

The Role of Deposit Insurance in Microfinance Institutions: A Systematic Literature Review

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Abstract

This study reviews how deposit insurance interacts with the operations, behavior, and stability of microfinance institutions (MFIs). Methods: A systematic literature review (SLR) was conducted using PRISMA-guided screening. Searches were run in five academic databases (Google Scholar, Web of Science, SpringerLink, Taylor & Francis Online, and ScienceDirect) using the string “deposit insurance” AND “microfinance,” producing 625 records. After removing duplicates and applying title/abstract and full-text screening, three studies met the final inclusion criteria and were synthesized. Results: The evidence shows three main patterns: (1) deposit guarantees can increase moral hazard in MFIs with weak governance (as seen in Indonesia’s rural banks), (2) depositor trust, often shaped by perceived safety, can reduce deposit volatility and panic withdrawals (as shown in Gabon), and (3) deposit insurance may shift higher-risk borrowers away from insured banks toward MFIs, changing where risk concentrates in the financial system. Implications: Deposit insurance policy should consider MFIs, not only commercial banks. If protection is extended to MFIs (fully or partly), it should be paired with stronger governance requirements, better supervision, and risk-based pricing to reduce moral hazard while supporting depositor confidence and financial inclusion.

INTRODUCTION

Microfinance institutions (MFIs) play a critical role in expanding financial access for populations underserved by conventional banking and in strengthening local economic resilience, particularly during periods of financial stress. MFIs serving low-income borrowers increasingly operate within a complex and interconnected financial ecosystem in which risk transmission, depositor behavior, and institutional governance materially shape both stability and outreach. These interactions have become more visible as the global financial system faces heightened vulnerabilities driven by technological change, financial inclusion initiatives, and evolving regulatory regimes.

As microfinance continues to transition from traditional group-based lending toward more diversified, deposit-taking institutional models, understanding the structural and behavioral determinants of MFI stability has become increasingly important. Recent research highlights how digital transformation is reshaping liquidity management, depositor interactions, and risk exposures across financial institutions in emerging markets. Hidayat, Anshari, and Setiawan (2024) note that digitalization and diversification strategies have become central to liquidity optimization and risk mitigation for banks operating in volatile environments. Similarly, Nguyen, Matousek, and Muradoglu (2024) emphasize that organizational culture and technological capability influence liquidity creation and capital decisions, suggesting that institutional behavior is a key determinant

of resilience. While these studies focus on mainstream banking, their implications extend to MFIs, many of which are increasingly adopting digital tools and diversified services to reinforce their operating models.

Parallel strands of global finance literature also document how systemic shocks affect institutional performance, particularly among entities serving vulnerable populations. Chen, Hu, and Ben (2021) show how platform design, reputation mechanisms, and ecosystem dynamics shape cash-flow stability in peer-to-peer lending markets—an adjacent sector whose risk dynamics can resemble microfinance during crisis periods. In addition, He and Hu (2023) revisit foundational theories of bank runs and depositor panic, underscoring how adverse expectations can destabilize financial institutions even when fundamentals remain sound. Comparable dynamics may arise in microfinance when depositors—often low-income and highly risk-averse—respond sensitively to shifts in trust, regulatory changes, and institutional distress signals.

Institutional fragility is further illuminated by evidence from shadow banking and the limits of depositor discipline. Dewi et al. (2023) find that depositors in shadow banking institutions often exhibit weak market discipline due to limited financial literacy and inadequate transparency—conditions that can mirror those in many microfinance contexts in developing economies. This insight underscores the vulnerability of informal or semi-formal deposit-taking institutions, where weak depositor monitoring may amplify risk-taking incentives and weaken governance. Such heterogeneity is also evident during financial crises, as documented by Hartarska, Nadolnyak, and Chen (2025), who report that MFIs display varied performance depending on capital structure, risk profiles, and macroeconomic exposure.

