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Mitigating failures, ensuring resilience: An analysis of risk management implementations in Indonesian Islamic banks

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A B S T R A K

Manajemen risiko dalam sektor perbankan memiliki urgensi yang tak terbantahkan. Sejarah telah menunjukkan betapa fatalnya konsekuensi ketika risiko diabaikan, seperti pada krisis keuangan tahun 1997 di mana beberapa bank mengalami kegagalan dan harus ditutup. Kegagalan tersebut tidak hanya merugikan pemegang saham, tetapi juga pihak ketiga yang telah menginvestasikan dana mereka. Adanya penelitian ini bertujuan menganalisis implementasi manajemen risiko yang diterapkan bank syariah di Indonesia. Metode yang digunakan dalam penelitian ini menggunakan analisis studi literatur melalui penelitian terdahulu yang relevan dengan penelitian ini. Hasil penelitian menunjukan bahwa mayoritas bank syariah di indonesia menerapkan beragam pendekatan dan langkah-langkah untuk mengelola risiko dengan efektif seperti identifikasi, pengukuran, pemantauan, dan pengendalian risiko. Selain itu, bank syariah juga mengadopsi pendekatan yang komprehensif termasuk analisis 5C.

A B S T R A C T

Risk management in the banking sector has an undeniable urgency. History has shown how fatal the consequences can be when risks are ignored, such as in the 1997 financial crisis where several banks failed and had to close. This failure not only shareholders but also third parties who have invested their funds. This research aims to analyze the implementation of risk management implemented by Islamic banks in Indonesia. The method used in this research uses literature study analysis through previous research that is relevant to this research. The research results show that the majority of Islamic banks in Indonesia apply various approaches and steps to manage risk effectively, such as identification, measurement, monitoring, and risk control. Apart from that, Islamic banks also adopt a comprehensive approach including 5C analysis.

Introduction

The financial sector plays a vital role in the economic structure which is manifested in various entities such as conventional banks and Islamic banks (Nuralam, 2018). The presence of this sector is not only important but also a basic need for the entire community, especially in the payment traffic process and financial services (Kusuma & Asmoro, 2020). The presence of banking is a crucial aspect in facilitating the flow of funds and distribution of credit to various economic sectors. As an intermediation institution, banking has a central role in accelerating overall economic turnover and stimulating sustainable economic growth. According to research conducted by (Ulfa, 2021) sharia banking has the potential to become a pillar that supports economic stability if it continues to be developed. In Indonesia, the development of sharia banking also shows a positive trend (Sudarsono, 2017). This is proven by data from the 2023 Indonesian Sharia Banking Snapshot which notes that 14 Sharia Commercial Banks, 21 Sharia Business Units, and 165 Sharia People's Financing Banks have been formed.

Providing financing by sharia financial institutions to customers is an activity that cannot be separated from the risks that must be faced by the institution (Suib, 2017). This risk is directly related to the expected rate of return from the financing provided. The higher the potential profit, the greater the risk involved. This risk can be personal, namely related to individual characteristics and abilities, as well as external factors such as changing market conditions and regulations. Apart from that, risks can also arise from unexpected situations that are beyond the control of financial institutions, such as economic crises or natural disasters (Launa & Mudjiyanto, 2022). So the principle of prudence becomes essential for banks and other sharia financial institutions. This principle aims to maintain the health of financial institutions and prevent violations of the law. By applying this principle, it can be ensured that the distribution of funds only reaches those who are entitled to receive it and avoid unwanted risks (Batubara, 2022).

Risk management in the banking sector has an undeniable urgency (Muhlis, 2020). History has shown how fatal the consequences can be when risks are ignored, such as in the 1997 financial crisis where several banks failed and had to close (Segaf, 2012). This failure not only harms shareholders, but also third parties who have invested their funds. The decline in the value of bank assets is the main trigger that causes the bank's inability to fulfill its financial obligations (Winanti, 2019). Therefore, implementing serious and consistent risk management is a must to protect banking stability, especially in terms of providing financing. Thus, researchers are interested in reviewing literature studies on risk management in Islamic bank financing in Indonesia. Literature analysis regarding risk management in Islamic banks is considered very important in efforts to provide understanding to the public regarding the level of implementation of risk management practices in Islamic bank financing. This research also aims to offer alternative solutions for bank managers to reduce risks associated with financing.

