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SOCIO ENVIRONMENT COMPENDIUM

VOLUME 4(1), 2021

eISSN: 2636-9656

2021

-SOCENTIUM-
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FACULTY OF BUSINESS AND
MANAGEMENT
UNIVERSITI TEKNOLOGI MARA



THE IMPACT OF ECONOMIC CYCLICALITY ON FINANCIAL RISKS: EVIDENCE OF ISLAMIC MICROFINANCE INSTITUTIONS

**International Journal Business and
Emerging Markets**

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LET'S GET TO KNOW

ABOUT

Loan portfolio is the largest asset component and a source of risk that a microfinance institution needs to treat carefully. The quality of the loan portfolio is very crucial as the loans are typically not backed by any physical collateral. Having dual roles of achieving social and financial objectives, lenders require the microfinance institutions to have long-term financial sustainability. The study aims to gauge whether financial risks of Islamic and conventional microfinance institutions are pro-cyclical to economic conditions.

DESIGN/METHODOLOGY/ APPROACH

The study utilises the dataset of 39 microfinance institutions for Afghanistan, Bangladesh and Pakistan from 2007 to 2013.

FINDINGS/EXPECTED FINDINGS

Findings indicate that financial risks are pro-cyclical with economic conditions for both Islamic and conventional banking institutions. However, Islamic microfinance institutions are exposed to a higher financial risk during an economic downturn.

ORIGINALITY/VALUE/ CONTRIBUTION

This implies that Islamic microfinance institutions should improve the quality of their portfolio to preserve sustainability and resilience.

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