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RISK MANAGEMENT ANALYSIS IN RURAL BANKS (BPR) MERGER

(CASE STUDY: 6 BPRs THAT ARE IN THE PROCESS OF MERGING INTO ONE IN MALANG RAYA)

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Abstract

This case study research aims to determine the risks that will increase during the BPR merger process based on the risk rating. The research was conducted on 6 (six) BPRs in the Greater Malang area which were in the process of being merged on December 31, 2022. This research was conducted in 4 (four) stages, which included assessing and determining the risk rating of 6 (six) BPRs individually, financial consolidation, assessing and determining the estimated risk rating of BPRs after the merger and the last was preparing recommendations for downgrading risk and risk mitigation. The results of this study indicate thatPost-merger credit risk and operational risk ratings of BPRs are projected to increase. This was mainly due to the low quality of productive assets originating from the six BPRs individually prior to the merger, inadequate BPR IT systems and an unstructured BPR office network that was deemed inefficient.

Keywords: *BPR, Merger, Risk Rating, Credit Risk, Operational Risk, Risk Mitigation*

INTRODUCTION

Rural Banks (BPR) include financial service institutions in the banking sector whose existence is easy to find in Indonesia, both in cities, districts and remote sub-districts. Even though they do not accept payment traffic services, BPRs are still the people's favorite, especially in the micro and small segment, because BPR services prioritize family relations with a fast and easy process. Meanwhile, the duties of the Financial Services Authority (OJK) as an independent institution are outlined in the Law of the Republic of Indonesia Number 21 of 2011, among others, to regulate and supervise the financial services industry, including BPRs, so that they always perform well.

BPR development must be carried out so that BPRs can develop in a healthy and sustainable manner and can make a more tangible contribution to the regional economy. In addition, BPRs are also required to be able to continuously improve their competitiveness in line with the challenges resulting from changes in people's economic conditions which are currently shifting towards digitalization. One of OJK's efforts to strengthen structure and competitive advantage is to encourage rural banks to increase capital. Sound capital is a key aspect in the effort to create a sound national banking structure. Capital is also the main source of support in running the operations of financial service institutions, including safeguards against unexpected risks and losses and as a safeguard in the event of a crisis. Besides that,

There are several alternatives for BPRs wishing to strengthen capital in order to increase the amount of core capital both to meet minimum core capital requirements and to increase business activities according to their capital capacity, namely capital deposit by shareholders or conducting mergers. Mergers are often still seen as a double-edged sword, where one end is strengthening capital and increasing business activities, but the other end will carry the risk of adding more complex BPR products and activities. There is research showing that mergers will increase bank capital and liquidity (Amalia, 2014) but on the other hand, efficiency after the merger does not experience significant changes and profitability after the merger is lower than before the merger (Cahyaningtyas, 2016).

In a study on Islamic bank mergers, Siregar concluded that the merger policy of Islamic banks was not in accordance with the hypothesis of accelerating market share growth and led to a decrease in the competitiveness of smaller Islamic banks (Siregar, 2021). In contrast to the results of research on banks in Indonesia, Jayadev concluded that the merger of banks in India with the aim of restructuring banks is needed to absorb risks in the face of global challenges but must be carried out carefully, especially with regard to issues of assessing the quality of loan portfolios, equity valuation, integration of information systems and HR issues (Jayadev, 2007). In line with Jayadev's research,

In the last 10 (ten) years, there have been 23 (twenty-three) BPR/S in the working area of the Malang OJK Office which have merged into 9 (nine) BPR/S, all of which are BPR/S with the same ownership group. In the Greater Malang area (Malang Regency, Malang City and Batu City), there are BPR Groups that have the same Controlling Shareholders (PSP) which are in the process of being merged in 2022. The BPR Group consists of 6 (six) BPRs, namely 2 (two) BPRs classified as BPR Business Activities (BPRKU) 1 and 4 (four) BPRs classified as BPRKU 2.

OJK as the regulator and supervisor of BPRs supports the direction of BPR consolidation policies, including mergers, but on the other hand has not prepared regulations in anticipation of the impact of increasing BPR risks after mergers. The implementation of a merger without preparation for risk mitigation measures is considered to have a negative impact on the performance of BPRs after the merger, so that BPRs need to obtain motivational references in considering the consolidation policy steps to be taken. This research is very important to achieve a successful BPR merger, bearing in mind that there will be a dynamic synergy between researchers who will estimate the risks faced by BPRs after the merger to be able to formulate risk mitigation efforts that must be carried out by BPRs and BPR management who will carry out these recommendations so that they can manage risks properly in order to maintain good BPR performance. Furthermore, if the merger goes smoothly, a positive response will definitely come from OJK and BPR shareholders.

