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ANALYSIS OF THE EFFECTIVENESS OF THE RISK MANAGEMENT APPROACH IN REDUCING FINANCIAL RISK

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The development of the banking sector in Indonesia, which is increasingly dynamic and complex, creates challenges in managing financial risk for banks such as Bank Mega. Failure to identify, measure and manage financial risks can have major consequences. Risk management is the key to overcoming financial risks, involving identifying, measuring, controlling and reporting risks. This research focuses on analyzing financial risk management at Bank Mega and aims to analyze the risk management framework, evaluate the effectiveness of the risk management approach, and provide recommendations. The data used is secondary data and literature. The results show that Bank Mega has implemented good risk management with positive performance indicators. However, it is necessary to pay attention to liquidity, asset quality and risk mitigation to increase the effectiveness of risk management. This research is expected to contribute to understanding financial risk management in the Indonesian banking sector.

1. INTRODUCTION

The development of the banking sector in Indonesia, which is increasingly dynamic and complex, has presented new challenges in managing financial risks for financial institutions. One of the large banks operating in Indonesia, namely Bank Mega, is facing increasing pressure in managing financial risks that can affect the health and continuity of its business. Failure to identify, measure and manage financial risks can result in significant losses, as well as damage the reputation and stability of the financial institution [1].

The risk management approach has become a critical foundation in addressing financial risks in the banking sector. This approach includes the processes of risk identification, risk measurement, risk control and risk reporting. In the context of Bank Mega, with increasingly growing assets, success in managing financial risk will directly impact operational sustainability and the bank's ability to provide safe and reliable services to its customers.

Financial risk management is a critical aspect of modern bank operations. Financial leverage, market fluctuations, foreign currency exposure, and credit risk are some of the various risks banks face [2]. According to Barth et al [3], effective risk management is the key to achieving stability and health of financial institutions. Therefore, banks like Bank Mega must develop strong risk management strategies and processes. The risk management approach involves risk identification, measurement, control, and reporting[4]. Bank Mega has implemented several techniques, such as Value at Risk (VaR) and stress testing, to measure financial risk[5]. These techniques can help banks identify potential risks and measure their impact on the bank's financial health.

Risk management as identifying, measuring, monitoring and controlling risks that can influence achieving an organization's goals. Good risk management can help banks to increase their stability and competitiveness[6][7]. Financial risk management is the process of managing risks related to an organization's finances. Financial risks can occur due to various factors, both unexpected and unexpected. Financial risk management aims to identify, measure and manage financial risks that may be faced by an organization[8][9][10].

The first step in managing financial risk is identifying the risks that may be faced. This includes credit, market, operational, and liquidity risks[11]. Once risks are identified, they need to be measured objectively. This often involves using mathematical and statistical models to quantify these risks [12]. Effective risk monitoring and reporting is key to knowing the extent to which implemented policies and strategies are successful. This allows management to take corrective action if necessary[13].

Risk management theory is important for understanding how financial risks are identified, measured and managed. This theory includes the concepts of risk measurement, portfolio diversification, and risk management based on probability and impact[14]. The effectiveness of financial risk management also involves relevant rules and regulations, such as the Basel regulations for financial institutions[15]. Bank Mega has adopted a risk management approach based on guidelines and regulations issued by the Indonesian banking supervisory authority[16]. Bank Mega also has a risk committee responsible for financial risk management[17]. In addition, the bank has an internal audit unit that plays an important role in ensuring compliance with risk management procedures[17].

A study Pranata [18] shows that Bank Mega has prioritized operational risk management, credit risk and market risk in its operations. This bank periodically performs risk evaluations to identify changes in the economic and market environment. Several studies have shown that the effectiveness of risk management can significantly impact the financial performance of financial institutions. A study Hartadi [19] states that good risk management can help banks reduce losses due to risk and increase profitability.

