IMPACT AND MITIGATION OF CREDIT RISK ON CREDIT UNION

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Abstract: The purpose of writing this paper is to determine the definition of credit risk, the factors that cause bad credit, the impact of bad credit and credit risk mitigation in cooperatives. Credit risk refers to the fact that the members cannot return the loan principal and interest in a timely manner, which causes the actual income results of the business unit to deviate from the expected profit goal, where the business unit experiences asset losses in the operation and management of credit cooperatives, where the factors that cause this credit risk described in the concept of negligent credit, namely causes originating from internal CU. Causes originating from borrowers (members) and causes originating from external factors of CU. The occurrence of bad loans certainly has an impact on the institutional development of cooperatives, especially the impact on the financial sector of cooperatives and the image of cooperatives, namely liquidity, net income (SHU) has decreased, institutional capital growth is low, ability to provide quality services to members has decreased, loan services are hampered The morale and morale of employees have decreased and the image of the cooperative in the community, especially members, is not good. To be able to prevent and avoid the work and bad effects of bad credit, it is necessary to mitigate credit risk. Risk mitigation is related to credit risk management. Credit risk mitigation has become a mandatory thing to be prepared if the company is in the credit financing business or disbursing loan funds. Credit risk mitigation can be done through several stages, namely screening of credit applicants, credit risk analysis and the Credit Risk Scoring Method.

Keywords: Credit Risk, Risk Impact, Risk Mitigation

1. Introduction

The development of cooperatives today has experienced rapid progress in realizing the noble mandate contained in Law no. 25 of 1992 concerning cooperatives, namely "Cooperatives, both as people's economic movements and as business entities, participate in realizing an advanced, just and prosperous society based on Pancasila and the 1945 Constitution in the national economic system which is structured as a joint effort based on the principles of kinship and economic democracy".

In addition, economic development in Indonesia cannot be separated from the basic philosophy that forms the basis of national and state activities, namely Pancasila and the 1945 Constitution.

The economy is structured and developed as a joint effort of all the people based on the principles of justice, efficiency, and democracy to realize prosperity, welfare and justice for all Indonesian people. Since the birth of cooperatives as the pillars of the people's economy until now, cooperatives in Indonesia have grown rapidly.

Temporary data from the Ministry of Cooperatives and SMEs, and in line with data from the Indonesian Central Statistics Agency (2020) states that by the end of 2020, the number of active cooperatives was recorded at 127.124 units with more than 25 million members. Of this amount, they were able to raise their own capital worth a total of Rp. 79.3 trillion and the remaining Rp. 90.4 trillion was obtained from outside.

In addition, of all these active cooperatives, they are able to manage assets worth a total of almost IDR 222 trillion with a business volume of IDR 174 trillion. In the end, from all active cooperatives listed, they were able to collect the remaining operating results (SHU) worth a total of IDR 7.2 trillion.

These data show that cooperatives in Indonesia have experienced extraordinary developments. The success of the cooperative organization as a business entity as a driving force for the people's economy continues, which is able to carry out its activities and achieve its goals. Cooperative orientation is as a service provider to its members, not profit-oriented, with the aim of improving the welfare of its members. Cooperative organizations consist of two households, namely cooperative companies and member households, acting as consumers and producers (Sugiyanto and Rahayu, 2018).

Apart from cooperative efforts in improving its performance, becoming an icon of the national economy, cooperatives cannot avoid problems in governance and risk management, and become one of the problems that are often experienced by cooperatives. These problems are related to credit risk, namely bad credit. The risk of bad credit is a manifestation of weak governance and implementation of risk management.

Credit risk is a potential risk that causes losses that are likely to occur in the company which can hinder the improvement of company performance. Risk is a hazard, threat or possibility of an action or event that has an impact that is contrary to the objectives to be achieved.
However, risk must also be seen as an opportunity, which is seen as contrary to the objectives to be achieved. So the key words are goals and impacts on the opposite side (Miswanto, 2012). Economic Times (2015) in Simon, C.C (2018) explains that risk is the chance that the actual return on investment will differ from the expected one.

The fundamental idea in risk-related finance is the relationship between risk and return on investment which implies future uncertainty about deviations from expected returns or expected returns and measures the uncertainty that investors are willing to take to realize a return on investment. There are various types of risk: liquidity risk, sovereign risk, insurance risk, business risk, default risk and so on (Duguh and Diggi, 2015).

Credit risk is the risk of loss associated with the opportunity for members (customers) to fail to meet their obligations at maturity (Hardanto, 2006). In other words, credit risk is the risk that the borrower does not pay his debts. Credit risk is the risk of loss in connection with the borrower being unable and or unwilling to fulfill the obligation to repay the loaned funds in full at maturity or thereafter (Wahyono, T and Ariya, D. T; 2015).

