ANALYSIS OF THE RISK OF MARKET COMPETITION IN THE MONTH OF RAMADAN IN IMPROVING THE ECONOMY OF *TAKJIL* TRADERS IN THE JATI UTOMO VILLAGE, NORTH BINJAI

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Abstract

This study aims to evaluate the effectiveness of internal control and the Diagnostic Control System (DCS) at PT ABC, a multinational personal care company that experienced sales fraud in the form of channel stuffing during the fiscal year (FY) 2024. Using a case study approach and data triangulation through observation, secondary document analysis, and interviews with four key informants, this study analyzes weaknesses in internal control based on the COSO (2013) framework, Simons' (2000) DCS, and the Fraud Triangle Theory. The findings indicate that all components of internal control were ineffective. The DCS was also misaligned with corporate strategy, as performance indicators focused primarily on sales volume and incentive schemes encouraged dysfunctional behavior. The combination of target pressure, weak controls, and cultural rationalization explains the occurrence of fraud in accordance with the Fraud Triangle Theory. This study concludes that the fraud at PT ABC resulted from weak internal controls that created opportunities for misconduct, as well as an ineffective DCS that generated pressure and rationalization for such behavior. The recommendations include strengthening the monitoring function by appointing a fully accountable local director rather than a nominal representative, redesigning KPIs and incentive schemes based on historical sell-out data to end consumers, and fostering an integrity-driven organizational culture to prevent recurring fraud.

Keywords: Internal Control, Diagnostic Control System, Fraud, Channel Stuffing, Personal Care Industry

INTRODUCTION

Multinational companies (MNCs) face more complex control challenges than domestic firms due to cross-border communication barriers, cultural differences, and geographic distance that limit direct supervision and increase fraud risk (Kennedy, 2019). High-profile control failures—such as Enron (2001), WorldCom (2002), and Indonesia's PT Hanson International (2019)—show that weak internal control can lead to major financial losses and lasting reputational damage. These risks are often amplified when MNCs operate in emerging markets like Indonesia, where control infrastructures may be less mature and rapid market-entry pressures can weaken oversight and internal communication (Ding, 2024).

This study examines PT ABC, the Indonesian entity of ABC Ltd in the personal care sector. ABC Ltd entered Indonesia in 2021 through a distributor and established PT ABC in 2023 to strengthen local market penetration, but in the same year PT ABC experienced sales fraud involving inflated sales figures to meet targets, followed by high product returns—identified as channel stuffing (KPMG, 2024). Since the fraud was uncovered, PT ABC has continued to report operating losses in 2023 and worsening in 2024, contrasting with the generally positive growth trend of the personal care industry in Indonesia. Given PT ABC's growth-stage transition from a distributor model to a local entity, this research focuses on two control systems most critical at this phase: internal control (evaluated using COSO, 2013) to protect transaction integrity and reduce opportunity for fraud, and Diagnostic Control System (DCS) (Simons, 2000) to ensure performance measurement and targets reflect real demand and support strategic decision-making. The goal is to assess how strengthening internal control and DCS can help PT ABC restore profitability and prevent similar cases in the future.

REVIEW OF LITERATURE

Internal control is a continuous process carried out by the board, management, and employees to provide reasonable assurance that organizational objectives are achieved—operational effectiveness, reliable financial reporting, and legal compliance (COSO, 2013). It is not only formal policies, but also the organization's culture and daily behavior. The COSO framework explains internal control through five integrated components: control environment, risk assessment, control activities, information & communication, and monitoring; when embedded in routine processes, these components help prevent, detect, and correct risks and strengthen governance (COSO, 2013; Arens et al., 2017).

In the sales cycle, internal control focuses on ensuring accurate recording of sales, safeguarding assets, and minimizing fraud risk. Prior literature highlights key practices such as segregation of duties across sales, billing, recording, and cash handling; formal transaction authorization (e.g., discounts, credit sales, returns); routine reconciliation and management reporting; and role-based access controls supported by audit trails to protect sales data integrity (Wirananda et al., 2022; Luthfih, 2023; Supriyanto & Resnika, 2023; Aizzudin et al., 2024).

Beyond basic controls, Simons' Levers of Control describe how management control systems align behavior with strategy through belief, boundary, diagnostic, and interactive systems (Simons, 2000). Diagnostic Control Systems (DCS) use targets and KPIs to compare actual performance against standards, detect deviations, and trigger corrective action; their

effectiveness depends on relevant measures, consistent reporting, and timely follow-up (Simons, 2000). To explain misconduct, Fraud Triangle Theory argues fraud arises from the interaction of pressure, opportunity (often created by weak controls), and rationalization—suggesting that strengthening internal control reduces opportunity while well-designed DCS can reduce pressure and limit rationalization (Cressey, 1953; ACFE, 2019; Romney & Steinbart, 2021).

