

## IMPLEMENTATION OF RISK MANAGEMENT IN EFFORTS TO PREVENT PROBLEMATIC FINANCING IN SHARIA BANKS

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### ABSTRACT

*The purpose of this study is to find out how the application of risk management in an effort to prevent problem financing in Islamic banks. This study uses a qualitative method with a descriptive approach. The data collection method used is library research. The results of the study show that Islamic banks apply 5C analysis before a customer takes financing to see whether the customer is eligible or not given financing by the bank. To prevent or minimize the occurrence of problem financing, banks carry out effective risk management with several implementations, including; risk identification, risk measurement, risk monitoring, and risk control. With the implementation of this risk management, the bank can reduce the amount of non-performing financing in the bank.*

**Keywords:** Risk Management, Troubled Financing, Islamic Banks.

### 1. INTRODUCTION

The banking sector is one of several elements that influence the economic development of a nation (Jamilah, 2016). The complexity of banking business activities and increasing financing exposure drive the rapid growth of the industry today, and is marked by the increasing understanding of the public about the transaction system through banks, be it sending, borrowing and other transactions.

In running its business, Indonesian banking institutions now use a dual banking system, namely the interest system (conventional) and the profit-sharing system (sharia). The growth of banks with a profit-sharing system is no less rapid than the growth of banks with an interest system, this is driven by the widespread public trust in the profit-sharing system (sharia).

Based on Law Number 21 of 2008, Islamic banks are defined as banks that conduct their commercial operations in accordance with Islamic principles. Islamic banks conduct operations by obtaining funds from the general public in the form of savings and using Islamic financing to distribute them. Islamic banks offer financing options that are productive and consumptive.

The provision of funds based on an agreement between a bank and another party that requires the financed party to return the money after a certain period of time accompanied by a fee or profit sharing is called financing based on sharia principles.

Risk exists in every commercial venture undertaken by banks. The implementation of risk management for Islamic Commercial Banks (BUS) and Islamic Business Units (UUS) is regulated in PBI No.13/23/PBI/2011. According to this document, risk is a type of uncertainty about a condition that will occur in the future based on decisions made at present (Fahmi, 2015).

Banks can be exposed to financing risks in the form of problematic financing or in other terms called NonPerforming Finance (NPF). According to Pratami (2011),

NonPerforming Finance (NPF) is the ratio between problematic financing and financing provided by Islamic banks.

Problematic financing refers to the rate of return on failed financing; the higher the rate of failure of bank financing repayment, the higher the risk it will bear, and the lower the rate of failure of bank financing repayment, the lower the risk it will bear (Jamilah, 2016).

The amount of financing that can still be accepted in Islamic banks according to PBI No.13/1/PBI/2011 concerning the Assessment of the Health Level of General Banks is 5%. To reduce the amount of problematic financing in Islamic banks, risk management performance is needed. It can be said that banks with an NPF level below 5% have succeeded in managing risk, but banks with an NPF level above 5% are unable to manage the risks they face.

PBI No. 11/25/PBI/2009, which regulates the use of risk management for commercial banks, states that additional risks taken by banks must be balanced with effective risk control. Risk management is needed in Islamic banking to mitigate risk. The science of risk management studies how an organization uses strategies to overcome existing problems by integrating various management techniques comprehensively and methodically (Fahmi, 2015).

Based on the increasing number of individuals taking financing, it is clear that Islamic banks need to implement risk management to reduce potential risks, especially risks related to funding channeled by banks. As a result, it is important to use proper risk management to reduce the dangers that may arise from current actions in the future.

Based on the description above, the author is interested in studying how to apply risk management in an effort to prevent the risk of problematic financing.

## 2. LITERATURE REVIEW

### Management

In a simple sense, "management" is interpreted as processing. The procedure for controlling or organizing a company to achieve the intended goals<sup>1</sup>. Planning, organizing, implementing, supervising, evaluating, and controlling activities are all components of management, which allow the best use of all organizational and corporate resources, including raw materials, land, natural resources, and human resources, to achieve organizational and corporate goals<sup>2</sup>.