Credit risk is the risk due to the failure of customers or other parties to fulfill obligations to banks or financial institutions in accordance with the agreed agreement. Duan Wenjie (2009) explains that the risk of bad credit is caused by negative information provided by the borrower which results in moral hazard.

This situation shows the existence of information asymmetry which causes creditors often cannot have sufficient information, cannot make accurate judgments, which affects transaction behavior and market efficiency (Zeng Zhiming, 2010). In this case, the cooperative will experience adverse economic events. Information asymmetry and adverse selection are longstanding problems in debt markets. Without addressing this issue, investors experience high search costs in identifying debt instruments that fit their risk profile.

Bad credit problems occur in every cooperative. For example, the case of bad loans occurred in cooperatives in Salatiga, where it was known that as many as 40% of cooperatives experienced bad loans (Rinastiti, 2012). Other bad credit problems occurred in Bantul Regency which occurred in several cooperatives and other financial institutions, where cases of bad loans occurred amounting to 10 billion (Tribunnews, 2013).

Bad loans on People's Business Credit which reached 10%. This bad credit case also occurred in the XXX Savings and Loan Cooperative under the auspices of the Maumere Main Swadaya Puskopdit, where it is known that the total value of credit defaults was 326 billion which occurred from 2018, 2019 and 2020 with an average NPL of 12% per year.

The problem of bad credit in this cooperative confirms that bad credit is a major and serious problem for every cooperative that requires attention in handling it. This problem is an interesting phenomenon that needs serious attention from the institutional side and borrower members. The impact of bad loans on cooperative institutions and members is very large. Bad credit (especially if it is severe) can reduce income, drain the cooperative's liquidity which can have an impact everywhere, such as difficulty paying operational costs, members cannot withdraw savings and in the worst case, the cooperative can collapse.

Given these various risks, it is appropriate if Cooperatives equip themselves with the application of the concept of Good Cooperative Governance and good risk management, as a consequence of a business full of risks. In this concept, risks that may arise should be prevented by implementing risk management in all lines (Wahyono, T and Ariya, D. T; 2015) through credit risk mitigation.

2. Literature Review

Based on the background above, several problems can be formulated as follows:

1 What is the definition of credit risk?
2 What are the factors that cause bad credit?
3 What is the impact of bad credit on cooperatives?
4 How to mitigate credit risk in cooperatives?

3. Method

Based on the problems above, the purpose of this paper are:

1 To know the definition of credit risk.
2 To find out the factors that cause bad credit.

3 To find out the impact of bad credit for cooperatives.
4 To know the mitigation of credit risk in cooperatives.

4. Result and Discussion

Definition of Credit Risk

Risk is a hazard, threat or possibility of an action or event that has an impact that is contrary to the objectives to be achieved. Economic Times (2015) in Simon, C.C (2018) explains that risk is the opportunity related to the actual return on investment that will be different from what is expected.

The fundamental idea in risk-related finance is the relationship between risk and return on investment which implies future uncertainty about deviations from expected returns or expected returns and measures the uncertainty that investors are willing to take to realize a return on investment.

There are various types of risk: liquidity risk, sovereign risk, insurance risk, business risk, default risk and so on (Duguh and Diggi, 2015). While credit risk is the risk of loss associated with the opportunity for members (customers) to fail to meet their obligations at maturity (Hardanto, 2006). In other words, credit risk is the risk that the borrower does not pay his debts.

Credit risk is the risk of loss in connection with the borrower being unable and or unwilling to fulfill the obligation to repay the loaned funds in full at maturity or thereafter (Wahyono, T and Ariya, D. T; 2015). Uha (2011). Credit risk is the risk due to the failure of customers or other parties to fulfill obligations to banks or financial institutions in accordance with the agreed agreement.

Credit risk is generally defined as the potential failure of credit customers to settle their obligations in accordance with the agreement. This definition can be applied to institutions in managing credit exposures based on receivables and leasing and working capital credit transactions. What is meant by credit risk is the risk caused by the failure of the counterparty to fulfill its obligations or is called bad credit risk. Risk is an inseparable element of banking (Balina and ak, 2014). Risk presents itself in various forms and its intensity varies from period to period making it difficult to mitigate.

Credit risk is very important to lenders, managers and directors. Song et al (2017) explain that Credit risk refers to the fact that the borrower cannot return the loan principal and interest in a timely manner, which causes the actual income results of the business unit to deviate from the expected profit goal, where the business unit experiences asset losses in operating and credit cooperative management.

