



Financial Performance as a Mediator of Risk Management on Organizational Performance

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ABSTRACT

Sharia Bank is a bank that conducts business activities based on sharia principles, or Islamic legal principles stipulated in the fatwa of the MUI such as the principles of justice and balance, benefit, universalism. This study aims to examine the effect of risk management represented by Capital Adequacy Ratio (CAR), Operational Efficiency (BOPO), and Nonperforming Loans (NPL), on organizational performance by mediating financial performance that is represented by Return on Assets (ROA) on Sharia Banking Companies recorded in IDX from 2013 up to 2017. The data used in this study were obtained from their Financial Statements. After passing the purposive sample stage, six Islamic Banking companies recorded in IDX were eligible for use. The results of the study show that risk management influences organizational performance, while financial performance does not mediate the effect of risk management on organizational performance. Thus, Sharia banking operations must be adjusted to sharia principles and the bank is expected to pay more attention to the efficiency of the operations to improve risk management. Companies must think about the benefits and risks of lending funds to other parties so that the company value remains optimal.

Keywords: Operation Efficiency, Credit Risk, Liquidity, Organizational Performance

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INTRODUCTION

Islamic banking in Indonesia has experienced rapid development every year. Islamic Banking Statistics issued by the OJK reveals that the total assets of Islamic banking had reached up to IDR 424,181 billion by December 2017, an 18.98% increase compared to the previous period. The total financing and Islamic banking receivables by December 2017 were recorded at IDR 285,785 billion, a 15.23% increase compared to the previous year. The third-party funds by December 2017 were IDR 334,719 billion, 19.83% higher than the previous year. People put great trust concerning funding/finance in sharia. The trust comes up from the excellent management of Islamic banking, especially that related to regulation and compliance. Islamic banking is believed to have excellent compliance and

obedience with the rules and laws outlined by Allah upon financial practices related to *Mu'amalah* activities among capital owners (*Shahibul Maal*), corporate managers, and other stakeholders. Sharia can maintain a good and right relationship among parties who make a transaction. Therefore, the implications of sharia compliance must be followed by a correct and appropriate sharia system and procedure so that it can be accounted for by the parties who carry out the transaction and are responsible to other parties as well as morally responsible to Allah.

Islamic financial institutions must consider the risks of the business they run to be away from any losses. Banking risk management is applied to all banking activities, one of which is a credit program. It is an activity that relies on the trust of the bank to the debtor to make the most of the bank funds and return them at a fixed time. Credit risk is the possibility of being unpaid by the debtor so that the bank must calculate, plan, and control credit risk before the credit fund is granted. Credit risk control is conducted through a series of banking risk management steps. Banking risk management consists of risk identification, risk measurement, risk evaluation, and risk management.

Risk management is the basis of banks/financial institutions in taking, deciding, and implementing the appropriate banking actions. A good risk management system can control risk and improve the financial performance of banks/financial institutions. Risk management affects business performance, (Nair & Choudhary, 2014). However, (Huston et al., 2011), stated that no link between assessed risk management and volatility-moderated annual returns. Operational efficiency, asset management and credit risk are found to be insignificant and does not individually affect Tobin's Q, (Alkhatib & Harsheh, 2012). Based on differences in previous research and theory development. Thus, the current research focuses on financial performance as a mediator of risk management influence on organizational performance: a study on Islamic banking in the IDX 2013-2017. This study aims to determine whether risk management affects the performance of Islamic banking organizations. Furthermore, it examines whether financial performance mediates the effect of risk management on the performance of Islamic Banking organizations?

THEORETICAL REVIEW

Risk Management

Organizational risk management is a comprehensive system of risk management to increase company value (Hanafi, 2016). Risk management aims to manage risk so that the organization can survive, or perhaps optimize risk control. (Bank Indonesia Regulation Number: 11 / 2 / PBI / 2009, 2009) identified four main aspects that can lead to minimal risk: 1) active supervision of the board of commissioners and directors, 2) policies, procedures, and limits, 3) the process of identifying, measuring, monitoring, and managing credit risk management information, and 4) Credit Risk Control.

Risk management suggests several steps. They are:

Risk Management Planning

Planning consists of steps to decide how we plan a risk management activity for a project. By looking at the scope and plan of the project and the environmental factors of the company, the project team can discuss and analyze the activities to do on the project.

