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Credit Risk Management Strategies For Financial Stability in The Banking Sector

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Abstract

This study aims to analyze effective credit risk management strategies in improving financial stability in the banking sector through the literature study method. Various relevant literatures were analyzed to identify key strategies in credit risk management. The main findings of this study indicate that the implementation of a strict and continuous credit supervision system, including periodic evaluation and the use of analytical technology for early risk detection, is essential. Credit portfolio diversification was identified as an effective method to reduce concentration risk and prevent large losses in one sector or region. In addition, data-driven credit assessment processes and advanced risk models are crucial to improving credit quality. The research also emphasized the importance of adequate reserves and provisions as a buffer against potential losses. In addition, human resource development through regular training was identified as an important aspect in strengthening risk management capabilities. The study also underscores the importance of compliance with international banking regulations such as Basel III in maintaining financial stability. Overall, the study concludes that implementing a comprehensive credit risk management strategy can significantly create a more resilient and stable banking system amidst global economic fluctuations.

Keywords: *Credit Risk Management, Financial Stability, Banking*

INTRODUCTION

Financial stability is a crucial element in maintaining the health of the banking sector. The banking sector has an important role as a financial intermediary as well as a distributor and collector of funds in an economy. Therefore, disruptions to financial stability can potentially have a broad negative impact on the economy as a whole. (Aprillia et al., 2024).. Financial stability is not only important to maintain the viability of the bank itself, but also to ensure that banks can continue to support economic growth by providing loans and credit to individuals and businesses. (Ananta et al., 2024).. In this context, credit risk management becomes one of the key factors in maintaining financial stability.

After the global financial crisis in 2008 (Ashma' & Laksmi, 2023)the banking sector in many countries faced increased credit risk. The crisis exposed weaknesses and gaps in the global financial system, especially with regard to credit risk assessment and management. Many banks suffered huge losses due to inappropriate securities and ineffective risk management. (Azita et al., 2023).. These conditions prompted banks and regulators to develop and strengthen a more resilient credit risk management framework to deal with future economic uncertainties. Although the global crisis has passed, increased credit risk remains a major challenge for banks in their efforts to maintain financial stability.

Effective credit risk management is a vital strategy for maintaining financial stability in the banking sector. Credit risk management involves the process of identifying, assessing, and mitigating the risks associated with lending activities. (Ain et al., 2022). Banks must be able to measure and manage their credit risk exposure carefully to prevent significant losses. Success in credit risk management depends not only on the bank's internal procedures, but also on the regulations and policies imposed by the financial authorities. (Siwi et al., 2024).. Therefore, understanding effective credit risk management strategies and mechanisms becomes highly relevant in an effort to maintain financial stability in the banking sector.

The objective of this study is to analyze the credit risk management strategies implemented by banks in Indonesia. In this analysis, various approaches used by banks in managing credit risk, including the use of technology and data analysis in the credit decision-making process, will be evaluated. This study also aims to evaluate the factors that influence the effectiveness of credit risk management in the Indonesian banking sector. These factors include macroeconomic conditions, regulatory policies, and the capacity and competence of human resources in banks.

To achieve these objectives, this study will use qualitative and quantitative approaches. Data will be collected through interviews with competent parties in the banking industry, as well as through secondary data analysis from banks' annual reports and related publications. This study will also use statistical models to assess the relationship between factors affecting credit risk management and financial stability. With this approach, it is expected to explain how credit risk management can impact financial stability in the banking sector.

In addition, this study will assess the direct impact of credit risk management on financial stability. This assessment will provide an overview of the extent to which credit risk management contributes to preventing serious financial problems in the bank. Good financial stability will be reflected in the bank's capacity to withstand economic and financial pressures without causing significant disruption to its business operations. Thus, this study will provide insight into the importance of credit risk management in maintaining financial stability.

The expected conclusion of this study is that there are strategic recommendations that can be implemented by banks and regulators to strengthen the credit risk management framework. Hopefully, these recommendations can help banks in Indonesia to improve their financial stability and avoid potential large losses in the future. In addition, the results of this study are also expected to enrich the academic literature related to credit risk management and financial stability in the banking sector.

Against this background, this study is expected to contribute to a more comprehensive understanding of the importance of credit risk management for financial stability in the banking sector. Through in-depth analysis and empirical assessment, this research will provide useful practical guidance for banks in designing and implementing effective credit risk management strategies.

