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Understanding the Role of Bank Relationships, Relationship Marketing, and Organizational Learning in the Performance of People's Credit Bank

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Chapter 6
THE PROFILES OF BPRS' CLIENTS

This chapter addresses the second research question to explore the relationship characteristics of the clients and possible threat of discontinuity of bank-client relationships driven from exogenous factors such as external shocks and competitor moves and endogenous factors such as dissatisfaction. This exploratory study is a starting point to further discuss an explanatory analysis of the client intention model in Chapter 8.

Discussions in this chapter follow the course of relationship duration logic. It mainly focuses on (a) the start of a relationship through the first credit contract; and during the development stage of a relationship some events may occur such as (b) a possible threat to the bank-client relationship in terms of a disruption in the supply of credit e.g. credit tightening, loan rate volatility, etc., from the peak of the 1998 economic crisis; (c) issues in conjunction with exclusiveness, repeated loans, and monitoring; (d) incentives to protect possible credit risks through credit rationing, compulsory savings, and collateral; (e) various sources of value of bank-client relationships; ultimately approaching to a point in time of dissolution issues i.e.; (f) client re-joiners who have switching experiences, intention to leave and related threats from competitors' luring tactics, preventive measures, and a satisfactory level of BPR services. The intention to leave issue is a salient characteristic in this chapter.

These discussions are organized into five sections. They are section 6.1 Ownership, Management, and the Duration of Relationships; section 6.2 The Implications of the Peak of the 1998 Economic Crisis upon BPRs' *Clients*; section 6.3 Bank – Client Relationships; section 6.4 Relationship Marketing: Intention to Leave the Relationship; and section 6.5 Conclusion.

6.1 Ownership, Management, and the Duration of Relationships

In general, BPRs' clients consist of small micro businesses and low income households. However, in this survey almost all clients have small micro businesses by coincidence. The household respondents, including employees of some institutions, could not provide three types of duration variables relevant for the current analysis. Those who could provide valid answers consisted of 81 men (61%) and 51 women (39%).

The average client age is 44 with 25 as the youngest and 65 as the oldest age. Their education levels consist of senior high school or lower, which accounted for 84%, and those with associate degrees or higher for the remaining 21 persons (16%). All of them are owners-managers of their businesses and hence self-employed people. There are three important

variables which are related to the time or duration of bank-client relationships, (1) the duration (age) of the business; (2) the duration of running the business; and (3) the duration of the relationship with an incumbent BPR.

Table 6-1: The average figures of starting year and duration of relationships from three selected variables

No.	Entity	Business	Managing business	BPR Client
1	Starting year (year *)	1989	1990	1996
2	Age/duration (years)			
	a. Mean	14.6	13.8	6.7
	b. Median	13.0	12.5	6.0

Note: For this table the average starting year and age/duration is measured e.g., the average starting year of the client business is in 1989, hence the age (duration) of the business is 14.6 years up to July 2003. The client started the business in 1990 and started being a BPR client in 1996, etc.

Source: Field survey Note: *) figures are rounded up

Table 6-1 reveals the average year of establishment of client businesses was in 1989, the oldest was established in 1965, and the newest (latest) was in 2001. As per end of 2003, the average duration of the business operation (hereafter, age) is approximately 15 years with a median of 13 years. The period of 1990-1995 had the highest number of business establishments, 67 companies (54%). The distribution of business age is a right skew, with 89 businesses or 71% of the total number of businesses established from 1990 to 2001.

On average, a client-respondent, as a manager, has had to run the business since 1990, the earliest was in 1965 and the latest was in 2002. From 1990 to 2002, 95 out of 126 persons (75%) started their businesses. The average duration they have run their businesses is nearly 14 years with a median of 13 years. These average figures of both the age of the business and the duration the client has managed the business are closely related. These imply that the majority of businesses were most likely started by the owner. There is a strong correlation between these two variables, i.e. + 0.88 (significant at 0.00%). In such a way, they are supposed to know almost the whole history of their business.