Discussion

Islamic Bank

Sharia banking is a financial system that operates based on sharia law (Lubis, 2018). One of the main principles of sharia banking is the cessation of usury which is considered a practice of economic exploitation, and the cessation of transactions containing speculation and uncertainty that are contrary to Islamic values (Meylianingrum, 2020). Sharia banking on the other hand supports the principle of fairness in transactions, where banks and customers share risks and profits proportionally. In addition, by avoiding investment in sectors that are considered detrimental to the environment or society, Islamic banking supports economic sustainability and the public interest. Islamic banking plays a significant role in the social, economic and financial fields of a country (Nur'aini, 2022). First, Islamic banking offers financial options that are in accordance with Islamic principles for Muslim individuals who wish to carry out financial transactions . This allows them to conduct financial business without violating their religious beliefs. Second, Islamic banking has the potential to increase financial inclusion by providing financial services to community groups previously not served by the conventional financial system, such as individuals with low incomes and small and medium businesses (Yaqin & Zuleika, 2024). Third, Islamic banking has the potential to become a catalyst for economic growth by supporting investment in fields that require sustainable development, such as infrastructure, agriculture and natural resources. Fourth, sharia banking can also help reduce social disparities by allowing zakat, alms and waqf to be distributed (Furqon, 2015). Thus, Islamic banking plays an important role in promoting financial inclusion, sustainable economic growth, and social justice within a country.

Risk

In general, risk is the possibility of loss or uncertainty in achieving certain goals (Arfan et al., 2016). In the banking context, especially Islamic banks, risk refers to the possibility of financial or reputational loss as a result of various internal and external factors. Islamic banks have different risks compared to conventional banks because their operations are based on sharia principles which prohibit usury, speculation and actions that are contrary to Islamic law (Oktaviana & Handoko, 2015). Islamic banking risks present various complexities that can affect the stability and continuity of the financial institution. When borrowers cannot repay their loans, banks can experience financial losses (Ismanto et al., 2019). Liquidity risk arises when banks have difficulty meeting their obligations due to a lack of cash, which disrupts bank operations (Nurrachmawati et al., 2023). Contract risk refers to the possibility of incompatibility between the structure of sharia products and legal principles. Sharia Compliance Risk indicates possible violations of sharia principles in bank activities, which has the potential to damage public trust. Reputation risk is related to the negative perception of the public or customers towards sharia banks, which can affect the bank's image and credibility in the eyes of the public. Market Risk relates to how the value of bank assets may change due to unpredictable changes in market conditions. Operational Risk originates from changes in market conditions. Legal risks include failure to comply with applicable laws and regulations, which may result in monetary and legal losses for the bank. Moral Risk indicates unethical behavior from parties involved in bank operations, which can damage the bank's reputation and integrity. Social Responsibility Risk involves the incompatibility of bank operations with social or environmental values, which can threaten the long-term sustainability of the bank

(Mustofa et al., 2023). To reduce negative impacts and ensure sustainable operations, Islamic banks must implement effective risk management strategies.

Risk Management

Risk management is the process of identifying, assessing, controlling, and monitoring risks related to the activities or operations of an organization (Melinda & Segaf, 2023). In the financial sector, especially in Islamic banks, risk management is very important because banks operate in an environment full of uncertainty and risk (Mardiana, 2018). Risk management allows banks to identify and manage the risks they face, such as financing risk, liquidity risk, operational risk, and sharia compliance risk, to minimize possible losses and maximize opportunities. The importance of risk management in Islamic banks also lies in fulfilling sharia obligations to protect customer interests and maintain business integrity within the framework of Islamic principles (Rahmany, 2017). Without implementing good risk management, Islamic banks will face a series of serious consequences (Ihyak et al., 2023). Islamic banks can experience significant financial losses as a result of their inability to manage risks related to their financing, investments, or operations. These financial losses can affect the bank's financial health and even threaten the continuity of its operations. In addition, the bank's reputation can be damaged if errors or failures occur in risk management which can cause a loss of trust from the public and customers (Handayani, 2020). A decline in public trust can also have a negative impact on bank liquidity, as customers withdraw their funds from banks due to concerns about their credibility and security. In addition, the failure of Islamic banks to manage risks effectively can lead to violations of Sharia principles such as ribawi or other non-Shariah practices that would substantially threaten the bank's integrity. To maintain the continuity and success of its operations and maintain public trust and the integrity of sharia principles, Islamic banks must implement effective risk management (Pratiwi, 2016). This is because failure in risk management can threaten the continuity of bank operations and the stability of the financial system as a whole (Yanti, 2020).

