

# Localization of Microfinance Institutions in Yunnan Province, China

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## Abstract

China's accelerated economic advancement since 2010 has highlighted the inequalities present in urban and rural development. This investigation delves into the localization and effects of microfinance institutions (MFIs) within the rural context of Yunnan Province, specifically concentrating on the Lijiang Institute of Health and Environment (LIHE). Notwithstanding government subsidies, conventional financial institutions encounter significant challenges in catering to the impoverished demographics of this area. The "Village Bank" initiative spearheaded by LIHE, a microfinance program, has received substantial endorsement from both local governmental entities and community members, effectively fostering local development and environmental sustainability for more than a decade. This paper examines the factors contributing to LIHE's acceptance among local populations and its role in facilitating local development. It presents a comprehensive overview of microfinance, introduces the "Village Bank" framework, and evaluates the economic, environmental, and socio-political ramifications of LIHE's initiatives. Additionally, the paper addresses the obstacles encountered by LIHE, encompassing issues of financial sustainability, collaboration with governmental bodies, and local participation. The findings suggest that LIHE's emphasis on self-organization, local participation, and selective localization of successful microfinance models are key to its success in Yunnan.

**Keywords:** Microfinance Institutions (MFIs), Localization, Rural Development

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## การปรับแต่งสินค้าของสถาบันการเงินรายย่อย ให้เข้าท้องถิ่นมณฑลยูนนาน ประเทศจีน

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### บทคัดย่อ

การเร่งพัฒนาเศรษฐกิจของประเทศจีนตั้งแต่ปี ค.ศ. 2010 ส่งผลให้เกิดความเหลื่อมล้ำของการพัฒนาในเมืองและในชนบทอย่างชัดเจน งานวิจัยนี้ศึกษาการปรับตัวให้เข้ากับท้องถิ่นและผลกระทบของสถาบันการเงินรายย่อยในระดับชนบทของมณฑลยูนนาน โดยมุ่งเน้นสถาบันสุขภาพและสิ่งแวดล้อมแห่งนครลี่เจียง (Lijiang Institute of Health and Environment: LIHE) แม้ว่าจะมีงบประมาณสนับสนุนจากภาครัฐแต่สถาบันการเงินรูปแบบดั้งเดิมยังคงเผชิญกับความท้าทายในการให้บริการแก่ประชากรที่ยากจนในเมืองแห่งนี้ แต่มี “ธนาคารหมู่บ้าน” ซึ่งเป็นโครงการริเริ่มของสถาบันฯ อันเป็นโปรแกรมการเงินรายย่อยที่ได้รับการรับรองจากองค์กรท้องถิ่นภาครัฐและสมาชิกชุมชน ส่งผลให้เกิดการส่งเสริมการพัฒนาท้องถิ่นและความยั่งยืนทางสิ่งแวดล้อมอย่างมีประสิทธิภาพมาเป็นเวลากว่าทศวรรษ งานวิจัยนี้ศึกษาปัจจัยที่ส่งเสริมให้สถาบันฯ เป็นที่ยอมรับในหมู่ชุมชนท้องถิ่นประกอบกับบทบาทของสถาบันฯ ในการส่งเสริมการพัฒนาในระดับท้องถิ่น งานวิจัยได้นำเสนอภาพรวมของระบบการเงินรายย่อย กรอบการทำงานของธนาคารหมู่บ้านและยังทำการประเมินผลกระทบทางเศรษฐกิจ สิ่งแวดล้อมและสังคมการเมืองอันเป็นผลสืบเนื่องจากโครงการริเริ่มของสถาบันฯ นอกจากนี้งานวิจัยยังอภิปรายถึงอุปสรรคที่สถาบันฯ พบเจอ ได้แก่ ปัญหาความยั่งยืนด้านการเงิน ความร่วมมือจากภาครัฐและการมีส่วนร่วมของท้องถิ่น ผลการวิจัยแสดงให้เห็นว่า การมุ่งเน้นของสถาบันฯ เรื่องการจัดการตัวเอง การมีส่วนร่วมของท้องถิ่นและการเลือกที่จะปรับตัวให้เข้ากับท้องถิ่นของโมเดลต้นแบบระบบการเงินรายย่อยคือกุญแจสำคัญของการประสบความสำเร็จในมณฑลยูนนาน

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## Introduction

In 2010, China marked a pivotal moment, ensuring its economy as the second-largest worldwide. Still, this economic progress has been mirrored by an escalating imbalance between urban and rural settings, especially apparent in provinces like Yunnan that are less-developed in China (Ding, 2014). To fix this unfairness, governmental agencies and NGOs have been collaborating to supply community services and development projects in countryside areas. However, traditional financial services have had trouble supporting these demographics, particularly in highland areas. The geographic isolation and the absence of a credit history present obstacles to the effectiveness of typical banking strategies.