The average duration of a relationship between the incumbent BPR and a client respondent is about 6.7 years (with a median of 6 years). The average starting year of a relationship with the incumbent BPR was in 1996, or 7 years after the business was established. The correlation between the age of the business and the duration of becoming a bank client is positive; although it is small, it is still statistically significant, that is 0.37 (sig. at 0.00). The time lag between the average year of establishment and the beginning of a bank-client

relationship signals important information about the risk of business failure around the start-up period. It may reflect a BPR's reluctance to grant a loan when a business is still young (new). The longest duration of a relationship started in 1982 and the most recent starting year was in 2003. In other words, the duration of a relationship was 1 year for the newest clients and 22 years for the longest ones. It is important to note that there are 134 clients that responded to the question about when they first started engaging in business transactions with the incumbent BPRs. About 10 respondents did not provide information about the year of business establishment and the duration of managing the business for some reasons, e.g. they probably could not remember to answer corresponding questions.

In addition to this, practical guidance in lending that have been widely published and applied in microfinance institutions, for example, only micro-businesses having been in operation for more than two years are eligible for some subsidized loan programs. Some BPRs may also use this guidance not only for subsidized loans but also for commercial loan rates as well. From empirical lesson should give the basis of BPR's lending policy. In other words, BPRs will likely reject credit applications from newly established businesses. As a consequence, the respondents are eligible to become BPR clients a few years after their businesses have been established.

The next important dimension of the relationship between BPR and its client is about who initiates the relationship. The BPR directors unanimously stated that they use a direct marketing approach generally known as "*jemput bola*" or, literally, actively catch the ball. This door-to-door approach shows that BPR actively initiates the relationship with the client. However, the facts paint a different story. 69 customers (57.5%) stated that they started the relationship by visiting the bank office. 46 persons (38%) were approached by loan officers to be customers of BPR, and the remaining 5 persons (4%) got recommendations from old bank customers. This survey may not fully represent the whole client population for at least two reasons, i.e. (a) the client samples were only drawn from several BPRs, those belonging to the case study members; (b) the clients are scattered within a 10 km radius of the BPR offices. Meanwhile, BPRs can serve their clients in a coverage area with a radius of about 50 to 60 km away. The closer the clients are to the BPR offices, the more likely they will initiate going to a BPR. Therefore, this phenomenon sheds light that direct marketing does not necessarily imply that the loan officers are always the initiators of relationships between BPRs and their clients. Chapter 5 has shown that loan officers make frequent visits to the doorsteps of delinquent clients rather than current-timely repaying clients.

The next section will elaborate further about the sequence of deposits and loan transactions and whether deposits precede loans or vice versa in the early years of a bank-client relationship. Common sense would say that clients would prefer loans first rather than deposits, except that loans are accompanied with compulsory savings that will show that savings and loan transaction events occur simultaneously. The reasons range from: (a) clients do not know the reputation of BPR where they will entrust their funds. They would like to avoid a possible banking failure where they may lose their money. Saving is a function of a bank's reputation that a bank should build over time; and (b) clients prefer to borrow from BPRs based on their needs and accessibility to them.

6.2 The Implications of the Peak of the 1998 Economic Crisis upon BPRs' Clients

Before proceeding to the core of the study in the next sections, this section will trace back to one disastrous event since the eruption of the economic crisis that led to the peak of the banking crisis in 1998. This shock paralyzed a vast majority of businesses and economic activities. This banking crisis episode was a period with the most hardships, especially for any commercial bank and its borrowers, as the banking crisis episode was widely reported through daily public news. Hence, little is known about the bank-client relationships between a BPR and its clients during this period where a threat to the relationship in terms of loan rate volatility, credit availability or credit crunch, durability of the relationship, etc., may be imminent. The following part will explore whether this shock disrupted the supply of credit from BPRs and threatened the durability of bank-client relationships from the point of view of client respondents.

The clients saw the peak of the 1998 economic crisis due to, among other things, the increase in prices of all available products in the market, the increase in interest rates, the shrinkage in market demand for their businesses, the shortages of funds available from commercial banks, etc. These consecutive events had put their businesses at risk and could have pushed them on the brink of financial ruin, except for those export-oriented businesses, which gained a windfall profit instead.

