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Financial Risk Management: Building Financial Readiness and Resilience in Facing Crisis and Economic Change in East Java

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ABSTRACT: Financial risk management is a crucial foundation for the sustainability of organizations and households, particularly in East Java, which faces regional and global economic dynamics. This study aims to examine financial risk management strategies in building financial preparedness and resilience in the face of crises and economic change. Using a literature review and local case studies, the study found that financial risk mitigation strategies in East Java should focus on diversifying revenue sources, optimizing liquidity, implementing strong internal controls, and continuous risk monitoring. The study findings indicate that organizational leaders, MSMEs, and local governments play a crucial role in strengthening a culture of risk management. The study's conclusions emphasize the importance of a holistic and collaborative approach to building financial resilience, enabling East Java to be more adaptive in facing global economic challenges.

KEYWORDS: Financial Risk Management, Financial Resilience, Financial Readiness, East Java, Economic Crisis

I. INTRODUCTION

Increasing global economic uncertainty over the past two decades has placed financial risk management as a crucial foundation for maintaining the sustainability of organizations, households, and the public sector. Phenomena such as the 2008 global financial crisis, the COVID-19 pandemic, rising global inflation, and geopolitical instability demonstrate the fragility of the financial system without adequate risk management strategies. According to Jiménez et al. (2024), financial risk management is a systematic process for identifying, evaluating, and managing risks that could threaten an entity's financial stability.

In the context of Indonesia, particularly East Java Province, this issue is increasingly relevant given East Java's strategic position as a driving force of the national economy. East Java contributes more than 14% to Indonesia's Gross Regional Domestic Product (GRDP), with an economic structure dominated by the trade, manufacturing, and Micro, Small, and Medium Enterprises (MSMEs) sectors. MSMEs employ more than 60% of the workforce in East Java, yet often face limited access to capital and weak financial risk management. Bhatt et al. (2023) emphasized that weak credit risk management is one of the main causes of MSMEs' failure to maintain their financial performance.

Financial risk management is not only about protection from losses, but also about financial readiness and financial resilience. Financial readiness encompasses an organization's ability to manage liquidity, maintain positive cash flow, and maintain a healthy capital structure (Chen & He, 2022). Meanwhile, financial resilience describes the ability of organizations and households to recover from shocks, such as economic crises, regulatory changes, or supply chain disruptions (Paz et al., 2023).

In East Java, the financial risks faced include:

1. Market risk, due to fluctuations in commodity prices such as tobacco, coffee, and sugar, which are leading export commodities (Fathi et al., 2024).
2. Credit risk, especially related to the high non-performing loan (NPL) of MSMEs that have difficulty accessing formal financing (Mariscal-Cáceres et al., 2024).
3. Liquidity risk, which occurs when MSMEs are unable to maintain stable cash flow amid fluctuating demand (Zimon et al., 2022).
4. Operational risk, including weak governance systems, limited financial literacy, and vulnerability to changes in fiscal and regulatory policies (Hudáková et al., 2023).

This situation demands more innovative mitigation strategies. Han et al. (2019) highlight the importance of business diversification to reduce non-systematic risk, while Yang et al. (2023) show that the use of derivative instruments can help companies withstand market volatility. Furthermore, implementing strong internal controls is also crucial. Hamed (2023) emphasized that a strong internal control system can prevent fraud, improve the accuracy of financial reporting, and strengthen long-term financial resilience.

Furthermore, leadership factors cannot be ignored. According to Okręglicka et al. (2023), the role of visionary leaders in building a culture of risk awareness contributes significantly to organizational sustainability. This is particularly relevant in the East Java context, where local governments and MSME leaders play a strategic role in building financial literacy and risk awareness at the community level.

Thus, this research is crucial to examine how financial risk management can build financial preparedness and resilience among communities and organizations in East Java. A literature review and local context analysis will provide a broader understanding of strategies, best practices, and challenges in implementing financial risk management in this region.

II. LITERATURE REVIEW

A. Basic Concepts of Financial Risk Management

Financial risk management is a systematic process for identifying, evaluating, and controlling risks related to an organization's finances. Jiménez et al. (2024) explain that financial risk management is not merely about protecting against financial loss but also a proactive strategy for maintaining organizational sustainability in the face of complex market dynamics. This includes market risk, credit risk, liquidity risk, and operational risk (Hudáková et al., 2023).