RESEARCH METHOD

This study uses a qualitative case-study approach with triangulation to improve validity. Data were collected through field observation, in-depth interviews, and secondary document analysis. Observation was used to examine how sales, purchase order approvals, distribution, and inventory monitoring actually operated, including signs of abnormal sales patterns and weaknesses in control practices. Interviews with four key informants (DU, CM, RFOM, and DRM) explored target setting, KPI use, reporting routines, decision-making, and how deviations were handled in practice.

Secondary documents—including KPI reports, budget plans vs. actual realization, and Profit & Loss statements—were analyzed to verify the narratives, identify variances and unusual trends (e.g., spikes followed by returns), and assess whether performance measures and follow-up mechanisms supported effective control.

RESULTS AND DISCUSSION

This chapter summarizes the findings from field observations, in-depth interviews with four key informants (DU, CM, RFOM, and DRM), and secondary data analysis. The evidence consistently shows a clear mismatch between PT ABC's reported sales growth and actual market demand. In FY2024, PT ABC recorded an exceptional sales increase of Rp 16 billion, yet market observations did not indicate higher consumer sell-out. Instead, sales were largely driven by repeated push-stock practices, where large volumes were pushed to retailers without considering real absorption capacity. This created overstock at the trade level, inflated rebate claims, and led to abnormal sales patterns in later periods. In 2025, reported sales fell sharply as returns occurred gradually, confirming that the FY2024 spike did not represent sustainable growth. As a result, financial report figures became less reliable for managerial decision-making because they were distorted by biased sell-in performance.

Interviews reinforced that PT ABC lacked credible sell-out visibility. DU indicated sell-out reports were not provided, while DRM explained that sell-out data is generally attainable—especially in modern trade—if negotiated early, at a relatively small cost. Internally, CM described strong pressure from DU and regional management to achieve targets, which discouraged open communication about weak market conditions. RFOM confirmed that evaluation depended mainly on reported numbers with limited field verification. DRM also observed that purchase orders were often unusually large and executed with minimal control, with distribution simply following instructions despite clear overstock risk. Triangulation therefore points to systemic weaknesses in culture, monitoring, and control design—particularly because budgeting and KPIs did not incorporate sell-out indicators.

Under the COSO (2013) framework, internal control at PT ABC is broadly ineffective. Leadership oversight is limited, responsibilities are concentrated, risk assessment

is not systematic (no formal risk register and no sell-out dashboard), and key control activities such as segregation of duties, layered authorization, and reconciliation are weak. Information flows top-down and tends to prioritize "good news," while monitoring is minimal, with limited independent review, exception reporting, or internal audit routines.

Similarly, PT ABC's DCS (Simons, 2000) exists formally but does not work as an effective early-warning system. Performance measurement and incentives focus heavily on volume, variance analysis is not timely or deep, and follow-up actions are slow—often taken only after overstock and returns become severe. Although RFOM provides monthly insights, corrective action is largely left to the Country Manager without strong oversight from top management.

Through the Fraud Triangle lens, the suspected channel stuffing can be explained by pressure (high targets and volume-based incentives), opportunity (weak segregation, approvals, and monitoring), and rationalization (push stock normalized as an expansion tactic). Overall, the case reflects not an isolated act, but an accumulation of systemic weaknesses in internal control and a DCS design that is not aligned with real market demand.

CONCLUSION

Findings show that PT ABC's internal control and Diagnostic Control System (DCS) are ineffective. The FY2024 sales spike did not reflect genuine market demand, but repeated, uncontrolled push-stock practices (channel stuffing), causing reported sales to misrepresent actual market conditions and creating an illusion of performance.

Using the COSO framework, all internal control components were found to be weak: the control environment does not provide a strong ethical foundation, authority and accountability are imbalanced, and the culture prioritizes targets over process integrity. Risk assessment is not performed systematically—especially for channel stuffing and sell-in vs. sell-out mismatches. Control activities are inadequate, evidenced by poor segregation of duties, weak multi-layer authorization, and insufficient data reconciliation. Information quality is also unreliable and non-transparent, while monitoring by both local and regional functions is limited, allowing early fraud signals to go undetected. The DCS is also poorly operated. Targets are set top-down without realistic market capacity assessment, and performance indicators focus mainly on sales volume, encouraging dysfunctional behavior. Volume-based incentives reinforce short-term orientation and create significant pressure on local management to achieve desired numbers. PT ABC lacks an effective exception review mechanism to detect abnormal sales patterns early, and corrective action is typically taken only after overstock becomes severe.

Viewed through Fraud Triangle Theory, the fraud can be explained by the interaction of: pressure (high targets and volume-based incentives—weak DCS), opportunity (weak internal control, especially lack of segregation and monitoring), and rationalization (push stock considered "normal" during expansion due to unreliable DCS). Overall, fraud did not occur spontaneously; it resulted from accumulated weaknesses in internal control and a DCS design misaligned with strategy, worsened by a culture that does not support transparency and accountability. In conclusion, strong internal control helps prevent fraud by reducing opportunity, while an effective DCS helps reduce pressure and rationalization—therefore, internal control and DCS function as complementary control systems.

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