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**“MARKET INTEGRATION IN ASEAN: SUSTAINABLE GROWTH AND CROSS CULTURAL ISSUES”**

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<tr>
<th>Time</th>
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<tr>
<td>18\textsuperscript{th} March, 2016</td>
<td>14:00 - Check in to the hotel</td>
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<td>6:00 Breakfast at hotel</td>
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<td>7:30 Pick up Indonesian participants to USSH and join in Opening Ceremony</td>
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<td>8:30-9:00 Opening Ceremony at Conference Hall D</td>
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<td>9:45-10:00 Coffee-break</td>
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<td>10:00-12:00 Panel Sessions I</td>
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<td>19\textsuperscript{th} March, 2016</td>
<td>10:00-12:00 Networking Meeting (Limited audiences Co-Host: USSH, VNU-HCM, Consulate General of the Republic of Indonesia Ho Chi Minh City, US, VAFA, BINUS, UKSW, UIL, STIE INDONESIA, UK Atmajaya Jakarta, Universitas Paramadina, Universitas Yos Sudarso)</td>
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<td>12:00-13:30 Lunch in front of Conference Hall D</td>
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<td>13:30-16:00 Panel Sessions II</td>
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<td></td>
<td>16:00-17:00 Closing Ceremony (give participants certification, awards for best paper, and announcement Insyma 14\textsuperscript{th})</td>
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<td>17:30-21:00 Gala Dinner “ASEAN FRIENDSHIP at Hofo (31 Le Duan Street, District 1, HCM City)</td>
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<td>20\textsuperscript{th} March, 2016</td>
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<td>7:00-8:00 Visiting center area of HCM City</td>
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<td>8:00 To Cu Chi Tunnel</td>
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<td>9:30-11:30 Visiting Cu Chi Tunnel</td>
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<td>12:00 Lunch at Cu Chi</td>
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<td></td>
<td>13:30 Back to HCM City</td>
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<td>15:00 To Tan Son Nhat Airport</td>
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RISK MANAGEMENT IN INDONESIA TO CREATE HEALTHY COMPANY IN ASEAN ECONOMIC COMMUNITY

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Abstract

In order to ensure that it can grow and improve shareholder wealth, a company needs to be managed as best as it can be. One of the management is in the financial risk management area. One importance of risk management is to prevent the company being in a disadvantageous position that can lead to bankruptcy. Many companies is going bankrupt because the risk management is too loose or not functioning as it should be. This paper examines risk management importance and learn from succesful and failed company about how risk management being performed. This paper use literature study to examine the theory of management risk and also examine the actual risk management practice. This paper are also examines risk management in companies in Indonesia in order to prepare to face global competition. This is to ensure companies can remain healthy even in the increasing global competition.

Keywords: Risk management, bankruptcy, competition

JEL Classification: G32

Introduction

A company is created in order to give maximum wealth to owner or shareholders. In order to do basically so the company must be healthy and continuously profitable. The management of the company must ensure that the operational of the company must flow well and undisturbed; they must also ensure that the marketing of the company is capable to sell the product well. And besides that the company must try to improve themself, improve their product whether the quality or quantity, improve their sales, improve their profit, etc.

A well managed company then will survive and reach success. From this optimism point it all sound so nice. However, running a company is not without challenge. Like driving a car or motorcycle toward a set goal risk of flat tire or accident always exist. This risk does not always comes true but when it does the danger can be extreme and can lead to death. A company in its daily operation and investment activities will always face risk. Risk is always part of every business. Even the safest investment such as bank deposit that is nowadays protected by many regulation still have risk moreover running a company. The risk increases even more with the arrival of competition.

For companies in Indonesia, recent Asean Economic Comunity (AEC) indeed brings new potential for companies to market their product but in another side also brings more competition which increase the risk of a company to lose a customer that might further cause decrease in sales and profit. So in this viewpoint the global market provides opportunities for
greater success but with an increased risk. Therefore in this competition era the management of a company must be more persistent in managing the company. So far despite the increasing recognition of the usefulness of management science, the application of management science itself was still lacking. Even in developed countries. There are still many managers of large companies that are still struggling to optimally utilize proper management knowledge in their company. This also happen in the risk management area. Do all company in developed country already have a sound risk management system?