Furthermore, risk management is seen as a crucial tool for enhancing organizational competitiveness. Kordova & Fridkin (2021) emphasize that an integrated risk management approach can strengthen organizational resilience in a dynamic business environment.

B. Financial Readiness

Financial readiness reflects an entity's ability to manage liquidity, capital structure, and cash reserves in the face of uncertainty. Chen & He (2022) emphasized that financial readiness has a positive relationship with sustainable long-term economic growth. Organizations with good financial readiness can withstand the negative impacts of market volatility, exchange rate fluctuations, and interest rate increases (Fathi et al., 2024).

In the context of MSMEs, financial readiness is often associated with effective working capital management, simple financial record-keeping, and access to formal financing instruments (Zimon et al., 2022).

C. Financial Resilience

Financial resilience relates to the ability of individuals, organizations, and regions to recover from economic shocks. Paz et al. (2023) define financial resilience as the adaptive capacity that enables organizations to survive a crisis through comprehensive risk mitigation strategies.

A study by Okręglicka et al. (2023) showed that visionary leadership and a culture of innovation contribute to strengthening financial resilience. In this regard, leaders play a role in building risk awareness across all levels of the organization. This aligns with Nour & Kisa (2024), who found that effective leadership communication enhances an organization's capacity to cope with crises.

D. Market, Credit, Liquidity, and Operational Risk

The main financial risks can be divided into four broad categories:

1. Market risk: fluctuations in asset prices, exchange rates and interest rates (Fathi et al., 2024).
2. Credit risk: the debtor's failure to meet payment obligations. Bhatt et al. (2023) demonstrated that weak credit risk management significantly impacts the declining performance of financial institutions.
3. Liquidity risk: the inability of an entity to meet short-term obligations due to limited cash flow (Mariscal-Cáceres et al., 2024).
4. Operational risk: includes governance weaknesses, human errors, system failures, and detrimental new regulations (Hudáková et al., 2023).

These four risks are closely related in influencing the financial stability of an organization.

E. Financial Risk Mitigation strategy

The literature suggests a variety of mitigation strategies that organizations can implement to strengthen financial resilience:

1. **Portfolio Diversification**– Han et al. (2019) stated that business diversification can reduce non-systematic risk and increase financial sustainability.
2. **Use of Derivative Instruments and Insurance**– Yang et al. (2023) found that derivatives can increase firm value by

protecting against market volatility.

3. **Liquidity Management**– Zimon et al. (2022) emphasize the importance of cash planning, cash flow control, and monitoring short-term liabilities.
4. **Internal Control**– Hamed (2023) and Mendes de Oliveira et al. (2022) show that strong internal controls prevent fraud, increase accountability, and support financial sustainability.
5. **Digital Technology**– Metin et al. (2024) stated that the application of information technology in risk management can accelerate risk detection and improve the accuracy of financial reports.

F. Continouns Monitoring and Evaliation

Financial risk management is a systematic process for identifying, evaluating, and controlling risks related to an organization's Risk monitoring is crucial for maintaining the relevance of mitigation strategies. Liu et al. (2024) developed a deep reinforcement learning-based model that utilizes macroeconomic indicators and market sentiment to more accurately predict financial risks. Cho et al. (2024) emphasized that continuous monitoring enables organizations to promptly respond to changing market conditions before risks escalate into crises.

G. The Role of Leadership in Risk Management

Leadership plays a central role in guiding an organization's risk-related culture. Okręglicka et al. (2023) emphasize that leaders who support innovation and risk-taking will increase organizational competitiveness. Meanwhile, Nour & Kisa (2024) found that effective leadership communication during a global health crisis helps create social and financial resilience.

In the context of modern governance, the implementation of ESG (Environmental, Social, and Governance) standards is also crucial. Zaporowska & Szczepański (2024) show that ESG can be used as a framework for managing operational risk, thereby strengthening long-term sustainability.