The importance of the risk management approach in managing financial risk at Bank Mega raises questions about the effectiveness of this approach in reducing risk exposure and increasing the bank's sustainability. Therefore, this research will analyze financial risk management at Bank Mega through a risk management approach.This research is expected to contribute to understanding financial risk management in the Indonesian banking sector, especially at Bank Mega. The results of this research can be a basis for Bank Mega and other financial institutions to improve their financial risk management practices to reduce potential risks and increase the financial stability of the banking sector.

2. METHOD

This research uses a qualitative approach to explore an in-depth understanding of financial risk management at Bank Mega. This approach was chosen because it allows researchers to collect more detailed data, understand the decision-making process, and evaluate the effectiveness of the bank's risk management approach [20]. This research is a case study that focuses on Bank Mega. This case was chosen because Bank Mega is one of Indonesia's large banks with a long history of managing financial risks. This case study will allow researchers to analyze the implementation of bank risk management in depth. The data used is Secondary Data. Secondary data was obtained from financial reports, annual reports, bank risk management policies, and related literature. This data will be used to provide context and support for the findings of the research.

3. RESULTS AND DISCUSSION

Risk Management Framework Analysis

Bank Mega Tbk has a Risk Management policy that is prepared to become a clear standard and reference in implementing Risk Management. This policy includes regulatory provisions such as Financial Services Authority Regulation (OJK). From Bank Mega's General Risk Management Disclosure, which can be seen atrisk_management_policy_2019.pdf (bankmega.com), The framework implemented by Bank Mega consists of five steps, namely:

1) Identify risks
   The first step is to identify all risks the bank may face, both internal and external. Internal risk originates from within the bank, including credit, operational, and market risks. External risks come from outside the bank, such as political, economic, and social risks.
2) Risk assessment
   After all risks have been identified, the next step is to assess these risks based on the probability of their occurrence and the impact they will have. Risks with a high probability of occurrence and a large impact must be managed more seriously.
3) Determining risk management strategies

The next step is to determine the appropriate risk management strategy for each type of risk. Risk management strategies can include avoid strategies, mitigation strategies and transfer strategies.

4) Implementation of risk management strategies
   The next step is to implement the established risk management strategy. Risk management strategies must be implemented effectively and efficiently to ensure that risks can be managed well.
5) Monitoring and evaluation
   The final step is to monitor and evaluate the effectiveness of risk management. Monitoring and evaluation are carried out regularly to ensure that risks remain controlled.

Based on this risk management framework, Bank Mega has implemented good risk management in managing financial risks. This can be seen from several indicators, including:

1) Implementation of standardized risk measurement methods
   Bank Mega has implemented a standardized risk measurement method by applicable regulations. This method is used to measure and monitor risk objectively and accurately.
2) Implementation of an integrated risk management information system
   Bank Mega also implements an integrated risk management information system. This system effectively supports identifying, measuring, monitoring and controlling risks.
3) Risk management policies and procedures that have been established and documented
   Bank Mega has established clear and documented risk management policies and procedures. These policies and procedures become a reference for all employees in identifying, measuring, monitoring and controlling risks.
4) Establishment of an independent risk management work unit
   Bank Mega also established an independent risk management work unit, the Risk Management Work Unit (SKMR). SKMR is tasked with assisting the Board of Commissioners and Directors in active supervision regarding risk management.
5) Implementation of standardized risk measurement methods
   Standardized risk measurement methods, by applicable regulations, have been implemented. This method is used to measure and monitor risk objectively and accurately.
6) Implementation of an integrated risk management information system
   Implementing an integrated risk management information system has also been carried out. This system effectively supports identifying, measuring, monitoring and controlling risks.

The research results reveal that the effectiveness of risk management contributes positively to Bank Mega's financial performance. Some of the findings include:

1) Risk Reduction, with a strong risk management approach, Bank Mega has successfully reduced financial risk exposure, which in turn helps reduce potential losses.
2) Increased Profitability, Good risk management helps banks achieve sustainable growth and profitability. Good risk management provides confidence to investors and customers.
3) Financial Stability, Implementing an effective risk management approach contributes to the bank's financial stability, reducing the likelihood of a financial crisis.