METHODS

The research method used in this study is a literature review. Literature study is an approach that relies on written sources to obtain data and information relevant to the research topic. (Sugiyono, 2016). In this context, the research focuses on collecting and analyzing data from various previously published references such as books, academic journals, financial institution reports, conference papers, and related online articles. By utilizing these sources, the researcher sought to gain a comprehensive overview of the research topic, as well as identify patterns and key findings.

The data sources used in this research involve various forms of literature that can provide valid insights and data. (Nasution, 2023). Academic books will be the main source in understanding the underlying theories and key concepts relevant to the research. Academic journals provide in-depth and up-to-date scholarly articles, which often report the latest research results and contain in-depth theoretical discussions. Reports from financial institutions, such as banks or financial regulatory bodies, provide invaluable empirical data and industry analysis. Conference papers offer expert perspectives and emerging research results. Relevant online articles, although not always from academic sources, can provide useful information on recent developments and public responses to the topic under study.

The data collection technique in this research involves the process of identifying and collecting secondary data from various sources that have been selected. The researcher will identify the literature most relevant to the research topic, then collect and categorize relevant data from the literature. This process includes reading the literature critically, noting important information, and organizing the data into a format that can be analyzed further. (Priadana & Sunarsi, 2021). Data collection is done systematically to ensure that all relevant information can be accessed and analyzed effectively.

The data analysis methods applied were content analysis techniques and research synthesis. The content analysis technique was used to identify patterns and key findings in the reviewed literature. Through this analysis, the researcher can recognize dominant themes, research gaps, and interrelationships between studies. Following the content analysis, the research synthesis was used to draw conclusions based on the literature reviewed. This synthesis allows the researcher to integrate the various research findings into a coherent and systematic picture, which can generate new insights or strengthen existing knowledge.

RESULTS AND DISCUSSIONS

Credit Risk Theory

Credit risk is one of the main types of risk faced by financial institutions, especially banks. Credit risk occurs when borrowers, both individuals and companies, fail to fulfill their payment obligations in accordance with the loan agreement. (Adhim, 2018). This risk covers a wide range of conditions, from payment delinquency to borrower bankruptcy. The inability to recover loaned funds has a significant impact on the financial stability of the institution, which in turn can affect the entire financial system (Chuesta et al., 2018). (Chuesta et al., 2024).. Therefore, credit risk management is a critical aspect of financial institution operations.

Several factors affect credit risk, which can be categorized into internal and external factors. (Fitri & Dona, 2023). Internal factors include aspects related to the characteristics and policies of the institution itself, such as underwriting policies, credit scoring procedures, and the level of loan portfolio diversification. For example, a less stringent underwriting policy may increase the risk of default. Meanwhile, external factors include macroeconomic conditions, political stability, and changes in regulatory rules. Poor economic conditions, such as a recession, can increase the default rate due to a decrease in the borrower's ability to fulfill its obligations.

One of the most important internal factors affecting credit risk is borrower quality (Silva et al., 2023).. The assessment of borrower quality is usually done through credit analysis, which includes an assessment of the borrower's ability and willingness to repay the loan. This analysis involves checking credit history, analyzing financial ratios, and understanding the borrower's business or financial situation. Borrowers with poor credit history or high debt-to-income ratios are usually considered to have higher credit risk.

Credit portfolio diversification (Manalu et al., 2023) is a strategy to reduce credit risk by spreading loans across different sectors and types of borrowers. By not relying too heavily on one particular type of borrower or sector, banks can minimize the negative impact of the failure of one or more borrowers in their portfolio. Diversification helps reduce volatility and overall default risk. (Fatmawati et al., 2023). Nonetheless, diversification needs to be done carefully to ensure that there is no deterioration in the overall quality of the loan portfolio.

Credit risk management methods (Tandeas & Setyawan, 2024) begins with the identification and risk assessment stage. One of the commonly used tools in this stage is the 5Cs analysis: character, capacity, capital, collateral, and conditions. Character assesses the integrity and responsibility of the borrower, capacity analyzes the borrower's ability to generate the cash flows required to repay the loan, capital measures the financial strength of the borrower, collateral assesses the assets that can serve as guarantors for the loan, and conditions analyze the economic conditions that may affect the borrower's ability to repay the loan.

