

# Financial Inclusion or Financial Risk? Rethinking Microfinance Governance for Equitable Development in Rural Economies

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## Abstract

Microfinance has long been celebrated as a financial innovation that promotes inclusion, poverty alleviation, and women's empowerment in rural economies. However, growing evidence indicates that in the absence of sound governance, microfinance institutions (MFIs) may inadvertently expose marginalised communities to systemic financial risks. This conceptual paper examines the paradox of microfinance, where efforts to enhance access to credit may exacerbate economic precarity through over-indebtedness, opaque lending practices, and weak institutional oversight. Drawing from three theoretical pillars—Inclusive Governance, Risk-Based Financial Regulation, and Social Capital Theory this study proposes an integrative framework for rethinking microfinance governance. The framework highlights the need to embed transparency, participatory oversight, and community-based risk assessment into MFI operations. It argues that without institutional reforms to address regulatory gaps and power imbalances, microfinance may fail to deliver on its developmental promise. Through a review of global trends and contextual illustrations from Southeast Asia, the paper contributes to policy discourse on how microfinance can move beyond financial access to become a driver of equitable development. It concludes with a call for hybrid governance models that balance financial innovation with social safeguards to protect the most vulnerable borrowers.

**Keywords:** Financial Inclusion, Financial Risk, Microfinance Governance, Equitable Development, Economies

**Introduction**

Microfinance has become one of the most frequently endorsed tools in the global development discourse for advancing financial inclusion among low-income and underserved populations. Originally designed to address credit inaccessibility among the poor, especially women, microfinance is now a multibillion-dollar industry operating in both formal and informal economic systems (World Bank, 2023). Microfinance institutions (MFIs) have grown from grassroots cooperatives to complex financial organizations, offering microcredit, savings, insurance, and entrepreneurship training. The foundational premise of microfinance rests on the belief that small-scale financial services can foster self-reliance, stimulate microenterprise development, and contribute to poverty alleviation in rural and marginalised areas.

While microfinance has achieved some undeniable successes, particularly in facilitating access to capital for women and rural households, its evolution has also given rise to new tensions and contradictions. In recent years, academic and policy researchers have increasingly questioned whether microfinance genuinely serves as a vehicle for inclusive development or whether it reinforces cycles of poverty through over-indebtedness, exploitative lending conditions, and poor regulatory oversight. Some scholars refer to this contradiction as the "microfinance paradox," a situation where institutions designed to empower the poor end up burdening them with unsustainable debt, social pressure, and financial precarity.

Several high-profile cases from South Asia and Southeast Asia have brought attention to these contradictions. For instance, in Cambodia, rapid microcredit expansion without corresponding borrower protections has led to land dispossession and coerced asset sales (LICADHO, 2021). In India, aggressive loan recovery tactics in Andhra Pradesh triggered a spate of borrower suicides, prompting state intervention and tighter regulation. These cases highlight a troubling pattern: the absence of effective governance mechanisms in MFIs can transform access to credit from a developmental lifeline into a form of structural vulnerability. Particularly in rural areas where formal regulatory institutions are weak, MFIs often operate with minimal accountability and transparency.

From a governance perspective, this situation raises significant concerns. In many developing economies, MFIs are not subject to the same level of scrutiny or regulation as traditional financial institutions. This regulatory blind spot allows practices such as inflated interest rates, opaque loan terms, and coercive group lending to proliferate unchecked. While central banks and financial regulators have made strides in extending oversight to MFIs, many continue to function in a legal grey area, particularly smaller, community-based lenders who may lack the infrastructure or capacity to meet formal compliance requirements. This institutional ambiguity can have serious consequences for borrowers, who often lack the financial literacy or legal recourse to challenge unfair practices.

Moreover, the governance of MFIs often lacks inclusivity. Decision-making is typically centralised among board members or donors, with minimal input from the very communities they aim to serve. Borrowers are rarely represented in governance structures, and grievance redress mechanisms, if they exist, tend to be bureaucratic, inaccessible, or ineffective. This top-down model undermines the core principles of participatory development and social accountability. It also risks eroding the social capital that MFIs rely on, particularly in group

lending models where peer pressure and communal enforcement play a key role in loan repayment. When borrowers feel excluded from governance processes, trust in the institution deteriorates, and the sustainability of microfinance as a development tool is compromised.