At the same time, sustainability-related considerations increasingly shape depositor preferences and the stability of institutional funding. Galletta et al. (2021), for example, find that banks with stronger control environments are more likely to attract stable deposits, suggesting that reputation and governance influence customer confidence and funding resilience. This is particularly relevant for MFIs, which rely on sustained client trust to limit withdrawal pressures and reduce liquidity volatility.

From a broader macroeconomic perspective, a growing body of evidence emphasizes the role of financial inclusion in shaping economic and social outcomes. Studies in Africa suggest that financial inclusion can significantly reduce income inequality and poverty (Mwakalila and Muba, 2025) and can influence budgeting priorities and human development outcomes (Barik and Lenka, 2023). However, expanding inclusion may also introduce or amplify risks for MFIs. Hakimi, Boussaada, and Karmani (2024) show that board characteristics moderate the relationship between financial inclusion and non-performing loans, reinforcing governance quality as a critical determinant of institutional stability. Related work also identifies nonlinear relationships between competition and performance in regulated microfinance industries, reflecting complex trade-offs among outreach, profitability, and regulatory constraints (Aguilar and Portilla, 2023). Market structure and funding strategies further shape financial stability, particularly in developing economies where capital access and liquidity buffers vary substantially (Kendo and Brou, 2025). Moreover, emerging analytical techniques, such as machine learning, are expanding financial institutions' capacity to predict and manage credit risk (Jeong, 2025).

Despite these advances, a significant gap remains: the literature rarely examines how deposit insurance mechanisms interact with MFIs, particularly regarding depositor behavior, institutional stability, risk-taking incentives, and crisis responses. Although Fianto et al. (2025) begin to highlight the relevance of deposit insurance for Islamic microfinance, broader empirical

and conceptual understanding remains limited. This gap underscores the need for a systematic synthesis at the intersection of deposit insurance and microfinance. As MFIs increasingly mobilize deposits and become integrated into formal financial safety-net frameworks, understanding how deposit insurance shapes risk behavior, depositor confidence, and institutional stability becomes an important research priority. Accordingly, this systematic literature review consolidates theoretical and empirical evidence on the effects of deposit insurance on MFIs, with particular attention to moral hazard, depositor behavior, liquidity dynamics, and regulatory implications.

METHODS

This study employs a systematic literature review (SLR) to synthesize existing academic work examining the intersection between deposit insurance and microfinance institutions (MFIs). Given that research connecting these two domains remains limited and conceptually fragmented, the SLR method enables a transparent, structured, and replicable process to identify, evaluate, and consolidate the available evidence. The review procedure follows the principles of the PRISMA framework to ensure methodological rigor and verifiable selection steps across studies.

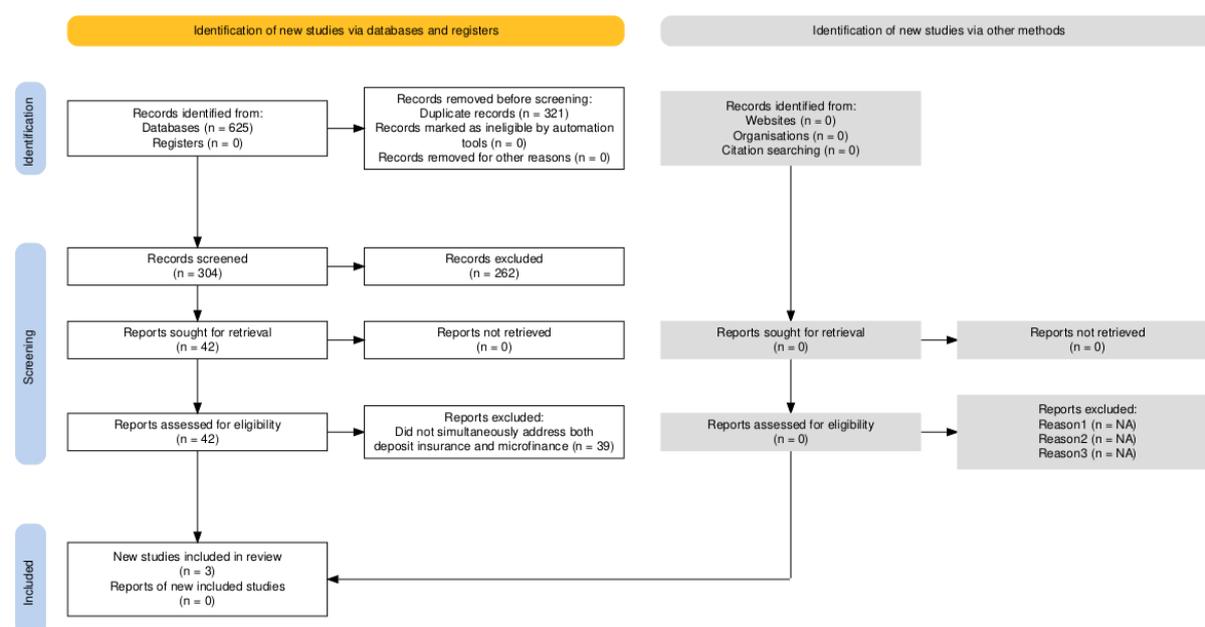
The search process began with a comprehensive retrieval of studies from five major academic databases well known for their coverage in finance, banking, and microfinance: Google Scholar, Web of Science (WoS), SpringerLink, Taylor and Francis Online, and ScienceDirect. A single Boolean string, "deposit insurance" AND "microfinance," was applied consistently across all platforms without restrictions on publication year or document type. This broad search strategy was designed to capture as wide a body of literature as possible, including early foundational work and more recent empirical studies.

