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The Analysis of the Effectiveness of Risk Mitigation and Sustainability Strategies in *Bank Perekonomian Rakyat Syariah* (BPRS)

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Abstract

Financing at Islamic banks carries significant risks, particularly in the form of problematic financing, which can reduce public trust. In recent years, economic uncertainties, such as inflation, digital transformation and regulatory changes have continued to challenge financial institutions. Thus, effective risk management is essential to mitigate these risks and ensure long-term sustainability. This study examines the financing risk management and sustainability strategies at Bank Perekonomian Rakyat Syariah (BPRS). Primary data was obtained through in-depth interviews with bank administrators and supervisors, while secondary data was obtained through official financing risk management policy documents. The data analysis uses a qualitative descriptive approach and linking findings to established Islamic banking theories. The results indicate that implementing financing risk management at BPRS has insufficient, as seen in high level of financing relaxation, problematic financing, and declining financing ratios. However, this condition does not reduce the profitability ratio. The Islamic bank maintains resilience by implementing internal sustainability strategies such as strengthening employee morale, changing standard financing procedures, assisting customers, and tightening financing distribution policies.

Keywords: *Bank Perekonomian Rakyat Syariah, Financing risk, Financial Problem, Mitigation, Sustainability.*

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Introduction

Risk is the potential for loss, either directly or indirectly (Hanafi, 2012), and these losses can be financial or non-financial (PBI, 2011). Financial losses can affect business continuity and result in the emergence of other risks such as returns and reputation. Meanwhile, non-financial losses are more likely to reduce public trust in the company (Chatta & Alhabshi, 2017). Risk can also be interpreted as deviation or departure from projections or plans with expected results (Altman et al., 2004). This condition can occur if management is unable to meet the projected financial conditions. The financial plans that the authorities cannot be achieved, so that management performance assessments decrease.

This risk is actually faced by all stakeholders such as fund owners and shareholders (Akintoye et al., 1998). The value of Islamic banks for fund owners as *shahibul maal* is more aimed at the level of profit sharing. Expectations for increasingly growing profit sharing will decrease if the results turn out to be the opposite. Return risk will occur and in time it can affect customer and even public trust in Islamic banks (Chatta & Bacha, 2017). For owners, risks will be faced in each financial year, because the hope of obtaining value for shareholders cannot be fulfilled by management. If this condition occurs in the long term, it means that there has been a decline in company value (Beidleman et al., 1990). If this risk is not immediately mitigated, it could be detrimental to shareholders because it will further reduce the value of the company. Therefore, Khan and Ahmed, (2001) stated that "risk can be defined as the variability or volatility of unexpected outcomes".

Management is obliged to mitigate risks, even before the risks occur (Grimsey & Lewis, 2002). Failure to anticipate this can have an impact on the emergence of other risks, known as systemic risk. Systemic risk is a risk where the failure of a bank not only causes losses directly faced by owners, customers, employees and the general public but also has an impact on the collapse of the national economy. The occurrence of systemic risk can be triggered by solvency, liquidity factors and national and international economic turmoil (Rustam, 2013). Islamic banking is a financial industry that contains a higher level of risk compared to other industries (Hamza, 2013). Therefore, the Islamic banking industry needs stricter regulation (highly regulated and supervised industry). This is influenced by the nature of the Islamic banking business which manages public funds and channels them back to the community (Riduwan & Pranata, 2020). The nature of the Islamic banking business which is more of a service nature is greatly influenced by public trust. Therefore, management needs to implement a better risk management system (Buscaino et al., 2012). The failure to manage risk in banking can have a wider impact because in general an economic crisis starts with a banking crisis (Khan & Ahmed, 2008).

Global economic disruption continue to shape national and international markets, affecting various sectors (Dayrit & Mendoza, 2020). The micro and small business sectors remain particularly vulnerable, often experiencing disproportionate economics strains. Regional economies that dependent on the tourism and education sectors, such as Bali and Yogyakarta, experienced more serious impacts due to shifting consumer behaviour, economic uncertainty and policy changes.

These financial uncertainties have direct impact on the Islamic financial services industry. Research by Riduwan et al., (2021), indicates that external shocks can lead to a 21% reduction in micro-costumer instalments and a 17% decline in saving and deposits. This condition triggers the emergence of financing risk and liquidity risk at the same time (Dirian et al., 2025). A difficult situation occurred at a relatively similar time, namely when a customer's instalments decreased, other customers withdrew their savings. If liquidity risk cannot be controlled, it can lead to other, more serious risks, such as a decline in reputation and trust (Vento & Ganga, 2009). The ability to manage risks is needed so that Islamic banks can survive in difficult economic situations.

Financing risk mitigation must be carried out both before the risk occurs and when the risk occurs (Hassan, 2009).

