier cash transfer from lender to borrower, its success is greatly hindered by low network coverage in rural areas and low digital literacy among the users, underlining the importance of well-established infrastructure and technical (digital) education, being a prerequisite for the widespread use of Fintech tools.

Specific attention within Africa is dedicated to women, enhancement of their decision-making power, social status and economic independence, which is described by the women's empowerment theory, dedicated to the promotion of access to financial services through microfinance, as evidenced by Asongu et al. (2024) to reduce female unemployment strongly. Okello et al. (2025) provide recent insights from Uganda, showing that microfinance institutions are positively impacting the existence of women entrepreneurship in rural areas. According to the study by Sanrquist et al. (2021), who studied the situation in Nairobi (Kenya), observed that supporting women with business plan training and a small initial loan to start a business brought positive findings in terms of profit increase and decreased violence against women and children in the household, as well as women's self-efficacy. Bagire and Namagembe (2020) accumulated positive experience and successful case studies from Uganda's Village Savings and Loans Associations (VSLAs) programme. In this way, empowerment theory helps to explain how vulnerable women in society can move to a position to comfortably run their businesses and make decisions in their household, and cement their position in the community. However, the picture does not look entirely positive as per the observations documented above. Deep-rooted gender inequalities, cultural barriers, and a lack of support from various institutions have been among the key limiting factors. In some cases, men can still control loans borrowed in women's names, or they are forced to prioritize family needs over the intended purpose that necessitated borrowing, subjecting these women to loan default and dragging them into financial bad books and history for future borrowing. This suggests that microfinance alone cannot solve gender inequality, but it is important when combined with education and tailored policy actions.

The setup of microfinance institutions can be promoted by public subsidies or grants from international organizations, but each of the microfinance organizations needs to reach a situation where the economic activity of the MFI covers the operational costs, more loans can be provided to the target groups, and no additional public support is needed. The financial sustainability principle covers this, as explained by Kinde (2012) in the case of Ethiopia.

As already outlined by Banna et al. (2022) and Derdabi and Dvouletý (2024), the widespread use of digital financial technologies (such as M-Shwari or M-Pesa) reduces transaction costs, opens up the market for affordable lending opportunities (such as Branch or VSLAs), fosters the diffusion of innovative solutions to rural communities and helps in reducing poverty.

Conclusion

This article has shown that the existing research on African microfinance research combines several theoretical approaches, such as social capital, group lending theories, poverty alleviation theory, financial inclusion theory and women's empowerment theory. The study explains the most prevailing ones in the previous studies, showing that it is necessary to use multiple approaches to understand all aspects of microfinance institutions, their effectiveness and their roles in reducing poverty. Examples of good practices identified in the previous literature are noted in the text.

The financial inclusion theory is backed strongly by advancements in digital services like M-Pesa, yet it struggles in areas lacking infrastructure, especially Internet coverage. The Women's Empowerment Theory holds potential but needs additional measures to tackle deep-rooted gender challenges, indicating that merely providing credit cannot eliminate these structural barriers without further systematic (institutional) support. It is argued that the scholarly community and practitioners need to integrate several theoretical frameworks while also being responsive to local conditions.

This article attempts to combine those fragmented theoretical perspectives and diverge in explaining African microfinance outcomes. By expanding on the combined influence of social capital theory, group lending theory, poverty alleviation theory, financial inclusion theory, and women's empowerment theory, this study summarises existing debates and offers a platform for future researchers and policy practitioners to build upon.

To progress microfinance expansion in Africa further, the policy objectives need to be stated clearly, set up in measurable indicators and focused on specific groups of target audiences, including those in poverty or women, yet the progress on the outcome indicators needs to be continuously monitored and evaluated as outlined by OECD (2023), ensuring the highest cost-effectiveness of the microfinance promoting initiatives.

References

Asongu, S. A., Zogo, T. E., Mete, M. C., & Mensah, B. D. (2024). Not all that glitters is gold: Financial access, microfinance, and female unemployment in sub-Saharan Africa. *World Affairs*, *187*(4), 421-436.