III. RESEARCH METHODS

This study uses a literature review with a systematic approach to identify relevant financial risk management strategies. Data sources were obtained from international journals, East Java economic research reports, and local government policy publications. The analysis was conducted by comparing global risk management theory with its implementation at the regional level, specifically in East Java.

IV. RESULTS AND DISCUSSION

A. Identification of Financial Risks in East Java

Financial risk management begins with identifying the risks faced by organizations, households, and MSMEs in East Java. Key risks include:

1. Market risk, particularly fluctuations in agricultural commodity prices (tobacco, coffee, sugar) and foreign exchange rates, which impact exports. Fathi et al. (2024) show that exchange rate and interest rate volatility are dominant factors in determining financial stability.
2. Credit risk, where MSMEs often face difficulties accessing formal capital, leading them to rely on informal loans with high interest rates. Bhatt et al. (2023) found that weak credit risk management is directly related to the declining performance of financial institutions.
3. Liquidity risk, related to limited cash flow for MSMEs and dependence on local markets. According to Mariscal-Cáceres et al. (2024), weaknesses in liquidity management have the potential to increase the risk of default and business instability.
4. Operational risk, including accounting system failures, lack of financial literacy, and changes in tax and labor regulations. Hudáková et al. (2023) emphasize that operational weaknesses contribute to declining financial performance, particularly in the MSME sector.

Thus, accurate risk identification is a prerequisite for building adaptive financial resilience in East Java.

B. Potential Impact Evaluation

Once risks have been identified, the next step is to assess the potential impact on business continuity. This evaluation is crucial for identifying the worst-case scenario that could impact the economic sector in East Java.

1. Mäkká et al. (2024) explain that risk evaluation allows organizations to prepare emergency mitigation protocols before major impacts occur.
2. Jia et al. (2022) found that allocating resources based on risk levels helps companies avoid significant losses due to

misprioritization.

In the East Java context, the evaluation shows that liquidity risk has the most significant impact on MSMEs because it directly relates to the continuity of daily operations. If cash flow is not maintained, MSMEs are vulnerable to bankruptcy, even if long-term business prospects remain good.

C. Financial Risk Mitigation Strategy

Various strategies can be implemented to minimize the impact of financial risks in East Java:

1. Portfolio Diversification

MSMEs and companies need to expand their markets to digital platforms and diversify their products. Han et al. (2019) demonstrated that diversification can reduce non-systematic risk and increase financial resilience.

2. Use of Derivative Instruments and Financial Insurance

Instruments such as futures, options, or credit insurance can help protect businesses from price volatility and default risk. Yang et al. (2023) found that the use of derivatives contributes to increased firm value by protecting against market fluctuations.

3. Strengthening Liquidity and Cash Flow

Zimon et al. (2022) emphasized that cash planning, cash flow management, and short-term debt control are key to mitigating liquidity risk. In East Java, these practices are particularly important for MSMEs facing limited working capital.

4. Proactive and Integrated Approach

Kordova & Fridkin (2021) highlight the importance of implementing a holistic and sustainable risk management process so that organizations can survive in a dynamic business environment.

D. Implementation of Internal Control

Strong internal controls are an important pillar in financial risk management.

1. According to Hamed (2023), an effective internal control system can ensure the sustainability of financial performance and reduce the risk of fraud.
2. Mendes de Oliveira et al. (2022) showed that a healthy internal control environment helps suppress fraudulent practices in Brazilian companies, and this principle is also relevant for MSMEs in East Java.
3. The implementation of digital technologies, such as cloud-based accounting applications, can improve financial transparency and accountability. Metin et al. (2024) added that integrating information technology into internal controls improves the security and reliability of financial data.

E. Continous Monitoring and Evaluation

Continuous monitoring of financial risks is important to adjust mitigation strategies.

1. Liu et al. (2023) suggest that monitoring based on macroeconomic indicators and sentiment analysis can improve the accuracy of risk predictions.
2. Cho et al. (2024) emphasize the need for rapid adaptation of risk strategies to changing market conditions.

For East Java, monitoring can be carried out through the establishment of a regional risk data center that monitors commodity price fluctuations, MSME NPLs, and other financial indicators.