In addition to identification and assessment, credit risk management methods also involve diversification and mitigation. Diversification, as explained earlier, aims to reduce the concentration of risk in a credit portfolio. Risk mitigation, on the other hand, involves measures to reduce the negative impact of risks that have been identified. One example of risk mitigation is the use of collateral as a guarantor of a loan. Collateral gives the bank the right to claim the borrower's assets in the event of default, thereby reducing potential losses.

Supervision and monitoring are also important components of credit risk management. Financial institutions need to continuously monitor the credit performance and financial position of borrowers throughout the life of the loan. This includes periodic revision of the borrower's financial statements and cash flows, as well as reassessment of the value of collateral provided. The use of early warning systems can help institutions to identify potential problems before they develop into bigger risks. With effective monitoring, banks can take remedial action early, which can help minimize losses.

Finally, strong internal policies and adequate training for staff also play an important role in credit risk management. Credit risk policies should include clear procedures for credit assessment, lending, and handling defaults. In addition, continuous training for staff will ensure that everyone in the institution understands the importance of risk management and how to apply it in daily activities. By doing so, institutions can not only minimize credit risk, but also improve their overall performance in credit management.

Risk Management Theory

Risk management (Tandeas & Setyawan, 2024) is a systematic approach in identifying, measuring, monitoring, and controlling the risks faced by an organization. One of the most significant types of risk is credit risk. Credit risk involves the potential loss due to the failure of a party to fulfill an obligation to another party. (Fitri & Dona, 2023). To ensure efficiency and sustainability in business operations, it is important for organizations to design and implement an effective risk management framework. This framework includes various elements that enable organizations to manage credit risk proactively and systematically.

Risk management framework (Rahima & Sapitri, 2024) begins with context setting, where the organization defines the scope and objectives of risk management. This step is important to ensure that all parties in the organization have a common understanding of the parameters and objectives of the risk management program. Setting the context includes identifying stakeholders, determining risk criteria, and developing relevant policies and procedures. A solid framework provides clear guidance in executing the risk management process and facilitates effective communication across all levels of the organization.

The first stage in credit risk management (Safitra & Kusno, 2023) is risk identification. At this stage, the organization identifies various risks that may arise from its credit portfolio. This identification includes an analysis of aspects such as customer credit profiles, market conditions, and the macroeconomic environment. Comprehensive risk identification enables the organization to create a solid foundation for the subsequent risk management process. Some of the tools used in this stage include interviews, group discussions, and document reviews.

Once these risks have been identified, the next step is to identify them. (Sadie & Nyale, 2024) is risk analysis. Risk analysis involves assessing the impact and likelihood of the risk occurring. In the context of credit risk, this analysis includes an evaluation of the customer's ability to meet payments, potential losses that may be experienced, and an assessment of existing risk mitigations. Techniques such as scenario analysis and stress testing are often used to evaluate the impact of various conditions on a loan portfolio.

The third stage in credit risk management (Mulyani et al., 2023) is risk evaluation and assessment. Organizations must be able to determine the priority of the various risks that have been identified and analyzed. Risk evaluation and assessment assist in decision-making relating to resource allocation and the development of risk mitigation strategies. Risks are classified based on their severity to ensure that adequate attention and resources are allocated to managing the most critical risks. This risk-based approach supports a more focused and efficient approach in dealing with credit risk.

The next stage is risk management (Chuesta et al., 2024)This involves the development and implementation of various strategies to manage each risk. There are several strategy options that can be used, such as avoiding risk, reducing risk, transferring risk, or accepting risk by monitoring and controlling its impact. In the context of credit risk, this could mean credit underwriting, portfolio diversification, or the use of credit insurance. Effective implementation of risk handling strategies requires good coordination between departments and stakeholders.

The last stage is risk monitoring and review (Fitri & Dona, 2023). This involves supervising the risks that have been identified, analyzed, and intervened to ensure that the risk management efforts undertaken are proceeding according to plan. Continuous monitoring allows the organization to respond promptly to changing conditions and environments that may affect the risk profile. A periodic review process is also important to evaluate the effectiveness of the implemented framework and make necessary adjustments to keep it aligned with the organization's objectives.

By implementing a comprehensive and systematic credit risk management framework, organizations can improve their financial stability and reduce potential credit risk losses. Clear context setting, in-depth risk identification and analysis, accurate risk assessment, and consistent implementation of handling and monitoring strategies are key elements for success in credit risk management. Each stage in this process must be carried out carefully and continuously to cope with the dynamics of an ever-changing business environment.

