

## Integration and Role of Islamic Business Ethics in Mitigation of Financing Risks in Sharia Rural Bank (BPRS) In Indonesia

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### ABSTRACT

**Introduction:** The high rate of Non-Performing Financing (NPF) at Sharia rural banks (BPRS) in the last five years (2021-2025) reaching 10,36% in 2025, indicates that the technical and administrative risk management approaches implemented so far have not been fully effective in addressing the problem of problematic financing

**Methods:** This study employed a qualitative approach, employing literature studies and analyzing secondary data published by the Financial Services Authority.

**Results:** The findings indicate that Islamic Business Ethics (IBE) strengthens financing risk mitigation in BPRS through three main mechanisms: (1) preventing moral hazard by internalizing trust, honesty (sīdīq), and responsibility; (2) Strengthening Management and Employee Integrity and increasing contract transparency through clarity and fairness while avoiding gharar; and (3) Sharia-Based Risk Culture Formation and strengthening partnership-based relationships based on ta'āwun and distributive justice. Thus, IBE functions not only as a normative-ethical principle, but as a strategic and preventive behavioral risk control mechanism that complements conventional risk management and supports sustainable financing quality and institutional stability in BPRS.

**Conclusion and suggestion:** BPRS needs to integrate Islamic Business Ethics values more systematically into their financing risk management policies. Internalizing the values of trustworthiness, honesty, and responsibility is not sufficient if outlined solely in a code of ethics; it needs to be reinforced with an ethics-based monitoring and performance evaluation system.

**Keywords:** Islamic Business Ethics, risk mitigation, moral hazard, Non-Performing Financing (NPF), BPRS

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## INTRODUCTION

Sharia Rural Banks (BPRS) play a crucial role in promoting Islamic financial inclusion, particularly in financing the micro, small, and medium enterprises (MSMEs) sector, which forms the backbone of the local economy in Indonesia. Data shows that MSMEs contributed approximately 60% to Indonesia's Gross Domestic Product (GDP) from 2021 to 2025 (BPS, 2025). As microfinance institutions adhering to Sharia principles, BPRS are required not only to meet the community's financing needs but also to maintain the integrity of Islamic values in all aspects of their operations. The development of the national Islamic financial industry from 2021 to 2025 showed a relatively stable growth trend despite facing global economic pressures. The Islamic banking sector, including BPRS Banks, recorded an increase in assets, financing, and third-party funds in line with increasing public literacy and preference for a Sharia-based financial system. This establishes BPRS's strategic position within the national Islamic financial ecosystem.

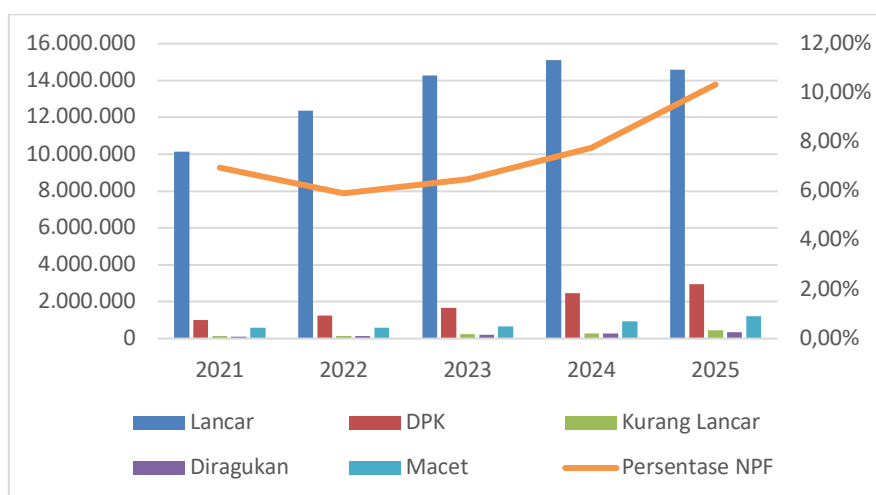
The Financial Services Authority (OJK) plays a crucial role in overseeing and strengthening the Islamic Rural Bank (BPRS) industry through risk management-based regulations. Regular oversight of the Non-Performing Financing (NPF) ratio, capital, and governance is conducted through the publication of Sharia Banking Statistics (SPS). This regulatory strengthening has been proven to contribute to increased transparency, stability, and resilience of BPRS in managing financing risks. Post COVID-19 pandemic, BPRS faced challenges in financing restructuring, declining asset quality, and liquidity pressures due to the weakening repayment capacity of MSMEs customers. However, the economic recovery phase encouraged institutional transformation through service digitization, strengthened financing feasibility analysis, and enhanced prudential banking principles (April et al., 2024). This momentum also strengthened the risk management system at the operational level.

In terms of governance, the implementation of Good Corporate Governance (GCG), Sharia compliance, and the internalization of Islamic business ethics are important instruments in reducing moral hazard and the risk of non-performing financing. Several empirical studies have shown that good governance has a significant correlation with NPF stability and the long-term sustainability of BPRS performance (Sabrina et al., 2025). As Islamic microfinance institutions, BPRS play a strategic role in financing MSMEs, particularly the informal segment that is underserved by conventional banking. BPRS performs an intermediary function by collecting and distributing funds based on the principles of fairness, transparency, and freedom from usury (R. Ramadhani et al., 2023). Financing schemes such as murabahah, mudharabah, and musyarakah are tailored to the business needs of customers, while simultaneously positioning BPRS as partners in local economic development (Danial et al., 2024). Literature research shows that BPRS play a significant role in providing Sharia-based capital, such as murabahah, musyarakah, and profit-sharing, which can reach MSMEs with limited collateral and high business risks conditions that often hinder MSME access to conventional formal financing (D. N. Ramadhani & Wafaretta, 2023).

The characteristics of MSMEs customers with limited capital and relatively high business risks require BPRS to strengthen financing supervision, mentoring, and education. Financing risk, reflected in the NPF ratio, is a crucial indicator of bank health. Therefore, controlling financing risk through good governance, integrated risk management, and strengthening institutional capacity are key prerequisites for the sustainability and resilience of BPRS in supporting the national economy (Riduwan et al., 2024). Financing risks that are not managed properly have a significant impact on the financial health and performance of BPRS. Specifically, non-performing financing can affect: Liquidity, because funds expected to be returned from customers are held back, reducing the bank's ability to meet short-term

obligations; Profitability, because the burden of provisions and losses arising from non-performing financing erodes profits; Public trust, because a high NPF ratio can reduce the confidence of depositors and potential customers in the stability of the bank; Industry stability, because if many BPRS experience financing problems, this has the potential to create a systemic effect that weakens confidence in the Islamic microfinance sector as a whole.

The following presents the significance of the NPF percentage of BPRS in Indonesia from 2021 to 2025, with an annual increase. The NPF rate in 2021 was 6.91%, and in 2025 it reached 10.36%.