Risk Identification

Risk identification starts with understanding the risk. After identifying the risk, we need to define and document the characteristics if it affects the project. Risk identification can be performed through risk source and problem analysis. Risk source analysis examines where the risk originates. The three sources of risk are an internal risk, which is from the internal organization, non-technical risk (human, material, financial), technical risk (design, construction, and operation), and risks associated with worry.

Qualitative Risk Analysis

Qualitative analysis of risk management is a process of looking at the impact and possible risks above. It is done by compiling the risks and prioritizing those which are possible to occur.

Quantitative Risk Analysis

Quantitative risk analysis is a method for identifying the risk of possible system failure and predicting the amount of loss. Quantitative Risk Analysis applies mathematical methods related to financial value.

Risk Management

Risk management can be done by doing activities that have no risk instead of those with high risk. We can also reduce risk by reducing the chance of unexpected events. Besides, we can also accept the risk but prepare a contingency plan in case the risk occurs. Moreover, we can entrust the risk to other parties, such as insurance companies.

Financial Performance

Financial performance appears in the company's profitability, where it shows the ability of a company to generate profits. Profitability ratio is one of the financial ratios used to determine the weaknesses and strengths of the company, is important information for management to evaluate the performance achieved by the company (Sudana, 2009). (Sudana, 2009), reveals that the return on assets (ROA) ratio is important for management to measure the effectiveness of a company in generating profits by utilizing the assets.

Organizational Performance

Performance is the result of the function of work or activities in an organization that is influenced by various factors to achieve the goals of the organization in a certain period. Performance is the success of personnel, teams, or organizational units in realizing pre-defined strategic goals with expected behavior. To achieve its goals, an organization must have effective and efficient performance because the performance of the organization is an accumulation of individual and group performance.

There is a difference between individual performance and organizational performance. Organizational performance is an outcome from the accumulation of individual performance collectively into group performance that ultimately accumulates into organizational performance, (Sinaga et al., 2020). The performance of the organization is something that illustrates the extent to which a group has carried out all the main activities to achieve the vision and mission of the institution. According to (Sinaga et al., 2020), Organizational performance measurement is commonly used balanced score card (BSC) and Good Corporate Government (GCG) method.

A management approach using Balanced Scorecard aims to obtain a comprehensive, coherent, and regular-performance measurement tool. Because Balanced Scorecard method as a performance measurement tool in an organization is not only based on a financial perspective but also on the non-financial one such as customer perspectives, processes, and learning and growth. Balanced Scorecard provides a clear and reasonable framework for all personnel to produce financial performance through the realization of various non-financial performance. By using Balanced Scorecard, organizational leaders can measure how effective their organizational units are in shaping values for customers now and in the future, building and improving internal capabilities, and developing human resources, systems. It can also create procedures necessary to improve performance in the future.

The Effect of Risk Management on Organizational Performance

Organizational performance is an outcome from the accumulation of individual performance collectively into group performance that ultimately accumulates into organizational performance, (Sinaga et al., 2020). Organizational risk management is a comprehensive system of risk management to increase company value (Hanafi, 2016). Risk management aims to manage risk so that the organization can survive, or perhaps optimize risk control.

Risk management is the basis of banks/financial institutions in taking, deciding, and implementing the appropriate banking actions. A good risk management system can control risk and improve the financial performance of banks/financial institutions. Risk management affects business performance, (Nair & Choudhary, 2014). However, (Huston et al., 2011), stated that no link between assessed risk management and volatility-moderated annual returns.

The efficiency of a bank must be initiated with optimal risk management so that it can control the risks and get maximum profits. Therefore, banking companies need risk management that can maintain organizational performance in such way. When successfully minimizing company risks to the safe level, risk management is successful, and it improves organizational performance. Thus, the general hypotheses are formulated as follows:

H1: Risk management affects organizational performance in Sharia banking.

Financial Performance Mediates the Effects of Risk Management on Organizational Performance.

(Sudana, 2009), reveals that the return on assets (ROA) ratio is important for management to measure the effectiveness of a company in generating profits by utilizing the assets. Organizational performance is an outcome from the accumulation of individual performance collectively into group performance that ultimately accumulates into organizational performance, (Sinaga et al., 2020).

