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Good Corporate Governance and Risk Management on Financial Cooperative Performance

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Abtract

The global economic challenges faced by Indonesia have led to a need for increased populist self-sustaining economic activities. This study aimed to examine the impact of good corporate governance and risk management on cooperative performance. The research was conducted at women's cooperative institutions registered with the Pasuruan Regency Cooperative and SMEs Office, with a total population of 336. Using purposive sampling, data was processed using Partial Least Square analysis. From the analysis conducted, the results of this study indicate that good corporate governance has no significant effect on risk management, good corporate governance has a significant effect on cooperative performance, and risk management has a significant effect on cooperative performance.

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1. Introduction

The world economy has undergone a shift in risk in the wake of the COVID-19 pandemic from 2019 to 2022. Currently, global economic pressures are causing various risks, including the risk of stagflation, financial uncertainty, geopolitical tensions, and inflation (Kemenkeu, 2022). Indonesia is also facing a range of economic risks, as highlighted by the Minister of Finance of the Republic of Indonesia, Sri Mulyani, in a press conference on 11th August 2022. She emphasized that currently, Indonesia is experiencing problems in the form of financial weakening due to high inflation and tightening of interest / monetary rates experienced by some countries.

The combination of these risks poses significant challenges for economic decision-makers. Geopolitical tensions between Russia and Ukraine and rising tensions in Taiwan are adding to the uncertainty and disruption in the supply and demand aspects, leading to soaring global inflation.

Countries, particularly those with high debt ratios of 60% to 100%, need to be cautious about stagflation and inflation. According to the IMF (IMF, 2021), over 60 countries are at risk of debt crisis or default due to the rising cost of debt and refinancing risk. The latest data that the IMF has released regarding the amount of global debt in 2021 is as figure 1.

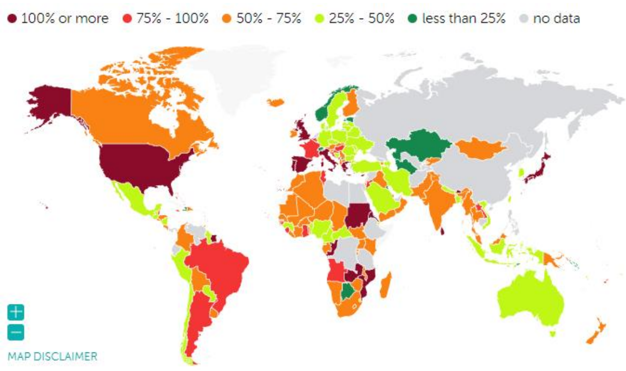
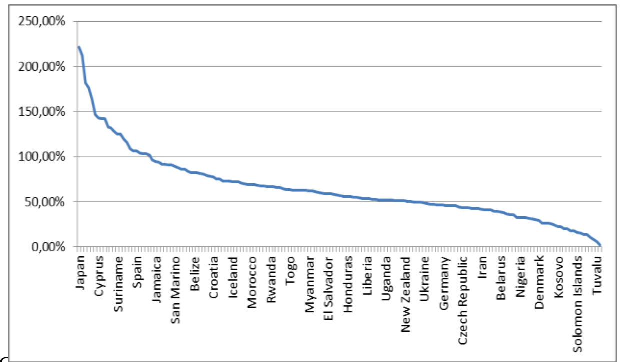


Figure 1. The Global Debt Map

Figure 1 highlights countries with total debt ratios ranging from more than 50% to more than 00% in different shades of orange, red, and dark red. The following graph will show more detail (figure 2).



Source: imf.org, 2023

Figure 2. 2021 Global Debt Ranking

The global debt ranking includes data on 190 countries, although some are not depicted in the figure due to limited space. The debt information of 20 countries is unavailable. The five countries with the highest foreign debt are Japan, Greece, Sudan, Eritrea, and Singapore. Developed countries such as the United States, Portugal, and Spain are ranked lower than 10^{th}. Indonesia stands at 129th with a debt of 40.71%, which decreased to 30.1% based on (Bank Indonesia, 2022a) in 2022, indicating positive economic growth and increased awareness of effective economic activities, both local and self-suf-ficient. This shift is reflected in the use of foreign debt funds for both sharia and conventional state securities (Bank Indonesia, 2022b). Such community-based, self-sufficient economic activities align with the principles of cooperatives, which aim to improve the well-being of their members.

