



An in-depth analysis of credit risk: taking proactive measures to tackle non-performing loans in the banking sector

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ABSTRACT

Banking distributes savings to borrowers, boosting economic activity. Recent Bank Indonesia (BI) data reveals a troubling trend of falling credit quality and growing NPLs in the industry. The global financial crisis, market competitiveness, and lax lending laws impact this. Banks' reluctance to adjust interest rates during economic uncertainty has increased businesses' repayment responsibilities despite decreasing income. Non-performing loans have grown unintentionally as regulators lower collateral and deposit restrictions to improve credit distribution. In this case, proactive credit restructuring is advocated. Reduce non-performing loans and stabilise banks. Banks use credit restructuring to help distressed debtors fulfil their obligations while safeguarding loan loss reserves. Effective credit management decreases loan risks and involves stakeholders. Qualitative descriptive study examines credit management techniques and challenging loan frequency. The results emphasise the necessity for strict credit standards, strong monitoring systems, and resolutions including restructuring loans and selling assets to reduce non-performing loan risks. Regulators, banks, and other stakeholders must collaborate to address NPLs and stabilise finances. Active credit management may assist banks manage NPLs and maintain economic development.

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1. INTRODUCTION

According to the most current information provided by Bank Indonesia (BI), there has been a decrease in the quality of bank credit, in addition to a noticeable increase in the number of loans that are considered to be non-performing of their obligations. It is possible to explain the rise in the number of loans that are considered to be non-performing to a variety of variables that have had an effect on the broader financial climate (Al-Qudah, 2023). In the first place, firms have been encountering difficulties in preserving their market positions as a consequence of the negative consequences of the global financial crisis and the growing competition of markets. In addition, the decision made by the banking industry to keep credit interest rates at their current levels despite the uncertain economic circumstances has also contributed to the rise in non-performing loans (NPLs) (Adusei, 2022; Kryzanowski, 2023). This circumstance has resulted in circumstances in

which businesses are in the position of having to cope with increased debt repayment requirements in comparison to their significantly reduced earnings. In addition, a decrease in the amount of care that financial institutions exercise when distributing credit has the potential to result in a rise in the number of loans that are considered to be non-performing. Additionally, it would seem that the steps that BI has adopted in order to loosen credit allocation, such as alterations to the criteria for collateral and reductions in the minimum deposit amounts, have a detrimental effect on loans that are considered to be non-performing (Ahmed, 2021; Hardiyanti, 2021). The deployment of credit restructuring efforts is a novel method to addressing the problem of non-performing loans, which is particularly relevant in light of the present crisis that is affecting the credit sector. The purpose of these strategic actions is to address the challenges that are brought about by the increasing number of loans that are considered to be non-performing and to create a more secure financial environment for both banks and borrowers (Kartal, 2023; Le, 2022).

Banks are required to take the appropriate step of credit restructuring in order to provide assistance to debtors who are experiencing difficulties in fulfilling their financial commitments in accordance with the legislation that are applicable (Acheampong, 2021; Bitar, 2022). The process of restructuring credit may be beneficial for financial institutions since it helps to reduce the number of loans that are considered to be non-performing and enables the preservation of provisions for loan loss reserves (CKPN) that would otherwise be put aside for loans that are potentially problematic. Because it is an entity that acts as a middleman and collects and distributes public monies in order to support economic activity, banking plays an extremely important function in the economy (Altinay & Taheri, 2019; Ari, 2021). Banking is a very important sector of the economy since it is responsible for a wide range of important activities. The management of risks, the facilitation of the movement of cash, and the contribution to economic stability are all tasks that fall under this category (Abbas, 2021; Al-Qudah, 2023). The first step in the banking process is the collection of cash from the general public via a variety of deposit types, such as current accounts, savings accounts, and deposits. After that, these money are transferred to the general population in the form of loans together with credits. Credit disbursement operations, on the other hand, are associated with inherent hazards, and financial institutions are required to make concerted efforts in order to successfully manage these risks (Boussemart, 2019; D'Amato, 2019). The possibility of having financial problems does not suddenly materialise out of thin air; rather, it manifests itself in the form of indicators such as late repayments (Agyabeng-Mensah, 2020).