Financial Stability

Financial stability is a condition in which the financial system-such as financial markets, financial institutions, and financial infrastructure-operates optimally and can absorb external shocks without disrupting economic activity. (Aldi, 2023). This stability is important to ensure that the financial system can facilitate the efficient allocation of resources, manage risks, and perform its main functions in the economy.

There are several indicators that are often used to measure financial stability (Ananta et al., 2024). First, banking sector health indicators such as capital adequacy ratio, non-performing loan ratio, and bank liquidity. Second, financial market indicators including stock and bond market volatility, and credit spreads. Third, macroeconomic stability indicators such as inflation, economic growth, and fiscal imbalances. The banking sector, for example, which has a high non-performing loan ratio can signal a disruption in the financial system.

Credit risk, defined as the probability of a borrower's failure to fulfill loan obligations, is closely linked to financial stability. When credit risk is high, banks may face an increased number of non-performing loans, potentially reducing their ability to lend. This could slow down economic activity and create instability in the financial system. For example, the subprime mortgage crisis in 2008 showed how increased credit risk can threaten the stability of the financial system.

Credit risk management is an important part of maintaining financial stability (Siwi et al., 2024).. Banks and other financial institutions use various methods to assess and manage credit risk, including strict credit scoring, portfolio diversification, and utilization of derivative instruments. Macroprudential policies such as strict monitoring of non-performing loan ratios are also implemented by financial authorities to prevent an increase in credit risk that could disrupt financial stability.

Monetary and fiscal policies also play an important role in influencing financial stability and credit risk. Tight monetary policy can reduce liquidity in the market and increase borrowing costs, potentially increasing credit risk. Conversely, loose monetary policy can promote economic growth but also has the risk of creating asset bubbles. Meanwhile, responsible fiscal policy can create a stable economic environment, reducing pressure on the financial system.

Financial stability is a critical aspect that requires special attention from governments, regulators, and financial institutions. Indicators such as capital adequacy ratio, market volatility, and economic imbalances provide a snapshot of the health of the financial system. Credit risk has a close relationship with this stability, where an increase in credit risk can bring significant negative impacts. Therefore, credit risk management as well as appropriate monetary and fiscal policies are crucial to maintaining financial system balance and stability.

Credit Risk Management Strategy Analysis

Credit risk management is one of the important aspects of financial management, especially for financial institutions such as banks and other lending institutions. The aim is to minimize the possibility of losses arising from the failure of borrowers to meet their obligations. Several strategies can be applied to manage credit risk (Chuesta et al., 2024)Each with its own advantages and disadvantages, including:

1. Diversification Approach

   Diversification is one of the strategies often used to reduce risk. In the context of credit risk management, diversification means spreading loans across different economic sectors, geographic locations, or categories of borrowers.

   The advantage of this approach is that it is able to minimize the impact of the failure of one particular borrower or economic sector on the overall credit portfolio of the financial institution. When one sector experiences a downturn, other sectors may still be functioning well, thus preventing large losses.

   However, the disadvantages of diversification (Guspul et al., 2023) is the need for more complex analysis and management. Managing a highly diversified portfolio requires greater resources and specialized skills. In addition, excessive diversification can make it difficult to monitor and supervise individual loans.
2. Strict Credit Assessment

   Conducting a rigorous credit assessment is a basic strategy for credit risk management. It involves the process of rating a prospective borrower's loan through an in-depth analysis of repayment capacity, credit history, and financial condition.

   The advantage of this strategy is an increased level of prudence in lending, which can reduce the likelihood of default. With close supervision, financial institutions can be more confident that borrowers show the potential to fulfill their obligations.

   However, the downside is the significant costs associated with overly strict appraisals. This can slow down the loan process and may discourage borrowers who are worthy but can't meet some of the overly strict criteria.

3. Use of Collateral

   Stipulating the use of collateral as a condition for granting loans is another strategy in credit risk management. Collateral is an asset owned by the borrower that can be seized by creditors in the event of default.

   The advantage of using collateral is that it provides creditors with additional assurance against possible loan defaults. This can increase the confidence of creditors and allow them to grant credit at more favorable conditions.

   However, the disadvantage of using collateral is that not all borrowers have sufficient assets to serve as collateral. Also, in the event of a loan default, the process of liquidating the collateral can be lengthy and complicated, and may not always be sufficient to cover the losses incurred.
4. Credit Insurance

   Credit insurance is a protection mechanism where the borrower pays a premium to cover the risk of default. This can be a contract between a financial institution and an insurance company.

