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Banking Risk Management Strategies In Addressing Credit Issues In Indonesia

Zakiya Az Zikra Ismail[1*], Nanda Riesta Nathania[2], Baidhowi[3]
[1-3]Law Program, Faculty of Law, Universitas Negeri Semarang
e-mail: [1*]azzikrazakiya@students.unnes.ac.id , [2]nandariestanathania@students.unnes.ac.id

Abstract

The issue of credit, particularly the increasing rate of Non-Performing Loans (NPLs), has become one of the primary challenges in Indonesia's banking sector. To address this risk, banks apply various risk management strategies to maintain financial stability and prevent more severe losses. This study aims to analyze the risk management strategies employed by banks in addressing credit issues in Indonesia. Through effective risk management, banks can reduce NPL levels, maintain financial stability, and enhance public trust in the Indonesian banking system. This research employed a qualitative method, utilizing literature analysis and secondary data obtained from various credible sources. The primary focus of this study is to examine the steps taken by banks to identify, assess, and control credit risks to suppress the growth of Non-Performing Loans (NPLs). Strategies implemented include the application of strict credit assessment systems, diversification of loan portfolios, and the utilization of technology to continuously monitor debtor performance. In addition, credit restructuring policies and the strengthening of corporate governance are also considered effective preventive measures to ensure financial stability.

Keywords: *Risk Management, Problematic Loans, Banking, Non-Performing Loan, Regulation*

INTRODUCTION

The banking industry plays a crucial role in a country's economy, especially in channeling credit to the public and businesses. However, lending activities carry risks, particularly credit risk, which can affect financial stability and the economy as a whole. Issues such as bad loans or NPLs have become significant challenges for Indonesian banks. Effective risk management strategies are necessary to maintain credit quality and mitigate potential losses.

In Indonesia, problematic loans are a key concern in banking. An increase in NPLs can reduce bank profitability and hinder financial sector growth. Therefore, appropriate strategies like strict credit analysis, portfolio diversification, and compliance with regulations from the Financial Services Authority (OJK) and Bank Indonesia are vital to reduce risks and improve credit efficiency.

This study aims to analyze the risk management strategies used by banks to address credit issues in Indonesia and evaluate their effectiveness in maintaining financial stability and reducing losses. By understanding these measures, the study hopes to offer deeper insights and recommendations for better risk management and a stronger banking system.

METHOD

This study employs a qualitative research method that focuses on literature review and secondary data analysis. The data used in this study are sourced from previous research findings, financial reports, policy documents, and publications from official institutions such as the Financial Services Authority (OJK), Bank Indonesia, and academic journals. The purpose of using this method is to provide a comprehensive and in-depth understanding of the strategies adopted by banks in managing credit risks and reducing the rate of non-performing loans (NPLs).

The qualitative approach allows the researchers to explore and analyze various strategies implemented by banking institutions, such as strict credit assessment, loan portfolio diversification, technology utilization for debtor monitoring, credit restructuring, corporate governance reinforcement, provisioning for credit losses, and regulatory compliance. By synthesizing existing literature and data, the study aims to highlight best practices in risk management and suggest recommendations that can support the development of a resilient and stable banking system in Indonesia.

RESULTS AND DISCUSSION

1. Risks Faced by Banks in Lending

In the banking sector, credit risk is one of the most fundamental challenges that must be managed with precision and vigilance. Credit risk arises when a borrower is unable or unwilling to fulfill their financial obligations to the bank, whether partially or in full. This failure directly impacts the financial stability of the bank, leading to reduced income, increased provisioning, and, in extreme cases, liquidity crises. One of the most common and preventable causes of credit risk stems from inaccurate assessments of a borrower's creditworthiness. Often, the data used during the credit approval process is incomplete, outdated, or invalid. In some instances, credit analysts may apply judgment subjectively, influenced by personal bias or flawed assumptions. These weaknesses can lead to the approval of loans for individuals or business entities with poor repayment capacity or unstable financial profiles.

Moreover, credit risk does not exist in isolation; it is heavily influenced by macroeconomic conditions. When the national or global economy experiences a downturn, such as during periods of recession, high inflation, or rising interest rates, the income levels of households and businesses tend to fall. This decline reduces their ability to meet credit obligations, thereby increasing the probability of non-performing loans (NPLs). Additionally, certain economic sectors are inherently riskier due to their volatility. The property and commodities sectors, for instance, are highly sensitive to market fluctuations. A sharp drop in asset prices or commodity values can significantly affect businesses operating in these sectors, triggering widespread financial strain and, in turn, a spike in default rates.

Internal weaknesses in bank governance and risk management frameworks can further exacerbate credit problems. When banks fail to establish effective oversight and early warning systems, they are often unable to detect early signs of borrower distress. This delay in identifying at-risk loans prevents banks from initiating timely interventions, such as restructuring or enforcement actions. Compounding the problem is the behavior of debtors themselves. While many borrowers genuinely struggle due to unexpected economic hardships, others may engage in opportunistic default, having no real intention to repay their loans from the outset.

The implications of poorly managed credit risk are serious and far-reaching. As the level of non-performing loans rises, banks experience declines in profitability due to foregone interest income and increased provisioning costs. Prolonged exposure to high NPL levels can lead to liquidity shortages, operational instability, and, in extreme cases, institutional failure. At a systemic level, widespread credit deterioration across multiple banks threatens the stability of the entire financial sector. Public trust in the banking system can erode rapidly, creating a climate of uncertainty that disrupts economic activity and undermines investor confidence.