Throughout the whole of the credit process, it is essential to have effective monitoring and administration, and this fact should never be ignored. In order to ensure that financial institutions continue to function without any hiccups, it is vital to have a solid understanding of the effect that liquidity disruptions brought on by bad loans have (Arham, 2020). As a result, it is very necessary to keep a careful eye on management procedures in order to reduce the likelihood of these dangers. To effectively address the issue of distressed loans, a collaborative strategy that includes the participation of regulators, financial institutions, and other relevant stakeholders is required (Bellotti, 2021; Liu, 2020). The use of loan restructuring as a short-term solution is essential, just as a seasoned financial advisor would suggest (Karadima, 2021; Kuzucu, 2019). The implementation of preventative measures, on the other hand, is of equal importance in order to lessen the possibility of facing problematic loans in the future. Because of this, the banking industry has the potential to continue to play an important part in driving the economy of the country forward (Banna, 2021). Monitoring and analysing credit operations on a continuous basis is very necessary in order to keep the financial system stable and ensure its continued viability going forward. It is possible for institutions to improve their capacity to resist future disruptions and to preserve the integrity of the financial industry if they place a significant emphasis on credit management. After everything is said and

done, it is absolutely necessary for all of the various stakeholders to collaborate in order to guarantee the consistency of credit operations and to foster economic expansion.

2. RESEARCH METHOD

The study used a qualitative descriptive methodology to investigate the correlation between credit management procedures and problematic loans in the banking industry. This technique enables a thorough examination of the many facets of credit management and how it affects the incidence of non-performing loans (NPLs). A wide variety of approaches is used to collect comprehensive and detailed data. Initially, comprehensive interviews are carried out with influential individuals in the banking sector, such as credit officers, risk managers, and regulatory authorities. These interviews provide useful insights into the viewpoints, encounters, and protocols linked to credit management techniques. Researchers may enhance their grasp of the intricacies and difficulties of credit management by directly interacting with industry specialists. Moreover, the study entails the scrutiny of case studies to investigate actual situations of credit management and the consequences of loan performance. This qualitative study allows researchers to find patterns, trends, and optimal strategies in credit management that either help avoid or worsen problematic loans. Furthermore, thorough investigation is carried out on pertinent documents such as banking rules, financial reports, and internal policies to get a full comprehension of the regulatory environment and institutional procedures pertaining to credit management. This documentary analysis provides a fuller understanding of the results from interviews and case studies by placing them within the larger regulatory framework. Furthermore, content analysis methods are used to methodically examine written material from many sources, such as reports, articles, and academic publications, that pertain to credit management and non-performing loans (NPLs). Researchers may use this method to recognise patterns that occur repeatedly, new patterns that are forming, and theoretical frameworks that contribute to the comprehension of credit management methods and their impact on loan performance. Finally, studying how participants behave and interact in specific situations, such banking operations and credit assessment procedures, offers vital personal insights into how credit management approaches are used in practice and how successful they are in reducing non-performing loan risks. Using a combination of several data gathering techniques with a qualitative descriptive approach improves the depth and quality of the study results. Researchers can provide complete insights into the complexities of credit management and its influence on the incidence of problematic loans by analysing data from various sources and viewpoints. This methodology guarantees that the findings of the research are strong, trustworthy, and practical for those involved in the banking sector.

3. RESULTS AND DISCUSSIONS

- 1) Factors contributing to the occurrence of non-performing loans in the banking sector Non-Performing Loans (NPLs) pose a significant risk to the banking industry.

These loans can be problematic for banks when borrowers have difficulty meeting their repayment obligations, which may result in financial losses. In banking, the causes of non-performing loans can generally be divided into two factors: Factors within the banking industry: Lenient credit policies: This can happen when banks lend without adequately considering the borrowers' ability to repay. Inadequate credit administration and monitoring systems can lead to banks being unable to effectively detect and monitor credit risks. Insufficient knowledge and expertise of credit officers can result in banks providing loans to individuals or businesses with unsuitable risk profiles (Arham, 2020; Boumparis, 2019). Questionable motives from individuals within the banking industry: This could include the mishandling of credit funds, falsification of documents, or manipulation of data. Flaws in the loan information system can lead to a lack of effective