In 3rd world countries where financial literacy is still lacking and many of the people doesnt even have a bank account, off course there are many business person especially in micro, small and medium business who does not even notice the risk that may exist in their business. Risk management in these companies virtually never existed. They never have plan on what are they going to do if the market change, what are they going to do if interest rate increase or if their buyers suddenly incapable to pay their debt or if their employees do fraud.

Then how risk management can be applied to these businesses given the increasing competition demanded the creation of better managed companies?

This paper tries to examine risk management and their importance. Examining how risk management in successful and failing companies and furthermore the condition of risk management in companies in Indonesia.

Literature Review and Discussion

Risk Management

In Indonesia Financial Minister rules No. 142/PMK.010/2009 risk management is defined as a series of procedures and methodologies used to identify, measure, monitor, and control risks arising from business activities. Kavaer and Spiegel (2003:4) define risk management in straightforward terms as the protection of assets which is accomplished through four steps: risk identification, risk analysis, risk control/treatment, and risk financing. From the definition, risk management seems like a simple management area but actually it covers a lot of things since there are many different risks that can be occured in a company. Culp (2002:15-25) list many different definition or variation of risk that might be faced by a company:

1. Event-driven risk. Risk that occur from certain event that happen from the currency value change to the natural disasters.
2. Market risk. Arises from the event of a change in some market-determined asset price, reference rate, or index.
3. Liquidity risk. Risk that occur in the event that cash inflows and current balances are insufficient to cover cash outflow requirements, often necessitating costly asset liquidation to generate temporary cash inflows.
4. Credit risk. The risk of the actual or possible non-performance by a firm.
5. Legal or regulatory risk. The related risk that actions taken by regulators constitute events that can unexpectedly raise costs and risks for market participants.
6. Intellectual risk. Risk that occur in the event that personnel with specialized knowledge leave a firm and make it difficult for the firm to continue managing the risks of its positions and portfolios.
7. Customer loss risk. A core risk that a business face which is the risk that the business loses its customers, either because a competitor attracts them away or because they no longer demand the products and services the company sell at the price they are quoting.
Supply chain risk. Risk that may occur at any point along a physical supply chain, or the chain that connect inputs to the firm’s production process to its outputs. There are so many risk that need to be faced by a company. And maybe even more than the list above. One risk can be connected or cause other risk as well. Any of these risk may cause loss to a company and if happen continuously it might caused bankruptcy. Before any management steps can be taken to control the risk, of course the risk itself need to be recognized. In risk management all these risk need to be identified by collecting a lot of information about it, need to be analyzed and latter controlled or treated. Kavaer and Spiegel (2003:7) mention several varieties of methods to control risk:

1. Risk Acceptance. Means that the facility decides not to purchase insurance against specific adverse events because the risk cannot be avoided, reduced, or transferred and in addition the loss and consequences are within the institution’s capabilities to resolve.

2. Exposure Avoidance. Theoretically aims to rid the institution of the service, personnel, or equipment that may cause the loss, or to advise the institution never to be involved in providing the service or program at all.

3. Loss Prevention. Use early detection and investigation by examining many information to pinpoint loss prevention areas.

4. Loss Reduction. Usually involves management of claims and ensures that all records are preserved and that all personnel are prepared in the event of a loss.

5. Exposure Segregation. Separates services, personnel, or activities identified as exposure risk to the institutions.

6. Contractual Transfer. Transfer or shift the risk to the organization that provides the service through insurance or contract.

As mentioned above there are many method that can be used to treat or control risk. This methods whether using internal management or seek help to external financial services all need some sum of fund which make risk financing as important part of risk management. The first method mentioned above is by accepting risk. Accepting risk means that any damage that might occur is accepted as a loss. Not all risk is acceptable. Unacceptable risk will need to be controlled by other means mentioned above. Unacceptable risk need to be avoided, prevented, reduced, or shared. For reducing loss, Berg (2010:87) stated that there are factors to consider for this risk treatment strategy include:

1. Can the likelihood of the risk occurring be reduced? (through preventative maintenance, or quality assurance and management, change in business systems and processes), or

2. Can the consequences of the event be reduced? (through contingency planning, minimizing exposure to sources of risk or separation/relocation of an activity and resources).

For transferring or sharing risk, Berg (2010:87) stated that this strategy may be achievable through moving the responsibility to another party or sharing the risk through a contract, insurance, or partnership/joint venture.

After certain methods of risk management is chosen and done it need to be supervised continuously to ensure the activity done is indeed worked as expected because if its not it just a wasteful spend of fund which need to be stopped.