**Figure 1. Prosentase NPF BPRS 2021-2025**

Source : OJK June 2025, Processed

On the other hand, in disbursing financing, BPRS face financing risks, which are the most dominant threat in the Islamic banking industry, thus requiring a comprehensive and contextual risk management approach to Sharia (Lubis, 2024). The challenge of maintaining financing quality at BPRS cannot be separated from the structure of the financing portfolio, which is highly concentrated in certain sectors, particularly the real-estate sector (Rahmah et al., 2024). In this context, the NPF level at Islamic Rural Banks is strongly influenced by the risk characteristics of each economic sector being financed.

**Tabel 1. BPRS Non-Current Financing by Economic Sector**

Economic Sectors	2021	2022	2023	2024	2025
Agriculture, forestry and agricultural facilities	48 644	35 704	54 059	71 950	99 064
Mining	6 325	5 458	7 122	13 563	17 896
Manufacturing	21 117	12 994	26 003	40 833	56 853
Water, gas and electricity	2 277	1 248	2 546	1 994	2 496
Construction	112 219	111 858	156 757	202 786	336 528
Trade, restaurants and hotels	183 612	169 686	232 729	382 290	458 697
cargo storage and communication	26 486	8 461	10 676	21 041	36 591
Business Services	32 715	53 515	85 230	135 697	194 954
Social Services	124 831	164 917	194 269	175 020	251 525

<b>Economic Sectors</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>	<b>2025</b>
Others (MSMEs)	274 730	290 669	334 899	425 690	569 972
<b>Total</b>	<b>832.955</b>	<b>854.509</b>	<b>1.104.291</b>	<b>1.470.866</b>	<b>2.024.576</b>

Source: OJK June 2025, Processed

This table shows non-current financing of BPRS by economic sector for the period 2021–2025 (data from the Financial Services Authority). Overall, the total non-current financing increased sharply each year, from 832,955 (2021) to 2,024,576 (2025), indicating a growing risk of BPRS financing. The majority of non-current financing is concentrated in the trade, restaurants, and hotels, construction, social/community services, and other sectors, which are the largest contributors each year. These sectors experienced significant increases, particularly in 2023–2025. Meanwhile, sectors such as electricity, gas, and water, and mining contributed relatively little. Essentially, non-current financing of BPRS continues to increase, dominated by the trade and construction sectors, making these two sectors the primary sources of financing risk.

Furthermore, in practice, this financing disbursement must be accompanied by adequate risk management. Financing risk management in Islamic banking currently often focuses on technical analysis such as the 5Cs + 1S (Character, Capacity, Capital, Collateral, Condition) + Sharia Compliance and evaluation of customer financial capacity (Zulkifli, 2024). Therefore, technically, it does not encompass the moral and ethical dimensions fundamentally inherent in the Islamic economic system. Islamic business ethics places the values of monotheism, trustworthiness, honesty, justice, and social responsibility as the primary orientation in all economic interactions, emphasizing not only legal compliance but also the internalization of moral values in the behavior of financial institutions and economic actors. Studies of Islamic business ethics in Islamic banking emphasize that strong Sharia compliance will support operational sustainability and increase public trust in the institution, while simultaneously distinguishing Sharia practices from conventional ones (Suhendi et al., 2023).

The technical nature of risk management approaches demonstrates the urgent need to develop a value-based risk mitigation model. Integrating Islamic business ethics into risk management not only broadens the scope of analysis from financial to behavioral aspects but also has the potential to strengthen long-term stability by fostering a culture of trust, honesty, and social responsibility in financing practices. This approach is particularly relevant for Islamic rural banks (BPRS), which have close social ties with MSMEs customers, making the ethical dimension more influential than merely technical administrative instruments (Soediro et al., 2024).

Several studies on financing risk mitigation in Islamic banking have been conducted previously. Among these, research on the implementation of Islamic business ethics in the context of financing risk mitigation remains relatively limited, particularly in studies that integrate Islamic values normatively with risk mitigation strategies implemented by BPRS. Many studies on business ethics in Islamic banks emphasize general principles such as honesty and social responsibility without linking them theoretically to the risk management function (Setiawan et al., 2025). Similar research conducted by Mahardhika focused on technical aspects such as risk identification, 5C feasibility assessment, and quantitative measurement of credit risk without deeply exploring how Islamic moral values such as justice, equality, and social responsibility can directly mitigate risk behavior or moral hazard at the operational level (Mahardhika et al., 2024). Meanwhile, existing Islamic business risk literature largely discusses the general framework of risk management or risk sharing, but has not

explicitly addressed how Islamic ethical values can serve as a financing risk mitigation instrument to strengthen financing quality and reduce NPF (D. N. Ramadhani & Wafaretta, 2023).

Recent research reinforces the premise that *maqasid al-shariah* provides contributions beyond traditional normative foundations and can also be used to enrich risk management frameworks oriented toward ethics and social responsibility. For example, research by (Agung Nugraha et al., 2025) shows that *maqasid* values such as *hifz al-mal* (protection of wealth), *hifz al-nafs* (protection of life), and *hifz al-din* (protection of religion) have been internalized in the financing feasibility analysis and monitoring processes of Islamic banks, with empirical results showing a decrease in the non-performing financing (NPF) ratio and increased customer trust when these principles are consistently applied in financing decisions (Agung Nugraha et al., 2025).

Other research also notes that most studies on *maqashid al-Shariah* primarily discuss implementation within the context of legal regulations, product compliance, or international governance such as ESG, while its application as a risk mitigation instrument for ethical value-based financing has not received adequate empirical attention in the context of microfinance institutions or Islamic MSMEs (Khairunnisa et al., 2025). Furthermore, quantitative research on Islamic banks in several developing countries shows that risk management systems tend to adopt conventional models based on the Basel Framework and then normatively adapt them to Islamic principles, without a profound paradigm transformation of values. This suggests that risk management is more focused on controlling financing exposure and balance sheet stability, rather than on establishing an ethical culture as a risk prevention mechanism from the beginning of the financing process (Syarifah & Rosman, 2024).

Argumentatively, financing risks in Islamic rural banks (BPRS) and Islamic banking stem not only from economic factors such as income fluctuations or macroeconomic conditions, but also from ethical deviations, including fraud, information manipulation, asymmetric information, and opportunistic behavior. When the values of trustworthiness and honesty are not internalized, even technical analysis such as the 5Cs + 1S are ineffective in preventing problematic financing. Therefore, integrating a technical approach to risk management and the internalization of Islamic business ethics is a fundamental strategy for maintaining financing quality, strengthening public trust, and ensuring the long-term operational sustainability of Islamic financial institutions. While previous research has made significant contributions to understanding the determinants of financing risk and the importance of ethics in Islamic economics, there are still limitations in the integrative aspect. To date, research integrating Islamic Business Ethics as a variable for mitigating financing risk, conceptually and empirically, has only examined the specific context of BPRS in the post-pandemic period of 2021–2025, with significantly increased financing risk pressures, and simultaneously linking ethics, governance, and financing stability. This remains relatively limited in the national literature.