The research results also show that Bank Mega has a structured and comprehensive risk management approach. Some of the key findings include:

1) Organizational structure, Bank Mega has a risk committee comprising senior executives responsible for risk management. This committee plays an important role in decision-making and risk management oversight.
2) Risk Management Approach, Bank Mega uses various techniques and models in measuring financial risk, including Value at Risk (VaR) and stress testing. The use of these techniques helps banks identify potential risks and measure their impact on the bank's financial health.
3) Implementation of Good Corporate Governance (GCG), Bank Mega strictly applies GCG principles in its operations. This includes transparency, accountability and active involvement of the board of directors in strategic decision-making.

Evaluation of the Effectiveness of Bank Mega's Risk Management Approach

In connection with financial risk management at Bank Mega, based on the financial report for June 2023, the data contained in the Performance Ratio table was obtained.

Table 1. Bank Mega Financial Ratio Table

	Performance Ratio	June 30, 2023
1	Minimum Capital Requirement (KPMM)	25.19%
2	Problematic productive assets and problematic non-productive assets to total productive assets and non-productive assets	1.69%
3	Problematic productive assets to total productive assets	1.01%
4	Allowance for impairment losses (CKPN) of financial assets against productive assets	0.59%
5	Gross NPLs	1.36%
6	Net NPLs	1.00%
7	*Return on Assets*(ROA)	3.77%
8	*Return on Equity*(ROE)	20.12%
9	*Net Interest Margin*(NIM)	5.35%
10	Operating expenses to Operating Income (BOPO)	62.62%
11	*Cost to Income Ratio*(CIR)	40.54%
12	*Loan to Deposit Ratio*(LDR)	75.92%

Source: Bank Mega Financial Report for the period June 2023

Bank Mega Financial Ratio Analysis

The following is a further description of each of Bank Mega's financial ratios for the period June 2023

1) Minimum Capital Requirement (KPMM) is a ratio that shows the amount of capital a bank must have to comply with OJK regulations. This ratio is calculated by dividing the amount of bank capital by the amount of risk-weighted assets (RWA). Bank Mega's KPMM is at 25.19%, which means it has sufficient capital to fulfill its obligations to customers and creditors. This shows that Bank Mega has a good level of health. This value meets OJK regulations, which require a minimum KPMM of 8% of total assets.
2) Problematic Productive Assets and Problematic Non-Productive Assets to Total Productive Assets and Non-Productive Assets. This ratio shows the comparison between problematic productive assets and problematic non-productive assets with total productive assets and non-productive assets. This ratio is an indicator of bank asset quality. Based on the data above, this ratio is 1.69%. This value meets OJK regulations, which require this ratio to be a maximum of 5%.
3) Problematic Productive Assets to Total Productive Assets. This ratio shows the comparison between problematic productive assets and total productive assets. This ratio is an indicator of the quality of bank assets. The smaller the value, the better. Based on the data above, the ratio is 1.01%. This value meets OJK regulations, which require this ratio to be a maximum of 5%.
4) Allowance for Impairment Losses (CKPN) of Financial Assets against Productive Assets. CKPN is a reserve formed by banks to anticipate a decline in the value of financial assets. This ratio shows the comparison between CKPN and productive assets. This ratio is an indicator of bank asset quality. Based on the data above, this ratio is 0.59%. This value meets OJK regulations, which require this ratio to be at least 2.5%.
5) Non-performing loans (NPL) is a ratio that shows the percentage of non-performing loans from the total credit disbursed by the bank. NPL is calculated by dividing the number of non-performing loans by the number of loans disbursed. Bank Mega's NPL is at 1.36%, which means a relatively low percentage of non-performing loans. This shows that Bank Mega has good asset quality. The NPL value meets OJK regulations, which require a maximum Gross NPL of 5%.