Based on the credit tightening issue, around 60% of the clients provided valid responses while the rest of the respondents had forgotten some precise events that took place about five (5) years previously. The valid answers show that most of BPRs' debtors, 69 persons (82%), felt there was no credit tightening in the period of the crisis. Only 13 persons (16%) believed so, while the other four clients felt they had easy access to loans. Those who remembered said

the tightening was in May 1998 (2 persons), June 1998 (6 persons), and July 1998 (2 persons). The experiences of BPRs' clients was different from those of commercial banks which performed tightening credit requirements or even turned down any new credit applications.

There are 80 client respondents remembered the interest rates applied to their loans, while the other 66 client respondents did not seem to care about the rates applied for their loans as long as they were able to repay installments regularly. Table 6.2 shows the distribution of loan interest as stated by the clients amid the financial crisis.

Table 6-2: Percentage of credit interest rate during the crisis period

No.	Interest rate % p.a.	Number of clients	
		Persons	%
1	24.00	1	1.3
2	27.00	4	5.0
3	30.00	24	30.0
4	36.00	28	35.0
5	42.00	15	18.8
6	43.20	1	1.3
7	48.00	6	7.5
8	60.00	1	1.3
Total		80	100.0

Source: Field Survey

As shown in Table 6-2, there are a significant number of clients, 24 persons (30%), who had a 30% interest rate p.a. and 28 persons (35%) with a 36% interest rate p.a. The average interest rate is 35.8% p.a. To judge how high the interest rate was in comparison to prior to the crisis or after the crisis, a reference can be made to Chapter 5. Is there any interest loan smoothing in the credit market of BPRs that proved the value of close bank-client relationships? Chapter 5 showed that interest rates of both loans and deposits set by BPRs are less volatile than interest rates set by commercial banks on their products (deposits and loans). This pattern implies that interest rates on BPRs' products are smoother[a] than those on commercial bank products for some reasons i.e., (a) commercial banks have been using a floating interest rate policy since the first episode of the banking crisis in 1991, far before the heavy financial crisis in 1997/1998. Meanwhile, until recently BPRs have not recognized or applied a floating loan interest rate policy for their debtors for a given loan contract. In the credit agreement it is mentioned that the interest rate remains unchanged until the due date; (b) in general, there is a common belief that BPR clients are simple people who have little knowledge about the fragility of the financial market and they prefer stability in their

contractual relationships; and (c) BPR is concerned that their clients are burdened by the increasing prices of things, so that they do not want to add to their problems by increasing interest rates as long as they can still survive.

Moreover, there are 56 debtors who think that the interest rate increase in the crisis period has no impact on loan installments, whereas 30 debtors think that it is burdensome. The second opinion of debtors has to be seen in the context of allocation priority of generated cash flow to fill their needs. In the crisis period, prices of primary (basic) needs of products skyrocketed immediately up to 100%, while their income might not have increased as fast as the increasing prices. Thus, the income which had been allocated to pay for the credit was diverted to pay for their most urgent basic needs, such as food and clothes. It is understandable that clients would feel burdened if the interest rate was increased as well, regardless of how big it was. Incumbent BPRs may set new interest rates that are a bit higher which are applied to any new loan contracts for both new and old clients.

The financial crisis has mixed impacts for client businesses. Some possible factors that may disrupt their businesses were asked to clients. The first two factors that were explicitly stated are the lack of credit availability and the shrinkage of their business market. Other options are open to clients' own answers. Out of those who remembered the hard time during the crisis, 47 persons did not have any difficulties in obtaining credit, without which it would have impeded their businesses, while 21 persons felt the bank loans somewhat affected their businesses. The latter should be interpreted carefully. They may be facing bigger financial distress whenever they have to repay loans as planned prior to the eruption of the financial crisis. The BPR clients in general were most likely affected by the financial crisis for at least two reasons: (a) they are not involved in an export-oriented business in which they lose their income source in real value for huge inflation erosion; and (b) those export oriented businesses have ample cash, since they were receiving windfall profits from the appreciation of their hard currency denominated as a source of income, while commercial banks remained to provide an export credit program with a loan rate far below the prevailing loan rate of BPRs. They certainly did not target the market of BPRs. While 44 clients perceived the shrinkage of their business market had somewhat of a negative impact on their businesses, the rest stated their businesses were significantly affected. Although some of them mentioned that other factors such as a lack of inputs disrupt their businesses, they consider market demand as the most important element of their business.