Formulation of the problem

The existence of an interest in carrying out OJK duties as a BPR supervisor that fully supports the consolidation plan because it has an impact on strengthening capital and increasing the competitiveness of BPRs, as well as the phenomenon of merger policies that will have an impact on the implementation of risk management and the absence of a provision requiring BPRs to evaluate the implementation of risk management in the merger process has prompted further research into the planned merger of 6 (six) BPR Groups in Malang Raya. Thus, the research questions to be answered are:

1. What is the estimated assessment of BPR risk management implementation after the merger? Is there a risk that will increase with the merger policy?
2. What efforts to lower the risk rating should be made by each BPR during the merger process?
3. What are the risk mitigation efforts that must be carried out by BPRs after the merger?

LITERATURE REVIEW

Mergers

Hitt (2002) defines a merger or business combination as an alternative effort or corporate strategy to expand its business, namely the agreement of 2 (two) companies to combine their operational activities which are equal or balanced where these companies have the resources and capabilities to work together to create a stronger competitive advantage. Supporting reasonsstrategy mergeramong other things increase the strength and speed of enteringmarket, overcome barriers to entermarket, reduce development costsproductnew with lower risk, improvediversificationin the market it has mastered, as well as reshaping the company's competitive reach to reduce the negative impact of high levels of competition onperformancefinance and limit its dependence onproduct marketfew or single.

Based on Law no. 40 of 2007 concerning Limited Liability Companies, a merger occurs when 1 (one) company or more takes corporate action and legal action in the form of merging with another existing company, resulting in a legal transfer of the assets and obligations of the merging companies and their legal entity status also ends at the time of the merger. Whereas in POJK No.21/POJK.03/2019 concerning Merger, Consolidation and Acquisition of BPRs and BPRS, a merger is a legal action of 2 (two) BPRs or more while maintaining one (1) bank to remain standing and the other bank is dissolved without prior liquidation, resulting in a legal transfer of assets, liabilities and equity and the legal entity ending of the BPR or BPRS that is merging.

According to Brigham (2001), mergers are strategic decisions of business leaders and the result of one of the fundamental aspects of corporate strategy, with various reasons, motivations and goals. The motivation or impetus to carry out the merger is the reason for synergy, namely that the value of the company after the merger must be higher than the value before the merger. In addition, the merger was carried out because the economic value of the assets being merged was considered high, which was assessed from the company's function in producingprofitfuture, not the cost to replace the asset.

Risk

Risk is the potential loss resulting from an event. There are 6 (six) risks in RBs listed in the provisions for Application of Risk Management for RBs, namely:

1. Credit Risk, namely the risk that occurs because the debtor or other parties fail to fulfill their obligations to the BPR and can be the main cause of BPR failure. This risk can

also occur due to the concentration of credit or provision of funds that are focused on certain debtors, certain economic sectors, certain types of credit, or even in certain regions.
2. Operational Risk, which is a risk that occurs due to inadequate internal processes, employee/employee errors, systems that experience failure, or external events that affect BPR operations so that they can result in direct or indirect financial losses, as well as the emergence of potential losses from lost opportunities to gain economic benefits. This risk is very significant for BPRs because it lies in the organizational structure, types of BPR products and services, the number of office networks that affect BPR business activities.
3. Compliance Risk, which is a risk that arises due to BPR non-compliance with applicable rules or regulations, causing weaknesses in the legal aspect and reflecting BPR activities that violate these provisions.
4. Liquidity risk, namely the risk that occurs because the BPR is unable to fulfill its maturing obligations using funding without disrupting its financial condition.
5. Reputation Risk, which is a risk that occurs because stakeholders' trust has decreased due to negative perceptions of BPRs. Apart from being able to appear without other risks, such as manipulation of information from business competitors, violations of business ethics and customer complaints/complaints, and weaknesses in BPR management, this risk can also be preceded by the emergence of other risks or also known as second-tier risk.
6. Strategic Risk, namely the risk that occurs because the BPR is not appropriate in taking and implementing strategic decisions and fails to anticipate changes in the business environment that disrupt the competitiveness of BPRs in the industry so that it has the potential to cause failure of the entire business.

BPR Risk Management

Based on POJK No. 13/POJK.03/2015 and SEOJK No. 1/SEOJK.03/2019 concerning Implementation of Risk Management for BPRs, BPR risk management is a methodology and procedure for identifying, measuring, monitoring and controlling risks that arise from all BPR activities and operational activities. This reflects that with activities and operational activities that are increasingly complex, the risks that must be managed by BPRs will increase so that the need for BPRs to be able to make efforts in implementing risk management will also increase. This needs to be done as an effort to strengthen competitiveness and improve the reputation of BPRs, as well as maintain institutional performance, which is in line with the policy direction for developing BPRs, namely, to create stability in the financial institution industry.

For more effective implementation, BPRs need to prepare procedures, develop, improve and analyze policies, organizational structures, procedures, limits and systems, as well as regularly improve guidelines for implementing risk management. Furthermore, BPR also needs to conduct outreach to all of its employees so that they can understand the application of risk management properly and are familiar with the risk perspective in each of their operational activities. In addition, BPRs must also have an internal audit function that is involved from the beginning of the process of preparation and development of procedures and policies, up to the implementation of risk management in all BPR business activities.