At the same time, microfinance's positive contributions cannot be dismissed. Numerous impact studies have demonstrated improvements in household consumption, women's agency, and small enterprise formation resulting from microfinance access. However, such benefits tend to be unevenly distributed and highly context-dependent. In regions with supportive regulatory environments and strong institutional capacity, MFIs have been able to deliver measurable social outcomes. In contrast, in fragile states or remote rural areas, the same models have sometimes intensified debt cycles and created new forms of dependency. This suggests that the success or failure of microfinance as an inclusive tool hinges not merely on its financial architecture, but on the strength and design of its governance systems.

Against this backdrop, this paper proposes a conceptual rethinking of microfinance governance in rural economies. Rather than viewing microfinance solely through the lens of access and outreach, the study emphasizes the need to interrogate how governance frameworks, including rules, accountability systems, participation mechanisms, and regulatory oversight, shape the experience and outcomes of microfinance. It argues that without institutional reforms rooted in inclusive governance and risk-based regulation, microfinance may fall short of its developmental promise or, worse, become an amplifier of rural vulnerability.

To build this argument, the paper synthesizes three interrelated theoretical frameworks: Inclusive Governance, which focuses on participatory and transparent institutional arrangements; Risk-Based Financial Regulation, which aligns oversight intensity with institutional exposure; and Social Capital Theory, which examines the role of trust and networks in shaping collective financial behaviour. These frameworks inform a new conceptual model titled Risk-Informed Inclusive Governance that seeks to balance financial innovation with social protections, particularly in under-resourced rural settings.

### **Problem Statement and Research Gap**

Despite decades of investment and optimism surrounding microfinance, global financial inclusion data reveals persistent challenges that disproportionately affect rural and marginalised populations. According to the World Bank's Global Findex Database (2021), around 1.4 billion adults globally remain unbanked, with nearly 76% of them residing in developing countries. While microfinance has helped reduce financial exclusion, particularly in South and Southeast Asia, it has also created new vulnerabilities due to regulatory blind spots, aggressive lending practices, and inadequate borrower protection mechanisms.

A core problem lies in the dichotomy between financial access and financial stability. In many countries, MFIs have successfully expanded access to credit but have not been equally effective in ensuring responsible lending and inclusive governance. For example, Cambodia's microfinance sector often cited as a model for outreach had a combined microloan portfolio of USD 11.8 billion by 2022, with an average loan size exceeding USD 4,000 per borrower (LICADHO, 2022). This is more than double the national GDP per capita, raising concerns over

household over-indebtedness and asset liquidation, especially among rural borrowers. A 2021 LICADHO report documented cases of families being forced to sell land or homes to repay loans, prompting international scrutiny over the sector's governance and social impact.

Similar concerns have surfaced in Latin America. In Mexico, the collapse of microfinance giant Ficrea in 2014—due to fraud and mismanagement, exposed the lack of transparency and regulatory oversight within the sector. Over 6,800 depositors lost their savings, sparking public protests and a crisis of trust in microfinance institutions (Reuters, 2015). In India, the 2010 Andhra Pradesh microfinance crisis further underscored these systemic risks. Reports of borrower suicides triggered by aggressive loan recovery practices and coercive group pressure led the state government to enact emergency ordinances to halt MFI operations. Subsequent investigations revealed a lack of borrower education, weak regulatory monitoring, and profit-maximising behaviours by MFIs that undermined the developmental mission of financial inclusion (Roodman, 2012).

These international examples highlight a common theme: the governance architecture of MFIs often lags behind their financial expansion. Many MFIs are not subject to the same consumer protection, transparency, or risk-based capital regulations imposed on formal financial institutions. Furthermore, in rural settings, institutional capacity to monitor and enforce financial regulations is typically weak, allowing informal practices, unregulated interest rates, and opaque loan structures to persist unchecked.