Babajide, A. A., Obembe, D., Solomon, H., & Woldesenbet, K. (2022). Microfinance and entrepreneurship: the enabling role of social capital amongst female entrepreneurs. *International Journal of Social Economics*, *49*(8), 1152-1171.

Bagire, V., & Namagembe, S. (2022). Savings Groups in Uganda. In *Transforming Africa: How Savings Groups Foster Financial Inclusion, Resilience and Economic Development* (pp. 261-269). Emerald Publishing Limited.

Banna, H., Mia, M. A., Nourani, M., & Yarovaya, L. (2022). Fintech-based financial inclusion and risk-taking of microfinance institutions (MFIs): Evidence from Sub-Saharan Africa. *Finance Research Letters*, *45*, 102149.

Bateman, M., Duvendack, M., & Loubere, N. (2019). Is fin-tech the new panacea for poverty alleviation and local development? Contesting Suri and Jack's M-Pesa findings published in Science. *Review of African Political Economy*, *46*(161), 480-495.

Buchenrieder, G., Nguefo Gnilachi, J., & Benjamin, E. O. (2019). Poverty alleviation through microcredit in Sub-Saharan Africa revisited: New evidence from a Cameroonian village bank, the Mutuelle Communautaire de Croissance. *Agricultural Finance Review*, *79*(3), 386-407.

Cassar, A., Crowley, L., & Wydick, B. (2007). The effect of social capital on group loan repayment: evidence from field experiments. *The Economic Journal*, *117*(517), F85-F106.

Chmelíková, G., Krauss, A., & Dvouletý, O. (2019). Performance of microfinance institutions in Europe—Does social capital matter?. *Socio-Economic Planning Sciences*, *68*, 100670.

Derdabi, A., & Dvouletý, O. (2024). Sustainable innovations for rural Africa: Case studies from Nigeria and Tanzania. *Journal of the International Council for Small Business*, *5*(4), 345-371.

Elsbach, K. D., & van Knippenberg, D. (2020). Creating high-impact literature reviews: An argument for 'integrative reviews'. *Journal of management studies*, *57*(6), 1277-1289.

Kinde, B. A. (2012). Financial sustainability of microfinance institutions (MFIs) in Ethiopia. *European Journal of business and Management*, *4*(15), 1-10.

OECD. (2023). *Framework for the Evaluation of SME and Entrepreneurship Policies and Programmes 2023*, OECD Studies on SMEs and Entrepreneurship, OECD Publishing, Paris, https://doi.org/10.1787/a4c818d1-en.

Okello Candiya Bongomin, G., Semukono, F., Baleke Yiga Lubega, J., & Yourougou, P. (2025). Does financial experience of women owners of micro businesses promote microfinance lending and their continued existence in rural Uganda?. *Asian Journal of Economics and Banking*, ahead-of-print, https://doi.org/10.1108/AJEB-01-2024-0008

Sarnquist, C. C., Ouma, L., Lang'at, N., Lubanga, C., Sinclair, J., Baiocchi, M. T., & Cornfield, D. N. (2021). The effect of combining business training, microfinance, and support group participation on economic status and intimate partner violence in an unplanned settlement of Nairobi, Kenya. *Journal of interpersonal violence*, *36*(7-8), 3903-3921.

Tadele, H., Roberts, H., & Whiting, R. (2022). Microfinance institutions' risk and governance in Sub-Saharan Africa. *International Journal of Social Economics*, *49*(3), 449-469.

Zambrano, A. F., Giraldo, L. F., Perdomo, M. T., Hernández, I. D., & Godoy, J. M. (2023). Rotating savings and credit associations: A scoping review. *World Development Sustainability*, *3*, 100081.

Contact

Victor Otieno Ogada
Department of Economics and Development, Czech University of Life Sciences
Kamýcká 129, 165 00 Prague, Czech Republic
ogada@ftz.czu.cz

Ondřej Dvouletý
Department of Entrepreneurship, Prague University of Economics and Business
W. Churchill Sq. 4, 130 67 Prague 3, Czech Republic
ondrej.dvoulety@vse.cz