State-backed monetary help is in place; still, a lot of community members view it as a brief opportunity rather than a long-term growth approach. Compounding the issue is a prevalent lack of environmental consciousness. A great number of rural economies have leaned on extractive or unsustainable activities that harm the natural ecosystem while failing to provide lasting economic gains (Zheng et al., 2014).

According to the National Bureau of Statistics of China (2021), the average disposable income per capita for rural inhabitants across the nation was recorded at 17,131 yuan, in contrast to 43,834 yuan for their urban counterparts. In poverty-stricken areas of Yunnan, the figure was substantially lower, at 11,740 yuan (Kunming News, 2021). The phenomenon of financial exclusion persists as a critical issue: a comprehensive national diagnostic study revealed that rural households depended on informal financial markets to fulfill approximately two-thirds of their monetary requirements (IFC & KfW, 2020). Such inequalities reveal the critical role of grassroots microfinance programs Village Bank.

Confronted with these simultaneous challenges, NGOs have launched distinct development models, among them microfinance options. An important case is the Lijiang Institute of Health and Environment (LIHE), a minor-sized NGO found in Lijiang City, Yunnan Province. Started in 2014, LIHE acts as a Microfinance Institution (MFI) and has been carrying out its notable “Village Bank” project for upwards of ten years. The program has garnered support from both local government and communities, aiming to promote environmentally sustainable development through microcredit (Chang & Huang, 2021).

This paper investigates how microfinance is applied locally within China, using the LIHE Village Bank initiative for illustration. It looks to investigate the potential of microfinance in fostering rural advancement while facing institutional, financial, and environmental hurdles. Specifically, the paper explores the following research questions:

1. Why is LIHE accepted by the local community in Yunnan?
2. How has LIHE contributed to local development through microfinance?

## 4

## Methodology

This study is based on qualitative desk research using secondary sources, including: Internal reports and documents provided by LIHE during the author's internship between 2018-2019; Published articles on LIHE and the Village Bank project (Ding, 2014; Chang & Huang, 2021); A total of 8 key documents published between 2014 and 2021.

No fieldwork, interviews, or focus groups were conducted. With the data shortage restrictions in mind, the research emphasizes three separate village-level case studies: Xinfang, Heyuan, and Guang. The choice of these instances depended on the presence of records and showcases various stages of the rollout of Village Banking programs.

The paper is systematically structured as delineated below: Section 2 elucidates the notion and international progress of microfinance. Section 3 introduces LIHE and the structure of its Village Bank program. Section 4 examines how LIHE aids in the advancement of economic, ecological, and involvement-related factors. Section 5 highlights the key challenges LIHE faces. Section 6 culminates with strategic policy recommendations for MFIs functioning within analogous contexts.

## The Concept and Global Evolution of Microfinance

Microfinance stands for a variety of financial services that include credit, savings, and insurance, aimed at supporting low-income individuals and those often excluded from financial opportunities (Adhikary & Papachristou, 2014; Hudon & Sandberg, 2013). It aims not just at offering loans, but rather at equipping individuals with financial resources that can alleviate poverty, enhance household stability, and foster entrepreneurial ventures. As Morduch (1999) notes, microfinance gained global prominence for its promise to provide “finance for the poor” without relying on traditional collateral.

Historically, the current microfinance movement arose as a reaction to the constraints of traditional support. After World War II, the strategies for growth underscored comprehensive foreign aid schemes, particularly the U.S.-driven Marshall Plan. Yet, these authoritative models commonly marginalized the rural disadvantaged, notably in developing regions, preventing them from obtaining loans and funding. From the 1960s onward, movements like the Green Revolution expanded agricultural productivity, yet financial exclusion remained a critical barrier (Getu, 2013).

Dr. Muhammad Yunus's initiative of the Grameen Bank in 1976 in Bangladesh is often seen as a key point in the practical development of microfinance. By extending nominal loans to women without necessitating collateral, Yunus contested the conventional banking paradigm and established the groundwork for inclusive financial practices (Ali, 2014). This paradigm demonstrated that repayment rates could sustain high levels even among the most impoverished demographics when trust, social cohesion, and collective guarantees were effectively utilized. As a result, microfinance rapidly expanded across the Global South.