6) Net NPL is a ratio that compares non-performing loans after deducting CKPN and total credit. Bank Mega's Net NPL is 1.00%. This shows that the quality of Bank Mega's productive assets is also relatively good, and this value meets OJK regulations, which require a maximum net NPL of 3%.
7) Return on Assets(ROA) is a ratio that shows a bank's ability to generate profits from each asset it owns. ROA is calculated by dividing net profit by total assets. Bank Mega's ROA is at 3.77%, which means it can generate profits from every asset it owns. This shows that Bank Mega has a good level of profitability. The ROA value at Bank Mega has met OJK regulations, which require a minimum ROA of 1%.
8) Return on Equity(ROE) is a ratio that shows a bank's ability to generate profits from any capital it has. ROE is calculated by dividing net profit by equity. Bank Mega's ROE is at the level of 20.12%, which means the bank can generate profits from every capital it has, which also means that Bank Mega has a very good level of profitability. OJK sets a minimum ROE limit of 12% so that Bank Mega has fulfilled the provisions.
9) Net Interest Margin (NIM) is a ratio that compares net interest income and total productive assets. The minimum NIM limit determined by OJK is 6%, so in this case, Bank Mega needs to increase its NIM ratio.
10) Operating Expenses to Operating Income (BOPO) is a ratio that compares operational expenses and operating income. Based on the data above, Bank Mega's BOPO is 62.62%. This shows that Bank Mega has good efficiency in managing its operational costs. This value meets OJK regulations requiring a maximum BOPO of 90%.
11) Cost to Income Ratio (CIR) is a ratio that compares interest costs and operating income. This ratio is an indicator of bank efficiency. Based on the data above, Bank Mega's CIR is 40.54%. This value meets OJK regulations requiring a minimum CIR of 30%.
12) Loan to Deposit Ratio (LDR) is a ratio that shows the comparison between total loans and total deposits. OJK sets a maximum LDR of 94%. Based on the data above, Bank Mega's LDR is 75.92%. This value meets OJK regulations. This shows that Bank Mega has utilized its third-party funds optimally.

The following are the achievements obtained by Bank Mega in previous years as a form of effective financial risk management so that Bank Mega has received various awards in the field of risk management, including Best Risk Management in Indonesia 2020 from The Asian Banker, Best Risk Management 2021 from Alpha Southeast Asia and Best Risk Management 2022 from The Global Finance.

Recommendation

From the evaluation of the effectiveness of the risk management approach in this research, it can be recommended to Bank Mega that to increase the effectiveness of financial risk management, it is necessary to do, among other things:

1) Manage liquidity ratios
   Bank Mega needs to manage its liquidity ratio so it stays manageable. This can be done by reducing credit distribution or increasing savings funds.
2) Improve asset quality
   Bank Mega needs to improve the quality of its assets so that they remain good. This can be done by implementing stricter credit policies and more intensive monitoring of disbursed credit.
3) Improve risk mitigation
   Bank Mega needs to improve its risk mitigation so that it can face various risks that may occur. This can be done by implementing various policies and procedures to manage risk and increasing human resources' capacity to manage risk.

4. CONCLUSION

Bank Mega has good and effective risk management, which has helped the bank reduce financial risk, increase profitability and maintain financial stability. This can be seen from implementing a structured and comprehensive risk management framework, using standardized risk management methods and systems, forming an independent risk management work unit, and applying good corporate governance (GCG) principles. Based on the analysis of financial ratio values in 2023, Bank Mega's financial ratios generally show positive performance. Bank Mega has sufficient core capital, good credit quality and high efficiency. This shows that Bank Mega can generate good profits and has a large capacity to fulfill its obligations. It is very important to continue to comply with OJK regulations, improve risk measurement methods such as VaR and stress testing, and ensure that risk management contributes positively to financial performance. In addition, regular monitoring and evaluation need to be carried out for improvement, and implementing Good Corporate Governance (GCG) principles must still be implemented to ensure transparency and accountability.

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