Financing risk mitigation can be started by making projections of potential risks that will occur (Wang et al., 2022). The projection of a risk shows that there are early symptoms that the risk will occur. Islamic bank management is obliged to take action to prevent risk; that is when there are symptoms of a situation that is less profitable economically and can have an impact on risk (Grimsey & Lewis, 2002). The complexity of Islamic banking business and services is still often an obstacle in anticipating risks (Mokni et al., 2016). Islamic banks with a variety of products and contracts mean that risk identification is often hampered so that preventive action on risks becomes too late. This condition triggers the emergence of other banking risks, so that the longer the delay time, the lower the management's ability to anticipate risks (Donkor & Duffey, 2013).

Financing risk in Islamic banks can occur due to internal and external influences from Islamic banks (Iyer & Purkayastha, 2017). Research by Kong et al., (2008), shows the fact that internal factors have a more dominant influence than external factors. Various internal factors that influence the occurrence of risks include moral hazard from Islamic bank employees, elements of negligence and collusion with their customers (Riduwan & Pranata, 2022). Meanwhile, external factors that have an impact on Islamic bank risk include natural disasters, health disasters such as pandemics and other factors beyond the reach of humans. External factors are often difficult to recognize, so risk events can occur at any time. Management needs to apply early warning and high alertness, to anticipate risks due to external factors (Belkin et al., 1998).

The type of financing risk that can be measured is the occurrence of problematic financing or non-performing financing (Ahmed, 2009). This risk indicates the customer's inability to repay his obligations, both principal and profit sharing or margin. Islamic banks are very interested in maintaining the level of performance of productive activities, because they are the main source of income (Istina et al., 2024). Mistakes in mitigating financing risk lead to hampered liquidity (Karlan & Zinman, 2008), and decreased profit sharing or financing margins. The influence of problematic financing on public trust was studied by Khan & Bhatti (2008), and the results showed that high levels of problematic financing can reduce trust, especially for fund owners. Saving customers or fund owners want better returns compared to conventional banks (Kabir et al., 2015). If these expectations are not able to be served by Islamic banks, it can cause a condition called displaced commercial or customers who save funds withdraw their funds and move them to other banks (Thomas, 2000).

Financing risk can also be influenced by the contract used (Riduwan & Pranata, 2020). Therefore, Islamic banks will tend to avoid using contracts that have higher risks than other contracts (Mollah et al., 2017). Profit sharing contracts (*mudarabah* and *musyarakah*) have higher risks than *murabahah* and *ijarah* contracts. Profit sharing risk lies in the uncertainty of the results that Islamic banks will receive in each instalment period (Miah & Sharmeen, 2015). Besides that, the complexity of the profit sharing administration system makes customers tend to be unwilling to use the contract (Haryono et al., 2016). Sale and purchase contracts (*murabahah*) and rental contracts (*ijarah*) are more widely used by Islamic banks and are in demand by customers because they are simpler and provide certainty of results (Tesemme, 2017).

Financing risks due to external factors continue to challenge financial institution (Riduwan et al., 2021). Many Islamic banks implement financing relaxation policies in order to maintain good financial performance, even though the quality of their productive activities remains unchanged (Nahar et al., 2022). The high level of financing relaxation indicates high financing risk (Gool et al., 2012). A pandemic that occurs over a long period of time can exacerbate financing risks (Nicola et al., 2020). Financing relaxation can be carried out for customers whose businesses have been affected by the pandemic. The reference standard for relaxation is based on Financial Services Authority regulations; that is customers can pay obligations according to their ability, in the form of partial principal or margin obligations and only share the profits (OJK, 2022). This condition has an impact on the low inflow of funds. A study conducted by Mahfudz, (2020) shows that there is an increase in other risks if problematic financing conditions cannot be resolved.

High financing risks in long term period can reduce public confidence, so mitigation capabilities and the implementation of sustainability strategies are needed (Fatemi & Fooladi, 2006). The collaboration with industry in one economic ecosystem can encourage economic sustainability (Arya & Sripastava, 2019). Even though sustainability is an abstract element (Bateman, 2005), Islamic banks must still formulate survival strategies to maintain business sustainability. According to Dyllick & Muff, (2016), management still often experiences difficulty in narrating internal problems so that the formulation of sustainability strategies becomes weak. Active involvement of all lines of the company may reveal various causes of problems within the company, (Baz & Laguir, 2017). Changes in policy strategy need to be made to respond to changes in the dynamically growing economic situation (Dyllick & Muff, 2016). Given the evolving landscape of financial risks and economic instability, Islamic banks must strengthen their mitigation strategies to ensure resilience and sustainability. The increasing complexity of financial products and contracts has heightened risk exposure, requiring adaptive approaches to risk management. This study applies banking risk theories, including displaced commercial risk and liquidity risk management, to evaluate the effectiveness of financing risk mitigation at Islamic banks. By addressing these challenges, the research aims to contribute to the development of sustainable financial strategies aligned with contemporary banking needs and global economic stability.