The initial search produced 321 publications from Google Scholar, 3 from WoS, 185 from Springer, 0 from Taylor and Francis, and 116 from ScienceDirect, yielding a total of 625 publications. All publications were then exported into a reference management system to identify and remove duplicate records. Due to overlapping indexing across platforms, particularly between Google Scholar, Springer, and ScienceDirect, a substantial number of repeated entries were detected. After the deduplication process, the dataset was reduced to 304 unique publications, forming the initial pool for the literature review.

The next stage involved screening the titles and abstracts of all 304 publications to assess their relevance to the central theme of this review. Publications were retained if they demonstrated initial alignment with at least one of the following aspects: (a) deposit insurance or depositor protection, (b) microfinance institutions, including rural banks (BPR/BPRS), cooperatives, or Islamic MFIs, and (c) depositor behavior, institutional risk, or financial stability in small-scale, community-based financial institutions. Publications were excluded if they focused exclusively on commercial banking without a microfinance component, examined financial inclusion without

addressing MFIs, discussed financial regulation unrelated to deposit insurance, or were not written in English in order to identify globally comparable publications. At the end of this stage, 42 publications met the basic eligibility requirements and proceeded to full-text assessment.

To ensure conceptual accuracy, a full-text review was conducted of all 42 eligible publications. This phase applied stricter criteria: a publication was retained only if it explicitly discussed deposit insurance (e.g., guaranteed deposits, insured deposits, or moral hazard arising from deposit insurance) and simultaneously examined microfinance institutions (such as banks, Islamic banks, rural banks, or issues of stability and governance in microfinance). Publications addressing only one component, either deposit insurance without microfinance or microfinance without deposit insurance, were excluded from the final synthesis. After this rigorous reading process, only 3 publications were found to directly address both deposit insurance and microfinance, and these form the core of this review. The remaining publications were categorized as supporting literature (conceptually relevant for context and background) or excluded entirely



due to thematic misalignment. A visual summary of the identification, screening, eligibility, and inclusion process is presented in the PRISMA flow diagram below.

Figure 1. Diagram Flow of PRISMA Framework

This multi-stage selection process ensured that the final evidence base was both comprehensive and methodologically curated. The small number of studies ultimately included in the core synthesis underscores the novelty of this topic and highlights a substantial research gap in understanding how deposit insurance shapes the behavior, stability, and risk exposure of microfinance institutions (MFIs). By consolidating insights from this limited yet highly relevant

body of literature, this review provides a structured foundation for advancing theoretical debate, informing policy implications, and guiding future empirical research on the evolving role of deposit insurance within the microfinance sector.