In general, the risk of bad credit in cooperatives has three main characteristics. The first is objectivity, as long as there is credit activity, credit risk will not be transferred based on the will of people and the existence of an objective. That said, credit risk is unavoidable.

The second is the loss of funds caused by credit risk which not only affects the survival and development of credit cooperatives. The third is controllable, credit cooperatives according to certain ways can advance credit risk identification, prediction, prevention and post-resolving problems, and risks can be minimized by controlling.

Factors Causing Credit Risk
Munaldus and Yuspita (2016) in a book entitled Beware The Beast Within – Strategies to Prevent and Control Negligent Credit Predators Credit Unions describe that there are three main factors that cause credit risk described in the concept of negligent credit, namely internal causes. CU, Causes originating from the borrower (members) and causes originating from CU external factors.

1. Causes originating from internal CU
The main cause of credit risk in this case is the high default on credit originating from within the CU which is closely related to the inappropriate design of loan products (CGAP, 2009).

This is closely related to the improper method of repaying installment loans, the number of installments that must be deposited does not match the income level of the borrower, a strict installment system, a long and inappropriate repayment period. Based on real conditions in CUs, the cause of high credit risk from internal factors is caused by several things (Munaldus and Yuspita, 2016), namely:

a. The loan application has been approved without going through the complete and correct collection of data or information on borrowing members, in relation to the ability to repay and the character of the borrower.
b. CU has overconfidence in borrowing members so that credit analysis is carried out incorrectly.
c. The number of billing staff is relatively small so that the billing is not effective.
d. CU credit policy is inadequate.

2. ***Causes originating from the borrower (member)***
The cause of the occurrence of high non-performing loans also comes from borrowing members. CGAP (2009) reveals that the causes of bad loans from members are caused by several things, namely borrowing members do not want to pay in installments and repay loans, borrowing members do not have the ability to repay and repay loans, borrowing members are sick or die, borrowing members experience family disasters and The business ventures of the borrowing members failed. Based on real conditions in the CU, the cause of the high credit risk from the borrower member factor is caused by several things (Munaldus and Yuspita, 2016), namely:
a. Loan plan not done well by borrower member
b. The loan amount applied for and received does not match the ability to repay
c. Weak family financial management system
d. Bad character of members and irresponsible for loans
e. Borrowing members do not have adequate understanding of loan policies and SOPs
f. The borrower's household is messy

3. Causes originating from external factors CU
The causes of high non-performing loans are also caused by external factors, namely natural disasters, economic crises, falling prices of main commodities, rising prices of necessities, government regulations.

Impact of Bad Credit for Cooperatives
Credit risk that occurs in cooperatives certainly has a huge impact on cooperatives. Munaldus and Yuspita (2016) reveal that there are seven implications of the impact of bad credit (negligent credit) on CUs.

1. Liquidity
When the credit default occurs, the principal and interest installments on the loan are not obtained. If this condition is exacerbated by the withdrawal of large deposits, it will certainly affect the cooperative's cash situation. Failure to maintain this liquidity will lead to a crisis of member confidence.

2. Net Income (SHU) has decreased
When credit is negligent, of course, the cooperative's SHU will decrease. This situation is due to the uncollectible interest income on the loan while costs still occur. This condition causes the occurrence of SHU to decrease.

3. Institutional capital growth is low
Institutional capital in cooperatives is a general reserve fund, donations and grants. At the end of each accounting period, the cooperative sets aside a reserve fund from the SHU. When the SHU decreases, of course, it has an impact on the small allocation of reserve funds. As a result, the cooperative's capital growth is disrupted.

4. The ability to provide quality services to members has decreased
The further impact of credit risk is the declining quality of service. This is due to decreased income and impaired liquidity, which of course requires cooperatives to make cost efficiency. When this happens, employee education cannot be carried out which causes the quality of cooperative human resources to be poor.

5. Loan services are hampered
Loan services were disrupted as a further impact of the cooperative's poor liquidity due to limited funds or cash. This situation causes loan services to be hampered and cannot be realized properly.

6. Employee morale and morale have decreased
Morale is influenced by the provision of compensation to employees. When bad credit occurs, of course, it also has an impact on the limitations of employee funds so that compensation cannot be given. This causes the morale and morale of employees to decrease.

7. The image of cooperatives in society, especially members, is not good.
High non-performing loans certainly have an impact on all financial aspects of cooperatives. When the financial aspect of the cooperative is disrupted, loan services, withdrawals of deposits and even payment of member fees cannot be carried out. This situation will worsen the image of cooperatives in society, especially members.
The further impact of this situation is of course a motion of no confidence from members to the cooperative and a massive withdrawal of member shares will cause the cooperative to collapse.