Law No. 17 of 2012 states that legal entities are established by individuals or cooperatives with the separation of wealth between members related to venture capital, fulfillment of shared aspirations and needs in the economic, cultural, and social fields in accordance with cooperative values and principles. This study was conducted in East Java Province, specifically in Pasuruan Regency, for several compelling reasons. East Java Province has the highest concentration of cooperatives in Indonesia as of 2021, and Pasuruan Regency was selected due to its remarkable potential for growth, as evidenced by its awards and recognition (Katadata, 2022). The regency was awarded the title of "Cooperative Driving Badge" in 2017-2022 and received commendation from the Minister of Cooperatives and SMEs for being the most innovative among regional heads. The East Java Cooperative service recorded 336 active women's cooperatives in Pasuruan Regency in 2020. 335 of these institutions, which remain functional, held successful Annual Member Meetings (RAT) during the same year.

The implementation of Good Corporate Governance (GCG) in cooperatives is crucial to improve their performance and increase stakeholders' trust (Haryanto, 2014; Putri et al., 2018; Kurniawan, 2018; Charita et al., 2021; and Bakhtiar et al., 2021). GCG principles such as transparency, accountability, responsibility, independence, and fairness can enhance the perception of stakeholders that good governance practices result in better cooperative performance (Utomo et al., 2018). Previous studies support the notion that the application of GCG leads to improved business outcomes and enhanced performance in cooperatives. Good management is a key factor in the improvement of cooperative performance, as administrators must be able to conduct activities that have a meaningful impact and communicate these activities effectively to stakeholders. GCG aspects in cooperatives encompass the disclosure of relevant information and the provision of timely end-of-period reports.

The management of cooperatives should be guided by relevant plans and regulations, including the Statutes/Bylaws (*AD/ART*) and policies outlined in Law No. 25 of 1992 concerning Cooperative. This law outlining the standards and criteria that must be met for effective cooperative management states : "(1) Cooperatives as a business unit and a mass economic movement take part in creating an advanced, just, and prosperous community on the basis of the state ideology Pancasila and the 1945 Constitution in the national economic order drawn up as a common business on the basis of the principles of collective effort and economic democracy; (2) Cooperatives need to develop themselves and to be developed into strong and self-reliant cooperatives so as to enable them to play a role as the pillar of the national economy; (3) The development of cooperatives constitutes the task and responsibility of the government and the people as a whole."

Good corporate governance (GCG) influences risk management (Sari & Widaninggar, 2020; Budiman & Krisnawati, 2021; Anik et al., 2021 and Setiadi & Supatmi, 2022). Cooperatives aim to ensure transparency and accountability in their operations through various measures such as submitting reports on meeting outcomes, holding annual Member Meetings, and presenting accountability reports with financial statements, balance sheets, and bad credit records. The implementation of Good Corporate Governance (GCG) has been shown to affect risk management practices in cooperatives (Rahayu & Utiyati, 2018) . According to the signaling theory , there may be differences in the quality of information between cooperatives, and it is the responsibility of cooperative managers to signal accurate information to stakeholders (Sofiatin, 2020).

Risk Management affects Cooperative Performance. Effective risk management is crucial for the overall performance of a cooperative. Studies have found that proper risk management, as evidenced by factors such as the Capital Adequacy Ratio (CAR), the Operational Efficiency Ratio (OER/*BOPO*), and the Non-Performing Loan (NPL), has a positive impact on financial performance (Mardiana, 2018). Based on the Signalling Theory, cooperatives must therefore effectively communicate and signal their condition to both internal members and external stakeholders through reliable data and information.

2. Hyphotesis Development

The signaling theory highlights the impor-tan-ce of cooperatives being able to effectively communicate information to their members to build trust and accountability. This involves providing clear and transparent information disclosure to stakeholders, particularly to cooperative members. Study by (Rahayu & Utiyati, 2018) ANNABOLA have demonstrated the correlation between good corporate governance (GCG) and effective risk management, in addtion to study conducted by (Cahyaningtyas & Sasanti, 2019; Wirawan & Dwija Putri, 2018). Voluntary disclosure of cooperative performance results can give stakeholders a more accurate picture of the cooperative's capabilities, helping to mitigate the perception of potential problems. Positive signals from cooperatives can be met with a favorable response from the market, providing competitive advantages and enhancing the overall value of the cooperative. This is supported by previous research conducted by Kandukuri et al. (2015); Indarti & Extaliyus (2013); Putri (2006) and concurs with the findings of Wardani (2020).