Based on the results of the analysis of the mapping of research articles regarding risk management of Islamic bank financing in Indonesia, 10 articles are relevant to the context of this research. The results of research conducted by (Rahman et al., 2022) show that the risk management process related to gold installment financing at BSM KCP Bogor Jalan Baru has been carried out through four main steps, namely identification, measurement, monitoring, and risk control. In addition, the most significant risk faced in the context of this financing is credit risk, which will be handled through a detailed evaluation of the five main aspects (5C), namely Character, Capacity, Collateral, Capital, and Economic Conditions. (Julistia & Hayati, 2022) stated that Bank Muamalat Indonesia KC Mas Mansyur Surabaya implemented a risk management approach consisting of several steps. The first step is to establish context, where they thoroughly understand the operational environment and the external factors that influence risk. Next, they carry out systematic risk identification to identify potential threats and opportunities. After that, an in-depth analysis of the identified risks is carried out, taking into account their impact and probability. The next step is risk control and management, where concrete strategies and actions are implemented to reduce previously identified risks. Finally, risks are evaluated periodically to ensure that the implemented risk management approach continues to be relevant and effective in dealing with the dynamics of the business environment. (Wahyuni & Nuroktafiani, 2021) stated that Bank BNI KCP Kuningan has succeeded in implementing risk management in accordance with the Standard Operating Procedures (SOP) set by the company. In providing financing, the bank has adopted a 5C analysis approach which includes Character, Capacity, Collateral, Capital, and Condition. This shows that the bank has carried out a comprehensive risk evaluation process. (Vitadiar & Muttaqin, 2022) found that Bank Jatim Syariah Madiun implemented six steps in risk management related to financing. These stages include determining context, risk identification, risk assessment, risk control, communication and consultation, as well as monitoring and review. At the risk assessment stage, this bank uses an approach involving 5C. (Syahrizal, 2021) stated that the implementation of risk management in capital murabahah financing by the BPD Jambi Sharia Business Unit has reached a satisfactory level. They have successfully identified, measured, managed and controlled the risks involved in the process. (Eprianti et al., 2020) explains that Bank BRI Syariah KCP Setiabudi Bandung implements comprehensive Risk Management in 25 iB micro financing. The approach includes risk identification, risk measurement, risk monitoring and risk control. In the risk identification process, Bank BRI Syariah adopts the 5C principle and carries out BI Checking and Track Checking. These measures aim to minimize the risks associated with 25 ib microfinance products. (Nengsih, 2022) found in his research that Bank Nagari Syariah Batusangkar Branch uses 5C analysis in its financing risk management. (Wahyudi et al., 2021) in his research stated that Bank Syariah Tanggamus implements a risk management process which consists of several important stages such as risk identification, risk measurement, risk monitoring and risk control. One key aspect of this process is the provision of risk information to regulators. This action is carried out with the aim of ensuring that the bank does not experience unexpected losses and to reduce potential risks effectively. (Katman et al., 2022) in their research found that BSI KCP Pettarani Makassar has adopted a proactive approach to risk management. Before the contract is approved, preventive steps are taken to identify and prevent potential risks that may arise in the future. During the contract period, the bank carries out strict supervision and control over the customer's business activities to mitigate related risks. At the final stage or completion of the contract, the process is carried out carefully and involves open communication, ensuring that all parties involved understand and fulfill their obligations appropriately. This shows BSI KCP Pettarani Makassar's commitment to managing risk holistically from start to finish.

Conclusion

The conclusion from the analysis of mapping research articles regarding risk management of Islamic bank financing in Indonesia shows that these banks apply various approaches and steps to manage risk effectively. The risk management process generally involves steps such as identifying, measuring, monitoring and controlling risks as well as adopting a comprehensive approach including 5C analysis. In addition, open communication with regulators and preventive actions are also an integral part of this risk management process. Overall, relevant and proactive implementation shows the Islamic bank's commitment to managing risk effectively from start to finish in the financing process.

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