Mitigation of Credit Risk in Cooperatives
Simon, C.C (2018) explains that risk mitigation is related to credit risk management. Credit risk mitigation has become a mandatory thing to be prepared if the company is in the credit financing business or disbursing loan funds.

1. Screening of Credit Applicants
Screening of credit applicants is carried out to conduct detailed, correct and accurate screening regarding credit applications made by members. Screening of applicants is carried out to find out and ensure that credit applicants are eligible or meet the requirements to apply for loans according to the policy pattern in the cooperative.
In this section, cooperative management can know clearly about the eligibility of members. If the member is eligible then the credit application process can be continued, but if not then the credit application process cannot be processed. The screening process for credit applicants is carried out with the aim of preventing the occurrence of bad loans.

2. Credit Analysis 5C
If the credit application has met the credit applicant screening stage, the next step is to conduct a loan assessment analysis or field investigation. Field investigations were carried out using 5C credit analysis. Wahyono, T and Ariya, D. T (2015) explained that the 5C analysis method is a credit analysis method that can be done to gain an understanding of the eligibility of prospective borrowers based on five provisions, namely character, capital, condition, collateral and capacity.

a. Character
Character is the nature of prospective customers whose assessment is carried out by surveyors. In this concept, cooperative management needs to assess the nature of the prospective borrower to determine the character of the prospective borrower. This character is closely related to the responsibility for repaying the loan so that it can avoid bad credit.

b. Capital
Capital is the capital or ownership of valuable goods owned by prospective customers that show their economic capabilities. Capital assessment is carried out to obtain legal certainty regarding the member's economic capacity. The economic capacity of members can be used as the basis for making credit decisions. Analysis of members' economic capacity provides an overview of the ability of members to fulfill their obligations. Analysis of members' capital capabilities to ensure members do not experience bad loans.

c. Collateral
Collateral is an assessment of the guarantees provided by prospective customers to cooperatives. Assessment of collateral is carried out to obtain legal certainty so that it can serve as a policy guideline for granting loans and avoiding bad loans.

d. Capacity
Capacity is the ability of prospective customers to fulfill their obligations to the cooperative.

e. Condition
Conditions explain all conditions owned by prospective customers, both background and family conditions.

The 5 C analysis is an important analysis carried out by cooperatives before providing loans. The 5C analysis is carried out to provide confidence to management about borrowing members, namely borrowing members who have good faith and have the ability to repay the principal and interest on the loan (Wahyono, T and Ariya, D. T, 2015).

3. Credit Risk Scoring Method

Credit Scoring (Financial Credit Management) is an action taken to determine the economic value of the company by managing the risks it faces, especially Credit Risk and Market Risk. Credit Scoring is carried out with the aim of facilitating the evaluation process of prospective borrowers, so that credit approvals can be realized correctly. This can be done by utilizing technology or automated software systems.

Credit Scoring accommodates scoring on the condition of prospective debtors and is carried out by credit analysts. Through this scoring technique, financial institutions can identify existing debtors that require better handling, and banks can take the necessary legal steps to prevent further losses and help reduce NPLs.

Wahyono, T and Ariya, D. T (2015) describe that there are nine main factors for the success of loan repayments, namely 1) comparison of THP to installments, 2) history of savings account ownership, 3) history of loan account ownership, 4) cash flow, 5) age, 6) ownership of residence, 7) domicile, 8) working time, and 9) completeness of documents.

5. Conclusions

Credit risk refers to the fact that the borrower cannot return the loan principal and interest in a timely manner, which causes the actual income results of the business unit to deviate from the expected profit goal, where the business unit experiences asset losses in the operation and management of credit cooperatives, where the factors that cause this credit risk described in the concept of negligent credit, namely causes originating from internal CUs, causes originating from borrowers (members) and causes originating from CU external factors.

The occurrence of bad loans certainly has an impact on the institutional development of cooperatives, especially the impact on the financial sector of cooperatives and the image of cooperatives, namely liquidity, net income (SHU) has decreased, institutional capital growth is low, ability to provide quality services to members has decreased, loan services are hampered, Morale and morale of employees have decreased and the image of cooperatives in the community, especially members, is not good. To be able to prevent and avoid the work and bad effects of bad credit, it is necessary to mitigate credit risk.

Risk mitigation is related to credit risk management. Credit risk mitigation has become a mandatory thing to be prepared if the company is in the credit financing business or disbursing loan funds. Credit risk mitigation can be done through several stages, namely screening of credit applicants, credit risk analysis and the Credit Risk Scoring Method.

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To avoid the occurrence of credit risk in cooperatives, it is expected that cooperatives can carry out the process of providing credit by applying credit applicant screening, credit risk analysis and the Credit Risk Scoring Method in an adequate and targeted manner.

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