Risk management is successful if it can reduce the nonperforming loan (NPL) ratio. When it is not good, especially in credit risk, the bank's bad credit level is high, and the rate of profit earned also decreases. This will automatically reduce the performance of the bank, which is considered as organizational performance. *The financial ratios, which consists of the ratio of CAR not significant to ROA, while BOPO negative and significant effect on ROA, (Sudiyatno & Fatmawati, 2013).* the credit risk variable (NPL), liquidity risk (LDR) and operational risk (BOPO) have a simultaneous effect on banking financial performance (ROA). While partially credit risk (NPL) and liquidity risk (LDR) have no effect on banking financial performance (ROA) and operational risk (BOPO) affect financial performance, (Afif, 2019). The explanations above go to the following hypothesis.

H2 = Alleged financial performance mediates the effect of risk management on organizational performance.

Conceptual Framework

The above framework concludes the following conception models:

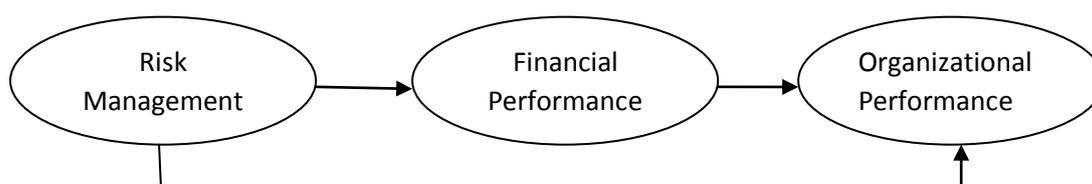


Figure 1. The conceptual framework that explains the effects of risk management, financial performance, and organizational performance

METHODOLOGY

This research is explanatory research with a quantitative approach. This type of research is chosen considering the objectives to explain the relationship and the effects. The hypothesis in the design of this study determined the variables used in the study. There are three variables, risk management variables, financial performance, and organizational performance. The samples of this study are 6 Sharia Banks listed in Indonesia Stock Exchange (IDX) around 2013-2017.

The independent variable in this study is risk management consisting of Capital Adequacy Ratio (CAR), Operational Costs to Operating Income (BOPO), and Nonperforming loans (NPL). The mediating variable is financial performance (ROA), according to the dependent variable, organizational performance.

The data are analyzed by testing variable X against the Y2 variable which is then mediated with variable Y1. Quantitative analysis analyzes certain object with numbers. It is intended to estimate the magnitude of the quantitative influence of changes in one or several other events by using smart PLS software statistical analysis tool with Smart PLS software (Ghozali, 2008).

RESEARCH RESULTS

Hypothesis Testing and Direct Influence Coefficient

Testing hypotheses and path coefficients directly influence risk management variables on organizational performance. The results of the test analysis of the direct influence among variables can be seen from the path coefficient value, t statistics and p value presented in Table 1.

Table 1. The Results of Direct Effect Hypothesis Testing

Free Variable	Dependent Variable	Coefficients Path	t statistik	p-value	Description
Man res	Financial performance	0.109165	0.692	0.4948	Not significant
Financial performance	Organizational performance	0.026866	0.175	0.8620	Not significant
Man res	Organizational performance	0.958381	5.297	0.0001	Significant

The results of testing the hypothesis presented based on Table 1 will be described as an explanation of the examination:

The Risk Management Effect on the Performance of Islamic Banking Organizations

The results of the first hypothesis testing are the relationship of risk management variables to organizational performance shows a positive path coefficient value of 0.958381. Positive path coefficient reveals that the relation of risk management variables on organizational performance is in the same direction. The p-values indicate 0.0001,

which is smaller than 0.05 and the t-statistic value of 5.297, which is higher than t-table 1.96. These results suggest a positive and significant effect of the relationship of risk management variables on organizational performance. Thus, hypothesis 1 is accepted. The implementation of risk management in Sharia banking in the Indonesia Stock Exchange effects on the performance of Sharia banking organizations listed on the IDX 2013-2017.

Hypothesis Testing and Variable Mediation Pathway Coefficients

Testing the mediation hypothesis aims to detect the position of the intervening variable in the model. The test may follow the procedure developed by Sobel known for the Sobel Test. It examines the effect of OCB on Islamic work satisfaction through spiritual leadership. It uses a free Sobel software test calculator for the significance of mediation version 4.0. Table 2 below presents the results of the Sobel Test analysis.