Management serves as an important component of every activity that serves as a guide to achieving the goals of resource planning, organization, and control. The main functions of management include the following:

#### a. Planning

According to Aderson as quoted by Marno, planning is making a collection of decisions for future actions<sup>3</sup>. Planning is the entire process of carefully deciding what to do in the future to achieve predetermined goals<sup>4</sup>. The three basic elements of planning activities are fact analysis, detailed planning, and data collection.

#### b. Organizing

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<sup>1</sup> Syfaruddin & Nurawati, *Pengelolaan Pendidikan Mengembangkan Keterampilan Manajemen Pendidikan Menuju Sekolah Efektif*, (Medan: Perdana Publishing, 2011), hlm. 16

<sup>2</sup> Ismail Solihin, *Pengantar Manajemen*, (Jakarta: Erlangga, 2012), hlm. 12

<sup>3</sup> Marno & Trio Supriyanto, *Manajemen dan Kepemimpinan Pendidikan Islam*, (Bandung, PT Refika Aditama, 2008), hlm. 13

<sup>4</sup> Sondang P. Siagian, *Fungsi-fungsi Manajerial*, (Jakarta: Bumi Aksara, 1992), hlm. 50

Organizing is the process of dividing the work that is expected to be accomplished by group members, establishing working relationships among them, and creating a conducive work atmosphere<sup>5</sup>. According to Robbins, the responsibilities involved in organizing may include figuring out what needs to be done, who needs to do it, how the work should be organized, who should report to whom, and where decisions should be made<sup>6</sup>.

c. Actuating

Implementation or actuating is to arouse and motivate all members of the group to want and work hard in achieving goals in accordance with the planning and efforts of the leadership organization<sup>7</sup>. Implementation is a close relationship between certain elements resulting from the arrangement of subordinates to be understood and the division of work that is effective and efficient to realize the actual business goals.

d. Controlling

Supervision is the measurement of subordinate performance in order to properly implement the plans that have been set to achieve organizational goals. Monitoring is done to ensure that the actions taken are in accordance with what was intended. The monitoring process can consist of several elements, such as setting work standards, evaluating performance, comparing performance with predetermined standards, and taking corrective action. Therefore, the process of selecting what will be achieved, especially what standards are applied in the form of implementation, evaluating implementation, and if necessary, adjusting to ensure that implementation is in line with what has been selected, can be characterized as supervision.

**Risk**

According to Duffield and Trigunarsyah (1999), risk is a threat to life, property, or financial gain as a result of potential danger. Risk is a variation in results that can occur over a certain period of time under certain circumstances (Halpin, D.W., and Woodhead, R.W., 1998). According to this definition of risk, there are items that are vulnerable to the advantages and disadvantages of a job and have uncertainty about the continuation of activities or actions that will be taken in the future.

General categories of risk types include:

- a. Pure risk, which is a risk that if it occurs will result in a loss and if it does not occur will not result in a profit.
- b. Speculative risk, which is a risk that can result in a profit or loss.
- c. Particular risk is a type of risk that has a local impact and individual sources.
- d. Fundamental risk that comes from nature is a risk that has the potential for significant impact.

**Risk Management**

Risk management science studies how an organization uses strategies to overcome existing problems by integrating various management techniques comprehensively and methodically (Fahmi, 2015). According to Herman Darmawi (2006), risk management is an effort to identify, evaluate, and control risks in every

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<sup>5</sup> Ulbert Silalahi, *Studi Tentang Ilmu Administrasi: Konsep, Teori, dan Dimensi*, (Bandung: Sinar Baru, 2002), hlm 135

<sup>6</sup> Robbin S.P, *Prilaku Organisasi*, Jilid I Terj. Tim Indek, (Jakarta: PT Indek Gramedia, 2003), hlm. 5

<sup>7</sup> Sukarna, *Dasar-dasar Manajemen*, (Jakarta: Mandar Maju, 2011), hlm. 84

business action to increase effectiveness and efficiency. Risk management is a systematic technique or strategy for managing uncertainty associated with risk, including; risk assessment, management strategy creation, and risk reduction through resource management or empowerment.