RESULTS AND DISCUSSION

The systematic search identified 625 publications containing the specified keywords, only a very limited number of studies explicitly examine the intersection between deposit insurance and microfinance institutions (MFIs). This scarcity of literature underscores the novelty of the topic and signals the need for a deeper understanding of how deposit insurance shapes the behavior, stability, and risk dynamics of MFIs. The findings reported in this section are drawn from these three core studies and serve as the empirical and conceptual basis for the thematic analysis discussed in the subsequent section.

Before proceeding to the thematic synthesis, it is important to outline the key characteristics of the three studies that constitute the core evidence base of this review. These studies differ in methodological design, institutional context, and analytical scope, yet each contributes a distinct perspective on how deposit insurance interacts with MFIs. Table 1 summarizes their main features, including research focus, data sources, and central findings. Providing this overview establishes a clear foundation for interpreting how insights from these studies collectively inform the cross-cutting patterns and themes examined in the sections that follow.

Table 1. Summary of Key Studies

No	Author	Year	Research Background	Method	Key Findings
1.	Miah, M.D and Suzuki, Y.	2020	Global Islamic banking and Islamic microfinance	Conceptual and theoretical analysis (Islamic financial system, risk sharing and risk transfer)	Deposit insurance and related financial safety-net arrangements contribute to greater risk aversion among Islamic banks, discouraging them from serving marginal and high-risk borrowers. As a result, these clients are increasingly served by Islamic microfinance institutions (e.g., the Rural Development Scheme), which absorb risks shifted away from the insured banking sector. In this way, deposit insurance shapes the structural allocation of risk between banks and microfinance institutions.
2.	Hidajat,	2020	Bank	An	Deposit insurance provided

	T		Perekonomian Rakyat (BPR)	empirical case-based analysis on documented fraud cases, regulatory reports, and descriptive evidence.	by Indonesia's Deposit Insurance Corporation (Lembaga Penjamin Simpanan or LPS) is implicated in managerial moral hazard in rural banks. Bank insiders justify fraudulent and imprudent lending practices on the grounds that depositor funds are protected. Weak governance structures in BPRs, when combined with deposit guarantees, can substantially increase the likelihood of fraud, loan defaults, and institutional failure.
3.	Keddad, B. and Obiang, J.R.	2024	Gabon, Deposit-taking microfinance institutions (MFIs)	An empirical panel analysis using econometric techniques (e.g., regression models on MFI panel data).	Deposit volatility in Gabon's microfinance sector is driven by macroeconomic shocks, institutional governance, and depositor confidence. Drawing on deposit insurance theory, the study suggests that expectations of safety and institutional credibility reduce the likelihood of panic-driven withdrawals and help stabilize deposits, even in the absence of an explicit microfinance-focused deposit insurance scheme.

The studies summarized in Table 1 differ in context and approach, but they point to several similar patterns in how deposit insurance relates to microfinance institutions (MFIs). These patterns guide the synthesis below. By looking at shared dynamics across different settings, this review identifies key insights that support the thematic discussion in the next sub-sections.

A review of the three studies included in the final sample shows several broad patterns across countries, methods, and institutional settings. Although each study uses a different research approach and focuses on a different environment, together they highlight structural, behavioral, and regulatory factors that shape how deposit insurance interacts with MFIs. Before moving to the thematic synthesis, these general points help explain the wider dynamics found in the literature.

One clear pattern is that MFIs are becoming more connected to national financial safety

nets, either directly through formal rules or indirectly through expectations and perceptions. Across the reviewed studies, MFIs operate in systems that are increasingly influenced by policies first developed for commercial banks, including depositor protection rules and risk-based supervision. Even where MFIs are not officially covered by deposit insurance, depositors may still believe there is government backing or an implicit guarantee, and this can affect both depositor decisions and management behavior. This suggests that the impact of deposit insurance can go beyond legal coverage and still shape behavior in microfinance settings that are not fully regulated.