Research shows that financial vulnerability among microfinance borrowers is not merely a result of poor financial literacy or moral hazard, but rather the consequence of institutional and regulatory gaps. For instance, Carpena et al. (2011) found that financial education alone had limited impact on borrower outcomes unless complemented by structural reforms such as contract standardisation and transparent interest disclosures. Similarly, research by D'Espallier, Guérin, and Mersland (2011) indicated that while women are overrepresented in MFI client portfolios, their decision-making power over loan use remains limited, especially in patriarchal rural environments, further complicating the narrative of empowerment.

Despite this growing body of empirical evidence, much of the academic literature continues to frame microfinance performance in terms of repayment rates, outreach metrics, and portfolio sustainability. While these indicators are important, they mask deeper governance issues related to institutional accountability, borrower participation, and social risk assessment. There remains a significant gap in integrating governance-based approaches into the analysis of microfinance impact, particularly in conceptualising how inclusive governance structures and risk-based financial regulation could transform MFIs from transactional lenders to development-oriented institutions.

Moreover, existing regulatory frameworks often take a top-down approach, focusing on licensing and financial reporting without incorporating participatory governance mechanisms. Community voices are frequently excluded from loan product design, grievance redress processes, and performance evaluations. In rural economies, where informal networks and social capital play a critical role in financial behaviour, the absence of culturally embedded governance practices undermines the sustainability and legitimacy of microfinance initiatives.

This paper responds to these gaps by proposing a conceptual framework that centres on Risk-Informed Inclusive Governance. It integrates insights from inclusive governance theory, financial regulation, and social capital scholarship to reimagine the microfinance institution as a democratic and risk-aware entity. The objective is not to reject microfinance but to ensure that it evolves into a system that empowers rather than endangers the very populations it aims to serve.

## **Literature Review and Theoretical Foundations**

### *Inclusive Governance*

Inclusive governance in microfinance is increasingly recognized as a critical factor to promote fair development, especially for vulnerable populations in rural economies. The intersection of governance and microfinance offers a framework to understand how participation in improved decision-making can empower marginalised communities and promote economic equity. This literature review plunges into the multifaceted role of inclusive governance in microfinance, analyzing its implications for fair development and the wider effects on rural economies.

At the heart of inclusive governance in microfinance is the active participation of various stakeholders, in particular marginalized communities. According to Ahmad and Islam (2024), empowerment and participation are key strategies for inclusive development. Their research stresses that allowing local communities to have a voice in decision-making processes strengthens social cohesion and guarantees that financial services are adapted to the needs of vulnerable populations. This aligns with Baskoro (2025), which explains how good village governance strategies which prioritize transparency and responsibility are essential to promote inclusive rural development. The integration of these elements improves not only confidence but also mobilizes local knowledge, which is essential to the effectiveness of microfinance initiatives.

Community representation within financial institutions, such as rural cooperative banks, plays an important role in the training of governance structures which prioritize the needs of the community. As detailed by Amoako and Asuamah Yeboah (2023), when the voices of the community are recognized in financial decision-making, the resulting financial products are more likely to be aligned with the aspirations and realities of the local population. This representation is fundamental in the fight against systemic inequalities, ensuring that microfinance serves as a tool to raise vulnerable groups rather than perpetuating their marginalization.

Inclusive governance also includes the structural dimensions of power and equity. Sánchez-Soriano et al. (2024) argue that inclusive governance goes hand in hand with social justice, because it allows communities to challenge the traditional dynamics of power and to engage in active decision-making. The authors point out that the equitable distribution of resources and power leads to sustainable development results. In rural economies, this empowerment is crucial because it allows communities to take up their socio-economic challenges with greater agency.

By examining local governance, Awoonor (2025) gives an overview of the way in which community participation influences rural development projects in Nigeria. The literature

review shows that active participation in local governance improves not only the effectiveness of microfinance initiatives, but also cultivates a feeling of belonging among the members of the community. This participatory approach generates confidence in financial institutions and promotes a collaborative environment where beneficiaries can defend their development needs without fear of exclusion.

Bardhan et al. (2021) also contribute to the discourse by proposing an integrated framework which analyzes the performance indicators of microfinance institutions from the point of view of several actors. Their research highlights the importance of assessing the effectiveness of microfinance governance in terms of inclusiveness and community engagement. Using a multipartite objective, it becomes obvious that sustainable performance is complexly linked to the way in which financial institutions incorporate the votes of local populations.