Above all, according to their repayment behavior BPR responded that the majority of clients, 66 debtors, pay according to the agreed schedule, while only 18 persons paid past the due date, and the rest have irregular payment patterns. The last group of clients may be temporarily in default due to a temporal inability to generate enough cash flow to meet all of their financial obligations as planned – but they are still willing to pay. This condition may signal to BPRs that clients are still committed to repaying the loans even in the worst economic conditions. It is important to note that this does not necessarily prove a fully genuine willingness of the clients to pay because in Chapter 5 it showed that account officers more frequently visit delinquent debtors to encourage timely repayment.

To sum up this section, there is a lesson to be learned that even during the most difficult financial time, the incumbent BPRs that are relatively stable are able to accommodate their clients' needs as if it were a normal period. Amid the peak of the economic crisis, the shock in the intermediary function of BPR was not the main source of the client business shrinkage. Therefore, a threat to break up the durability of a relationship is not imminent where both parties can 'lean against the wind', which may be driven by a survival instinct.

6.3 Bank – Client Relationship

In this section some dimensions of bank-client relationships will be explored ranging from the initial development of the relationship, the perceived value creation, and the monitoring phase in the course of the relationship building.

The start of the bank-client relationship and the chronic credit hungry phenomenon

One out of three assumptions underlying a guidance of rural finance (microfinance) institution development in Indonesia according to a Steinwand study (2001: 46, 309) is that the rural population has a "chronic credit thirst" and is too poor to save[1]. Is that reason still valid for the current situation?

By matching the year of first being a client to incumbent BPRs and the first loan received, the outcome shows that they'd be related to BPR for the first time through credit instead of deposit. It does not necessarily prove that they are credit thirsty clients. The reasons for this will be covered later. First, an analysis will be made to determine whether clients first

[1] Steinwand refuted the validity of the assumption by proving through empirical data even since 1934 – this assumption really does not match with the facts (see for example pp. 66 and 104). In general, BPR directors believe their clients are able to save in monetary or real assets. Two other assumptions are: (2) rural financial institutions can offer comparable services considerably cheaper that the usurious money lender, and (3) with the establishment of rural financial institutions the "cancer of usury" i.e., the money lender can be eradicated.

relate to BPR as debtors. Two "event" variables or indicators will be used in the analysis: (1) the first year becoming a client and (2) the first year receiving credit through BPR. These event variables can be used directly or transformed (recoded) into a duration. When there are no statistical differences in average values between these two variables, then the clients know or get in first contact with BPR through a credit transaction. In other words, the null hypothesis is (a) there is no correlation between the two variables or the correlation coefficient of the two variables is zero. It means that the initiation of a BPR-client relationship is not credit. Otherwise, client initiated BPR-client relationships through credit. The second analysis is (b) a paired sample test towards the average differences between the duration in becoming a client and the duration since initial loan approval up to 2003. If the difference is zero and statistically insignificant, it proves that the start of the bank-client relationship is through credit.

Table 6-3: The average difference between the duration of being a client of BPR and the duration of being a debtor

Paired Differences					t	d.f.	Sig. (2-tailed)
Mean difference	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
			Lower	Upper			
-0.05	1.171	0.111	-0.27	0.18	-0.405	110	0.686

Source: Field Survey

Therefore, if the null hypothesis of (a) is rejected will have the same meaning as alternative analysis of paired sample test of (b) is accepted. Out of the 111 valid respondents, the outcome of the correlation coefficient is 0.949 (sig., two-tailed at 0.000%) which means the null hypothesis is rejected. This hypothesis test is reexamined by a paired mean difference test in Table 6-3. The average time period of being a client is 7.2 years, and the length since becoming a debtor is 7.24 for n=111, with the following result:

The results of hypothesis (b) show that there is no significant difference between the duration of first being a client of BPR - the duration of first being a debtor. The average duration difference is (-0.05) with a 95% confidence interval of the difference, i.e. between -0.27 and 0.18 or the t statistic is small, as much as -0.405, with a significant level (2 tailed) of 68.6 %, which is much bigger than 0.025%, both of which show that the null hypothesis of this test is accepted. These two tests can simply prove that the start of a bank-client relationship is by coincidence through a credit transaction.