A second pattern concerns the fragile nature of funding in microfinance, which makes depositor protection especially relevant. MFIs often rely on short-term deposits from low-income clients, which can make their liquidity more unstable than that of commercial banks. The studies indicate that deposit swings are not driven only by economic conditions but also by trust in the institution, limited information, and how people see risk. In settings with weak governance or limited oversight, deposit volatility can quickly create serious financial pressure. This highlights the importance of depositor confidence, which is one of the main goals of deposit insurance. Overall, the evidence suggests that MFIs are very sensitive to policies or signals that change depositor expectations.

Another shared finding is that MFIs can be especially exposed to governance problems, and this risk can increase when deposit insurance exists. The synthesis shows that many MFIs have governance weaknesses, such as strong control by a small group, limited internal checks, and uneven management quality. When deposit protection is in place, managers may feel less pressure to act carefully because losses may be seen as covered by a guarantee. Compared with commercial banks, which often have stronger risk systems and tighter external monitoring, MFIs in some settings depend more on personal trust and community relationships. This can make them more vulnerable to risky behavior or fraud when deposit protection reduces discipline.

Finally, the review shows that deposit insurance in microfinance should not be viewed only as a tool to protect small depositors. The evidence suggests wider effects, including shifts in how risk is shared across the financial system, changes in lending behavior, and spillover effects from bank regulation to microfinance. Deposit insurance can shape not only depositor confidence but also the strategic choices of financial institutions, influencing where risk ends up, whether in banks or in MFIs. As a result, deposit insurance may affect which institutions serve higher-risk borrowers, how risk is managed, and where failures are more likely to happen.

These general findings point to issues that need closer attention. The rest of this section groups the main insights from the three included studies into three connected themes: (1) moral hazard effects of deposit insurance in MFIs, (2) the role of deposit insurance in depositor trust and deposit volatility, and (3) the influence of deposit insurance on risk shifting and the position of MFIs within the wider financial system.

Deposit Insurance and Moral Hazard in MFIs

A key theme in the reviewed literature is that deposit insurance can create moral hazard in microfinance institutions (MFIs), especially where governance is weak and regulation is uneven. When deposit protection exists, whether formal, informal, or simply believed to exist—it can change the incentives of managers and loan officers, particularly in small deposit-taking MFIs such as rural banks. Compared with commercial banks, many MFIs have simpler internal controls and weaker governance, which gives more room for risky decisions. This makes MFIs

more exposed to risk-taking when an external safety net is available.

Evidence from Indonesia's rural banks (BPR) illustrates this clearly. In documented cases of fraud and mismanagement, insiders justified high-risk and irresponsible lending by referring to the national deposit insurance system. The guarantee weakened the sense of consequence: managers treated depositor funds as "safe" even when lending practices were poor. This is a standard moral hazard mechanism, but it can be more severe in microfinance because institutions are smaller, less diversified, and depend heavily on community deposits.

Moral hazard is also stronger when depositor discipline is weak. Many MFI depositors have limited financial knowledge and cannot easily monitor institutional risk. If they believe deposits are guaranteed, they have even less reason to pay attention to warning signs. This reduces external pressure on managers, and weak internal governance may not be enough to prevent excessive risk-taking.

The literature also links deposit protection to weaker loan quality. In the Indonesian cases, risky lending included poorly supervised loans, related-party lending, and loans made without strong screening. Managers could justify these practices because depositors would be compensated if the institution failed. Over time, this worsened loan performance and raised the risk of failure.

Overall, this theme shows that deposit insurance, meant to support stability that can encourage risky behavior in MFIs when governance and oversight are weak. This highlights the need to align deposit protection rules with the specific characteristics of MFIs, rather than applying bank-style schemes without adjustments.

Depositor Trust and Deposit Volatility in MFIs

The second theme concerns depositor trust and deposit volatility. MFIs often rely heavily on short-term deposits, and deposit stability depends strongly on whether depositors believe the institution is safe. Microfinance depositors are often low-income households with limited savings buffers and high sensitivity to risk. As a result, even small shifts in confidence can trigger withdrawals and create liquidity stress, even when the institution is not fundamentally insolvent. Evidence from Gabon shows how this works in practice. Although MFIs there are not clearly covered by a formal deposit insurance scheme, depositor behavior still reflects the idea that safety and credibility matter. Deposit volatility is shaped by macroeconomic conditions, governance quality, and local political factors. The findings match deposit insurance theory: when people expect protection or believe the institution is credible, they are less likely to withdraw deposits in panic.