Considering this gap, this study seeks to offer a more comprehensive approach by analyzing Islamic Business Ethics as a financing risk mitigation instrument in Islamic rural banks (BPRS) in Indonesia. This study not only examines the technical mechanisms of risk control but also examines how Islamic ethical values are internalized in financing policies, customer selection processes, monitoring, and organizational culture. A qualitative approach, through a documentary study of official reports from regulators such as the Financial Services Authority (OJK) and Bank Indonesia, as well as the annual reports of the BPRS industry for the 2021–2025 period, is used to provide a holistic empirical picture of the relationship between ethics, governance, and financing stability.

Therefore, this study is expected to enrich the literature on financing risk mitigation management in Islamic banking by presenting an integrative perspective on Islamic Business Ethics and BPRS financing stability, while also providing conceptual and practical contributions to strengthening the Islamic microfinance industry in Indonesia.

## LITERATURE REVIEW

### Basic Concepts of Islamic Business Ethics

Islamic Business Ethics is a set of moral principles derived from the Qur'an, Sunnah, consensus (ijma'), and analogy (qiyas) that govern human economic behavior in order to achieve *falah* (well-being in this world and the hereafter). Unlike conventional business ethics, which tend to be based on economic rationality and utilitarianism, Islamic business ethics is rooted in the monotheistic paradigm, which positions economic activity as part of worship and a trust (Asmar et al., 2023). According to classical scholars such as Al-Ghazali and Ibn Khaldun, economic activity must be carried out based on the principles of justice ('adl), balance (tawazun), and benefit (Pohan et al., 2023). In the contemporary context, Islamic business ethics encompasses the following principles:

**Table 2. Basic Concepts of Islamic Business Ethics**

No	Basic Concepts of Islamic Business Ethics	Explanations
1	Tawhid (Unity of God):	The awareness that all economic activity is under the supervision of Allah.
2	'Adl (Justice)	Avoiding harm to others and upholding fairness.
3	Amanah (Trustworthiness)	Responsibility and integrity in managing funds.
4	Shiddiq (Honesty)	Transparency of information and reporting.
5	Tabligh (Communicative and educational)	Conveying accurate information.
6	Fathanah (Professionalism and competence)	Skill in business management.

Source: OJK June 2025, Processed

These principles serve as the normative foundation for all Islamic economic institutions, including the Islamic financial industry (Keuangan, 2021).

### Islamic Business Ethics in the Islamic Finance Industry

Islamic Business Ethics (IBE) is a set of moral values derived from the Quran and Sunnah that govern economic behavior in a fair, transparent, and responsible manner. In the context of Islamic finance, business ethics not only serves as a moral norm but also serves as the operational foundation of financial institutions, maintaining a balance between profitability and social welfare (Soediro et al., 2024). Conceptually, Islamic business ethics is based on the principles of monotheism (tawhid), justice ('adl), trustworthiness (amanah), goodness (ihsan), and social responsibility (mas'uliyah). The principle of monotheism positions economic activity as an act of worship, so every transaction must be free from *gharar* (worship), *riba* (usury), and *maisir* (gambling). (Haqi & Muchlis, 2024). Meanwhile, the principle of trustworthiness (amanah) requires financial institutions to maintain customer trust through transparent contracts and responsible fund management. In modern Islamic financial practices, Islamic Business Ethics is also closely linked to the concept of *maqasid al-Shariah*,

particularly the protection of assets (*ḥifz al-mal*). The values of monotheism and justice (*‘adl*) contribute to a strong moral foundation in the Islamic economic system, ensuring that businesses are not merely profit-seeking but also morally responsible to the wider community. This concept is seen as a solution to the moral crisis in many contemporary economic practices (M. Ilham et al., 2025).

The implementation of ethical values has been proven to improve an institution's reputation, customer loyalty, and long-term financial stability because business decisions are based not only on economic rationality but also on moral considerations. Recent research shows that the internalization of Islamic ethics in Islamic banks has a positive impact on governance quality and stakeholder trust, as the implementation of Islamic values such as transparency, accountability, fairness, and Sharia compliance strengthens customer trust and corporate reputation, which in turn enhances customer loyalty and the sustainability of the institution's financial performance. For example, empirical research shows that transparency and sharia compliance within the framework of Good Corporate Governance have a significant effect on increasing customer trust in Islamic banks, thereby strengthening long-term relationships between banks and stakeholders and strengthening the overall operational stability of banks (Sulistiyo et al., 2020a).

### **Financing Risks Faced by Sharia Rural Banking (BPRS)**

Financing risk is the primary risk faced by BPRS because it is directly related to the quality of the financing portfolio disbursed to customers. The Non-Performing Financing (NPF) ratio is used as a key indicator to measure the percentage of non-performing financing (default or delinquent) within a financing institution's overall portfolio. Recent empirical articles indicate that financing risk remains a primary focus in studies of Islamic banking management risk in Indonesia, particularly BPRS, and serves as a direct measure of the health financing situation (Liestyowati, 2024). A panel study of BPRS noted that various internal variables such as the operational efficiency ratio (BOPO), profitability, and bank size significantly influence NPF, indicating that NPF is not a single indicator but also reflects the quality of management and efficiency in financing decision-making (Siska Lutfiana & Dita Andraeny, 2025).

BPRS generally focus financing on the MSMEs (Micro, Small, and Medium Enterprises) segment due to their local financial inclusion strategy. However, the characteristics of MSMEs, such as limited collateral, income volatility, and high dependence on local economic conditions, create higher credit risk compared to Islamic commercial banks (Liestyowati, 2024). In this context, MSMEs financing often exhibits a higher NPF than corporate or commercial financing. A recent quantitative case study showed that MSMEs in the Islamic Sharia-compliant financial institutions (BPRS) tend to have a higher NPF than non-MSMEs, which is a key driver of problem financing in the Sharia sector (Anwar & Sari, 2025). Theoretically, Sharia financing risk management adopts prudential banking principles through the 5C analysis of Character, Capability, Capital, Collateral, Condition, and Sharia Compliance to assess customer eligibility before financing is approved. Empirical studies by BPRS show that consistent application of the 5C and 1 SC can help identify customers with high-risk profiles and prevent financing problems, particularly through evaluating the customer's business character and repayment capacity as a first step in risk mitigation (Studi et al., 2024).

### **Risk Theory and Financing Risk Management**

From an economic, financial, and Islamic perspective, risks should not only be avoided but also addressed through proportional mitigation. The following are several theories closely related to the various risks faced by Islamic banking, particularly in financing distribution.

Credit/Financing Risk. In banking literature, credit risk, or in the Sharia context, financing risk, is the potential loss resulting from a customer's failure to fulfill obligations under a contract. In a BPRS (Small Bank Restructuring Agency), this risk is reflected in the Non-Performing Financing (NPF) ratio, which indicates the proportion of non-performing financing to total financing. The asymmetric information theory introduced by George Akerlof explains that an imbalance of information between lenders and borrowers can trigger market failure. In the context of BPRS, MSMEs customers often lack formal financial reports, resulting in banks facing limited information regarding the capacity and character of their businesses. This situation increases the risk of misjudgment of financing.