Since all these risks may connected to the success or failure of a company then the management of risk as an effort to prevent these risk will also connected to the success or failure of the company. How good and how this risk management is performed will determine the company success or failure.
Financial Risk Management and Successful and Failing Companies

When done properly, risk management can be used to prevent loss. The word “done properly” become the main issue here since in many bankruptcy and falling company cases risk management as financial management sciences are fictitious or had been modified in such a way that is quite doubtful whether financial management science, especially in terms of the management of risk has been done properly.

One example of is the much discussed lately about the usefulness of hedging as a risk management tool. Some people began to accuse the use of derivatives in hedging as one of the causes of the failure of the company. But before we accede to these allegations, let us see first whether it is true that the cause of the failure of the company is merely a tool of financial management or whether this happens again due to the inability and failure of the management of the company in utilizing various financial management tools properly.

One method of risk management that is become more common nowadays is hedging. Shoup (1998:187) stated that a hedge is the offset of a given position by an equal and opposite position, in which the effect of the offset reduces or eliminates the effects of a value change in both side. From this definition, it shows that hedging can be a tool to share risk. In this world, indeed there are people that are willing to accept risk in order to gain profit, but for companies in general who depends on its daily operations of production and sales they need to protect the smoothness of their production and marketing cycle. If this is the case, then the hedging, of course, can be their choice as a solution to protect the smoothness of their funding.

The case of Enron failing is one example. As a big company in energy industry, enron is in a huge need of risk management to protect them from various risk. One risk that can endanger them is the fluctuation of energy price. Therefore Enron chose to use derivatives in hedging in order to keep a stable energy price. In order to do this, then according to the definition of hedging above, Enron need to make a hedging contract with another “equal” entity in the “opposite position”. Rather than doing that Enron chose to create a dummy entity which is funded by their own company to do this hedging transaction which is of course a fictitious hedging transaction. In reality this means what Enron do is not sharing risk to other party but aggressively accept risk by itself. Enron is basically naked unprotected to energy price fluctuation, accepting any profit or loss that can occur wholly. Of course, the problem of fictitious hedging is not the sole cause of the downfall of Enron, but can indicate a problem in which Enron not only do not have a good risk management but also make efforts to cover it up and showed authoritarian cultures and the problems in the company’s audit system. And all this will bring bigger risk like fraud, corruption, etc. Other problem that happened in Enron is the compensation system which encourage their employee to make any deal that give short term earning while ignoring cash flow or actual profit for the company. Since this activities is allowed freely due to the aggressive culture then risk management to sort and filtering is less able to function properly. This means useless and risky investment might easily qualified without any strict checking.

In Indonesia the case of Century Bank is also started from the bad investment done by the owner where around 2 Trillion Rupiah of foreign securities investment were without rating, long-termed, have low-interest, and difficult to sell. Even Bank of Indonesia see this as irregular investment. Since one of the steps in financial risk management is to check and ensure the quality of the investment, it is necessary to question the quality of Century Bank management risk in that point in analysing and filtering any investment proposals that arise. Is the bank even have risk management system? Is it functioned properly? Or yet another
high-ranking officials can decide on their own and bypassing all system created? indeed before the financial crisis in 97, almost all private banks are controlled by the owner who also doubles the board of commissioners and directors. The owner banks freely lend funds to her own business or their colleagues that might not necessarily good, which means fund investment decision does not need to go through the process of checking and analysis of investment propriety. If the problem of the leaders of companies bypassing the company's management system can still occur in large companies and how the medium and small companies? it is possible medium and small companies does not have a risk management system and if any, it might still be bypassed easily. Indeed, companies can have the best risk management systems to deal with all of their financial risks but dealing with top management ethic and behavior is sometimes another different challenge.

From the Century Bank case, we learned that one of the biggest financial losses can occur from investment. These investment goes unchecked or unauthorized. Investment that goes wrong can cause huge loss. Allen (2012) mentioned several companies that suffer great loss in investment such as: Toshihida Iguchi of Daiwa Bank’s New York Office loss $ 1.1 billion trading treasury bonds between 1984 and 1995; large Swiss bank UBS in 2011 which reported a loss of $2.3 billion do to unauthorized trading by Kweku Adoboli; Sumtomo Corporation that lost $2.6 Billion in a failed investment by their senior trader Yasuo Hamanaka.