Inherent Risk

Inherent risk is an inherent risk in BPR business activities, both measurable and unmeasurable, influenced by internal factors such as the information technology capacity and human resources of the BPR, and external factors such as government regulations and natural conditions, so that it has a material impact on the BPR's financial position. The assessment is carried out by considering quantitative and qualitative parameters but does not take into account the control efforts made by BPRs at each BPR.

Quality of Implementation of Risk Management (KPMR)

KPMR is an assessment of the risk control system carried out by the BPR in all risk management applications, where all parameters or indicators are qualitative in nature. KPMR varies significantly depending on the characteristics, level of complexity, risk appetite and risk tolerance of the BPR. In general, the assessment is carried out by taking into account qualitative parameters or indicators.

Risk Rating

Determination of the risk rating is carried out by taking into account the results of the inherent risk assessment and the KPMR so that it can also be said that the risk rating is the risk of BPR activities after taking into account the KPMR for each risk. The materiality and significance of each type of risk will influence and determine the overall risk profile of the BPR, which means it is determined by how big the impact of a risk is on the BPR's financial performance.

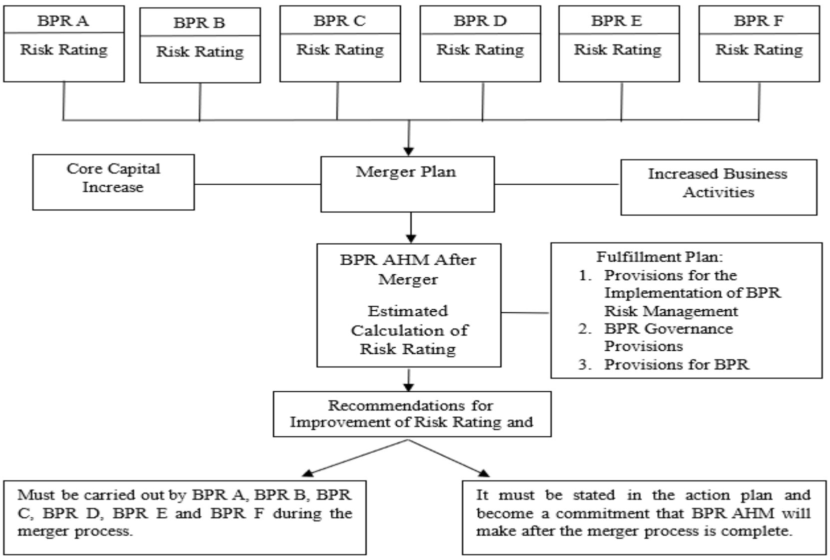

Figure 1 Flow of Case Study Thinking Framework

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METHOD

Data Types and Sources

This case study research will use primary data in the form of an online questionnaire submitted to the Directors of 6 (six) BPR Groups and secondary data in the form of financial reports of 6 (six) BPR Groups for the position of December 31, 2022.

Population and Sample

The data for this study are population in nature, namely primary and secondary data from 6 (six) BPR Groups that are in the process of being merged. All BPRs are conventional BPRs under the supervision of the Malang OJK Office, consisting of 2 (two) BPRs located in Malang City and 4 (four) others located in Malang Regency.

Stages of Analysis

Stage 1: Assessment of the Risk Rating of 6 (six) RBs

In this stage, an assessment of the implementation of risk management for each BPR prior to the merger will be carried out based on the BPR's financial statements for the position of December 31, 2022. An assessment of the risk rating that reflects the implementation of risk management as a whole is carried out in accordance with POJK and SEOJK as follows:

1. Assessment of the inherent risk level of each type of risk, with categories namely:

Table 1
Risk level assessment

Rating	Information
1	Very low inherent risk
2	Low inherent risk
3	Moderate inherent risk
4	High inherent risk
5	The inherent risk is very high

2. Determination of the KPMR level with the following rankings:

Table 2
Determination of the KPMR level

Rating	Information
1	KPMR is very adequate
2	Adequate KPMR
3	KPMR is quite adequate
4	KPMR is inadequate
5	KPMR is inadequate

3. Determination of the level of risk for each type of risk with reference to the following:

Table 3
Determination of the level of risk for each type of risk

Inherent Risk Level	KPMR level				
	Very Adequate	Adequate	Adequate	Inadequate	Inadequate
Very low	1	1	1	1	1
Low	1	2	2	2	2
Currently	2	2	3	3	3
Tall	2	3	4	4	4
Very high	3	3	4	5	5

4. Determination of Risk Ratingby referring to and taking into account the significance and materiality of the risks to the overall risk profile of the BPR, it is therefore necessary to conduct a study of the level of risk or volume and the importance of the overall risk profile of the BPR as well as the impact of problems resulting from these risks on the BPR's financial performance. The risk rating consists of 5 (five) ratings, namely Rating 1, Rating 2, Rating 3, Rating 4, and Rating 5 where the smaller the rating, the lower the risk. In preparation for this merger, 6 (six) risk ratings will be generated for each BPR.