The purpose of risk management policy is to determine, measure, monitor, and regulate the course of bank business activities with appropriate risk levels in a directed, integrated, and long-term manner. Risk management functions as a filter or early warning system due to banking operations (Karim, 2016).

The following are the objectives of risk management (Karim, 2016):

- a. Inform the regulator what dangers exist.
- b. Ensure the bank does not suffer intolerable losses.
- c. Reduce costs due to various uncontrolled dangers.
- d. Calculate risk exposure and concentration.
- e. Capital allocation and risk management.

Risk management framework

- a. Risk Identification
- b. Risk Measurement
- c. Risk Monitoring
- d. Risk Control

Risk based on bank business

- a. Financing Risk
- b. Market Risk
- c. Liquidity Risk
- d. Operational Risk
- e. Legal Risk
- f. Reputation Risk
- g. Strategic Risk
- h. Compliance Risk

### **Financing**

According to Law No. 10 of 1998 concerning Banking, financing based on sharia principles is defined as the provision of money based on an agreement between a bank and another party that requires the financed party to return the funds after a certain period of time as compensation or profit sharing.

The following can be concluded from the financing concept given above:

- a. In accordance with its role, Islamic banks offer funds in financing transactions.
- b. After a certain period of time, every customer who uses the facility (debtor), whatever form of financing obtained from Islamic banks, is required to return the financing to the Islamic bank with compensation or profit sharing.

Islamic bank management must focus on three important components of financing to maximize fund management, namely<sup>8</sup>:

- a. Safe refers to the belief that money has been placed and can be withdrawn at a predetermined time. Before distributing Islamic bank funding, a business assessment must be carried out to ensure that the business being financed is worthy of setting these requirements.

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<sup>8</sup> Muhammad Ridwan, *Managemen Baitul Maal Wa Tamwil (BMT)*, (Yogyakarta: UII Press, 2004), hlm. 164

- b. Smooth is that funds in Islamic banks can rotate quickly and smoothly. The growth of Islamic banks will be better if the money turnover is faster. Islamic banks must therefore focus on market sectors with high daily, weekly, or monthly turnover.
- c. Profitable is the calculation of accurate projected funds, to ensure that the funds thrown get income. The more precise in projecting a business, the greater the possibility of failure can be minimized.

### **Troubled Financing**

Problematic financing is financing whose quality is based on the risk of the condition and compliance of the financing client in fulfilling the obligation to pay profit sharing and pay off the financing. Therefore, the evaluation of the quality of funding can be divided into:<sup>9</sup>

- a. Smooth; if installments and margins are paid on time, there are no arrears, in accordance with the provisions of the contract, always provide accurate and timely financial reports, in accordance with the receivables agreement, and bind strong collateral.
- b. In special attention: if the payment of principal and/or margin is 90 days late from the schedule. However, financial reports are always done correctly, regularly, and with sufficient collateral.
- c. Less Smooth; if there are arrears in principal and/or margin installment financing that are more than 90 to 180 days old, the financial reports submitted are inconsistent and doubtful, the receivables agreement documentation is lacking, and binds strong collateral.
- d. Doubtful; if there are arrears in principal or margin installment financing that are more than 180 to 270 days past due. The customer does not provide financial information or cannot be trusted, the receivables agreement documentation is lacking, and the collateral binding is insufficient.
- e. Bad; if there is a principal and/or margin installment payment that is past due and has not been paid for 270 days and there is no proof of a receivables agreement and collateral commitment.

Problem financing refers to the rate of return on failed financing; The risk to be borne depends on the level of failure of bank financing returns which ranges from high to low (Jamilah, 2016).

### **Islamic Bank**

Based on Law Number 21 of 2008, Islamic banks are defined as banks that conduct their commercial operations in accordance with Islamic principles. Islamic banks conduct operations by obtaining funds from the general public in the form of savings and using Islamic financing to distribute them. Islamic banks offer financing options that are productive and consumptive.