H_1: Good corporate governance (GCG) has a significant positive impact on the risk management of women's cooperatives in Pasuruan Regency

H_2: GCG has a significant positive impact on the Performance of women's cooperatives in Pasuruan Regency

Institutional theory provides a framework for understanding the relationship between organizations and their environment, including the structures and processes they adopt, and the consequences of these institutional processes. This theory can also be used to explain decision-making and roles within organizations (Meyer & Rowan, 1977; Scott, 2008; Villadsen, 2011). Cooperative institutions are based on the principle of kinship and have a dual role as both an economic and educational institution, as well as a means of community democracy (Sudarsono, 2000). To achieve their objectives, cooperative organizations must have a strong commitment to fulfilling their responsibilities (Gainau, 2014). Previous study has shown a positive correlation between risk management and company performance, leading to the hypothesis (Putra & Cipta, 2021; Nazariyah et al., 2021; Pradnyaswari, Ary and Putri, 2016; Pratiwi & Kurniawan, 2018)

H_3: GCG has a positive impact on the performance of women's cooperatives in Pasuruan Regency

The measuring instrument for this research will be GCG in cooperative institutions, which will be assessed using five aspects as described by (Dasuki, 2018; Kusuma putra & Cipta, 2021) : transparency, accountability, independence, responsibility, and fairness. Each of these aspects will consist of several specific statements.

Transparency intended on transparency in information disclosure. The items of transparency measurement include; a) Cooperative institutions provide transparent financial reports, including cash flow, income statements, and balance sheets. b) The institution openly announces any partnerships with external parties. c) Accurate delivery of product and service information is readily available. d) The institution welcomes and implements constructive criticism and suggestions from members.

Accountability intended on Clear division of functions, rules, and job descriptions. The items of transparency measurement include; a) Operations and systems are aligned with standard operating procedures/standard operating manuals. b) Adequate human resources are placed in the relevant divisions. c) Members hold individual positions, avoiding duplication of roles. d) All positions are filled. e) Software tools are used to enhance performance.

Responsibility intended on the cooperatives is compliance with legal requirements/responsibility. The items of transparency measurement include: a) Documents are kept secure, ensuring accountability. b) Annual member meetings are held regularly. c) The cooperative operates within legal framework. d) The institution adheres to commitments made to both members and external parties.

Independency intended on The cooperative has professional management, independent of any external influence. The items of transparency measurement include: a) The cooperatives have professional management, b) The institution diversifies its partnerships, avoiding reliance on a single entity, c) The management is free from any interference from outside parties.

The study measures the risk management variables through various ratios, such as NPL and the ratio of risk-weighted assets (RWA), as cited from a study by (Chairani, 2016; Rahayu & Utiyati, 2018). To evaluate the financial performance, the study utilizes return on assets (ROA), return on equity (ROE), and Net Interest Margin (NIM) ratios, as per studies by Ikhsan (2013; Nuraeni & Rakhmawati (2016); Sudarmawanti & Pramono (2017); and Timan (2019).

3. Data and Methods

The study employed both questionnaires and observation as data collection methods. Members of the cooperative were sent questionnaires to provide answers and necessary information (Mardalis, 2008). Additionally, the study conducted observations at the cooperative office in Pasuruan Regency by reviewing the available annual reports. The target population of the study is the Women's Cooperative in Pasuruan Regency, which comprises 336 cooperative groups. The study used purposive sampling to carefully select the sample, following criteria set by Ferdinand (2011). The sample criteria include: a) Women's cooperative groups registered with the cooperative service, b) Passive women's cooperative groups, c) Non-sharia cooperative groups, d) Savings and loan cooperative groups, e) Cooperative groups that have held their annual member meeting (RAT) in the past three years, f) Cooperative groups with a minimum of 100 members, and g) Cooperative groups with a profitable value.

Contains the research design used (methods, data sources, population and research samples, data collection techniques, research variables and their operations and data analysis techniques) so that readers can reproduce the research properly.

Table 1 illustrates the results of the Purposive Sampling method applied in this study. The initial population of 336 women's cooperatives in Pasuruan district was reduced to 47 through the application of several criteria, including the exclusion of inactive cooperatives registered at the cooperative service (1), cooperatives that have not held RATs for three consecutive years (107), and cooperatives with fewer than 100 members (181). The final sample of 47 women's cooperatives represents 14 different districts, as depicted in Figure 3.