Governance structures within microfinance institutions, as they are explored by Rasel and Win (2020), reveal important implications for decision-making processes. Their systematic review emphasizes that the governance of microfinance must be reactive and adaptive to the needs of the community. Institutions that adopt an inclusive governance model are better placed to promote an environment where vulnerable populations can not only access financial resources but also participate in training on their terms of engagement. This adaptive governance can considerably mitigate the risks of exploitation, which often accompany microfinance in rural areas.

The role of capital impact, as articulated by Udohaya (2025), shows how innovative financial solutions can allow the means of the poorly served. The author argues that promoting an inclusive approach to impact investment in microfinance leads to better results for economic equity. When communities have participation in the financial decision-making process, the resulting impact capital can open the way to sustainable development that reflects community values and priorities.

Inclusive governance in microfinance plays a vital role in improving fair development for vulnerable populations in rural economies. Thanks to a reinforced participation in decision-making processes, local communities can better plead for their needs and aspirations. The literature highlights the importance of transparency, representation and empowerment, because they collectively contribute to the creation of more equitable financial systems. By adopting inclusive governance, microfinance can transcend its traditional roles, transforming into a powerful catalyst for social justice and economic empowerment in rural contexts. The positive implications of these governance models highlight the need for research and current practice to ensure that the benefits of microfinance reach those most in need.

#### *Risk-Based Financial Regulation*

The effectiveness of staggered governance in microfinance institutions (IMF) has attracted more and more attention in the field of financial regulation, particularly in relation to exposure to risk, the volume of loans and the influence of global regulatory frameworks such as those established by the Basilea Committee and the World Bank. This literature review evaluates these elements to present a nuanced understanding of how staggered governance structures can optimize the functioning of IMFs and improve financial stability.

Escalonada governance in IMF refers to a hierarchical structure that allows organizations to administer variable risk levels more effectively. This approach is critical, since IMFs often serve the most vulnerable populations and face significant risk exposure due to the nature of their clients, which may lack formal credit history or stable income (Adrian, 2018). Consequently, these institutions must navigate a complex risk network, which may include credit risk, operational risk and market risk. In line with this, Apostolik and Donohue (2015) describe that understanding financial risk is essential for any institution that seeks to implement risk-based regulations effectively. They argue that adapting risk management practices to specific operating contexts, especially in low capacity environments, can lead to better financial results.

However, the implementation of staggered governance also raises challenges in terms of aligning these practices with international regulatory standards. The Basel Committee has established a framework that, although well-intentioned, can be too burdensome for smaller IMFs, which can lack resources and the ability to meet (Romano, 2014). This raises the question of whether rigid adherence to Basel regulations helps or hinders the effectiveness of microfinance. For example, Jones (2014) argues that global banking standards can sometimes exacerbate the difficulties that IMF face in low-income countries, which suggests that a unique approach for all could inadvertently suffocate financial inclusion instead of promoting it.

The volume of the loan that IMFs can administer effectively also depends on their governance structures. Effective staggered governance can cultivate a stronger risk management framework, improving the ability of an IMF to expand its loan portfolio while minimizing risk exposure. Newbury and Izaguirre (2019) discuss the implications of supervision based on risk in low capacity environments, and point out that when IMF adopt governance practices that are in accordance with their operational realities, they can increase their volume of loans without significantly increasing their risk profiles. Therefore, this adaptability is crucial to ensure that IMFs can meet the liquidity needs of their customers while maintaining financial stability.

The role of regulatory bodies such as the World Bank is also fundamental in the configuration of staggered governance. The World Bank group emphasizes the need for financial regulation that is sensitive to the local context (ICPs, 2019). This perspective is aligned with the argument against the mechanical adoption of the Basel standards, since it underlines the need for regulations to be adaptable to the different capacities of financial institutions in different geographies. Through initiatives that focus on the concentration of risks and classification of claims, regulatory institutions can improve supervision while promoting an environment conducive to financial stability.