Stage 2: Consolidation of Financial Statements

The financial statements of 6 (six) BPRs for the position of December 31, 2022, will be consolidated so that in the end it will produce a financial report for BPR A resulting from the Merger (AHM) for the position of December 31, 2022.

Stage 3: Assessment of AHM Rural Bank Risk Rating Estimation

Furthermore, an assessment and determination of the risk rating will be carried out again in the same stages as Stage 1 above including the assessment and determination of the inherent risk level and KPMR as well as the risk level for each of the 6 (six) types of risk so that an estimated final risk rating of AHM BPR will be obtained.

Stage 4: Compilation of Recommendations for Improvement of Risk Rating and Risk Mitigation

Based on the estimated results of inherent risk, KPMR and the risk level of each type of risk, it can be identified which risks are considered high with inadequate control efforts so that they can potentially increase the risk rating of AHM BPR after the merger which in turn can also affect the financial performance of AHM BPR. From this identification process,

RESULTS AND DICUSSION

BPR Risk Rating A

The inherent risk level for BPR A's credit risk is considered high, mainly due to the relatively low quality of its assets. These ratios illustrate that BPR A has a significant amount of credit restructuring, which has the potential to cause a significant reduction in the quality of current loans to non-current ones. BPR A's credit growth is below the industry average, but most of it is channeled to economic sectors that have been controlled by BPRs so that BPRs have the ability to understand their debtors.

Similar to credit risk, the level of inherent risk for BPR A strategic risk is also considered high, mainly due to the establishment of a business strategy with high-risk products or services that require infrastructure, such as human resources and IT, which must be specially prepared. In addition, BPR A seeks to add customers or debtors to new market shares and new economic sectors, the success rate of which is uncertain, and which has the potential to cause quite high deviations in the achievement of its business plan. In contrast to credit risk, BPR A's strategic KPMR level is considered inadequate, mainly due to inadequate risk management framework, management information processes and systems and internal control systems.

Table 4
Assessment of the level of inherent risk and the level of Rural Bank KPMR A

Risk Assessment	Inherent Risk	KPMR	Risk Level
Credit	4	3	4
operational	3	3	3
Obedience	2	4	2
Liquidity	3	4	3
Reputation	3	4	3
strategic	4	4	4
Total	19	22	19
Average	3,17	3.67	3,17

Rural Bank Risk Rating B

The low quality of assets and the lack of a strategy for providing funds, coupled with the existence of external factors that affect the ability to pay and cause a decrease in debtor credit quality, results in the level of inherent risk for BPR B's credit risk being considered high. This shows that BPR B has a non-performing productive asset component, most of which are loans that have a significant amount of arrears. In addition, BPR B also has a number of low-quality restructured loans that have the potential to experience a decline in quality.

The high inherent risk for BPR B's credit risk has been offset by the credit risk KPMR level which is considered quite adequate. In terms of the oversight of the Board of Directors and Commissioners, the risk management framework, management information processes and systems as well as the internal control system for BPR B credit risk are considered to be sufficient.

The level of inherent risk for risks other than operational risk, liquidity risk, reputation risk and strategic risk is considered moderate, as well as for compliance risk is considered low. However, the KPMR level for strategic risk is considered inadequate because there are still weaknesses in the risk management framework which includes the implementation of policies and procedures for strategic risk that have not been properly documented and administered and have not been implemented consistently. In addition, there are still weaknesses in the strategic risk management process and information system which have not been implemented comprehensively so that they cannot be used optimally for the Board of Directors in making decisions.

Table 5
Assessment of the level of inherent risk and KPMR level of BPR B

Risk Assessment	Inherent Risk	KPMR	Risk Level
Credit	4	3	4
operational	3	3	3
Obedience	2	3	2
Liquidity	3	3	3
Reputation	3	3	3
strategic	3	4	3
Total	18	19	18
Average	3.00	3,17	3.00

BPR Risk Rating C

The assessment of the level of inherent risk for BPR C is considered quite good and there is no inherent risk that is classified as high or very high. The inherent risk level for credit risk, operational risk, liquidity risk and strategic risk is considered moderate, while for compliance risk and reputation risk is assessed as low.