The consequence of information asymmetry is the emergence of adverse selection. The selection of high-risk customers due to imperfect information. Moral Hazard: Changes in customer behavior after the contract is concluded, for example, inappropriate use of funds. In BPRS, which frequently use relationship-based financing, the risk of moral hazard is relatively high if supervision is weak. Recent research shows that strong sharia governance can reduce moral hazard and financing risks (Rosidi et al., 2024). Risk management in Islamic banking follows systematic stages:

*First*, Risk Identification: The initial process of identifying risk sources, including financing risk, liquidity risk, and operational risk. In Islamic rural banks (BPRS), identification is carried out through analysis of business characteristics, economic sectors, and customer track records. *Second*, Risk Measurement: Risk measurement is carried out through: Non-Performing Financing (NPF) ratios, collectibility analysis, and probability of default calculations. Research shows that quantitative indicator-based measurement needs to be combined with a maqashid sharia approach to be more contextualized to socio-economic risks (Agung Nugraha et al., 2025). *Third*, Risk Control: Control is carried out through policies limiting financing to specific sectors, determining collateral, and portfolio diversification. A study of Islamic rural banks (BPRS) in Riau showed that strengthening risk mitigation policies can increase the institution's resilience to spikes in NPF (Adiyes Putra et al., 2025). *Fourth*, Risk Monitoring: Monitoring is conducted periodically through installment payment evaluations, field visits, and an early warning system. Recent research shows that active monitoring has a significant effect on reducing non-performing financing at BPRS (Binti Mu'akhirah et al., 2025).

## **METHOD**

This descriptive qualitative approach was chosen for the following research, along with documentation studies and content analysis. This approach was then used to gain a deeper understanding of the role of Islamic business ethics in mitigating financing risks at Islamic rural banks (BPRS) during the 2021-2025 period. The descriptive research aims to systematically describe the development of the BPRS industry, the dynamics of financing risks, and the strengthening of regulations and governance within the context of the national Islamic financial industry (Susilowati & Falikhatun, 2023). The data used is secondary data sourced from official documents and publications of financial institutions. The primary source is the Islamic Banking Statistics (SPS) report published by the Financial Services Authority (OJK) on its official website ([www.ojk.go.id](http://www.ojk.go.id)) for the 2021-2025 period, as well as various reports from Bank Indonesia. Supporting data was obtained from BPRS annual reports, reference books, and scientific articles and journals relevant to the themes of Islamic business ethics and financing risk management (Widarjono & Hapsari, 2024).

The data collection technique was conducted through documentation, namely the process of identifying, selecting, and classifying documents based on relevant themes such as financing quality, NPF ratio, risk management regulations, and the implementation of governance and Sharia compliance. The collected data was then analyzed using a thematic content analysis approach through the stages of data reduction, theme grouping, and interpretation (Asmar et al., 2023a). The theoretical framework used includes Islamic Business Ethics, Financing Risk Management, and the concept of Risk Mitigation in Islamic banking. The integration of these three frameworks provides an analytical tool to explain how the internalization of ethical values such as honesty, trustworthiness, justice, and transparency functions not only normatively but also operationally in strengthening financing risk control and maintaining the stability of BPRS (Hendri et al., 2025).

## RESULT AND ANALYSIS

### Characteristics of Islamic Rural Bank Financing Risks in Indonesia (2021-2025)

The Islamic financial industry, including Sharia Rural Banks (BPRS), frequently faces financing risk. This financing risk represents the potential for losses resulting from customers' failure to meet their short-term and long-term obligations. In conventional banks, this financing risk is equivalent to credit risk, and it is also the risk that is frequently encountered, with the largest and most dominant percentage. Meanwhile, the financing risk characteristics commonly inherent in Islamic banking include the financing structure and quality (Widarjono & Hapsari, 2024).

#### Financing Structure

Based on Islamic banking statistics released by the Financial Services Authority (OJK) for 2021-2025, the financing structure of Sharia Rural Banks (BPRS) was dominated by working capital financing, with an average proportion reaching 45%-55% of total financing, with this segment being channeled to MSMEs. This segmentation dominance indicates that the primary risk for BPRS is its reliance on the financial stability of MSMEs and public purchasing power.

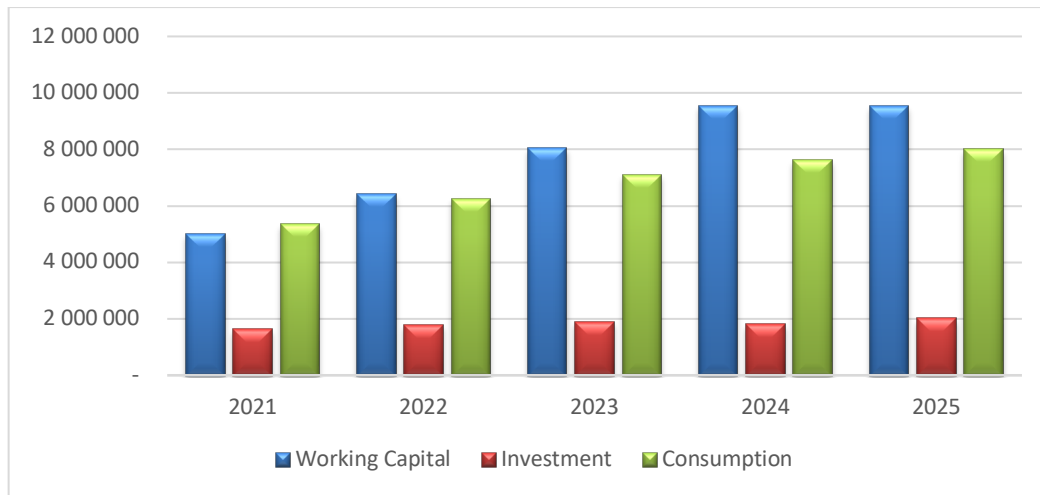
**Table 3. The structure of BPRS financing usage for 2021-2025 (in millions of Rupiah).**

Type of Use	2021	2022	2023	2024	2025
Working Capital	5 000 389	6 412 857	8 033 645	9 540 591	9 531 403
Investment	1 637 637	1 787 144	1 903 083	1 815 946	2 006 770
Consumption	5 345 774	6 248 275	7 088 729	7 628 999	8 003 279

Source: OJK June 2025, Processed

Table 3 type of Use data for 2021–2025 shows the development of financing use based on working capital, investment, and consumption purposes. In general, all three types of use have increased year over year. Working capital experienced a significant increase from 5,000,389 in 2021 to approximately 9,531,403 in 2025, indicating the increasing need for business actors to finance business operations. Investment financing tended to be more stable with slight fluctuations, but still increased from 1,637,637 in 2021 to 2,006,770 in 2025. Meanwhile, consumption financing also continued to increase from 5,345,774 in 2021 to 8,003,279 in 2025, reflecting the increasing public demand for financing for personal needs.