The case of Nepalese commercial banks, as examined by Giri (2020), illustrates the complexities of aligning the national government with the corporate governance mechanisms related to the risk management of Basel. In this context, the adoption of staggered governance structures has allowed these banks to meet the regulatory requirements while effectively managing their loan volumes. Giri's study emphasizes that flexibility in governance is essential to respond to specific regional challenges, such as various borrower profiles and economic conditions.

However, it is still a call to the prudential standards that are reviewed in accordance with international best practices, particularly with respect to risk concentration and supply, as Union mentioned (2019). This is aligned with the point of view that although staggered governance can be beneficial, it must be complemented with sensible regulatory frameworks that promote compliance without compromising financial inclusion. Integration of these considerations can lead to a more resistant financial system capable of supporting broader economic objectives.

The effectiveness of staggered governance in microfinance institutions depends on a delicate balance between mitigating risk exposure and fostering the volume of loans while adheres to international regulatory standards. Although staggered governance has different advantages, such as improved risk management frameworks and the potential of an increase in loan volumes, it must navigate the complex land formed by the Basel Committee and the World Bank regulations. Future research should focus on longitudinal studies that evaluate the impact of personalized governance structures in different regional contexts, further clarifying the ways for financial inclusion and effective stability in the MFIs. When critically evaluating how these various elements interact, interested parties can strive to achieve a balanced regulatory framework conducive to sustainable growth for microfinance institutions.

#### *Social Capital Theory*

The interaction between social capital and institutional responsibility in microfinance, particularly within the framework of group loan models, presents a vital research area. The center of this dynamic is the concept of government, which serves as a fundamental mechanism that can mitigate exclusion and promote financial inclusion between marginalized communities.

The share capital, often characterized by the networks, the norms and the confidence that facilitate collective action, is manifested as a crucial resource in microfinance. In group loan models, share capital plays a double role: it improves the probability of loan reimbursement and creates an environment that supports the solidarity of the borrower (Panda, 2016). This notion is echoed by Indriani, Irawan and Khristiana (2023), who claim that the share capital can significantly increase the solvency of borrowers in the group loan scenarios. Their findings suggest that when people are integrated into solid social networks, it is more likely that it honors their financial commitments, which strengthens the general stability of the group. Therefore, the promotion of social capital through organized groups not only contributes to individual empowerment but also to institutional sustainability.

However, the accumulation of share capital must be complemented with an institutional responsibility framework to ensure that it does not lead to exclusion based on social hierarchies or a dynamic of unequal power within the groups. The governance structure of microfinance institutions (IMF) is critically associated with this aspect. Rasel and Win (2020) emphasize that effective governance is essential to safeguard against the dangers of exclusion and inequality. They postulate that well-governed IMFs can balance the interests of various groups of interested parties, thus democratizing access to financial resources. It is essential that governance structures are designed to be inclusive, thus reflecting the collective voice of all group members, particularly the most marginalized.

In addition, Tahmaebi and Askaribezaeh's research (2021) highlights the need to promote social networks that increase share capital and at the same time improve institutional performance. Its social media analysis approach indicates that the intertwining of social relations and institutional frameworks can lead to better financial results for borrowers when government structures are transparent and responsible. This is aligned with the ideas presented by Chakrabarty and Bass (2014), who argue that corporate governance practices within IMFs must be robust enough to resist operational challenges and institutional gaps. They affirm that the various compositions of the Board and the commitment of the interested parties are fundamental to ensure that IMF responds to the needs of their clients, which reinforces the notion of responsibility.

The role of share capital extends beyond personal networks to cover a broader community empowerment, particularly in contexts such as Bangladesh, where microfinance has been a fundamental tool for economic elevation. Islam (2016) analyzes how NGOs can take advantage of the share capital to empower communities while holding institutions. The synergy of responsibility and social capital can avoid the marginalization of certain groups, ensuring that all community members can access financial services and participate in economic activities.

In addition, Antohi (2016) defends the transformative potential of microfinance as a means to improve share capital, which in turn encourages innovation and resistance within communities. It suggests that microfinance can serve as a capital catalyst for social initiatives that not only train borrowers but also create inclusive economic environments. This perspective reinforces the argument that social capital and institutional responsibility must function together to ensure that the benefits of microfinance permeate throughout the community, instead of concentrating power and resources within a select group.