However, the KPMR level for operational risk and strategic risk is considered inadequate due to the lack of oversight by the Board of Directors and Commissioners in implementing operational and strategic risk management policies, as well as the efforts of the Directors and Commissioners in evaluating and establishing policies as operational and strategic risk mitigation measures are also considered to be lacking. In addition, the implementation of policies and procedures in the context of operational risk management and strategic risk carried out at BPR C is considered inconsistent, including in the implementation of setting risk limits when there are new products or services. The internal control system for implementing operational risk management and strategic risk is considered weak, because the activities and levels within the BPR C organization that are exposed to operational risk and strategic risk do not understand and do not carry out the internal control function so that there is no clarity regarding the responsible part of the internal control system for these risks, including the internal audit unit. Assessment of the level of inherent risk and the level of Rural Bank KPMR C for all types of risk produces a risk level for each type of risk as follows:

Table 6
Assessment of the level of inherent risk and KPMR level of BPR C

Risk Assessment	Inherent Risk	KPMR	Risk Level
Credit	3	3	3
operational	3	4	3
Obedience	2	3	2
Liquidity	3	3	3
Reputation	2	3	2
strategic	3	4	3
Total	16	20	16
Average	2.67	3,33	2.67

Rural Bank Risk Rating D

In general, the weakness in the KPMR level of BPR D lies in the application of the risk management framework which includes the adequacy of its policies and procedures. BPR D does have a risk management policy for operational risk, liquidity risk, reputation risk and strategic risk, but there is no alignment between the policy and the vision, mission, business scale and business complexity of the BPR so that it is likely to have a significant impact. In addition, the procedures contained in the risk management policy have not been carried out consistently in all BPR functional activities and have not been evaluated or updated in procedures if there has been a significant business change or if there has been a change in provisions. Even though the KPMR level of BPR D is dominated by inadequate scores,

Table 7
Assessment of the level of inherent risk and the level of Rural Bank KPMR D

Risk Assessment	Inherent Risk	KPMR	Risk Level
Credit	3	3	3
operational	3	4	3
Obedience	2	3	2
Liquidity	3	4	3
Reputation	3	4	3
strategic	3	4	3
Total	17	22	17
Average	2.83	3.67	2.83

Rural Bank Risk Rating E

Strategic risk at BPR E is considered to have high inherent risk, especially because the majority of BPR E's strategy is to switch to a new strategy with new products that require HR with special expertise and/or more complex IT infrastructure with an uncertain success rate and most of BPR E's business activities are in the market share/economic sector and new customers.

In contrast to the inherent risk assessment, on the other hand almost all of the KPMR levels at BPR E are considered inadequate, except for the KPMR level for credit risk which is considered quite adequate. Operational risk, compliance risk, liquidity risk and reputation risk where the level of inherent risk is considered sufficient, with an inadequate KPMR level, the final risk level is assessed at 3 (three). However, for strategic risks where the inherent risk is considered high and the KPMR level is considered inadequate, the risk level is assessed as 4 (four).

Table 8

Assessment of the level of inherent risk and the level of Rural Bank KPMR E

Risk Assessment	Inherent Risk	KPMR	Risk Level
Credit	3	3	3
operational	3	4	3
Obedience	3	4	3
Liquidity	3	4	3
Reputation	3	4	3
strategic	4	4	4
Total	19	23	19
Average	3,17	3.83	3,17

Rural Bank Risk Rating F

Of the six risks managed by BPR F, only credit risk is considered high inherent risk and for compliance risk, inherent risk is considered low. As for the other four risks, the inherent risk is considered moderate. The inherent risk for BPR F's credit risk is considered high, partly because BPR F has poor asset quality, namely a significant amount of credit restructuring, a decrease in credit quality from current to non-current collectibility, a significant increase in arrears and a concentration of high-risk economic sectors. This was coupled with the amount of BPR F's credit growth, which was below the industry average, resulting in an increase in the potential for credit risk.

Contrary to the inherent risk assessment, the KPMR level for credit risk is considered sufficient, which is the best implementation of the KPMR level among other risks which are considered inadequate. This causes the risk level for credit risk to be rated the highest, namely 4 (four), considering that the inherent risk assessment is very influential in assessing the final risk level for each type of risk. Assessment of the level of inherent risk and the complete level of KPMR BPR F for all types of risk produces a risk level for each type of risk as below:

Table 9

Assessment of the level of inherent risk and KPMR level of BPR F

Risk Assessment	Inherent Risk	KPMR	Risk Level
Credit	4	3	4
operational	3	4	3
Obedience	2	4	2

Liquidity	3	4	3
Reputation	3	4	3
strategic	3	4	3
Total	18	23	18
Average	3.00	3.83	3.00

Consolidated Financial Statements

The total core capital of BPR AHM after the merger has reached over IDR 50 billion so that it is categorized as BPRKU 3 (three) as stipulated in POJK Number 12 of 2016. This BPRKU 3 (three) category is a new thing for BPR AHM management considering that before the merger was carried out none of the 6 (six) BPRs were classified as BPRKU 3 (three). One of the consequences for BPRs with a core capital of more than IDR 50 billion is that they are required to have at least 3 (three) members of the Board of Directors in order to realize better BPR governance provisions.

The liquidity condition of BPR AHM is still within adequate limits so that what needs to be done by the management of BPR AHM is to focus on efforts to improve the quality of earning assets where the NPL ratio of BPR AHM is still very high. However, the capital condition with a CAR ratio above 100% reflects that BPR AHM has sufficiently strong capital reserves as a buffer for credit risk and operational risk in the short term after the merger is completed. In addition, BPR A before the merger had a fairly good reputation in Malang City so that the conditions after the merger are expected not to have an impact on decreasing the reputation and trust of its customers.