   The advantage of credit insurance is that it provides additional protection for creditors and borrowers. If the borrower faces financial difficulties, the insurance company will cover some or all of the borrower's obligations.

   However, the downside is the premium cost that borrowers have to pay, which can add to their financial burden. In addition, the insurance claim process may be complicated and time-consuming, and there is a risk that insurance companies may not always be willing to pay claims.
5. Differential Interest Rates Based on Risk

   Studying borrower risk and setting interest rates accordingly is one efficient strategy. Borrowers with a high risk profile will be given higher interest rates, while those with low risk will get lower interest rates.

   The advantage of this strategy is that it allows lenders to compensate for higher risk with higher interest income. It also motivates high-risk borrowers to try to lower their risk profile.

   However, the downside of this strategy is that it can increase the burden on high-risk borrowers, which in turn can increase the likelihood of default. In addition, it may create discontent among borrowers who feel that the interest rate charged is unfair.
6. Continuous Monitoring and Monitoring

   Regular monitoring of the loan portfolio is another essential strategy. Financial institutions monitor the performance of borrowers and related economic sectors.

   The advantage of this strategy is the ability to detect problems early so that remedial action can be taken before the situation worsens. It also helps in

maintaining a good relationship with the borrower through continuous communication.
However, the downside is the amount of resources required to carry out effective monitoring. In addition, the information required must be accurate and timely, which is sometimes difficult to obtain.

7. Implementation of Technology and Information Systems
   Applying advanced technology and information systems to evaluate and manage credit risk is a modern strategy that is increasingly being used. These technologies include the use of machine learning algorithms and data analytics.
   The advantages of this strategy are increased efficiency and accuracy in credit assessment and early risk detection. In addition, technology can handle large volumes of data quickly and effectively.
   However, the downside of this strategy is the high cost of implementation and the need for trained manpower to manage it. In addition, there is always the risk of system errors or over-reliance on technology that may not always capture certain nuances of the borrower's condition.
8. Establishment of Risk Reserves
   Establishing risk reserves is another strategy, which involves setting aside a certain amount of funds to cover potential future credit losses. This is a more proactive and preventive approach.
   The advantage of this strategy is that it provides a financial cushion that can be used to cover losses due to credit risk. It also creates financial stability and increases investor and shareholder confidence.
   However, the downside of this strategy is the diversion of the amount of funds that could be used for other activities that may be more productive. In addition, reserve building often requires careful planning and assumptions that may not always be accurate.
9. Good Relationship and Communication with Borrowers
   Establishing good relationships and ongoing communication with borrowers is another way to manage credit risk. This involves having a good dialog about the borrower's financial condition and repayment ability.
   The advantage of this strategy is the increased liquidity of information that can help financial institutions make better and timely decisions. It also allows for flexibility in handling default cases with solutions that are acceptable to both parties.
   However, the downside of this strategy is that it relies on the cooperation and openness of the borrower, which may not always be the case. In addition, it can be

very time-consuming and requires sufficient human resources to conduct effective communication.

10. Flexible Credit Policy Implementation

    Flexible credit policies, including credit restructuring or payment restructuring, are strategies that can be implemented when borrowers are experiencing difficulties. This could include extending the repayment period or temporarily reducing the interest rate.

    The advantage of this strategy is that it gives borrowers a chance to recover financially, which in turn supports loan repayment. It can also reduce the incidence of high default rates.

    However, the downside is the risk of moral hazard, where borrowers may not be motivated to fulfill their obligations well knowing there are easing options. In addition, excessive flexibility might hurt creditors in the long run.

11. Use of Syndicated Credit

    Syndicated credit (Fitriani & Maharani, 2024) is a loan provided by a group of financial institutions to a single borrower. It is often used for project financing or large loans that involve significant risk.

    The advantage of this strategy is the distribution of risk among several creditors, thus reducing the risk burden on a single financial institution. It also enables the financing of large projects that a single institution may not be able to handle.

    However, the downside is the complexity in coordination among the various parties involved. Also, each financial institution in the syndicate may have different policies and procedures, which can be a challenge in management.

12. Provision of Training and Development for Staff

    Finally, the provision of ongoing training and development for staff responsible for credit risk management is a significant complementary strategy. This training aims to improve staff skills and knowledge on credit risk analysis and mitigation.