Overall, working capital was the largest source of financing, followed by consumption and investment. This indicates that financing is primarily used to support business activities and consumer needs. If illustrated in the figure, there is a striking difference between each type of use.



**Figure 2. The structure of BPRS financing usage for 2021-2025 (in millions of Rupiah).**

Source: OJK June 2025, Processed

For investment financing, the portion obtained is relatively smaller, ranging from approximately 20% to 30%. Investment financing also carries more complex long-term risks, depending on business prospects, regional economic cycles, and customer managerial competency. This was evident in 2021-2022, when investment volumes were low. Then, economic recovery took place between 2023 and 2025 after the pandemic, with investments reaching 2,006,770 million in 2025. Massive economic mobility, with investment showing a positive trend, is evident. However, if prudent measures and early risk mitigation are not implemented, a number of risks will be encountered (Astuti et al., 2024b).

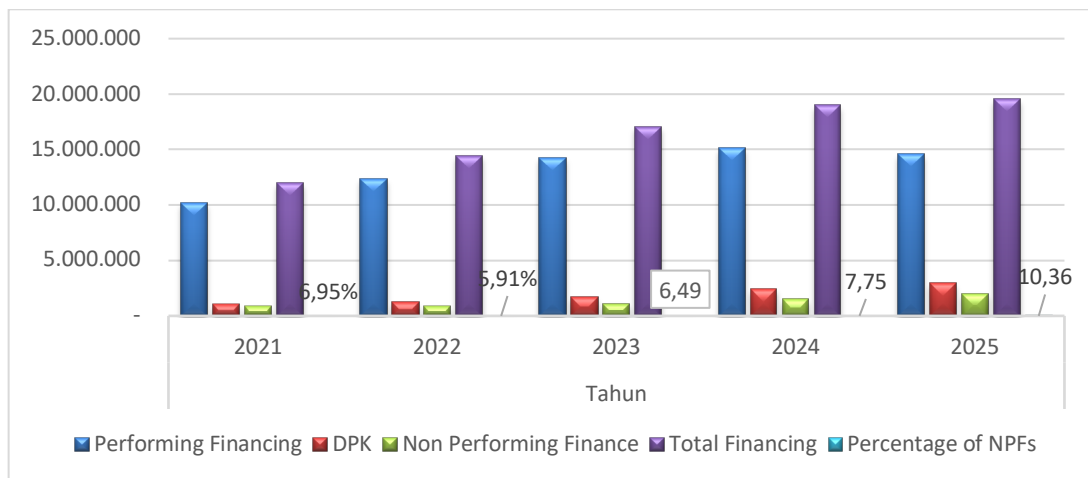
Financing risks are also frequently encountered, particularly in consumer financing. Consumer financing in the 2021-2025 period was in the range of approximately 20% to 25%. Risks in this segment are relatively more manageable than working capital, as it generally uses a fixed-margin murabahah financing scheme. However, risks remain when household income declines due to inflationary pressures and economic slowdown.

### Financing Quality

The financing risk characteristic that BPRS inevitably face is financing quality. Financing quality indicators can be seen from trends in non-performing financing (NPF) and the distribution of financing quality. A rising NPF trend signals that BPRS must take immediate action to mitigate financing risks, as it can impact BPRS operations. The following data shows the level of BPRS financing collectibility in Indonesia. Financing quality is one of the characteristics of financing risk that cannot be avoided by BPRS. Financing quality can be seen from the development of non-performing financing (NPF) and the distribution of financing collectibility levels. An increasing NPF trend indicates an increasing risk of problematic financing, requiring BPRS to take immediate mitigation measures to maintain operational stability and financial health. Therefore, monitoring the level of financing collectibility is crucial

as an indicator for assessing financing quality and the ability of BPRS to manage financing risk.

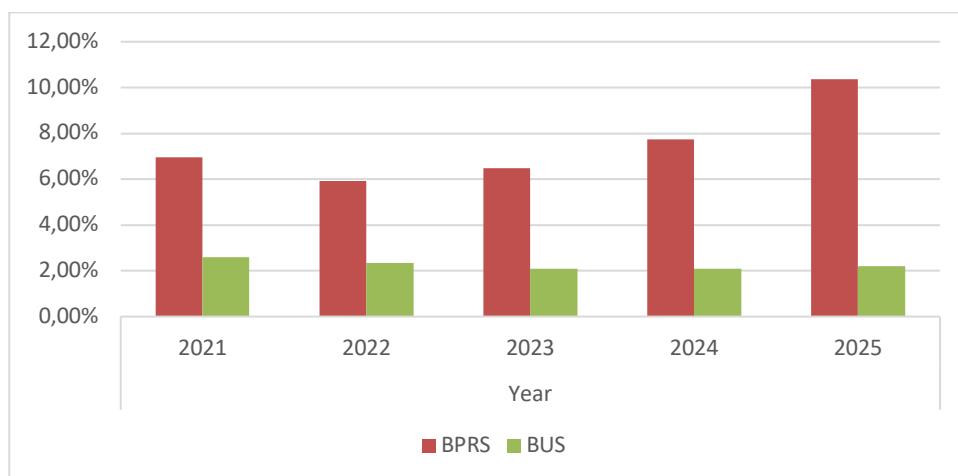
The following data shows the collectibility level of BPRS financing in Indonesia



**Figure 3. Collectibility of Financing for 2021-2025**

Source: OJK June 2025, Processed

According to OJK data, the NPF ratio of Islamic rural banks (BPRS) has shown a periodic upward trend from 2021 to 2025. It began at 6.95% in 2021 and reached 10.36% in 2025. This contrasts with Islamic banks (BUS), which remained in the 2% range. This puts the NPF ratio of BPRS at a higher level than that of Islamic commercial banks (BUS).



**Figure 4. Percentage of NPFs between BUS and BPRS**

Source: OJK June 2025, Processed

Several researchers have stated that the high NPF (Non-Performing Loan) ratio in BPRS (Small Business Institutions) reflects the inherent financing risk characteristics of small, loss-prone customer businesses, their continued reliance on the informal sector, and their limited risk management systems (Siska Lutfiana & Dita Andraeny, 2025). Meanwhile, the distribution of BPRS financing quality, as classified by the Financial Services Authority (OJK) for the 2021-2025 period, shows significant dynamics in both volume and risk quality, which subsequently impacts the categorization of financing as current, special mention, substandard, doubtful, and non-performing (default). The following is a compilation of BPRS financing quality categorizations for 2021-2025.