However, after the merger, the number of BPR AHM office networks is quite large and is spread unevenly throughout the Greater Malang area, including relatively close distances between office networks and they are still in the same district or village. Even though the condition of BPR AHM's profitability after the merger is projected to be adequate and stable, the efficiency measures of BPR AHM's office network after the merger that can be carried out by management will have a significant impact on its performance and financial condition. Office network efficiency measures that can be taken are mapping office locations that are less than 20 kilometers between other office locations and adjusting the number of human resources according to the needs of each office.

At the time of the merger, BPR AHM will also make adjustments to the number of management based on the provisions of Article 4 POJK Number 4/POJK.03/2015 concerning Implementation of Governance for BPRs so that there is a decrease in salary costs, facilities and honorarium for BPR AHM management compared to the total cost of salaries, facilities and honorarium for the management of the six BPRs before the merger. In addition, if adjustments have been made to the number of human resources after an evaluation of the performance or productivity of human resources in each office network, the human resource cost, which is the largest expense in the component of BPR operational costs, will also be reduced. Adjustments to the number of managements, human resources and closing office networks can reduce operational costs by 11.42% per year, by also

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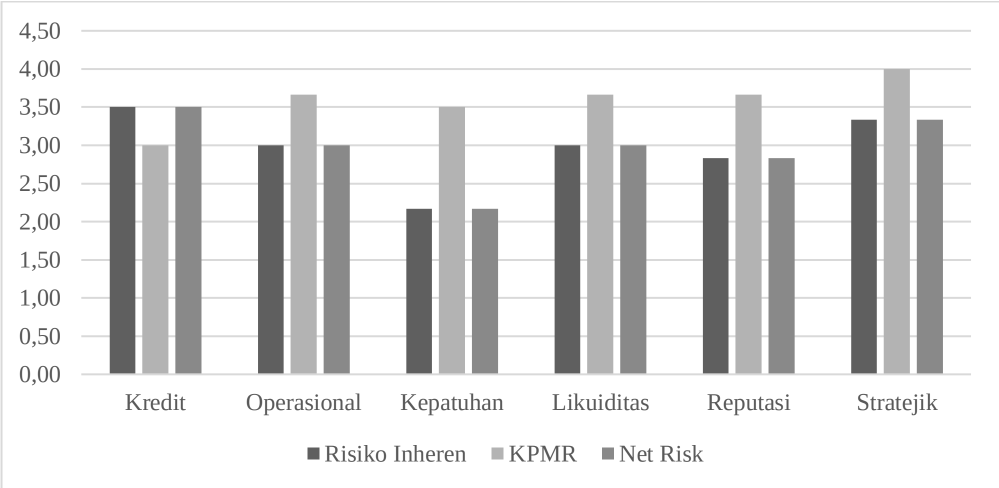
considering management's span of control, it can further optimize the pattern of internal control carried out by BPRs. However, these efficiency measures must be carried out carefully and not violate applicable regulations because there will be the potential for legal risks and reputational risks for BPRs.

AHM Rural Bank Risk Rating Estimation

The average value of the inherent risk level, KPMR level and risk rating of each type of risk generated can be illustrated in the bar chart as shown below:



Graphic Image 2
The average value of the inherent risk level, the KPMR level

From the diagram above, we can see together that the average inherent risk level for credit risk is the highest inherent risk level compared to the other 5 (five) risks. This shows that before the merger, the biggest risk that was inherent in the business activities of all BPRs and that could have a material impact on the financial position of BPRs was credit risk. However, qualitatively all BPRs have implemented a credit risk control system which is considered the most adequate compared to the other 5 (five) risks, which is reflected in the KPMR level assessment. Meanwhile, strategic risk is a risk with an inadequate KPMR level compared to the other 5 (five) risks.

The following is an estimation of the level of inherent risk, the level of KPMR and the level of risk of each type of risk at BPR AHM after the merger is carried out:

Table 10
Assessment of the estimated level of inherent risk, KPMR level and risk level

Risk Assessment	Inherent Risk	KPMR	Risk Level
Credit	4	3	4
operational	4	4	4
Obedience	2	4	3

Liquidity	3	4	3
Reputation	3	4	3
strategic	3	4	3
Total	19	23	20
Average	3,17	3.83	3,33

The projected higher risk level at BPR AHM after the merger is credit risk and operational risk.