However, trust has two sides. While it can stabilize deposits, it can also weaken depositor monitoring. If depositors feel safe, they may ignore early warning signs, especially when financial literacy is low. This can allow governance problems and risk-taking to grow unnoticed. In short, trust can reduce short-term volatility but may also hide deeper risks when oversight is weak.

Risk Shifting and the Structural Role of MFIs under Deposit Insurance

The third theme shows that deposit insurance can shape how risk is distributed across the financial system. The reviewed literature suggests that insured banks tend to avoid high-risk borrowers because they face stricter rules and closer supervision. As a result, marginal borrowers, such as microenterprises and informal workers, are more likely to be served by MFIs.

In this setting, MFIs absorb risks that insured banks prefer not to take. MFIs become the

main lenders for higher-risk clients, often with less protection and lighter regulation than banks. This creates an imbalance: banks operate with stronger safety nets, while MFIs face higher risk with fewer protections. Over time, this can make microfinance portfolios more fragile and increase the chance of stress during downturns.

Overall, this theme shows that deposit insurance does more than protect depositors. It can influence which institutions serve which clients, where risk ends up, and where financial pressure is most likely to appear. This implies that deposit insurance policy should consider system-wide effects, including how it may shift risk toward MFIs.

DISCUSSION

The synthesis of the three core studies shows that the relationship between deposit insurance and microfinance institutions (MFIs) involves a complex mix of incentives, governance structures, and depositor behavior. When these findings are considered together with the broader supporting literature on banking stability, depositor discipline, and financial inclusion, a clearer pattern emerges: deposit insurance does not only affect the institutions it directly covers, but can also reshape risk in the wider financial system, including MFIs.

The first key insight from the core studies relates to moral hazard in MFI settings where deposit insurance is present. Evidence from Indonesia on fraud cases in BPR/BPRS shows how deposit guarantees can weaken managerial caution, allowing risky lending practices under the belief that depositor losses will be repaid. This aligns with Dewi et al. (2023), who argue that depositor discipline can decline when people believe that formal or informal safety nets will absorb institutional risk. In a similar way, He and Hu (2023), in their review of foundational work by Diamond, Dybvig, and Bernanke, highlight that deposit insurance can reduce incentives for both depositors and managers to monitor risk, increasing the chance of moral hazard. Together, these findings support the view that deposit insurance can create harmful incentives in MFIs, especially when internal governance is weak or underdeveloped.

A second important point concerns depositor behavior and deposit volatility, which is especially relevant for MFIs that depend heavily on small, easily withdrawn deposits. Evidence from Gabon suggests that depositor trust, based on institutional reputation or the belief that some form of protection exists, plays an important role in stabilizing MFI liquidity. Supporting studies reinforce this. Galletta et al. (2021) show that depositor decisions depend not only on financial indicators but also on institutional credibility and trust signals, meaning that perceived safety strongly shapes behavior. In addition, Mwakalila and Muba (2025) find that stronger financial inclusion is closely linked with institutional trust, which helps explain why depositor confidence supports more stable participation in financial services in low-income settings. Overall, the literature suggests that deposit insurance, directly or indirectly, can reduce panic withdrawals and support deposit stability, but it may also weaken market discipline by reducing depositor responses to risk.