Table 2. Sobel Test Result

Correlation	A	B	SE _A	SE _B	t count	sig	information
risk management - financial performance - organizational performance	0.10917	0.02687	0.69172	0.17543	0.1099	0.4562	Non sig

Financial Performance mediates the influence of Risk Management on Organizational Performance.

The test of the effect of risk management variables on risk management in the initial model by involving financial performance mediation variables suggests that risk management does not have a significant effect on financial performance. Financial performance has no effect on organizational performance.

DISCUSSION

The Effects of Risk Management on Organizational Performance

The effect of risk management on organizational performance in the formulation of the first hypothesis suggests that risk management influences organizational performance. In this study, the risk management variable refers to Capital Adequacy Ratio (CAR), Operational Costs to Operating Income (BOPO) and Nonperforming loans (NPL). The most dominant perceived indicator is the Capital Adequacy Ratio (CAR), which has the most important role in banking risk management because banking assets will have a major influence on the operations of Sharia banking. The Capital Adequacy Ratio (CAR) set by Bank Indonesia is 8%. If a bank's Capital Adequacy Ratio (CAR) is below 8%, the bank is unable to absorb losses that may arise from the bank's business activities. If the CAR is above 8%, the bank is increasingly solvable. In this study, the data shows that the value CAR in the six banking samples is above 8%. Thus, the sample company is solvable.

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Organizational performance in the current study refers to financial indicators and learning and growth perspective. The most dominant indicator is a financial perspective. The results of the study show that the size of the company's debt will determine funding policy steps to fund the company's operations and continue to improve the performance.

Path analysis model shows that the risk management variable influences organizational performance. This research is in accordance with the idea of (Nair & Choudhary, 2014) that the application of risk management has a significant effect on business performance. However, it contradicts the research of (Huston et al., 2011), stated that no link between assessed risk management and volatility-moderated annual returns. The good management of risk will improve the performance of an organization. Therefore, to achieve high organizational performance, we need to manage the company's risk management. Good risk management and implementation of sharia banking will reduce banking risk, one of which is traffic risk. The application of high-risk management to increase corporate profits can indirectly improve the performance of Islamic banking organizations. The implementation of the appropriate risk management must be in line with the annual plan of the company, analysis assessment of lending to borrowers and banks evaluation, so the banking companies can be properly managed, and they can improve the performance of the organizations.

The Effects of Risk Management on Organizational Performance Mediated by Financial Performance

The effect of risk management on organizational performance through financial performance mediation is examined to answer the second hypothesis that risk management influences organizational performance with financial performance as intervening. In this study, risk management variables go to three indicators, Capital Adequacy Ratio (CAR), Operational Costs to Operating Income (BOPO), and Nonperforming loans (NPL). Organizational performance variables refer to two indicators, financial perspective and learning and growth perspective. The mediating variable in this study is a financial performance with the Return on Asset (ROA) indicator.

Testing the influence of risk management variables on organizational performance, in the initial model involving financial performance mediation variables can be known that, directly risk management affects the performance of the organization, and risk management directly has no significant influence on financial performance, and financial performance has no effect on the performance of the organization. The results of this study are in line with the opinion of (Alkhatib & Harsheh, 2012), which states that variable operational efficiency, asset management and credit risk are found to be insignificant and doesn't individually affect Tobin's Q. The results of this study contradict the opinions of (Afif, 2019) and (Attar et al., 2014) who stated that risk management affects the company's financial performance. Companies must think about the benefits and risks whenever they lend funds to other parties. Besides, dividend policy must also be considered so that the company's value remains optimal.

CONCLUSION

The current study concludes that risk management represented by the Capital Adequacy Ratio (CAR), Operational Costs to Operating Income (BOPO) and Nonperforming Loans (NPL) has a direct positive and significant effect on organizational performance among sharia banks listed in IDX 2013-2017. Appropriate risk management can improve financial performance.

Besides, financial performance is not as a mediator of the effect of risk management on the performance of sharia banking organizations listed in IDX 2013-2017. Sharia banking operations must be in accordance with sharia principles and sharia banking must improve risk management supervision, because highly efficient supervision of sharia bank performance can improve sharia banking performance.

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