Recommendations for Improvement of Risk Rating and Risk Mitigation

The high level of inherent risk for credit risk found in BPRs A, B and F is mainly due to the relatively high ratio of NPLs and ratios of low quality credit, so recommendations that can be given to BPRs in improving or downgrading the risk rating from decreasing the level of inherent risk for credit risk are, of course, by reducing the ratio of NPLs and low quality credit ratios before the BPRs merge. This will cause the quality of the productive assets of the BPR prior to the merger to improve. Meanwhile BPR A and BPR E are considered to have an inherent risk for high strategic risk,

The estimation of BPR AHM's risk rating shows that the level of inherent risk for credit risk is projected to increase mainly due to the low quality of assets at AHM BPRs, namely AHM BPRs still have to settle non-performing loans and low-quality loans in the form of arrears originating from the six BPRs prior to the merger. The focus of BPR AHM on improving the quality of its productive assets after the merger will result in on the other hand the potential for BPR AHM's credit growth to be hampered. Meanwhile, the level of inherent risk for post-merger BPR AHM operational risk is projected to increase because the number of post-mergers BPR AHM office networks has become very large compared to the six individual BPRs before the merger and has not been supported by the implementation of an adequate IT system which has resulted in a weakening of internal control. The number of AHM BPR office networks that are not structured properly will have the potential for inefficient expenses in the long term.

In compiling recommendations for risk mitigation efforts for AHM BPRs after the merger, data will also be processed originating from the nominative loans granted to the six BPRs for the position of December 31, 2022, to find out the distribution of debtors by business location and economic sector. Based on the combined nominative data listed in the monthly report for the position of December 31, 2022, we can see the average value, variance, minimum, maximum and standard deviation of the credit collectibility of 9,869 credit accounts whose business locations are spread across 19 districts/cities in Indonesia and consist of 62 (sixty-two) economic sectors.

Before Mergers

Improving the risk rating of BPRs before the merger can mainly be done for BPRs that have a high level of inherent risk. The level of inherent risk for credit risk can be carried out by improving the quality of productive assets, including through efforts to settle non-performing loans so that the NPL ratio and low quality credit ratios can improve, either by increasing the intensity of collection so that the amount in arrears can be reduced, taking legal action to settle bad loans (for example by means of simple lawsuits and collateral auctions), asking the debtor to sell collateral or take over collateral that has been guaranteed to the BPR. In addition, BPRs can evaluate and improve the credit analysis that has been carried out so far in the context of efforts to mitigate credit risk.

In contrast to credit risk, from a strategic risk perspective, it is more optimal to determine the business strategy and preparation of a business plan for the AHM BPR strategy and business plan after the merger, not the individual BPR strategy and business plan prior to the merger. Infrastructure improvements, such as HR and IT, in accordance with the determination of the strategy and business plan of BPR AHM after the merger can be carried out simultaneously with the preparation stage for the merger so that the qualifications of HR and IT after the repair are indeed in line with the business strategy of BPR AHM later. However, if the BPR's individual business strategy prior to the merger is still relevant to the strategy and business plan of the AHM BPR after the merger, improvements in the quality of human resources and IT infrastructure can be prepared from now on.

Furthermore, during the preparation stage and the merger process, the determination of the vision, mission, strategy and preparation of the AHM BPR business plan after the merger should have been completed so that at this time socialization and training can be carried out for all 6 (six) BPR employees, including matters related to the risk management framework in every operational business activity of AHM BPR after the merger. The socialization is intended so that all employees can find out which activities, products and services of BPR AHM are exposed to risk at each level of the organizational structure and understand what must be done to mitigate and manage these risks.

In addition to preparations from the BPR HR side, it is deemed necessary to prepare IT infrastructure at the stage of the merger process so that by now a Core Banking System (CBS) should have been established which will be used in accordance with the business strategy, products, services and activities of BPR AHM after the merger. This IT infrastructure is also expected to be able to support the implementation of risk management and management decision-making processes related to the risk management of AHM BPRs. The new CBS installation can be carried out in parallel in the office network that will be used after the merger to find out early if there are problems in its use and to socialize it to all employees as well.

Procurement of an adequate IT system is also one of the steps that can be taken to reduce the operational risk of the six BPRs prior to the merger, provided that the IT or CBS system held at the six BPRs is the IT or CBS system that will be used by AHM BPR after the merger. In addition, another effort that can be made to reduce the inherent risk level of operational risk is through an office network efficiency plan by considering access distances between office network locations and their span of control. Thus, if the six BPRs prior to the merger were able to complete the steps listed above prior to the merger,

Table 11
Final risk rating for credit risk and operational risk

Risk Assessment	Inherent Risk	KPMR	Risk Level
Credit	3	3	3
operational	3	4	3
Obedience	2	4	3
Liquidity	3	4	3
Reputation	3	4	3
strategic	3	4	3
Total	17	23	18
Average	2.83	3.83	3.00

After Merger

Saunders (2018) suggests that there is also a risk in credit risk due to a certain concentration in the loan portfolio provided, so that banks must set concentration limits on the number of loans as an effort to mitigate credit risk. In this case the AHM BPR after the merger can place concentration limits on lending according to the exposure of the debtor's business location and economic sector. The majority of AHM BPR debtor business locations are in the Malang Regency area, which dominates by 55.75%, considering that most of the AHM BPR office network locations are in the Malang Regency area. However, the average value of credit collectibility for debtors in the area is not as good as the average value of credit collectibility in the Batu City area, Malang City, Pasuruan Regency and Nganjuk Regency, which are also business locations, have quite a number of AHM BPR debtors. This condition can also be considered by management in efforts to mitigate credit risk, namely to set concentration limits on extending credit to debtors in the Blitar Regency, Kediri Regency and Lumajang Regency before evaluating the causes of the decline in debtor credit quality there and making improvements to weaknesses in lending to debtors in these areas, for example the lack of BPR HR competence in conducting credit analysis which can be corrected by conducting various training in the field of credit.