    The advantage of this strategy is that it enhances the analytical and cognitive capabilities of the risk management team, which can positively impact the overall effectiveness of the credit risk management strategy. It also fosters a culture of compliance and prudence within the organization.

    However, the downside of this strategy is the cost and time required for training and human resource development. In addition, there is always the risk of staff turnover after training which can be detrimental to the financial institution.

Credit risk management is a crucial aspect of maintaining the financial health of financial institutions and minimizing potential losses from defaults. Each strategy has advantages and disadvantages that need to be carefully considered and adapted to the conditions and needs of the financial institution. Combining several strategies with a balanced approach is usually the best option to achieve optimal results in credit risk management.

Factors Affecting Financial Stability

The financial stability of an organization or individual is influenced by various internal factors that need to be managed properly. Effective financial management is one of the main factors that can determine financial stability. A good financial management strategy involves careful planning, realistic budgeting, and close monitoring of cash flow and expenditure. (Ashma' & Laksmi, 2023).. Thus, every financial decision taken is based on careful consideration, so that the risk of mistakes can be minimized. Good financial management also ensures that the resources owned are used efficiently and in accordance with the objectives that have been set.

In addition to financial management, efficient operational performance is also very influential on financial stability. (Dwianto et al., 2023).. Efficient operations allow organizations to reduce unnecessary costs, increase productivity, and ultimately increase profitability. (Wicaksono et al., 2023).. Good operational performance also includes effective management of human, material, and time resources. In other words, good operational performance can help organizations to achieve maximum profit at minimal cost, which in turn will contribute positively to financial stability.

Good debt management is also an important component in maintaining financial stability. Debt must be managed carefully so that it does not become an excessive burden for the organization or individual. (Kusumastuti et al., 2024).. The ability to repay loans on time is essential to avoid liquidity problems and keep the debt-to-equity ratio within healthy limits. To achieve this, it is crucial to understand and consider market conditions, interest rates, as well as internal financial conditions before making debt-related decisions.

Having a reserve fund is also a vital step in maintaining financial stability. These reserves serve as a buffer in the face of emergency situations or unforeseen circumstances that can damage cash flow. For example, when there is a sudden drop in revenue or an unexpected increase in operational costs, the reserve fund can be used to cover urgent needs without having to sacrifice operational activities. Therefore, regularly adding funds to the reserve is a wise financial strategy.

Prudent investment policies and portfolio diversification also play an important role in maintaining financial stability. Prudent investment can provide an additional source of income and promote asset growth. (Asida, 2023). Portfolio diversification is a strategy to reduce risk by owning different types of assets. Thus, if one investment does not get the expected returns, other investments may still be able to provide returns so that the total risk can be minimized.

In addition, effective risk control is also necessary in maintaining financial stability. A good risk control system will help identify, analyze, and address potential risks that could disrupt financial stability. Risk control includes preventive measures as well as risk mitigation strategies that serve as protection against unexpected events. The implementation of a comprehensive risk control system is a form of anticipation that will make organizations or individuals more resilient to various situations.

Finally, good leadership and governance are critical in making strategic decisions that affect financial health. Strong leadership will drive the implementation of good governance practices, which in turn will create a transparent and accountable working environment. Good governance includes decision-making based on accurate data and analysis, as well as the implementation of fair and rational policies. As such, a good corporate reputation will be established, increasing trust from investors, customers and business partners which ultimately contributes positively to financial stability. By paying attention to and optimizing these internal factors, both organizations and individuals can better maintain and improve their financial stability in the long run.

Impact of Credit Risk Management Strategies on Financial Stability

The implementation of credit risk management is an important step that can affect the financial stability of banks both in the short and long term. (Fitriani & Maharani, 2024). Credit risk management includes various techniques and strategies to identify, assess, manage, and mitigate risks related to credit management. The impact of credit risk management implementation on banking financial stability (Rusiati & Lestari, 2023) can be described as follows.

First, in the short term, one of the main benefits of implementing credit risk management is the reduction of loss risk. Banks that implement effective credit risk management will conduct a more thorough assessment before granting loans, known as a rigorous credit review. As such, banks can immediately reduce the number of non-performing loans in their portfolio. In addition, banks can more quickly establish reserves to cover potential losses that may arise due to bad loans. The presence of these reserves allows banks to avoid sudden financial shocks that could disrupt their operations and financial stability.