**Tabel 4. Collectability of Financing BPRS During 2021-2025**

Collectibility of financing	Years				
	2021	2022	2023	2024	2025
Performing Financing	10.138.834	12.358.430	14.262.782	15.105.878	14.573.996
DPK	1.012.012	1.235.336	1.658.383	2.408.792	2.942.880
Non Performing Financing	832.955	854.509	1.104.291	1.470.866	2.024.576
Sub-Standard	128.118	129.464	225.528	283.424	450.017
Doubtful	102.094	120.769	208.439	265.145	360.299
Lost	602.742	604.276	670.325	922.296	1.214.261
Total Financing	11.983.801	14.448.275	17.025.456	18.985.536	19.541.452

Source: OJK June 2025, Processed

Current financing consistently increased from IDR 10.13 trillion in 2021 to IDR 15.10 trillion in 2024. However, it experienced a slight slowdown in mid-2025, declining to IDR 14.5 trillion. This was due to several factors, including a 10.36% increase in non-performing financing, which resulted in a reduction in current financing. Furthermore, segmentation within the MSMEs sector, the dominant customer base for BPRS financing, experienced a weakening, which directly impacted borrowers' capacity, resulting in an increase in non-performing financing. Furthermore, global and domestic economic uncertainty also hampered financing. Based on the current financing trend at BPRS, when analyzed from a sharia banking risk management perspective, current financing reflects the quality of financing appraisals, the accuracy of contracts, post-contract monitoring, and the alignment of risk profiles with management's financing policies.

Meanwhile, in the special attention category for 2021-2025, there was a significant increase from IDR 1.01 trillion (2021) to IDR 2.94 trillion (2025). Theoretically, the third-party funds (DPK) category is an early warning signal in financing risk management. In credit risk management theory, DPK reflects a decline in customer repayment capacity, the potential for moral hazard, and the impact of macroeconomic pressures on MSMEs, which are the primary market segment of BPRS. Furthermore, a consistent increase in DPK indicates a weakening quality of the financing portfolio and has the potential to drive an increase in the NPF in the following period. Non-performing financing at BPRS (School Based Banks) for the 2021–2025 period showed a significant upward trend, from IDR 832.9 billion in 2021 to IDR 2.02 trillion in 2025. This increase occurred progressively across all categories, namely Substandard, Doubtful, and especially Loss, which increased from IDR 602 billion to IDR 1.21 trillion. Structurally, the dominance of the non-performing category indicates that some financing has passed the initial distress stage and entered the loss of economic value (loss) phase (Hidayati, 2025). From a credit risk management perspective, this condition reflects an increased probability of default (PD) and loss given default (LGD), which directly increases the risk exposure of BPRS financing portfolios. This phenomenon also indicates weaknesses in the early warning system, early restructuring, and post-contract monitoring, resulting in financing that should have been rescued at the substandard or doubtful stage instead migrating to the loss category (Abrar ZA, 2024).

From the perspective of information asymmetry theory, the increase in non-performing financing can be explained by adverse selection mechanisms and higher moral hazard in the micro and informal segments, the primary segment of BPRS. Limited customer financial information and the dominance of character-based lending approaches increase the risk of misjudgments in repayment capacity (Rahmawan, 2025). Furthermore, in the context of the economic cycle, pressure on the real sector has the potential to reduce customer cash flow, accelerating the transition from collectibility to non-performing. Academically, the consistent increase in non-performing financing over five years indicates that the problems are structural, not simply short-term fluctuations. This necessitates strengthening risk governance, improving the quality of financing analysis, and integrating Sharia-based prudential principles into the entire financing cycle of BPRS.

## DISCUSSION

### Financing Risk Mitigation Practices at BPRS

Regulatory documents and official industry reports indicate that BPRS financing risk mitigation practices tend to focus on technical mechanisms such as financing feasibility analysis, performance monitoring, and 5C assessments. Some of these practices align with general risk management principles, but they do not address the value-based aspect of developing decisions based on Sharia ethics. Empirical studies show that BPRS generally still rely on a technical approach as the core of their financing risk mitigation practices, which include:

**Table 5. Core Financing Risk Mitigation Practices in BPRS**

No	Core Financing Risk Mitigation Practices		Explanations
1	Financing Feasibility Analysis		Before financing is disbursed, banks conduct a feasibility analysis based on the financial aspects of prospective borrowers to predict the potential for default. This analysis includes the business profile, repayment capacity, and cash flow projections of borrowers, which are assessed as feasible or not.
2	Financing Monitoring	Performance	After financing is disbursed, BPRS implement performance monitoring on fund utilization and installment payment flows, including identifying early warning signals that could lead to problematic financing
3	5C Assessment (Character, Capacity, Capital, Conditions, Collateral) + 1S (Sharia Compliance)		Banks use the 5C principle in the underwriting stage as a primary indicator for evaluating the financing risk of prospective borrowers, particularly in popular products such as murabahah.
4	Non-Performing Management	Financing	Several studies by BPRS (Small Business Credit Institutions) in Riau indicate that the high risk of non-performing financing (NPF) has prompted banks to segment their financing and tighten disbursement policies to maintain control over their NPF.

Technical Implications: Although this mechanism aligns with general risk management principles in the banking sector, its limitation is that the analysis focuses primarily on quantitative aspects of repayment capacity, collateral, and borrower profile without explicitly considering the broader Sharia framework (Sulistiyo et al., 2020a). Recent empirical research shows that socioeconomic factors, including economic inequality and the operational efficiency of Islamic rural banks (BPRS), significantly influence the NPF level of Islamic rural banks in Indonesia, underscoring the importance of financing diversification to reduce high NPF ratios (Syarifah & Rosman, 2024).

Several risk mitigation measures are implemented through portfolio Diversification: Reducing the concentration of financing in only one segment (MSMEs) by adding financing to other, relatively more stable segments. Stricter Credit Analysis: Implementing a quality credit scoring approach and aggressive risk analysis before disbursing financing. MSMEs Assistance: Islamic rural banks can provide business management assistance to MSMEs customers to improve their repayment capacity, thereby reducing the risk of non-performing financing.

Examples of these mitigation measures are recommended in the Islamic financing risk management literature, including 5C analysis and the development of a data-based monitoring system for early detection of potential non-performing financing. Furthermore, in the context of Islamic ethics, financing risk mitigation means that every policy, financing decision, and mitigation strategy not only avoids *riba* (usury), *gharar* (excessive uncertainty), and *maysir* (speculation) but also upholds the *maqāṣid* (objectives of sharia). Recent scientific studies indicate that the *maqāṣid* (objectives of sharia) has begun to be applied as a framework for risk assessment and decision-making in financing at Islamic banks, including BPRS (Small Sharia Banks), indicating a more holistic direction for risk mitigation (Agung Nugraha et al., 2025).