Hence, it can not be used to conclude entirely that SMEs & low income households are credit hungry and have no capacity to save, since in the course of a bank-client relationship there is proof that micro financial institutions can fulfill the credits from the savings of SMEs & low income households (see again Steinwand 2001). Clients are like BPR directors: they are risk adverse decision makers. They will minimize perceived or calculated risks given their expected return as much as the can. They are willing to put their money into BPRs only when they know the risk profile of BPRs – and hence they entrust their money in reputable BPRs to minimize the risk of losing money by avoiding possible bank failure[2]. They prefer credit to deposits not merely because of the fact that they need additional funds to run their businesses, but also because they are credit hungry. They may have a certain amount of money but they are reluctant to put it in BPRs until they know the risk profile. A deposit is like a loan portfolio of any BPR with the difference that before granting a loan a BPR has the right to investigate client applicants while a deposit owner has no right to do so. Therefore, it is a mater of a sequence of deposits and loan transactions driven by the perceived risks they can accept.[3]

Exclusiveness

Clients can maintain either a single bank (exclusive) relationship or have multiple bank relationships. Each type of relationship has different implications of possible benefits and costs of the relationship. The data shows that 108 clients (81%) have exclusive relationships with one BPR only and 25 clients (19%) have relationships with more than one BPR/MFI[b]. Empirical studies (Chapter 2) explain an exclusive relationship has advantages in term values but also has potential hold-up costs. Those clients who maintain an exclusive bank relationship may have little alternative sources of raising external funds, higher switching costs, and possibly banks extract rent from them. While those clients who maintain more than one bank-relationship may have greater bargaining power, more alternative sources of external funds, and lower switching costs. Then, it can be expected the first group of clients has a lower intention to leave the relationship than the second. The data corroborates this expectation, as there is a strong and significant correlation between the exclusiveness of a relationship and the intention to leave (r=-0.612, sig. 0.00). Furthermore, the potential risks of switching through a 2x2 cross-tabulation table of these two variables (exclusiveness and intention to leave) are

[2] One client in Biak, West Papua, was coincidentally found to save his money in a BRI Unit and applied for a loan from a BPR (in Chapter 9). In general, a BRI unit is more reputable than a newly established BPR.

[3] It true that some very poor people who need credit initially have no capacity to save, but as long as they have the opportunity to develop a business, they will be able to save in the future. The credit is just a discounted future savings – or surplus of income above their consumption needs.

explored. Therefore, the original response category of each variable is recoded into a dichotomy value (two categories), as shown in Table 6-4.

Table 6-4: Cross tabulation exclusiveness of relationships and client intention to leave

		Exclusiveness		
		Low (multiple bank/MFIs)	High (exclusive)	**Total**
Intention to leave	High	16	7	23
	Low or none	8	101	109
	Total	24	109	132

Source: Field Survey

Table 6-4 shows that among 24 clients who have multiple bank relationships (low exclusiveness), 16 of them have a high intention to leave. Those who have more than one bank relationship may have higher bargaining power. Therefore, they have alternative sources of financing and are highly likely to switch or have a high intention to leave. On the other side, among 109 exclusive clients, only 7 clients have an intention to leave. The 7 out of 109 clients reflect a potential future risk of defection. It is good news for BPRs that are able to maintain single bank relationships with their clients. The potential risk is low, in this case less than a 10% potential turnover (exit) rate.

Repeated loans

A bank-client relationship has more meaning as far as repeated loan contracts occurring within the course of a relationship. A repeat loan is a repurchase transaction within the duration of a relationship between a BPR and its clients. During the 6.7 year average duration of the relationship (Table 6-1), clients receive repeat loans at an average of 5.2 times (Table 6-5). It implies that BPR grants repeat loans once every 1.25 years. Almost every year a client receives a loan renewal. A strong correlation between the duration of a bank-client relationship and the frequency of repeat loans can be expected. There is a strong correlation between the duration and repeat loans of working capital i.e. 0.735 (sig. 0.00), while a correlation between the duration and repeat loans, both for working capital and consumer loans, is 0.643 (sig. 0.00). Only 3 clients have both working capital and consumer loans out of a valid response from 142

clients. No one has ever received investment loans. In general, every BPR allocates more working capital and consumer loans. Investment loans are the least offered. Nevertheless, it is actually expected that some clients receive investment loans. It could happen by chance that client respondents do not receive such investment loans for one reason or another. Further reasons underlying this phenomenon are not investigated.