Methods

This research was conducted at the *Bank Perekonomian Rakyat Syariah* (BPRS) in Yogyakarta. The total population was 13 BPRS with a research sample of 3 BPRS spread across Bantul, Yogyakarta, and Sleman. The three regions were selected because they host numerous BPRS head offices. Additionally, all three are major tourist and educational hubs, making them particularly sensitive to economic fluctuations. This study examines the financing risk management and sustainability strategies at *Bank Perekonomian Rakyat Syariah* (BPRS). Primary data was obtained through in-depth interviews with bank administrators and supervisors, while secondary data was obtained through official financing risk management policy documents. The data analysis uses a qualitative descriptive approach and linking findings to established Islamic banking theories.

Result and Discussion

Economic uncertainties and market fluctuations continue to impact the performances of BPRS, leading to the implementation of financing relaxation policies. The financing relaxation policy needs to be implemented for two reasons: the interests of Islamic banks and their customers. For Islamic banks, financing relaxation is part of a technique for maintaining financial performance, especially productive activities, so that they remain optimistic. If relaxation is not carried out, problematic financing will experience a significant increase. Therefore, relaxation can administratively maintain good financing performance.

Customers are also interested in the relaxation policy, which is increasing the ability to survive due to the decline in business affected by the economic downturn. Relaxation policies to reduce margins or profit sharing and reduce principal instalments have a positive impact on the continuity of customers' businesses. Apart from that, administratively, these customers' collectability level is maintained because they remain at the current customer level. However, the relaxation of financing has a negative effect on Islamic banks, causing them to decrease liquidity, profit sharing, and reputation.

Table 1. Financial Data of BPRS (2020-2024)

Period	Financing Relaxation (%)	Problematic Financing (%)	Return on Asset (%)	Return on Equity (%)
2020	11,7	6,24	1,77	20,31
2021	26,7	5,97	1,99	23,64
2022	25,9	5,45	1,60	19,91
2023	9,4	6,62	1,77	21,05
2024	-	4,55	2,76	29,28
Average	18,4	5,7	1,97	22,83

Source: Official Document of Islamic Bank (2023)

Relaxation of financing has the potential to be problematic or carry high risk. However, without its implementation, financial risks may inevitably arise, potentially leading to broader instability. From Table 1, it can be stated that financing relaxation at BPRS is classified as very high, because the average is at 18.4%. There is a tendency for relaxation to increase, and the peak will occur in 2021 and 2022. Even though the relaxation application policy is relatively strict, relaxation requests continue to occur. The main requirement for providing relaxation is that there is a direct influence of economic downturn on the customer's business conditions and that it was relatively smooth before the pandemic occurred.

The relaxation approval process submitted by customers is also very complicated because the management is obliged to ensure the correctness of customer data. Bank officers will first register affected customers and analyze the possibility of payment failure if relaxation is not implemented. The condition of the debtor's business is a determining factor in the decision to apply for financing relaxation.

Financing Risk and Sustainability Strategy

Financing risk has the potential to cause losses to financial institutions as a result of debtors' failure to fulfil their obligations (Fatemi et al, 2006). The risks can come from various sources, including the debtor's inability to repay the loan, changes in macroeconomic conditions, market volatility, and changes in regulations or government policies. These risks have a significant impact on the profitability and stability of financial institutions.

By analyzing the data of problematic financing, it can be recognized that there is a relationship between high levels of relaxation and the risk of problematic financing. In 2021, when relaxation is at 26.7%, problematic financing is at 5.97%, and then also experiences contraction if there is a change in relaxation, as happened in 2022 and 2023. In 2022, financing relaxation is at level of 25.9%, the position of problematic financing was 5.54%, but in 2023, when relaxation was at 9.3%, a far decrease from before, it turned out that problematic financing was at 6.62%, up higher than in previously. The relaxation conditions reflect the potential for problematic financing or at least the potential for risks to occur.

However, the effect of financing relaxation does not occur for company profit ratios, such as Return on Assets (ROA), Return on Equity (ROE), because the average is still above the minimum standard required by the Financial Services Authority, that is 1.78% which is higher than the minimum standard of 1% and ROE is at 21.23%, higher than the minimum standard equal to deposit profit sharing. Only in 2022, there will be a rather serious contraction because ROA and ROE will decrease from before.