In later empirical research, like Banerjee et al. (2015), microfinance programs were evaluated using randomized controlled trials across six different nations. Their findings indicate that while microfinance may not significantly reduce poverty in the short term, it is still modestly positive in consumption smoothing, supports business creation, and improves women's empowerment, especially when paired with non-financial services such as training or collective organizing. Morduch (2021) additionally contends that the potential of microfinance warrants reconsideration through the framework of institutional quality and contextual adaptability.

### **The Rise of Microfinance in China and the Case of LIHE**

In China, microfinance began to attract attention in the 1990s as the government and civil society actors sought alternatives to mainstream financial systems for rural development. One of the initial pilot endeavors was a community development fund instituted in Guizhou Province in 1994. Nonetheless, this initiative disbanded within a span of six years as a result of untenable governance frameworks and excessive dependence on donor management (Ding, 2014). Notwithstanding its unsuccessful outcome, the case yielded significant insights for subsequent initiatives.

Emerging in 2014, LIHE took shape as an MFI dedicated to the highland regions of Lijiang City, Yunnan Province, China. Drawing from global models yet adapting to local socio-environmental dynamics, LIHE designed its flagship "Village Bank" program with a dual aim: to foster economic empowerment and to encourage environmentally sustainable practices. Unlike earlier projects, LIHE limited donor influence and promoted self-governance among villagers with key adaptations that contributed to its long-term viability.

In the framework suggested by LIHE, every community independently decides on the structure for involvement, the amount of loans, the relevant interest rates, and the procedures for monitoring. LIHE then matches the community's contributed funds to create a capital pool. This cooperative methodology is consistent with the conceptualization by Hudon and Sandberg (2013) of microfinance as extending "beyond banking," wherein the principles of empowerment, social accountability, and sustainability are accorded equal significance.

Importantly, LIHE's operations are based on document archives and internal project reports from 2014 to 2021, reviewed as part of this study. This study did not involve the execution of field interviews or focus groups; instead, this manuscript relies on secondary research, encompassing institutional publications, grey literature, and academic studies such as those conducted by Ding (2014) and Chang & Huang (2021). These materials highlight how LIHE gradually expanded its model by emphasizing participatory governance and using community-based structures for decision-making and accountability.

### Village Bank

LIHE's initiative known as the "Village Bank" is carefully crafted to unite local economic progress with ecological responsibility. By leveraging insights gleaned from prior domestic shortcomings and exemplary global practices in microfinance, LIHE has developed a customized model that is specifically adapted to the unique socio-economic and environmental circumstances of the highland regions of Yunnan. The model involves funding sourced both from local community contributions and external donors, but with a deliberate reduction in the proportion of donor capital to encourage local ownership and sustainability. Though financial supporters monitor fund utilization, the villagers predominantly hold the power to make decisions, enhancing grassroots empowerment and accountability.

To clarify, the operational model of the Village Bank in Lijiang was developed beginning in 2010 and formally launched in February 2011. Since then, LIHE has applied this model in various villages here. The implementation process of the Village Bank generally consists of the following six steps:

1. Hold a Village Meeting: LIHE staff collaborate with selected local representatives to organize initial discussions. To enhance comprehension, these delegates are frequently extended invitations to travel to various locales where analogous microfinance projects have achieved notable success. This step helps build trust and clarifies the project's objectives.

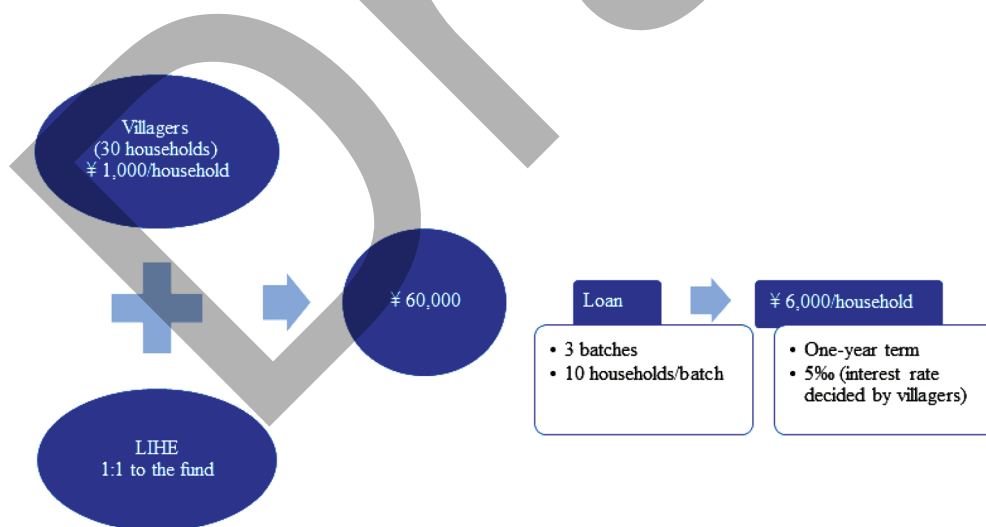
2. Share Experiences and Build Consensus: When they are back, delegates will host discussions to relay information to fellow villagers, expressing their views and dealing with community challenges.