Islamic banks are financial institutions that base their operations and offerings on the Qur'an and the Hadith of the Prophet SAW. In other words, Islamic banks are financial organizations that primarily engage in the provision of finance and other services related to the movement of money and payments, all of whose practices comply with Islamic sharia principles.<sup>10</sup>

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<sup>9</sup> Trisadini, P., *Transaksi Bank Syariah*, (Jakarta: PT Bumi Aksara, 2013), hlm. 105

<sup>10</sup> Setia Budhi Wilardjo, "Pengertian, Peranan dan Perkembangan Bank Syariah di Indonesia", *Jurnal Unimus*, Vol. 2, No. 1 (2005), hlm. 3

The following are the duties and responsibilities of Islamic banks, according to (Muhammad, 2005: 15–16):

- a. Purifying the operation of Islamic banking to further increase public trust.
- b. Increasing the sharia awareness of Muslims in order to grow the Islamic banking market.
- c. Building cooperative relationships with ulama, because in Indonesia in particular the influence of the role of ulama on Muslims is quite strong.

Sharia principles are agreements based on Islamic law that regulate how banks and other parties can save money, finance commercial ventures, and engage in other sharia activities. The Islamic financial system upholds a number of rules or regulations, including:

- a. Loans with a value other than the specified value are not eligible for repayment.
- b. The lender must share the profit or loss resulting from the operations of the institution that borrows the money.
- c. “Making money from money” is prohibited in Islam. Since money has inherent value, it is used only as a means of trade and not as a commodity.
- d. Gharar-related components are prohibited. The outcome of the transaction must be clear to both parties.

Only companies that are not prohibited in Islam are allowed to receive investment.

### **3. RESEARCH METHODS**

Qualitative techniques with a descriptive approach are used in this study. The data collection method used is literature study. Literature study is the process of collecting facts and information from library sources or literature that are relevant to the writing of this research. such as books, theses, journals, internet browsing, and other publication sources that are relevant to this research.

### **4. HASIL DAN PEMBAHASAN**

#### **Implementation of Risk Management in Efforts to Prevent Problematic Financing in Islamic Banks**

Every action taken has a certain amount of risk; the greater the opportunity taken, the greater the risk that must be accepted. By adopting effective and appropriate risk management, any risk, no matter how small or large, can be reduced or avoided, allowing for the prevention of future dangers.

Likewise with banking organizations, where every action has various risks, both small and large. As a result, banks must be able to take preventive measures by recognizing risks that may arise sooner. Banks must then be able to use risk management to address existing or potential problems.

Financing risk cannot be separated from the risk faced by the bank. The risk associated with financing is the possibility that customers will not repay their debts to the bank. Banks are required to use special techniques to mitigate this risk so that the possibility of problematic financing is small.

Every action from before financing begins until it is completed contains steps taken by the bank to avoid problematic financing. Prevention of problematic financing begins before the customer receives financing, the bank applies the concept

of caution to all actions, especially financing, because the risks that often arise in financial institutions are in financing transactions at the bank.

Before customers receive financing, the bank conducts a 5C analysis to determine whether the customer qualifies for financing. Through this analysis, the bank can determine whether the customer will have difficulty in meeting their obligations in the future. The bank takes the form of a 5C analysis as follows:

- a. *Character*, banks consider the character of potential customers to determine whether or not they are honest in their efforts to fulfill all their responsibilities. When potential customers apply for financing, banks conduct interviews to learn more about them. The bank also asks about them to people around them, such as the village head or the customer's neighbors to find out more about their character.
- b. *Capacity*, banks consider the customer's ability to take a closer look at their business or their ability to pay. The capacity to manage this business and how to overcome challenges can be recognized by managing business experience.
- c. *Capital*, the bank determines whether a customer's business is running smoothly based on the customer's sales report.
- d. *Collateral*, if the prospective customer is unable to pay his debt to the bank, the collateral can be confiscated by the bank.
- e. *Condition*, banks consider economic conditions related to the potential income of customers. Because there are certain companies that are very dependent on economic conditions.