The financial ratio affected is the Financing to Deposit Ratio (FDR) or the ratio between funds received to financing disbursed, which is 72.69%, lower than the authority's minimum standard of at least 80%. The lowest condition will be in 2022, where the FDR position is at 68.49%. However, Islamic banks were able to survive and even continued to experience business growth. Based on official documents of risk management policy and in-depth research through interviews, it was obtained from the data during the economic downturn that management prioritized collaborative and selective strategies with an ethical rather than legal approach (Adaga et al., 2024). This means that management gives high appreciation to customers and employees who consistently carry out work standards that meet strict health protocols and take a non-financial approach to customers (Sancha et al., 2023), such as providing compensation and other social programs, (Harel, 2021). Meanwhile, a selective strategy was carried out, especially in providing new financing and relaxation policies. The business sectors that are not affected by the pandemic will be prioritized and approvals will be tightened for providing financing relaxation facilities.

Sustainability strategy in the context of financing refers to the approach taken by financial institutions to ensure that their financing operations support long-term sustainability goals. This strategy includes efforts to integrate environmental, social and governance (ESG) aspects into financing decisions (Khan, 2022). The financial institutions may consider financing environmentally friendly projects, ensuring that the debtor's business practices do not damage the environment or violate the human rights, and adhere to the high standards of ethics and transparency (Weber & Feltmate, 2016). Apart from that, the management has also made many changes to internal policies such as the use of new technology, implementation of risk management and good governance. The management simultaneously makes various changes to respond to the latest changes, such as technological adaptation, service and approaches to consumers (Ferrel, 2019).

Microfinance, like BPRS customers in general, has a higher risk than secondary and large financing (Ibtisem & Bauri, 2013). However, in general, the risk of Islamic banks is lower than conventional banks (Chamberlain et al., 2020). Risk mitigation capabilities can be started by scoring customers based on existing financial data (Gool et al., 2012). Banks are required to be able to analyze the influence of external conditions, before a risk event occurs (Abedifar, 2013). Micro businesses have high economic turnover and strong repayment capacity (Godquin, 2004). However, administratively, they are unable to fulfil banking requirements (Giné et al., 2010). This condition creates high risks and causes Islamic banks to be uninterested in financing, especially if there is an economic downturn (Nicola et al., 2020)

BPRS is not responsive enough to external events that affect financial performance. Microfinance risk mitigation that is not carried out properly has not been able to prevent risks from occurring (Fatemi & Fooladi, 2006). The high level of financing relaxation and problematic financing is an important indicator of risk events in Islamic banks. Islamic bank management is not capable enough to manage potential risks, which shows that there is still weakness in measuring, monitoring and controlling financing risks, thus affecting financing performance (Abdulla et al., 2012).

Islamic banks have successfully carried out financing relaxation and mitigation of financing risks due to relaxation, so that the negative effects do not affect financial performance (Disemadi & Shaleh, 2020). Various profitability performance ratios still show a growth, such as RAO, ROE. Meanwhile, the negative influence of relaxation is found in the NPF and FDR ratios. The increase in NPF can be influenced by a decrease in FDR, because good quality financing is getting lower, while in fact, the ability to withdraw financing has decreased. Even though financing risks have increased and profits have decreased, Islamic banks are able to survive and maintain business sustainability by implementing internal and external policy innovations (Cerciello et al., 2022), such as strengthening employee spirituality, a more social and humanist approach to customers (Manasakis, 2018), changes in financing standards, selective distribution of funds, digital-based services, and collaboration with other financial industries.

Conclusion

Islamic banks have shown significant resilience during the economic downturn compared to conventional banks. There are several factors that support this resilience such as Unique Operational Principles for which it shows that Islamic banks operate based on Islamic principles; that is the prohibition of usury (interest) and the implementation of a profit-sharing system. This system creates a closer relationship between banks and customers, where risks and profits are shared together. This allows Islamic banks to be more flexible in dealing with uncertain economic situations, such as those that occurred during the pandemic.

Furthermore, the portfolio diversification of *Bank Perekonomian Rakyat Syariah* tends to have a more diverse financing portfolio, including financing for sectors that are more resistant to economic shocks, such as the agricultural, health and small and medium enterprises (SMEs) sectors. This helps Islamic banks to minimize financing risks that may arise due to the pandemic. Focus on the Real Economy: Islamic banks focus more on the real economy by funding real and productive business activities. This is different from conventional banks which focus more on the financial sector. This focus allows Islamic banks to remain relevant and support economic growth despite the crisis.

Public trust is the main thing in BPRS as during the pandemic, there has been an increase in trust in financial institutions that are based on ethical and moral values. Islamic banks, with their Islamic values, have gained more trust from people who are looking for more stable and fair financial solutions in times of crisis. Supportive regulations, the government and financial services authorities provided additional support to Islamic Rural Bank during the pandemic, both through monetary and fiscal policies. This helps Islamic banks to remain liquid and operate smoothly**.**

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