3. Assess Financial Needs and Decide Participation: A collective discussion follows to estimate the community's capital needs. While choices arise from a group dynamic, every household holds the freedom to join in or opt out of the scheme.

4. Negotiate Financial Terms: Families involved will negotiate the details about the loan, such as the amount of household contributions, repayment period, interest rate, risk-sharing mechanisms, and management duties.

5. Elect Management Team: To ensure transparency, a village committee is selected by the members to manage fund allocation and repayment monitoring. LIHE provides training but does not directly manage daily operations.

6. Match Funds and Launch Project: After the village raises its internal capital, LIHE matches the amount and signs a formal contract with the committee, launching the fund pool and distributing loans in rotating batches.



**Figure 1:** Xinfang, Heyuan Village started its first Village Bank project in 2011 following this process. Retrieved from Official Account of LIHE. 2024 by the Author.

For example, as Figure 1 shows, in Xinfang Village, the first site of implementation, LIHE launched the Village Bank in early 2011 with 30 participating households. The total reached 30,000 yuan with 1,000 yuan from each participant, and with LIHE matching that, it climbed to 60,000 yuan. The fund was distributed to 10 households at a time, with each receiving 6,000 yuan at an interest rate of 5% per year (not per month as previously stated). After one year, the next batch received the loan upon the return of the first. Interest collected was retained by the village for public welfare purposes. All decisions, such as fund allocation and member selection, were made by the local community, while LIHE served primarily as a facilitator and guarantor of procedural fairness.

By 2021, the Village Bank model had expanded beyond Xinfang. In Heyuan Village, where over a span of five years, the establishment of nine Village Banks engaged 203 households. Significantly, these programs revealed an extraordinary repayment rate of 100%, showcasing their financial stability, while the families involved noted an average economic growth rate of 62% (Ding, 2014). In Guang Village, 12 Village Banks were linked to environmental conservation efforts, successfully protecting over 7,700 hectares of community natural reserves (Chang & Huang, 2021).

This strategy of microfinance not only confronts economic exclusion but also promotes a strong spirit of collective ownership. Villagers, by being co-investors, turn into proactive overseers of how funds are used and how repayment practices unfold. This reduces ordinary challenges faced in microfinance, such as default or moral hazard. The requirement for co-investment and community-led governance turns the project into a social mechanism rooted in mutual trust and social capital, aligning with the literature on successful microfinance (e.g., Morduch, 1999; Banerjee et al., 2015).

Moreover, the engagement of local leaders, like village chiefs or revered seniors, is crucial in linking LIHE with the wider community. As influencers, they legitimize the initiative and lower resistance among skeptical households, a tactic that compensates for LIHE's limited staff and resources.

In summary, the Village Bank system as performed by LIHE showcases a locally relevant, community-centric financial innovation that enhances both economic stability and ecological responsibility. As it gives economic help, it seeks more active participation from community figures, encourages a collaborative mindset, and widens perspectives on ecological topics.



## Contributions

There is a considerable acknowledgment regarding the potential of microfinance to uplift the economic standing of low-income households (Bhuiya et al., 2016). This portion examines the role of LIHE's Village Bank scheme in three intertwined aspects: economic empowerment, environmental sustainability, and strengthening community participation and governance. These aspects reflect LIHE's localized model of microfinance and its broader developmental implications.