Table 1. Purposive Sampli*ng*

No.	Purposive sampling	Total
1	Women's cooperative groups recorded/registered with cooperative service	336
2	Passive women's cooperative groups recorded in cooperative service	(1)
3	Non-sharia cooperative groups	(0)
4	Non-savings and loan cooperative groups	(0)
5	Cooperative groups that haven't held their annual member meeting (RAT) in the past three years	(107)
6	Cooperative groups with 100 members	(181)
7	Unprofitable cooperative groups.	(0)
The total number of cooperatives that meet the sampling criteria.		47

Source: Processed Primary Data, 2022.

As depicted in Figure 3, the majority of cooperatives that adhere to the principles of Good Corporate Governance (GCG) are located in the sub-districts of Pandaan, Purwodadi, and Gempol. The research employs a path analysis approach, utilizing the WrapPLS analysis tool. This analysis consists of two stages, the outer model analysis (measurement model) and the inner model analysis (structural model).

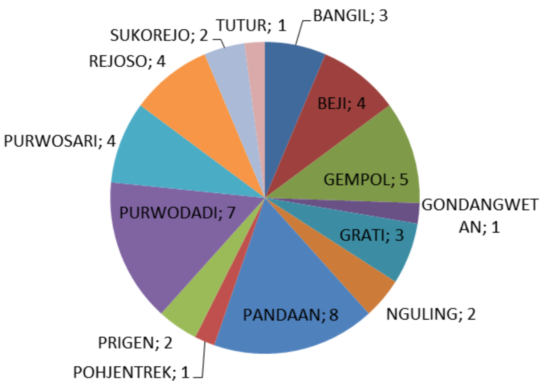


Figure 3. The Pasuruan Regency Women's Cooperative that Meet the Sampling Criteria

4. Result

Outer Model analysis

In this study, the measurement model (outer model) analysis evaluates the correlation between latent variables and their corresponding indicators. In this research, the measurement model analysis (outer model) focuses on exploring the relationship between the formative indicator models and composite latent variables. By carefully evaluating the results of each indicator for each variable, the measurement model can effectively eliminate any indicators that are not needed and assess the goodness of fit of the models used. The results of the indicator exploration and the calculated weights for each variable are presented in Table 2.

As depicted in Figure 3, the majority of cooperatives that adhere to the principles of Good Corporate Governance (GCG) are located in the sub-districts of Pandaan, Purwodadi, and Gempol. The research employs a path analysis approach, utilizing the WrapPLS analysis tool. This analysis consists of two stages, the outer model analysis (measurement model) and the inner model analysis (structural model).

Table 2 reveals that all indicators have a value greater than 0.3 and a P-value less than 0.001, satisfying the validity criteria. The goodness-of-fit of the model used is further evaluated through the fit and quality indices, as depicted in Table 3.

Table 2. The Results of The Indicator Exploration for Each Variable Using WrapPLS

No.	Variable/ Indicator	Weight	P Value	Notes / Information
Good corporate governance				
1	Transparency	0.668	< 0,001	Used in models
2	Accountability	0.659	< 0,001	Used in models
3	Responsibility	0.668	< 0,001	Used in models
4	Independence	0.581	< 0,001	Used in models
5	Fairness	0.473	< 0,001	Used in models
Risk Management				
1	*Non Performing Loan*	-0.515	< 0,001	Used in models
2	*Risk Weighted Asset*	0.561	< 0,001	Used in models
Cooperatives Performance				
1	Return on Asset	0.461	< 0,001	Used in models
2	Return on Equity	0.517	< 0,001	Used in models
3	Net interest margin	-0.412	< 0,001	Used in models

Model Fit And Quality Indices

Table 3 provides the results of the measurement model's fit and quality indices. Despite not having exceptional Average R-squared (ARS) and Average adjusted R-squared (AARS) results, the model can still be considered reliable as long as it meets all fit criteria. These criteria are simply guidelines (rule of thumb), and a good value of goodness of fit indicates that the model is suitable for use.

Structural Model or Inner Model Analysis

The inner model test results, depicted in Table 4., show that all hypotheses in the study have been accepted except for one. Specifically, the hypothesis regarding the effect of GCG on risk management showed a low and insignificant effect of only 18.9%.

The inner model test results, depicted in Table 5 show that all hypotheses in the study have been accepted except for one. Specifically, the hypothesis regarding the effect of GCG on risk management showed a low and insignificant effect of only 18.9%.