identification and monitoring of troubled loans, potentially resulting in banks facing difficulties. Factors Affecting External Banking: Business failure can occur due to a range of factors, including challenging macroeconomic conditions, fierce competition, or unforeseen natural disasters. Adversity can befall debtors or their business endeavours, such as unexpected accidents, illnesses, or unfortunate demise. During challenging economic times and with the burden of high interest rates, individuals may find it difficult to meet their loan obligations, including repayment of installments and interest (Acheampong, 2021; Ali, 2023; Dao, 2020). Exploiting the unhealthy banking competition climate by debtors: This may include misusing credit funds for speculative or high-risk investments. Customers with questionable character, such as misusing funds and displaying low moral values, may engage in activities like using credit funds for non-essential purposes or failing to fulfil their obligations. Furthermore, there are various other factors that can contribute to the occurrence of non-performing loans, including: Government regulations or policies can pose challenges for debtors in managing their businesses. When faced with natural disasters, the impact on debtor assets can be significant. This can lead to a decrease in their ability to fulfil their financial obligations, such as repaying installments and loan interest. Non-performing loans can have adverse effects on banks, including: Managing rising operational expenses: Banks need to allocate extra resources to address the issue of non-performing loans. Declining profitability: Incurring losses due to non-performing loans can have a negative impact on banks' overall profitability. Managing liquidity risk: Non-performing loans can lead to liquidity shortages, which can make it challenging for banks to fulfil their obligations to customers. Decreasing public trust: The rise in non-performing loans can erode public confidence in banks, making it harder to secure funds from customers. Thus, banks must implement a range of strategies to mitigate the risk of non-performing loans, including: Implementing more stringent credit policies: Banks should prioritise conducting thorough and meticulous credit analysis prior to extending loans to borrowers. Improving credit administration and monitoring systems: It is crucial for banks to enhance their credit administration and monitoring systems in order to effectively manage credit risks. Improving the knowledge and expertise of credit officers: Banks should prioritise providing training and development opportunities to credit officers, enabling them to enhance their skills in credit analysis and collection. Establishing an anti-corruption culture: It is crucial for banks to establish an anti-corruption culture in order to prevent any misuse of credit funds. Harnessing the power of information technology: Banks have the opportunity to enhance the efficiency and effectiveness of credit analysis and collection processes through the use of information technology (Chortareas, 2020; Corbae, 2021).

- 2) Non-Performing Loans (NPLs), or troubled bank credits, can present a range of challenges for banks, debtors, and the overall financial system. Here are a few potential issues that could come up

Just like a seasoned financial expert, banks have to deal with the unavoidable rise in operational costs. These costs include various expenses like salaries for debt collectors, fees for lawyers, and provisions for credit losses. As a result, the bank's profitability may take a hit from troubled loans, which could result in reduced dividends for shareholders and restrictions on business growth (Horobet, 2021). In addition, loans that are in trouble can lead to liquidity risk, which can create challenges for banks in meeting their obligations to customers. If not handled properly, this can potentially result in financial crises. In addition, the increase in troubled loans can undermine the confidence of the public in banks, leading customers to withdraw their funds and damaging the bank's reputation. This, in turn, poses difficulties in attracting new customers. When borrowers have loans that are in trouble, they may face consequences from the bank, including late fees, penalty interest, and the withdrawal of credit facilities. In addition, borrowers may experience stress and mental pressure when dealing with troubled loans and trying to meet their

repayment obligations. In addition, in the event that borrowers are unable to repay their loans, banks have the authority to take possession of their assets as collateral. This could potentially pose difficulties for them in securing credit in the future, as they may be placed on banks' blacklists. When troubled loans start piling up, it can seriously undermine the stability of the financial system. Banks may find it difficult to fulfil their obligations, which could potentially lead to financial crises. In addition, when banks become more cautious in lending due to troubled loans, it can hinder economic growth by reducing funds flow into the real sector. With the expertise of a seasoned financial professional, banks can take proactive measures to minimise troubled loans. This includes strengthening credit policies, conducting thorough credit analysis prior to lending, and implementing robust credit administration and monitoring systems to effectively track credit risks. In addition, it is crucial for banks to offer comprehensive training and development programmes for credit officers, enabling them to strengthen their expertise in credit analysis and collection. Establishing a strong anti-corruption culture within banks is crucial in order to safeguard against the misuse of credit funds. In addition, banks can leverage information technology to enhance the efficiency and effectiveness of credit analysis and collection processes (Beck, 2022; Chen, 2022; Dashottar, 2021).