### 1. Economic Empowerment

LIHE's Village Bank initiative has demonstrated positive economic outcomes for local households. Although each loan disbursed is relatively modest, as mentioned above, in Xinfang Village, the first 30 participating households contributed 1,000 yuan each, matched by LIHE for a total of 60,000 yuan, such funding serves as a crucial buffer against economic vulnerability. As a rule, these funds are specifically intended for projects that bring in profits, encompassing livestock raising, the growing of small vegetable crops, and obtaining necessary farming implements, as illustrated in the files from 2011 to 2021. Although the quantitative results are somewhat constrained in scope, they underscore the initiative's ability to facilitate development at the household level in the absence of substantial investment.

### 2. Environmental Sustainability

LIHE emphasizes an integrated model of economic and environmental development. In a region historically characterized by extractive and unsustainable practices such as unregulated logging, the Village Bank project introduces a mechanism of eco-conditional lending. Villages that breach the environmental protocols indicated in the agreement might potentially forfeit their access to project financing. This rule has empowered local residents to engage in mutual oversight, leading to the formation of a united incentive scheme designed to protect their environmental treasures. The instance is the previous case about environment protection case in Guang Village. The ability of microfinance to function as a tool for community-based environmental governance is a distinctive innovation in LIHE's model.

### 3. Strengthening Community Participation and Governance

The Village Bank model prominently features a commitment to self-organization and the idea of community ownership. LIHE merely offers initial training and co-financing, whereas the villagers independently determine operational decisions, including loan amounts, interest rates, and repayment conditions, through regular meetings. Loan management committees are democratically elected, and public monitoring is encouraged.

This participatory structure has helped to establish trust in a financial system that might otherwise be misunderstood as exploitative. At the outset, various community members questioned the program, connecting their fears to its distinctive financial arrangements. By leveraging the influence of village elites, LIHE was able to build legitimacy from within. Local leaders first participated in study trips to model villages, then facilitated community-wide meetings to discuss the rules of operation. The collaborative strategy made sure that those who joined in the effort grasped both the benefits and duties linked to their engagement.

The united investment of private funds elevates the villagers' ownership perception, which boosts their readiness to oversee the repayment process and make sure loans are used correctly. LIHE retains the right to withdraw support if environmental or financial norms are violated, reinforcing local accountability without undermining autonomy.

## Challenges

While the Village Bank initiative executed by LIHE in Yunnan serves as a pertinent exemplar of localized microfinance, its execution has encountered considerable obstacles. These obstacles can be delineated into three principal categories: limited inclusion of the poorest households, institutional and regulatory vulnerabilities, as well as financial sustainability and operational capacity.

### 1. Limited Inclusion of the Poorest Households

Despite the common belief that microfinance aids in reducing poverty, various academics have noted that MFIs could overlook the poorest individuals (James et al., 2012; Ali, 2014). In the case of LIHE, while over 200 households participated in the Heyuan Village Bank network, the model requires an initial capital contribution from each household, typically 1,000 yuan, which can be a significant barrier for those receiving the government's

minimum subsistence guarantee. LIHE's own data indicates that some of the most impoverished households have been excluded from participation due to this entry requirement (Chang & Huang, 2021).

Moreover, concerns have been raised in the wider microfinance literature regarding repayment pressures and social sanctions. Although LIHE refrains from utilizing coercive enforcement mechanisms, its operational framework is substantially predicated upon the apprehension of reputational harm and the influence of social pressure among villagers to guarantee loan repayment. While this method has achieved a 100% repayment rate in some villages, it also raises the risk of deepening social tensions or inadvertently reinforcing informal hierarchies. LIHE must remain vigilant to ensure that these pressures do not become exclusionary or punitive.

## 2. Institutional and Regulatory Vulnerabilities

The successful functioning of LIHE has been, in part, reliant upon a tenuous collaboration with the local governmental authority, which has traditionally faced challenges in executing its own poverty alleviation initiatives. LIHE has been permitted to advance with limited disruption due to the acknowledgment by government representatives of the inadequacies of their own efforts and their subsequent consent for the NGO to administer projects autonomously.

This setup is fundamentally precarious. As noted in microfinance scholarship (Ali, 2014), the absence of a clear regulatory framework increases the risk that MFIs might be viewed either as beneficial agents of rural development or as illicit financial actors. LIHE currently operates in a regulatory gray zone: there is no comprehensive legal framework in China specifically governing MFIs, nor mechanisms for formal registration or monitoring. Conversely, entities such as the Grameen Bank are governed by the regulatory frameworks established by national microcredit regulatory bodies.

This absence of official acknowledgment brings forth several dangers: shifts in government strategies may occur, authorities might attempt to regain oversight of financial initiatives, or MFIs could encounter allegations of unlawful fundraising. Without institutional backing, the sustainability and legitimacy of LIHE's operations remain uncertain.