Table 3. Result Model *Fit and Quality Indices*

Model Fit And Quality Indices	Value	Fit Criteria	Result
APC	0,281 P=0,009	P<0.05	Good
ARS	0,117 P=0,101	P<0.05	Not Good
AARS	0,088 P=0,133	P<0.05	Not Good
AVIF	1.005	acceptable if <= 5, ideally <= 3.3	Ideal
AVFIF	1.090	acceptable if <= 5, ideally <= 3.3	Ideal
GoF	0.248	small >= 0.1, medium >= 0.25, large >= 0.36	Small
SPR	1.000	acceptable if >= 0.7, ideally = 1	Ideal
RSCR	1.000	acceptable if >= 0.9, ideally = 1	Ideal
SSR	1.000	acceptable if >= 0.7	Acceptable
NLBCDR	1.000	acceptable if >= 0.7	Acceptable

Source: Processed Data, 2022
Notes: APC; Average Path Coefficient, ARS; Average R-squared, aars; Average adjusted R-squared, AVIF; Average block VIF, AVFIF ;Average full collinearity VIF, SPR; Sympson's paradox ratio, RSCR; R-squared contribution ratio, SSR; Statistical suppression ratio, NLBCDR; Nonlinear bivariate causality direction ratio

Table 4. Inner Model Test Results

No.	Relationship Among Models	Coef.	*p-value*	Notes / Information
1	*Good corporate governance* → Risk management	0,189	0,084	*Weakly Significant*
2	*Good corporate governance* → Cooperatives performance	0,342	0,005	*Highly Significant*
3	Manajemen risiko →Cooperatives performance	0,312	0,010	*Highly Significant*

5. Discusssion

The Impact of Good Corporate Governance on Risk Management

The results showed that Good Corporate Governance affects Risk Management. GCG has a significant but weak impact on risk management in women's cooperatives. This study supports the findings of previous studies by (Rahayu & Utiyati, 2018; Cahyaningtyas & Sasanti, 2019; Wirawan & Dwija Putri, 2018), which showed that higher GCG values lead to lower risks and lower GCG values lead to greater risks in these cooperatives.

The Impact of Good Corporate Governance on Cooperatives Performance

As seen from the average values of the GCG and cooperative performance indicators, the women's cooperatives tend to follow, legal requirements and perform well, surpassing the standard values set. The results of the analysis support previous research conducted by Putra & Cipta (2021); Kandukuri et al. (2015); Indarti & Extaliyus, 2013; Putri, 2006), showing that an increase in GCG implementation leads to a corresponding increase in cooperative performance. This is because the principles of GCG, such as transparency, accountability, responsibility, independence, and fairness, create a more organized and efficient financial performance, building trust among cooperative members and stakeholders. Therefore, the higher the implementation of GCG, the fewer problems arise in the implementation of women's cooperatives, leading to improved performance overall.

The Impact of Risk Management on Cooperative Performance

The results of this study reveal that effective risk management has a significant impact on cooperative performance. This finding indicates that the better the risk management practices implemented by women's cooperatives in Pasuruan Regency, the higher their performance will be. Similar results were found in the study by (Attar & Islahuddin, 2014) entitled "The Influence of the Implementation of Risk Management on the Financial Performance of Listed Banks on the Indonesia Stock Exchange", which revealed that risk management practices, including credit, liquidity, and operations, have a significant impact on the financial performance of banks listed on the Indonesia Stock Exchange. Moreover, these results align with the institutional theory, which postulates that sound organizational policies and management practices, such as risk management, lead to the attainment of organizational goals. The study by Putra & Cipta, (2021); Nazariyah et al. (2021); Pradnyaswari, Ary and Putri, (2016); Pratiwi & Kurniawan (2018) also supports this conclusion.

The discussion suggests the interpretation of the results in accordance with the research objectives and hypotheses (if any). The order of discussion is the same as the research objective. The discussion of the results is argumentative regarding the relevance of the results, theories, previous research and empirical facts found, as well as showing the novelty of the findings

6. Conclusion and Suggestion

Conclusion

The results showed that Good Corporate Governance affects Risk Management. The effect of good corporate governance on risk management is low. Good corporate governance has a strong effect on cooperative performance. Risk management affects Cooperatives performance. The results of this study support the notion that good corporate governance (GCG) practices are crucial for improving the risk management and financial performance of cooperative institutions.

Suggestions

This study has certain limitations that should be addressed in future research. First, the study was limited to Pasuruan Regency, and future research should explore a wider area to strengthen the results. Second, the measurement of GCG in this study was purely quantitative, and future research should also consider a qualitative approach to provide a deeper understanding of GCG. Finally, this study focused on non-Sharia or conventional cooperatives, and future research should explore the effects of GCG on Islamic cooperatives to provide a more comprehensive understanding.

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