**Table 6. Comparison of BPRS Risk Mitigation Approaches**

No	Aspec	Current Technical Approach	Value Based Decision Making Approach Islamic Ethics)
1	Main Focus	Repayment Capacity, Collateral, Non-Performing Financing (NPF)	Debtor Welfare, and Maqāṣid Sharia
2	Decision Basis	Financial Analysis	Financial Analysis + Ethical Values
3	Evaluation Output	Default Risk & Profitability	Economic & Social Impact + Sharia Compliance
4	Key Indicators	5Cs, Non-Performing Financing (NPF), DSCR	5C + 1S + Maqashid Sharia Index
5	Objectives	Maintaining Bank Stability	Maintaining Community Stability & Welfare

Source: Synthesis of BPRS scientific articles 2023–2025

### **The Role of Islamic Business Ethics in Financing Risk Mitigation Behavior at BPRS**

Islamic Business Ethics is not merely a formality for Sharia compliance, but also serves as a driving instrument for effective financing risk mitigation behavior. Thematic analysis shows that Islamic Business Ethics impacts three main domains:

#### **Moral Hazard Prevention**

In the context of Islamic financing, moral hazard is one of the primary risks that needs to be mitigated. In profit-sharing financing, such as *mudharabah* and *musyarakah*, this risk

arises primarily because the bank lacks full control over the customer's business behavior after the contract is signed, creating the opportunity for customers to provide inaccurate information or misappropriate financing funds for purposes other than the initial agreement. Moral hazard is also often correlated with low awareness of customer compliance with financing provisions, which then impacts high NPF rates (Kadir & Katili, 2021).

Islamic Business Ethics fundamentally emphasizes the values of honesty (shiddiq), trustworthiness, and responsibility (mas'uliyah) as the core of Islamic transactions. Thus, Islamic business ethics plays a crucial role in preventing moral hazard by instilling the values of trust and fairness in financing relationships. These values are not only considered moral norms but also serve as an internal control mechanism to mitigate the potential for moral hazard (Fahrezi & Hamka, 2025). By internalizing Islamic ethical principles in the customer selection process and financing implementation, BPRS is expected to foster a strong moral awareness among customers, enabling them to act honestly and responsibly in the use of financing funds. Islamic ethics encourages customer accountability in the trust entrusted to them by the institution, thus lowering the potential for misuse of funds compared to systems based solely on commercial contracts (Aprilian & Sudarmawan, 2024). In this context, the value of trust makes customers more responsible in their selection, capital use, and reporting of business activities, thereby reducing the tendency for misuse of funds or report manipulation, which are the core of moral hazard (syauqiyah, 2025).

### **Strengthening Management and Employee Integrity**

Second, Islamic business ethics serves to strengthen management integrity, requiring bank leaders and employees to be not only technically competent but also to possess a moral commitment to the principles of fairness and transparency. High management integrity has been shown to correlate with reduced fraud rates and improved financing quality in Islamic financial institutions (Anwar & Sari, 2025). The implementation of Islamic Business Ethics in BPRS operations serves as an anchor of integrity for management and employees. This integrity is a concrete manifestation of the values of Siddiq (honesty) and Tabligh (transparency), which are mandatory for every Islamic banking employee. Operationally, this management and employee integrity is manifested in the transparency of contracts, which is the primary preventative approach to mitigating financing risks (Adiyes Putra et al., 2025).

Islamic ethics emphasizes that every contract (akad) must be drafted clearly, fairly, and free from uncertainty (gharar). Employee integrity is required to ensure that customers are explicitly aware of their rights and obligations without any hidden information (Syarifah & Rosman, 2024). Quantitative research shows that transparency regarding the disclosure of costs, profit margins, and contract components significantly influences customer perceptions of contract fairness. When this transparency aspect is adequately met by employees with integrity, customer trust increases, thereby minimizing the potential for disputes due to misunderstandings about contract terms (Sulistiyo et al., 2020a).

The integration of management integrity into the contract transparency process at BPRS contributes directly to risk mitigation through three main mechanisms:

- a. **Clarity of Rights and Obligations:** Detailed information provided by employees with integrity enables customers to understand the consequences of financing, including profit-sharing proportions and potential risks of loss. This prevents unilateral claims in the future.
- b. **Risk Transparency:** Openly communicating the risks of losses and resolution mechanisms builds a high level of trust. Honest management will minimize misinterpretations, which are often the root of problematic financing. Contract clarity will undoubtedly strengthen the legal relationship between customers and BPRS.

- c. Legality and Certainty of Relationships: Clarity of contracts that are guarded by the moral integrity of management will strengthen the legal relationship between customers and BPRS, thereby creating legal certainty based on ethics (Mahardika et al., 2024).

### **Sharia-Based Risk Culture Formation**

Third, Islamic ethics foster a healthy risk culture within the organization. A Sharia-based risk culture instills the awareness that risk management is part of the responsibility of worship and trust, not merely an administrative obligation (Sulistiyo et al., 2020b). Thus, all levels of the organization are encouraged to be prudent and professional in disbursing financing. Islamic business ethics plays a fundamental role in transforming risk management from mere administrative compliance to a healthy organizational culture (risk culture). A Sharia-based risk culture is rooted in a value-based financing approach that emphasizes the Maqasid al-Shariah principle, where financial institutions' contributions are directed toward social aspects, justice, and sustainability, going beyond mere financial gain (Wahyuning & Khotimah, 2025).

The Value-Based Intermediation (VBI) model conceptually encourages BPRS to treat customers as partners, not merely debtors. This paradigm shift increases customer commitment to payment obligations because they feel involved in a larger, more equitable economic goal. The implementation of this risk culture is clearly reflected in the musyarakah contract, which upholds fairness through the proportional distribution of profits and losses as agreed (Astuti et al., 2024a). The operational manifestation of this risk culture is clearly reflected in the musyarakah contract, where the bank and customer agree to share profits and mitigate the risk of loss fairly and proportionally (Yunus & Rizal, 2025). By maintaining a mutually reinforcing partnership based on Islamic ethics, BPRS can mitigate financing risks through two main channels: **First**, building honesty through mutual trust is the first step in creating an ecosystem of honesty. When customers feel they are considered business partners by the BPRS, they feel a sense of moral responsibility to be honest. This automatically reduces the customer's desire to conceal profits or provide false data (information asymmetry). This culture of mutual trust becomes the most effective risk mitigation tool because customers feel that maintaining the bank's continuity is part of maintaining the blessings of their own business (Mubarok et al., 2026).

The second, family friendly business mentoring (Consultative Monitoring) is the second step, changing the way banks supervise customers. While supervision often feels like "rigid collection" in conventional banks, in Islamic ethics, supervision is carried out through mentoring. BPRS officers act as discussion partners, helping customers find solutions if their businesses encounter problems. With this open and family-friendly communication, potential default risks can be detected early, allowing the bank and customer to find solutions together before problems escalate (Sulistiyo et al., 2020b).