### 3. Financial Sustainability and Operational Capacity

Being an NGO, LIHE faces rigorous rules that forbid it from participating in profit-driven commercial endeavors. Unlike larger MFIs that charge interest to cover their operating costs and ensure long-term sustainability (Adhikary & Papachristou, 2014), LIHE reinvests all interest revenue back into the community, which limits its ability to accumulate reserves or scale up its operations.

The organization is completely dependent on outside contributions and the goodwill of volunteers and local participants. In the context of global economic slowdown and increasing competition for donor funding, this model raises concerns about long-term viability. LIHE's refusal to collect interest for its own institutional growth, while ethically commendable, places it in a structurally precarious position.

Furthermore, operational constraints, including the limited size of the management team, the absence of digitized monitoring tools, and reliance on localized leadership, render the assurance of quality control and standardization across various villages a formidable challenge. This may hinder the replicability of the model in other provinces or regions with less cohesive community structures or weaker local leadership.

### Conclusion

The case of the LIHE offers valuable insights into the localized implementation of microfinance in underdeveloped rural regions of China. Through an analysis of the Village Bank program active since 2011 in Lijiang, Yunnan Province, one can derive significant insights into community involvement, regulatory landscapes, and localized methods.

Firstly, local participation is the cornerstone of success. Attention is drawn by LIHE to the vital necessity of self-structuring, community interactions, and collective decision-making. Rather than promoting collective development through top-down directives, the Village Bank model enables villagers to contribute personal funds and develop household-level plans for sustainable livelihood enhancement. By leveraging the influence of local elites to initiate and advocate for participation, LIHE effectively builds trust while reducing operational resistance. This framework supports the belief that when rural residents are granted autonomy and transparent access to information, they can build a just and community-centered financial framework.

Secondly, navigating the legal and regulatory context is critical. Though microfinance connects to fairly minor financial metrics, it carries on as a financial pursuit that must adhere to the limits of authorized monitoring. In the instance of LIHE, the lack of delineated regulatory structures governing MFIs in China renders its operations susceptible to fluctuations in governmental perspectives. While LIHE has benefitted from a cooperative stance by local authorities, this goodwill cannot be guaranteed over time. In the absence of national legislation, LIHE has attempted to safeguard its operations through legally binding contracts with village-level management groups. This contractual approach has proven to be a temporary substitute for formal legal protection but is insufficient as a long-term safeguard.

Thirdly, selective localization enhances effectiveness. LIHE's Village Bank model builds on the global principles of microfinance, particularly those inspired by the Grameen Bank and earlier community fund initiatives in China. However, its success stems from contextual adaptation rather than direct replication. Unlike the countryside of Bangladesh from the 1970s, modern rural China showcases remarkable distinctions in its cultural, economic, and institutional frameworks. LIHE has taken on the essential tenet of independently run financial services; yet, it has altered the governance systems, funding designs, and methods for community engagement to suit the specific circumstances of Yunnan. Learning from previous failures, such as the overly donor-dependent model in Guizhou, LIHE prioritized bottom-up participation and gradually reduced external control.

## Policy Recommendations

In order to facilitate the continued advancement and replication of localized microfinance initiatives within rural China and in other regions, the subsequent policy-oriented recommendations are put forth:

Establish a legal framework for MFIs. Given the rise of informal financial organizations in underprivileged regions, it is crucial that the government establishes laws to clearly define their roles, duties, and oversight structures. A dedicated regulatory body for MFIs could enhance institutional legitimacy while protecting communities from exploitation.

Provide targeted subsidies to include the ultra-poor. While the Village Bank model promotes financial self-sufficiency, entry thresholds like initial capital contributions can inadvertently exclude the most vulnerable households. Local governments or philanthropic foundations could offer matching grants to help the ultra-poor join such schemes without distorting the model's emphasis on self-help.

Support NGO-government collaboration through institutionalized partnerships. LIHE's success partially stems from an informal division of labor between the NGO and the local government. Establishing these agreements within shared frameworks or MoUs promises to safeguard reliability during periods of political flux and administrative changes.

Encourage adaptive models rather than standardized solutions. Microfinance programs must be culturally and institutionally tailored to local contexts. Donor and development agencies should support the idea of being adaptable, fostering innovation, and conducting relevant assessments to make certain that their initiatives truly fit the community's needs rather than sticking to rigid protocols.

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