Ultimately, the balanced governance of IMF is essential to maintain this delicate interaction between social capital and institutional responsibility. When governance frameworks prioritize inclusion and transparency, they can effectively take advantage of the share capital not only to improve financial performance, but also to guarantee the equitable distribution of resources. The institutions that do not address these dynamics risk perpetuating cycles of exclusion and inequality within their loan policies.

In conclusion, the examination of the interaction between share capital and institutional responsibility within microfinance reveals critical information on how balanced governance can avoid exclusion in group loan models. Adopting an inclusive approach that values the contributions of all interested parties is essential to promote social capital and at the same time hold the institutions. Literature firmly supports the opinion that a nuanced understanding of these relationships is crucial to develop sustainable microfinance practices that empower communities and promote financial inclusion. Continuous research in this area is necessary to explore innovative governance models that can further improve this vital interaction, ensuring that the benefits of microfinance are accessible to all.

Table

*Thematic Discussion Summary*

Theme	Key Insights	Representative Authors
<b>1. Inclusive Governance and Community Empowerment</b>	Inclusive governance enhances participation of marginalized communities in decision-making, aligning microfinance services with local needs. Emphasis on transparency, representation, and empowerment in village and institutional structures fosters social cohesion.	Ahmad & Islam (2024); Baskoro (2025); Amoako & Asuamah Yeboah (2023); Sánchez-Soriano et al. (2024); Awoonor (2025); Bardhan et al. (2021); Rasel & Win (2020); Udohaya (2025)
<b>2. Risk-Based Financial Regulation and Staggered Governance</b>	Staggered governance structures optimize microfinance operations by managing credit and operational risks. Regulatory frameworks like Basel must be context-sensitive to avoid excluding low-capacity IMFs. Flexibility in governance aids in increasing loan volumes and financial resilience.	Adrian (2018); Apostolik & Donohue (2015); Romano (2014); Jones (2014); Newbury & Izaguirre (2019); ICPs (2019); Giri (2020); Union (2019)
<b>3. Social Capital and Institutional Responsibility in Group Lending</b>	Social capital facilitates trust, peer monitoring, and group solidarity, improving loan repayment and institutional sustainability. Inclusive governance prevents exclusion based on social hierarchies. Community-based governance structures and social networks enhance performance and equity.	Panda (2016); Indriani et al. (2023); Rasel & Win (2020); Tahmaebi & Askaribezaeh (2021); Chakrabarty & Bass (2014); Islam (2016); Antohi (2016)

Table 1 summarises the essence of each thematic cluster, connecting the conceptual insights

**Policy Implications**

This study highlights the urgent need to reframe governance approaches in microfinance institutions (MFIs), especially in rural and low-capacity environments. One of the foundational policy shifts recommended is that regulatory bodies must mandate greater transparency by requiring MFIs to publish default rates, interest margins, and repayment performance in formats that are accessible and understandable to borrowers. Presenting these data in a borrower-friendly format helps demystify financial products and builds trust between institutions and communities, particularly those that may lack formal financial education. This kind of accessible reporting not only fulfills principles of financial literacy and transparency but also aligns with global financial inclusion goals promoted by institutions such as the World Bank and the Consultative Group to Assist the Poor (CGAP, 2021). Improved disclosure standards would reduce information asymmetry, enabling communities to make informed choices and hold MFIs accountable.

Secondly, a key governance reform lies in the institutionalisation of community participation mechanisms within rural MFIs. Participation should not be an ad hoc feature or limited to token representation; rather, it must be embedded in the decision-making frameworks of financial institutions. This includes formal representation of borrower groups in board consultations, structured feedback mechanisms, and co-design of financial products based on

local needs. Evidence from Baskoro (2025) and Sánchez-Soriano et al. (2024) affirms that when local voices are integrated into governance systems, it strengthens transparency, reduces default risks, and increases the relevance of microfinance products. Institutionalising such participatory structures will also help prevent elite capture or the marginalisation of vulnerable subgroups within communities, a problem that has been documented in less inclusive microfinance settings (Banerjee & Duflo, 2011). These governance enhancements further align with the UN Sustainable Development Goals, particularly SDG 10 (reduced inequalities) and SDG 16 (inclusive institutions).