F. The Role of Leaders and Financial Managers

A healthy risk culture can only be achieved if leaders and financial managers play an active role.

1. Okręglicka et al. (2023) found that visionary leadership influences the creation of corporate innovation and sustainability through risk awareness.
2. Nour & Kisa (2024) emphasized that effective communication from leaders strengthens team involvement in risk management.
3. Zaporowska & Szczepański (2024) emphasize that risk policies based on sustainability principles (Environmental, Social, and Governance standards) can strengthen organizational competitiveness.

In East Java, the role of MSME leaders and local governments is crucial in building a culture of financial literacy and risk awareness.

V. CONCLUSIONS

Financial risk management is a fundamental element in building financial preparedness and resilience for individuals, organizations, and local governments. Based on a literature review and contextual analysis in East Java, several key points can be concluded:

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1. Complexity of Financial Risk

Financial risks faced by organizations and MSMEs in East Java include market, credit, liquidity, and operational risks. Market risk arises from volatility in commodity prices, exchange rates, and interest rates (Fathi et al., 2024). Credit risk is particularly significant in the MSME sector due to limited access to formal capital (Bhatt et al., 2023). Liquidity risk arises from weak cash planning and unstable cash flow (Zimon et al., 2022). Meanwhile, operational risk is influenced by weak governance, low financial literacy, and regulatory dynamics (Hudáková et al., 2023). Accurate risk identification is a crucial first step in preventing greater financial losses.

2. The Importance of Financial Readiness

Financial readiness is characterized by an organization's ability to maintain liquidity, manage its capital structure, and maintain financial reserves (Chen & He, 2022). For MSMEs in East Java, financial readiness means independence in managing working capital, simple accounting records, and the ability to anticipate revenue fluctuations.

3. Financial Resilience as a Pillar of Sustainability

Financial resilience relates not only to the ability to survive but also to the ability to recover after a crisis. Paz et al. (2023) emphasize that organizations with high financial resilience are able to maintain long-term sustainability even under conditions of uncertainty. In the context of East Java, this is particularly relevant for MSMEs facing economic shocks due to the pandemic, inflation, and supply chain disruptions.

4. Effectiveness of Mitigation Strategies

Literature reviews show that effective financial risk mitigation strategies include business diversification (Han et al., 2019), the use of derivatives and insurance instruments (Yang et al., 2023), strengthening liquidity (Zimon et al., 2022), and implementing strong internal controls (Hamed, 2023). Furthermore, the integration of digital technology into the financial system has been shown to increase transparency, accountability, and speed of response to risks (Metin et al., 2024).

5. Continuous Monitoring and Evaluation

Systematic and continuous risk monitoring is a key factor in maintaining effective risk management. Liu et al. (2024) demonstrated that a technology-based approach and macroeconomic indicators can enhance risk prediction. For East Java, implementing a data-driven risk monitoring system is crucial to support more responsive decision-making.

6. The Role of Leadership and Risk Culture

Visionary leadership plays a role in building a healthy risk culture within an organization. Okręglicka et al. (2023) emphasized that proactive and innovative leaders can increase competitiveness through appropriate risk management. Furthermore, effective communication from leaders strengthens team engagement in risk management (Nour & Kisa, 2024). At the regional level, East Java leaders need to promote financial literacy, MSME training, and sustainability- based policies (Zaporowska & Szczepański, 2024).

7. Implications for East Java

- From a practical perspective, financial risk management can serve as a guideline for MSMEs, corporations, and local governments to increase financial resilience in the face of crises.
- From a theoretical perspective, this research contributes to enriching the literature on financial risk management at the regional level, particularly in the context of local economies based on MSMEs.
- From a policy perspective, integration of financial literacy programs, more inclusive banking policies, and technology-based financial monitoring systems is needed.

8. Financial risk management in East Java must be positioned as a primary strategy in facing economic uncertainty. Comprehensive risk identification, adaptive mitigation strategies, continuous monitoring systems, and proactive leadership are key factors in building financial readiness and resilience. With a holistic and collaborative approach between businesses, academics, the community, and local government, East Java can strengthen its economic foundations and become more resilient in the face of crises and global economic changes.

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