In contrast to the location of the debtor's business, debtors' economic sectors appear to be more evenly distributed and not highly concentrated in certain economic sectors. The highest portion of lending to the economic sector does not reach 20% of the loan portfolio. The average value of credit collectibility by economic sector is quite even with a range of 1.00 to 3.08. The economic sector that should receive attention from BPR AHM is the real estate sector which has a higher average credit collectibility value compared to other economic sectors. From these data,

The standard deviation value for the average credit collectibility value according to the economic sector is not as large as that seen in the debtor's business location data. This shows that the BPR policy in setting limits on the concentration of lending based on the debtor's business location is riskier than the concentration limits on lending based on the economic sector. However, it is understandable that the determination of concentration limits on lending based on the location of the debtor's business is greatly influenced by the location of the AHM BPR itself, so that it will be difficult to spread the amount of credit disbursement in a wider area.

Besides being able to be used to provide an overview and character of the debtor according to their business location, the calculation of the average credit collectibility value according to the debtor's business location can also be used by BPR AHM in planning the expansion of the office network in the future. The plan to expand the AHM BPR office network in the long term, apart from considering cost efficiency, must also be in line with the potential target market according to the debtor's business location, including credit quality in the area. The strategy for preparing the BPR AHM office network plan with consideration of efficiency and credit quality data in certain areas can be one of the steps for AHM BPR to mitigate credit risk and operational risk after the merger is completed.

CLOSING

Conclusion

The estimated inherent risk rating for credit risk and operational risk for BPR AHM after the merger is classified as high, resulting in a projected increase in the credit risk rating and operational risk. This was mainly due to the low quality of productive assets originating from the six BPRs individually prior to the merger, inadequate BPR IT systems and an unstructured BPR office network that was deemed inefficient.

Efforts that could be made by all BPRs prior to the merger to lower their risk rating were to lower their respective NPL ratios and low-quality credit ratios to improve productive asset quality, among others by increasing collection intensity to reduce arrears, settlement of non-performing loans through sales, auctions or collateral requisitions. In addition to that, determining the vision, mission, plans and business strategies of BPR AHM after the merger and socializing this to all HR of each BPR before the merger, including matters related to the risk management framework in every operational business activity of BPR AHM after the merger needs to be done so that the KPMR level in the application of risk management can be increased.

In this merger process BPRs need to accelerate efforts to implement IT systems that will be used throughout the BPR AHM office network after the merger later and ensure that the IT systems are reliable and support the complexity of their business, including supporting decision making related to the implementation of risk management. From the point of view of efficiency efforts, BPRs need to carry out a cost and benefit analysis of the existing office network to assess the productivity and effectiveness of each office network by taking into account the span of control and the distance between office network locations. In addition, an evaluation of HR performance can also be carried out according to the achievement of Individual Performance Indicators (IKI) to ensure that all HR have adequate technical competence.

Improving the competence of human resources in the field of credit so that they can produce a better quality and comprehensive analysis of credit granting is one of the first steps in mitigating credit risk after the merger has been completed. Another effort that can be taken is to set limits on loan concentration in each economic sector that will be given credit by also taking into account developments in national economic conditions, infrastructure readiness and HR competence, and of course the applicable Legal Lending Limit (LLL) provisions with the aim of mitigating credit risk. As a measure to mitigate credit risk, operational risk and strategic risk,

Implications

Although this research has the limitations of being a case study on the 6 (six) BPRs that are the object of research so that the recommendations resulting from this study cannot be generalized to other BPRs that are in the process of being merged without conducting similar research, this research supports the statement that banking mergers must be carried out more carefully related to issues of productive asset quality, information systems and HR problems that are exposed to increased credit risk and operational risk, especially if the BPR does not apply risk management to manage credit risk and operational risk adequately.It is therefore expected that the results of this case study research can be used as material for consideration for shareholders in making decisions on BPR mergers and for BPR management who are in the process of merging.

In addition, this research is also a consideration for BPR regulators and supervisors, namely the OJK, to require an assessment of the implementation of risk management and to conduct an analysis of potential risks that will increase in the merger process in order to be able to recommend more effective and efficient BPR improvement steps. This will facilitate the merger process resulting in BPRs with increasing financial performance and support government programs to strengthen the structure and competitive advantage of the banking industry, especially BPRs.

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