- 3) Efforts to address non-performing loans (NPLs) in the banking sector are of utmost importance, considering the substantial risk they present to financial institutions. When borrowers have difficulty meeting their repayment obligations, it can result in losses for banks. Financial institutions have the ability to implement a range of strategies to address non-performing loans, which can be divided into two main categories: preventative measures and remedial actions.

Preventive Measures: These steps are implemented proactively to reduce the likelihood of NPLs arising. Important preventive measures include: Implementing more selective and cautious lending practices to tighten credit policies. This requires a focus on bolstering credit analysis, improving credit requirements, and broadening credit portfolios. Improving the skills and expertise of the lending team, including credit analysts, collection officers, and risk management personnel, through ongoing training and development. Implementing robust monitoring and supervision systems for approved credits through cutting-edge information technology and cultivating a culture of strong supervision within the organisation. Promoting financial education and literacy among bank customers, especially borrowers, to emphasise the significance of comprehending credit risks and implementing prudent financial management (Asiama, 2019; Grigoli, 2018).

Remedial Actions: These measures are implemented once NPLs arise to minimise bank losses and support borrowers in meeting their obligations. Actions to address the issue include: Restructuring loans through adjustments to credit terms, such as modifying installment schedules, decreasing principal amounts, and extending loan durations. Transforming loans into alternative forms, such as investments or equity participation, with expertise and precision. Offering supplementary assets to enhance the security of loan repayment assurances. Engaging in the sale of distressed loans to external entities, including debt collection firms or other players in the financial sector. Taking legal measures, such as initiating civil lawsuits or filing for bankruptcy. Financial institutions must carefully select suitable preventive and remedial actions that are customised to the unique situations of borrowers and non-performing loans. In order to address NPL issues systematically, it is crucial to collaborate with various stakeholders, such as government bodies, regulators, and other institutions. This requires a focus on bolstering regulations and policies surrounding lending, improving collaboration among institutions, and establishing a solid infrastructure to address non-performing loan resolution (Hoshi, 2023; Tran, 2022; Xie, 2022).

4. CONCLUSION

Overall, effectively managing non-performing loans (NPLs) in the banking sector requires a thorough and sophisticated approach that combines proactive measures to prevent NPLs and reactive strategies to tackle existing ones. With the utmost responsibility, the aim is to ensure the security and reliability of the financial system, while also minimising any potential losses for banks and assisting borrowers in meeting their commitments. Implementing preemptive measures is crucial in managing NPLs and reducing the chances of their occurrence. With a strong focus on financial management, this approach involves the adoption of strict lending practices. These practices are marked by careful credit policies that prioritise in-depth credit analysis, thorough risk assessment, and diversified credit portfolios. Enhancing the skills and expertise of banking personnel, including credit analysts, collection officers, and risk management professionals, through ongoing training and development initiatives is crucial. In addition, it is crucial to enhance monitoring and supervision systems using cutting-edge technology and promote a culture of thorough oversight within banking institutions. In addition, it is essential to prioritise financial education and literacy for bank customers, particularly borrowers. This will help promote responsible financial behaviour and increase awareness of credit risks. Just as a seasoned financial expert would advise, it is crucial to take both preventive measures and remedial actions to effectively address existing non-performing loans (NPLs) and minimise losses for banks. These remedial strategies are implemented once non-performing loans have emerged and aim to alleviate financial difficulties for both banks and borrowers. Implementing necessary measures involves reorganising loans by making changes to credit terms, like adjusting payment schedules, reducing loan amounts, or extending repayment periods. Expertise and precision are crucial when transforming loans into alternative forms, such as investments or equity participation, in order to maximise recovery potential. In addition, it is common for companies to provide additional assets to strengthen loan repayment guarantees and to sell distressed loans to external entities, such as debt collection firms or financial institutions. If other options are not enough, you may consider taking legal actions, such as civil lawsuits or bankruptcy filings, as a final course of action. Financial institutions must customise these strategies to suit the specific situations of borrowers and non-performing loans, all while promoting cooperation with relevant stakeholders. Through the implementation of stronger regulatory frameworks, improved inter-institutional coordination, and the establishment of reliable infrastructures for resolving non-performing loans, the banking sector can successfully reduce the risks associated with these loans and maintain financial stability in the future.

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