Third, national financial inclusion strategies should prioritise the integration of risk dashboards and early warning systems at the institutional level. These tools can support MFIs in proactively managing credit risk, especially in contexts marked by economic volatility, climate disruptions, or sociopolitical instability. A dynamic risk dashboard that monitors repayment trends, borrower stress indicators, and geographic risk patterns would enable MFIs to intervene early, rather than after default or financial collapse. As suggested by Newbury and Izaguirre (2019), adaptive regulatory support that facilitates internal risk assessments within MFIs can enhance financial resilience without overburdening the institution with compliance demands. More importantly, embedding these tools within inclusive governance structures ensures that risk assessments reflect not just institutional concerns but also community vulnerabilities. When financial empowerment strategies are aligned with dignity, consent, and voice, the microfinance sector can shift from mere outreach to transformative inclusion, creating systems that are both responsive and equitable.

## **Conclusion**

This conceptual paper reframes microfinance not merely as a technical credit tool or a poverty alleviation mechanism, but more profoundly as a governance challenge. The prevailing paradigm in microfinance tends to treat financial inclusion as a problem of outreach, extending credit to underserved populations with the hope that economic activity and productivity will naturally follow. However, such approaches often overlook the governance ecosystem within which microfinance operates. This paper argues that the paradox of financial inclusion and risk, wherein expanding access to credit can unintentionally deepen debt cycles or institutional fragility, can only be resolved by embedding principles of social accountability, risk-sensitive regulation, and inclusive participation into the operational DNA of microfinance institutions (MFIs).

The design and delivery of microfinance services must therefore go beyond risk mitigation and portfolio sustainability. It must also embrace equitable governance practices that protect the dignity, rights, and voice of borrowers. Microfinance should not simply focus on lending to the poor but should ensure that the financial products and institutional structures reflect the lived realities of those communities. When MFIs operate without inclusive feedback loops or when governance is captured by elite interests, they risk replicating the very hierarchies and exclusions they are meant to disrupt. This is particularly salient in rural economies where literacy gaps, geographic isolation, and social hierarchies can prevent meaningful borrower engagement. Consequently, ensuring that community representation, especially of women and marginalized groups, is structurally embedded in decision-making frameworks is essential to promoting both legitimacy and effectiveness in microfinance.

Moreover, the interconnection between risk and governance must be acknowledged as a dynamic relationship. Risk in microfinance is not merely financial or operational; it is also social and institutional. A weak governance framework exacerbates the risk of exclusion, mission drift, and ethical failures, as seen in instances of borrower over-indebtedness or coercive recovery practices. Embedding risk-based regulatory practices that are context-sensitive, especially in low-capacity rural environments, is therefore crucial. Tools such as early warning systems, community grievance redress mechanisms, and participatory audits can serve not only to protect institutions but also to empower borrowers. This dual focus on institutional resilience and community agency reflects a governance-driven vision of financial inclusion.

In this light, hybrid governance models become not just desirable but necessary. These models blend formal institutional structures with community-based governance mechanisms to foster adaptive, responsive, and equitable microfinance systems. For instance, village financial councils or borrower forums can act as intermediaries that bridge the institutional and grassroots levels. Such hybrid arrangements can also facilitate the co-design of financial products that are sensitive to seasonal income flows, social obligations, and gender-specific constraints. They bring into the microfinance space an ethos of mutual accountability, where borrowers are not merely clients but stakeholders with agency and collective voice.

Ultimately, for microfinance to serve as a true pathway to equitable rural development, it must be grounded in a governance model that recognizes its inherently social nature. Technical efficiency in lending must be balanced with ethical considerations, participatory mechanisms, and responsive regulation. This reframing offers a more holistic understanding of what sustainable financial inclusion entails, one that centers people, not just portfolios. As this paper suggests, the next frontier of microfinance lies not in financial innovation alone, but in rethinking the governance architectures that underpin it. Only then can microfinance evolve from a tool of access to a vehicle for empowerment and justice in rural and marginalized communities.

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