The third key insight relates to how deposit insurance can shape risk distribution across the financial system and, in doing so, influence the structural position of MFIs. Conceptual analysis in Islamic banking suggests that banks covered by deposit insurance often avoid higher-risk borrowers to meet regulatory standards, which can shift risk toward MFIs that face lighter oversight or have no explicit guarantees. This risk shift is consistent with broader banking research. Nguyen et al. (2024) show that liquidity creation and capital decisions are strongly influenced by institutional culture and regulatory incentives, suggesting that deposit insurance

and related rules can indirectly encourage banks to reduce risk exposure. Algeri et al. (2021) also report that small cooperative banks show connected risk patterns influenced by their regulatory environment, indicating that institutional behavior responds to the rules and incentives around them. Applied to a two-tier system, these studies support the pattern seen in microfinance: insured banks become more risk-averse, while MFIs take on clients with higher default risk. Supporting literature also points to governance weaknesses in MFIs, which can strengthen the effects of deposit insurance. Barik and Lenka (2023) show that governance quality plays a major role in how financial institutions in emerging markets manage inclusion and control corruption. This supports the idea that MFIs, often limited by weaker management capacity and internal audit systems, may be more exposed to harmful incentives created by safety nets. Aguilar and Portilla (2023) add that regulated MFIs face complex trade-offs between competition, outreach, and performance, meaning they must balance social goals and financial sustainability under persistent constraints. These studies suggest that MFIs operate with smaller buffers and fewer safeguards, so they may react to deposit insurance incentives differently from commercial banks.

Overall, combining the thematic findings with supporting studies leads to a consistent message: deposit insurance can create system-wide effects that go beyond its main goal of protecting depositors. It can influence depositor behavior, institutional risk-taking, competition, and how risk is shared across sectors. Where governance capacity is limited, these effects may create vulnerabilities by concentrating risk in MFIs that do not enjoy the same protections as commercial banks. On the other hand, where depositor trust is fragile, even informal or perceived protection can help stabilize microfinance deposits, showing that deposit insurance can act as both a stabilizing tool and a possible source of risk.

These insights suggest that deposit insurance design should be informed by how it affects the microfinance system. Policymakers may need to consider whether partial coverage for MFIs, risk-based premiums, and stronger governance standards could reduce unintended effects. Supporting studies also show that regulation cannot be separated from wider financial inclusion goals, because safety nets shape both institutional and depositor behavior across the system. For this reason, the findings of this review support the growing view that MFIs should be included in discussions on financial safety-net design that not as side actors, but as important parts of the system whose stability and risk exposure are directly influenced by deposit insurance policy.

CONCLUSION

This systematic review examines how deposit insurance interacts with the operations, behavior, and stability of microfinance institutions (MFIs). It draws on evidence from three studies that met the final inclusion criteria and links the results to a wider supporting literature. Although direct empirical research on deposit insurance and microfinance is still limited, the synthesis highlights several clear patterns that help explain how financial safety nets shape the broader financial system, especially in settings where MFIs are central to financial inclusion.

Across the three core studies, deposit insurance shows a dual effect. On one hand, it can support stability by strengthening depositor confidence. On the other hand, it can encourage moral hazard in institutions with weak governance. Evidence from Indonesia suggests that deposit guarantees may unintentionally support fraud or careless lending, reflecting long-standing concerns

about moral hazard in insured institutions. In contrast, findings from Gabon indicate that even perceived safety, based on reputation or expectations of support, can reduce deposit swings and help MFIs cope with economic shocks. This dual effect shows why safety-net policy must be designed carefully for MFIs, which are often more fragile than commercial banks.

The review also suggests that deposit insurance affects risk across the system, not only within individual institutions. Insights from Islamic banking show that insured banks may avoid high-risk borrowers to meet regulatory targets, pushing these clients toward MFIs that are less protected and often less supervised. This risk shifting helps explain how deposit insurance can shape long-term market structure and where risk concentrates.

Overall, policy debates on deposit insurance should not focus only on commercial banks. MFIs serve clients who are highly sensitive to economic shocks and trust, yet many MFIs operate with weaker safeguards. If deposit protection is extended to MFIs, fully or partly, it should be paired with stronger governance standards, better supervision, and risk-based premiums to limit moral hazard.

Finally, the small number of direct studies points to a major research gap. Future work should test how different protection designs, such as partial coverage, tiered coverage, or community-based guarantees, affect MFI behavior and stability across different regulatory settings.

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