



# FINANCIAL AND SOCIAL EFFICIENCY ANALYSIS OF ISLAMIC MICROFINANCE INSTITUTIONS

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## ABSTRACT

**Purpose**The purpose of this paper was to investigate the impact of credit risk-taking on financial and social efficiency and examine the relationship between credit risk, capital structure and efficiency in the context of Islamic microfinance institutions (MFIs) compared to their conventional counterparts.  
**Design/methodology/approach**The stochastic frontier approach was used to estimate the financial and social efficiency scores, in a first step. In a second step, the impact of risk-taking on efficiency was evaluated. The authors also took into account the moderating role of capital structure in this effect using the fixed and random effects generalized least squares (GLS) with a first-order autoregressive disturbance. The used dataset covers 326 conventional MFIs and 57 Islamic MFIs in six different regions of the world over the period of 2005&ndash;2015.  
**Findings**The overall average efficiency scores are less than 50%, where CMFIs could have produced their outputs using 48% of their actual inputs. IMFIs record the lowest financial (cost) efficiency that is equal to 28% on average. The estimation results also reveal a negative impact of nonperforming loan on financial and social efficiency. Finally, the moderating effect of leverage funding on the relationship between credit risk-taking and financial efficiency was confirmed in CMFIs. However, leverage seems to moderate the effect of risk-taking behavior on social efficiency for IMFIs.  
**Originality/value**This paper makes an initial attempt to evaluate the effect of risk-taking decision and its implication on efficiency and MFIs&#39; sustainability. Besides, it takes into consideration the role played by the mode of governance through the ownership structure. In addition, this research study sheds light on the importance of the financial support for the development and sustainability of these institutions, which in return, contributes to a sustainable economic

**Keywords:** *Financial and Social Efficiency; Credit Risk-Taking; Capital Structure; Conventional and Islamic Microfinance Institutions; Stochastic Frontier Approach*