From the cases above and many other past cases had actually shows that investment activities that bypass risk management system might cause huge damage for companies but yet it still happened and still repeatedly done by many of the large companies and by those who are already educated economist who certainly should have been able to master the science of financial management, including financial risk management. They prefer to use their own experience and instinct in deciding their investment decisions.

If done properly risk management will do its function to prevent or reduce loss. Economist Intelligence Unit (2007:7) record that in 2002 Pictet Asset Management (PAM), the investment business of Pictet & Cie, one of the largest Swiss private banks, decided to create a separate risk function and it has demonstrably saved the business from investment losses while proving an attractive selling point to PAM’s institutional investors, which provide the bulk of its SFr122bn (US$100bn) in assets.

Strong Willingness, Understanding and Involvement of the Board of Commisioners, Audit, Monitoring and Strong Supervision

From the above discussion it is known that running a company is similar to running a country where violations of the rules may occur at any time. This is especially for publicly listed companies where there are different interests among all stakeholders of the company. Enron clearly shows the difference between the interest between the directors, management and owners of the company which clearly the directors and management of the company playing with every aspect of the company ranging from incentive systems, culture, investment, risk management systems and even to the system of financial reporting for their own interests even though they know that the companies increasingly deteriorated. Even from other cases all show the same thing.

This means that if from the beginning the company want avoid all that there must be a strong undeterred desire to enforce good governance because no matter how good a system is created, but if it can be evaded, then everything is useless. Control, supervision and stronger supervision of an independent board that is fully think just for the good of the company is
absolutely necessary. Just as the accounting and auditing systems that would be meaningless if it is not strictly enforced, the risk management system must also be strictly enforced. All risk should be assessed and then determine if they are well managed. Gianluca Oderda, head of risk control of Pictet Asset Management (PAM) in Economist Intelligence Unit (2007:7) clearly stated that the limits are dictated by compliance which means risk management quality is determined by the compliance toward it.

Given the involvement of the owner of the company is absolutely necessary, then the owner of the company itself must have a sufficient understanding of risk management and a variety of methods including cover a wide range of knowledge about the stock, hedging, etc. which is quite complicated and difficult for ordinary people. What happens during this time was the owner does not understand well and just rely entirely on the directors and management which basically means they are not able to perform monitoring functions. If this is the case then the owner must be willing struggling to improve his understanding of all of it, seek help from independent outsiders and experts or forcing the directors and the company to clarify and details of all of their reports if they want their proposals approved. Economist Intelligence Unit (2007:6) that survey 218 executives around the world finds out that they agreed that the internal drivers of risk management is a greater commitment from the board.

To further increase the possibility of the implementation of the company’s risk management system, both the creator of risk management system must be different from those who run it and the employee of risk management department are not supervised by investment decision makers. This will reduce the chance of conflict of interest.

In the end the whole culture of the company must be modified to favor and support risk management system not against it. In Enron case the culture is an aggressive culture that also ignore rules violation as long it create short termed benefit. Indeed to repair and build well functioned risk management system in this environment is difficult if not impossible. The board must be strict to erase this kind of company culture and create culture that support compliance and respect.

**Indonesian Companies Risk Management and Global Competition**

In Indonesia risk management mostly only done by big company. Most of mid and small company might not even understand the term of risk management due to the low level of financial literacy. Even in the bank industry, the government through OJK (*Otoritas Jasa Keuangan*) the authority in financial service industry is recently still trying to advise banks to establish good risk management in their company through the enforcement of various regulations. In the context of rural bank, the enforcement are also still have to be done through several steps since some banks may not have been ready yet. For non-bank financial institutions, the rules actually has been made by OJK, but government still have to push the socialization through various ads and training which indicate that there are still many companies in this industry experiencing difficulties in applying risk management.

Companies outside bank and financial institutions are not in better condition regarding risk management implementation. Government for example has to advise many companies especially medium and small company to use insurance service to ensure the safety of their business. The use of insurance as a risk management efforts is certainly an effort that can be called a basic effort. This indicates that companies in Indonesia still lags behind foreign companies in developed countries that are already using more complex instruments as efforts to support risk management.
In regarding to global competition in ASEAN region, offcourse there are other countries that have the same condition, or worse than Indonesia, but do not forget that there are also countries like Singapore and Malaysia, which began to enter the phase of developed countries where their companies in terms of risk management may have more organized and orderly. This is what competition about, it means a company must always try to move forward and catch up in order to survive or better to win the competition and achieve its objectives.