Banks can decide whether consumers are eligible for loans by using risk management. In order for banks to avoid unpleasant situations in the future, such as bad customer behavior that causes customers to not fulfill their responsibilities, risk management becomes very important. Banks can also learn how money will be spent by asking these analytical questions.

### **Analysis of the Implementation of Risk Management in Financing Prevention Efforts**

Risk is often seen as the possibility of a predictable loss, which allows for the formulation of preventive measures. There are various risks that may occur in the banking industry, financing risk is by far the most dominant risk. The risk associated with this financing is the possibility that customers will not fulfill their obligations to the bank. To prevent the emergence of this problematic funding, banks must be able to implement risk management. The causes of problematic financing can arise from internal or external problems. Internal and external factors that can affect the risk of non-performing finance include the following:

- a. Internal factors, namely factors from within the bank, in the form of:
  1. Account Officer (marketing) errors in 5C analysis, both before and after financing is obtained.
  2. Inappropriate investigation of customer ability to pay which usually occurs before obtaining financing.
  3. Lack of monitoring of financing customers.
  4. Missing daily collections for customers using financing.
- b. External factors, namely factors from outside the bank, include:
  1. The customer already has one company and then establishes a second company to avoid being assessed for his/her ability to pay.
  2. Relocating your business.

3. Uncertain economic conditions that result in a decrease in the customer's business income.
4. The customer is sick and unable to work
5. Bad customer behavior.
6. The customer's ability to no longer pay.
7. Financing customers who have died.

Based on the factors that can cause problematic financing above, it can be concluded that the causes of problematic financing can arise from internal or external problems of the bank. From these two factors, it is clear that external factors or factors that are not related to the bank are the most influential in the occurrence of problematic financing, because the customer's condition ultimately determines whether the financing is delayed or fails.

Banks are expected to have a way to prevent or minimize the occurrence of problematic financing related to the conditions that cause it. Therefore, banks must carry out effective risk management so that any problems that result in problematic financing can be resolved and do not harm the bank. Here are some examples of the application of risk management:

a. Risk identification

Risk identification is an effort to find or know the risks that may arise in activities carried out by companies or individuals. Banks can identify risks by using the 5C analysis, which evaluates customers based on character, ability to pay, business environment, collateral value, and economic environment. In addition, document accuracy is very important because it allows banks to identify potential dangers in the future.

b. Risk measurement

Risk measurement is an effort to find out the size of the risk that will occur. The three types of financing risks measured by the Bank are smooth, less smooth, and bad. These types of risks are very helpful in categorizing financing risks so that they can choose the optimal method for implementing efficient risk management for problematic financing.

c. Risk monitoring

Risk monitoring is an effort to observe the development of financing, identify and predict potential problems so that quick action can be taken. Banks can monitor from the time the request for funds is made before the loan is completed or paid off. In addition to routine daily visits for direct monitoring, banks can also monitor customer business activities through supervision.

d. Risk control

Risk control is a tool in the decision-making process to reduce or eliminate the risks they face. Banks can use a number of strategies, including rescheduling, reconditioning, restructuring, and discussions to reduce funding risk.

Based on the example of the application of risk management above, banks can use the application of risk management effectively, especially in reducing the amount of problematic financing in the bank.

## 5. CONCLUSION

Problematic financing can arise from internal or external bank problems. The implementation of risk management in an effort to prevent problematic financing in Islamic banks is found in every action starting from before financing occurs until financing is completed. The action taken by the bank before the customer takes

financing is by implementing the 5C analysis, namely an analysis to see whether the customer is eligible or not to be given financing by the bank. To prevent or minimize the occurrence of problematic financing, banks must carry out effective risk management with several applications, including; risk identification, risk measurement, risk monitoring, and risk control. By implementing this risk management, the bank can reduce the amount of problematic financing in the bank.

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