2. Risk Management Strategies

To address and mitigate these increasingly complex credit risks, banks in Indonesia have adopted comprehensive and interconnected risk management strategies. These strategies are designed not only to anticipate and respond to existing risks but also to build institutional resilience against future uncertainties.

The first and perhaps most essential strategy is the implementation of a strict credit assessment system. Banks are expected to carry out detailed evaluations of each borrower's financial background, including their income stability, credit history, debt-to-income ratio, and business prospects. This process is supported by modern data-driven approaches, such as the use of artificial intelligence (AI), machine learning algorithms, and big data analytics. These technologies enable banks to develop accurate credit scoring models that significantly reduce the potential for human error or bias. Furthermore, the application of the prudential principle ensures that every credit decision is made with caution and by the internal policies of the bank, as well as regulations set by the Financial Services Authority (OJK).

In addition to accurate borrower assessment, diversification of the loan portfolio is a crucial risk mitigation approach. Rather than focusing loans in a single sector, such as property or agriculture, banks strive to spread their lending activities across various segments of the economy, including manufacturing, trade, consumer finance, and services. Geographic diversification is also essential. By distributing credit exposure across different regions, banks can limit the impact of localized economic shocks, such as natural disasters, regional economic slumps, or political unrest. This strategic allocation of credit helps stabilize overall portfolio performance.

The use of technology also plays a transformative role in modern risk management. Banks now rely on advanced monitoring systems that track borrower behavior in real time. These systems can detect patterns such as missed payments or abrupt changes in account activity, which serve as early warning indicators of potential default. Furthermore, banks use technology to monitor broader market and sector-specific developments that could affect borrower performance. With these insights, they can implement proactive measures, such as restructuring loans, offering temporary payment relief, or reevaluating loan terms, to reduce the risk of default before it materializes.

When a borrower begins to face difficulties, credit restructuring becomes a viable solution. This may involve extending the loan term, reducing the interest rate, or rescheduling installment payments. During times of economic crisis, such as the COVID-19 pandemic, this strategy has proven vital in supporting debtors while maintaining the quality of the bank's credit portfolio. Restructuring allows borrowers to regain financial stability, while the bank avoids immediate losses and maintains the integrity of its assets.

Another pillar of effective credit risk management is the enforcement of Good Corporate Governance (GCG). Strong governance requires that banks establish clear, transparent, and enforceable internal policies related to credit processing and risk evaluation.

These policies must be understood and consistently applied by all employees involved in the lending process. Internal control units and audit departments are responsible for ensuring that credit approvals and disbursements follow standard operating procedures (SOPs). Transparency in financial reporting—especially concerning asset quality, risk exposure, and NPL ratios—is also crucial to build accountability and trust among regulators, shareholders, and the general public.

In anticipation of credit losses, OJK requires that banks maintain adequate provisions under the "provision for credit losses" regulation. These reserves act as a financial buffer to absorb unexpected defaults. Although setting aside provisions may reduce a bank's net profits in the short term, it is a vital step to ensure long-term financial sustainability and liquidity readiness. Proper provisioning enhances investor confidence and enables banks to navigate economic downturns without compromising their operational capacity.

Finally, regulatory compliance forms the foundation of a stable credit risk management system. Banks must adhere to specific requirements established by OJK and Bank Indonesia, particularly in terms of maintaining a Non-Performing Loan (NPL) ratio below 5% and ensuring a sufficient Capital Adequacy Ratio (CAR). These indicators are used by regulators to evaluate the soundness of a bank's capital structure and its capacity to withstand financial shocks. By meeting these benchmarks, banks not only ensure compliance but also build the resilience needed to weather future crises.

CONCLUSION

Problematic credit (NPL) remains a central challenge in Indonesia's banking sector due to its impact on profitability and financial stability. Banks have responded with various risk management strategies: strict credit assessment, portfolio diversification, debtor monitoring via technology, credit restructuring, corporate governance reinforcement, increased provisions, and regulatory compliance.

These strategies have proven effective in reducing NPLs and maintaining financial stability amid economic challenges. However, their success depends on consistent implementation and adaptive regulations.

To face future credit risks, collaboration between regulators and the banking industry is essential to build a stronger and more sustainable banking ecosystem. Technological innovation must also continue to support more efficient and accurate risk management practices. With cooperation from banks, regulators, government, and society, Indonesia's financial system can become more resilient against domestic and global economic challenges.

SUGGESTION

1. For Banking Institutions
   Banks should consistently implement strict credit risk assessment procedures and leverage technological innovations such as AI-based credit scoring and real-time monitoring systems to enhance early detection of problematic loans.

2. For Regulators (OJK and Bank Indonesia)
   It is essential to continuously update and adapt financial regulations in response to dynamic economic conditions, while also promoting good corporate governance and transparency among banking institutions.

3. For Policymakers
   A supportive policy environment should be developed to encourage responsible lending and borrowing practices. Government programs may also assist in stabilizing sectors most vulnerable to economic downturns.

4. For the Public and Debtors
   Greater awareness and financial literacy regarding loan obligations and the importance of responsible credit behavior are crucial. This can reduce default risks and support a healthier financial ecosystem.

5. For Future Research
   Further studies could explore quantitative data on the impact of individual risk strategies or compare credit risk management practices between conventional and Islamic banks in Indonesia.

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