Regarding small and medium company in Indonesia so far risk management is almost doesn’t exist. Most business owner doesn’t prepare what are they going to do for example if their buyers is unable to pay their debt. They doesn’t prepare reserve accounts or any other method and mostly use either general lawsuit, liquidation act or even worst some still secretly use abusive debt collectors and if it is still unresolved they will give up while hoping they dont experience financial difficulties. If there are more people who do not pay the debt because of the crisis for example the company are not going to survive and threatened to bankruptcy. If there is increase in interest rate they dont know what to do and worse if if there is a change in the market that was not favoring their business, they will be in big confusion doesn’t know what to do. For small and micro company it is worse when the raw material to produce their product rise, generally they will “gulung tikar” (close their business) and do “alih profesi” (change their profession). This is very common to happen in small and micro industry in Indonesia. Although micro, small, and medium companies are praised for their growth and contribution to overall national GDP, in reality their durability and survivability against change and other risk is alarming. They mostly can only hope for government protection which sometimes are not available or the implementation is late.

All this fact has become a concern even for government who realise the potency and the risk of micro, small and medium business. there were many calls for the businessmen began to pay attention to risk management. It is accompanied by cooperation among insurance providers and by doing many socializing since the financial literacy is till a big concern. Many research done by academist on risk management area is mostly done in big company while due to differences in characteristics and resources, in various fields ranging from management over structure and IT systems to specialty of knowledge, large corporations’ practices cannot easily be adapted to small and medium enterprise (Napp, 2011:3). Since the practical application of the risk management science to small and medium business is limited, Napp (2011:3) stated that the logic aim was to suggest a possible mean for the risk identification, analysis and monitoring, which can be applied by small and medium company to manage their internal financial risks. If all of this was capable to be done then is there any profit for the company regarding the escalating competition nowadays? Yes, Economic Intelligence Unit (2007:14) recorded that the discipline of risk management has moved on from mere loss avoidance to become a key contributor to market advantage, via improved corporate reputation and a better standing among those charged with oversight, such as regulators and rating agencies. Certain approaches, such as decentralised risk management with centralised co-ordination, have become accepted best practice.

For a big company they must have a special division to work on risk management but it must be coordinated to make the risk management system efficient. This division must not be independent from other division and accountable for their work to the board of shareholders. And finally every company big and small must have awareness of risk and preparing analyzes and strategies to face these risks.
Nowadays there many general principles and guidelines such as ISO 31000 and other that can help companies to start building and operating their risk management system. This many guidelines and principles will help companies that has difficulties to start their own risk management system. The government also encourage the creation and operation of various companies engaged in the field of financial services which will help companies with less knowledge and hesitate to develop itself into a company that is more resilient and resistant to various situations.

Conclusion

Management theories and management practices that were taught in schools are in actuality had been developed through times. This theory and practices are often does not contain clear steps of application. Since companies might differs one another and the nation where those companies are located also might have different policies, often become the cause why many management theory stops at philosophical stage and give freedoms to management of the companies of how to applicate it to their company. That’s why the difference of the quality of manager might result in difference of the quality of management system in company. In reality manager as human doesn’t only consist of skill and knowledge but also many other traits, interest, problems, etc.

The key of good risk management is a strong will on the part of company management to implement any risk management rules that have been made, do any checking on each proposed investment, hedging proposal, the proposed fund-raising, etc. Learn from various companies that fell and suffered losses, it was found that the company's risk management is not strictly adhered to, but there are those who overstep those regulations. The authority of a person can be a weapon to overstep the rules that have been made. Moreover, shareholders sometimes less understood this and allow this to happen. This means risk management science is already proven its capability to manage risk and now it depend on the company’s stakeholder willingness to do it fully and properly.

In the future, risk management systems need to be made and translated to be understood and includes concrete steps and clear. This clarity will create a system that made it easy to apply and shareholders are also easier to supervise. The existence of independent commissioners and oversee the company clearly needed.

The government also needs to continue to socialize the risk management of this problem since there are many entrepreneurs in Indonesia are still not aware of this. Moreover, in the medium and small scale companies are very reliable government in expanding jobs and increasing the country's GDP which turned out to be very vulnerable to failure and bankruptcy. Dissemination efforts need to be supported by efforts to support the establishment of companies in the field of financial services.

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Sustainable Growth and Cross-Cultural Issues

Market Integration in ASEAN

in the International Annual Symposium on Management

Paper Presenter

Rosemarie Sutjianti

Certificate of Appreciation