### **Integrating Islamic Business Ethics with Financing Risk Mitigation**

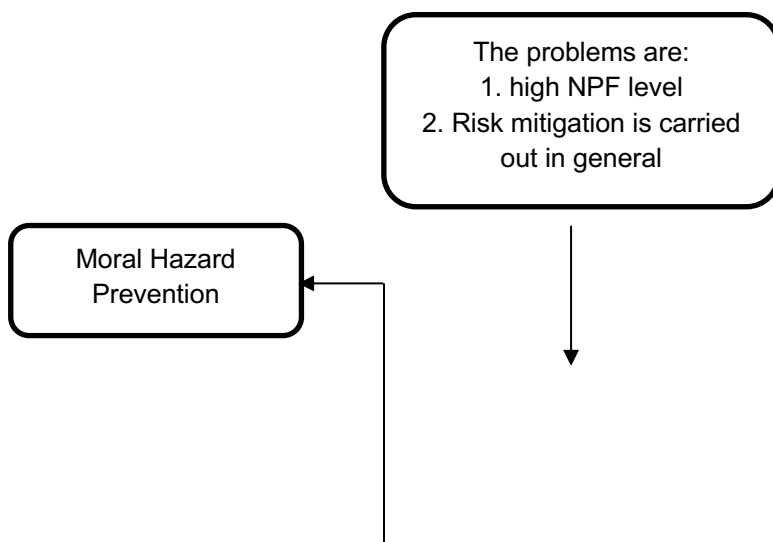
The integration of Islamic Business Ethics into financing risk mitigation represents a more holistic approach than simply a technical risk management model. In addition to assessing the financial aspects of financing, value-based risk management also prioritizes Islamic moral values such as honesty, trustworthiness, justice, and concern for welfare as strategic instruments to prevent moral hazard and unidentified risks at an early stage (Mahardika et al., 2024). These values serve as a risk prevention mechanism because they influence the behavior of financing actors from the selection stage to business monitoring (Agung Nugraha et al., 2025).

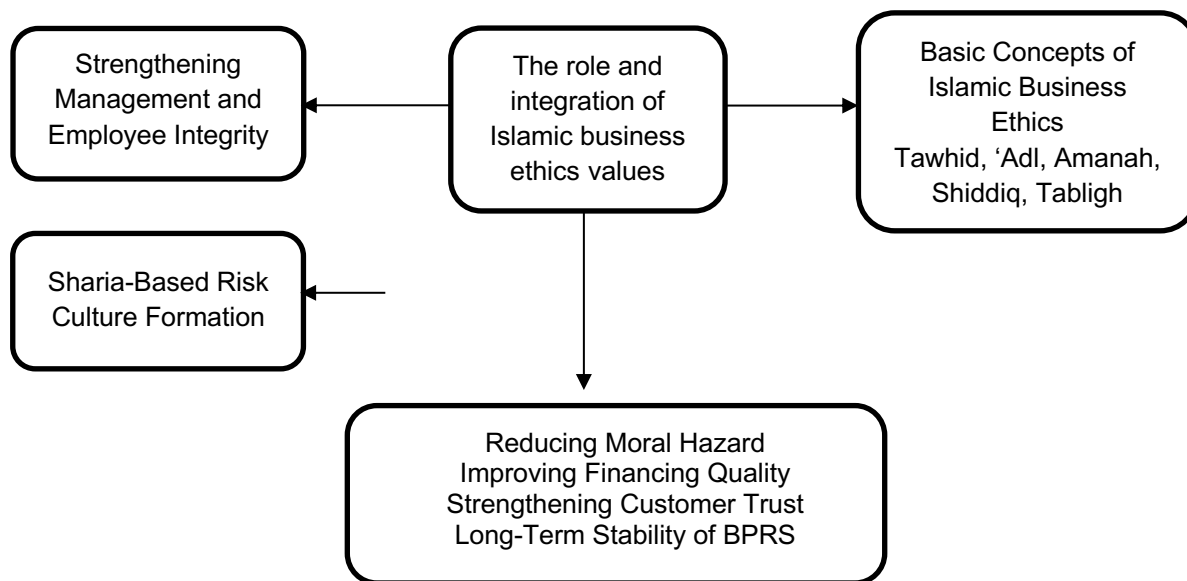
From an Islamic perspective, financing risks are not solely related to financial aspects, but also the consequences of low integrity, weak adherence to sharia-compliant contract principles, and a lack of moral responsibility on the part of transaction participants. Ethical values such as trustworthiness and honesty are considered fundamental elements that can minimize the tendency for opportunistic behavior (moral hazard), as they create an honest, fair, and transparent cooperative environment. The integration of Islamic ethical values into financing decisions has a positive impact on financing stability. The maqasid sharia values embedded in the entire decision-making process enable Islamic banks to focus more on sustainability and the welfare of society, rather than solely on profit. Through this approach, the relationship between banks and customers becomes more trust based, resulting in a lower risk of default and greater financing sustainability (Asmar et al., 2023a).

Furthermore, the integration of Islamic Business Ethics into BPRS risk management plays a crucial role in reducing NPF. The values of trustworthiness, fairness, and transparency of contracts encourage more selective financing analysis and more responsible monitoring. This approach reinforces the principle of prudence in fund distribution (Mahardika et al., 2024). Therefore, the integration of Islamic Business Ethics into BPRS risk management is not only normative, but also operational and strategic in reducing the NPF ratio. Briefly, this integration can be formulated in the following points:

1. Internalization of Trustworthiness Values in Screening  
Encourages deeper character assessment to minimize adverse selection.
2. Transparency of Contracts as Preventive Control  
Clarity in margins, ratios, and payment obligations reduces the potential for disputes and moral hazard.
3. Relationship-Based Monitoring Approach  
Monitoring is not only administrative, but also based on business development and partnerships.
4. Strengthening Sharia Risk Culture  
An organizational culture based on the values of monotheism, honesty, and responsibility increases risk awareness across all levels of management.
5. Integration of the 5Cs with Islamic Moral Values  
Character is associated with trustworthiness. Capacity is associated with responsibility. Capital is associated with fair risk distribution. Collateral is associated with the principle of prudence. Condition is associated with consideration of the benefit.

The following presents the results of the integration and role of Islamic business ethics in mitigating financing risks at Islamic rural banks (BPRS) in Indonesia from 2021 to 2025. Integrating Islamic business ethics values and roles is expected to reduce the level of non-performing financing, the highest percentage of which is due to moral hazard.





**Figure 5. The Concept of Integration and the Role of Islamic Business Ethics in Mitigating Financing Risks in BPRS**

## CONCLUSION

Based on the discussion, it can be concluded that financing risk issues in BPRS (School Based Financial Institutions) for the 2021–2025 period are not solely caused by external economic factors, but are also related to behavioral risk, particularly moral hazard, low contract transparency, and weak partnerships between institutions and customers. The high NPF ratios in some BPRS indicate that risk mitigation approaches relying solely on 5C analysis and administrative procedures have not been fully effective in reducing problem financing. Islamic Business Ethics (IBE) plays a strategic role in the BPRS financing risk mitigation system. First, it serves as a normative foundation that instills the values of trustworthiness, honesty, and responsibility throughout the financing process. Second, it serves as a preventative mechanism that fosters ethical behavior within both the institution and customers, thereby reducing the potential for moral hazard. Third, it serves as an instrument for strengthening Sharia-based good corporate governance, increasing contract transparency and building sustainable partnerships. The novelty discovered is that IBE is not merely a complementary moral value but also functions as a core ethical framework in BPRS financing risk management. The integration of technical risk management approaches and Islamic business ethics creates a more comprehensive risk mitigation model that aligns with the characteristics of Islamic financial institutions. Consistent implementation has the potential to reduce the NPF rate and strengthen the stability and sustainability of Islamic rural banks (BPRS) in Indonesia.

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