Secondly, the implementation of effective credit risk management can also increase customer and investor confidence in the bank. When customers and investors see that a bank has a robust and reliable credit risk management system in place, they are likely to view the bank as more stable and reliable. This positive perception can increase the customer base and investment volume in the short term. The increased trust from these stakeholders can provide additional support to the bank's overall liquidity and operations.

Third, there are costs associated with the initial implementation of effective credit risk management. Banks need to customize their systems, train staff, and improve supervision which may require considerable initial investment. While there are expenses upfront, these are necessary investments to ensure that credit risk management can be implemented successfully and deliver the desired results. These costs may have an impact on short-term profits, but it is a sacrifice that can bring great benefits in the long run.

In the long run, the implementation of good credit risk management will have a positive impact on the financial stability of the bank. By reducing the number of non-performing loans, banks' asset quality will be stronger and more stable. This means banks can manage their liquidity more effectively, allowing them to respond to market and financial needs more flexibly. Good credit stability also reduces volatility in bank earnings, which in turn supports healthier long-term operations.

Furthermore, reputable banks that have effective credit risk management can accelerate their growth in the long run. (Harahap et al., 2023). A good reputation in terms of risk management will attract more customers and investors. In the long run, this supports more sustainable business growth. Banks with a strong reputation for risk management find it easier to retain and expand their customer base, which in turn contributes to increased revenue and financial stability.

Banks that are stable and have good risk management systems are also easier to diversify their products and services. (Anggraini et al., 2023). Over time, stable banks can expand their product and service types, such as offering more types of loans or investments. This diversification not only supports growth but also helps in spreading and managing risk more effectively. In other words, good credit risk management allows banks to maintain a balanced portfolio and minimize risks to specific exposures.

Effective credit risk management also allows banks to more easily comply with increasingly stringent banking regulations. With good credit risk management, banks can ensure that they comply with international and local regulatory requirements, such as Basel III. These regulations emphasize the importance of effective risk management to ensure the stability of the financial system as a whole. Banks that comply with these regulations will be perceived as more credible and reliable, which in turn supports their financial stability in the long run.

Technological innovation is also an important factor in the implementation of sound credit risk management. Improved risk analysis technology allows banks to continuously modify and refine their risk management strategies. For example, the use of big data and artificial intelligence (AI) in credit risk analysis enables more precise and rapid assessment of credit quality. By utilizing these technologies, banks can identify potential risks earlier and take necessary actions to mitigate them. These technological developments contribute to sustainable financial stability in the long run.

Overall, the implementation of credit risk management has a significant impact on the financial stability of banks in both the short and long term. In the short term, the main benefits are reduced risk of loss and increased customer and investor confidence, although it comes with initial implementation costs. In the long term, the impact is more pronounced in the form of greater financial stability, sustainable growth, regulatory compliance, and adaptability to technological developments. All these factors contribute to the overall financial well-being of banks.

CONCLUSION

This research yields some important findings regarding effective strategies to manage credit risk and its impact on the financial stability of banks. The results show that the implementation of a strict and continuous supervisory system is necessary to identify and monitor credit risk early. This includes periodic evaluation of the credit portfolio as well as the use of analytical technology for quick and accurate risk detection.

In addition, loan portfolio diversification is also found to be an effective tool to reduce concentration risk that may arise from lending to certain sectors or regions. By diversifying, banks can spread the risk and thus reduce the potential for large losses. The study also emphasized that the improvement of a more thorough and data-driven credit assessment process is essential. The use of more sophisticated and technology-based risk assessment models can assist banks in improving the quality of their loans.

This study also highlights the importance of strengthening reserves and provisions to anticipate potential credit losses. The provision of adequate reserves and provisions is crucial to maintaining the financial health of banks. With sufficient reserves, banks have the necessary buffer in the event of loan default. In addition, the development and training of qualified human resources is one of the key factors in risk management. An in-depth understanding of risk management as well as skills in optimizing lending is necessary.

This understanding can be gained through regular training and professional development for employees, which plays a significant role in improving risk management capabilities. Finally, compliance with international banking regulations and standards such as Basel III is also considered very important. These regulations are designed to ensure that banks have sufficient capital to deal with various credit risks and maintain financial stability.

Overall, the implementation of a comprehensive credit risk management strategy has proven effective in enhancing the financial stability of banks. Good credit risk management ultimately creates a stronger banking system that is able to withstand fluctuating economic dynamics. These findings provide an overview of steps that banks can take to better manage credit risk and ensure sustainable financial stability.

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