Table 6-5: Average frequency of repeat loans during the course of the duration of a bank relationship (x times)

No.	Type of credit	Average	Std Dev	Valid answer
A	**Total clients of a conventional BPR**			
1	Working capital	5.2	4.0	122
2	Consumers	2.8	1.0	4
B	**Total clients of a conventional and sharia BPR**			
1	Working capital	5.2	3.8	142
2	Consumers	2.4	1.1	5

Source: Field Survey
Note : There is no discernable difference in the outcome of average and standard deviation of repeat loans from total clients in groups A and B.

Table 6-5 conveys the average repeat loan was 5.2 times with a standard deviation of about 4 times during the course of the relationship duration of both total clients of conventional BPRs only or for all BPRs – both conventional and sharia. Working capital credit is the most sought after, as it has a maturity date of less than one year. This fact is consistent with the macro or aggregate of BPRs in Central Java and Indonesia, that is working capital credit is the biggest portion.

Monitoring

Monitoring is an important stage in a credit circle within a bank-client relationship framework, especially in collecting, updating private information of clients to reduce asymmetric information problems, as well as persuading clients to repay loan installments punctually and in a full amount. Monitoring is a process where (a) an account officer visits clients; (b) has a particular method of visit; and (c) turnover may affect information gathering, processing, storing, and retrieval. Following discussions embrace these three aspects of monitoring.

Table 6-6: Location where an account officer visits during the monitoring phase according to clients

Location/place	never	occasionally	no clear pattern	frequently	always	valid response	average score
	Response category						
1. Business site	8	14	6	44	60	132	4.0
2. Home	12	18	7	45	42	124	3.7
3. Home-business site	12	16	10	36	48	122	3.8

Source: Field survey

Table 6-6 reveals the visits of account (loan) officers to the business site, which are considered as occasional visits by 14 clients, frequent by 44 clients, and always by 60 clients. The remaining 8 clients claimed that loan officers never visit their business sites and 6 clients recognize no clear pattern of loan officer visits. These figures, with an average score close to 4.0, also reveal the majority of clients claim the loan officers frequently visit their homes or home-business sites. These figures at least explain two insights; (a) most clients admit the direct and active approach of loan officers to them; and (b) some clients use their homes as their business sites[4]. Generally, loan officers follow the clients' preference to maintain a good relationship and cooperation with them. It is related with the personal views of some clients, as to minimize the negative opinion that the visit to the home/business site is to ask for a late payment. In fact, the meeting points are actually not limited to these three options. It means they can meet at any place they agree on.

The second aspect of monitoring is about the method of visit, which is either formal, casual, or both. A formal visit is a routine, scheduled visit when a loan officer checks on the progress of the business and takes some notes, while a casual visit is an unscheduled visit, where a loan officer only asks about the client's family or business and does no note taking.

Table 6-7 shows that the client respondents give a score of 2.5 i.e., between 2 (seldom) and 3 (irregular or no clear pattern) of a loan officer's visit. These figures disclose an irregular pattern of visits for both formal and casual visits of loan officers to clients. Therefore, clients tend to have varied experiences of a loan officer's visit, or the distribution indicates that the combination between formal and casual go together.

[4] It is a common pattern for micro and small businesses to operate in their residences having their "business site/office" under one roof as an efficiency consideration. However, recent developments show that medium and large sized businesses use a building for multi-purpose objectives: as a home-office, home-factory, and home-warehouse.

Table 6-7: Method of client visits during the monitoring phase according to clients

Method and objective of visit	Response category: never	occasionally	no clear pattern	most likely	always	Valid response	Average score
Method of visit							
1. Formal	36	31	25	39	2	133	2.5
2. Casual	24	50	45	24	0	143	2.5
Objective of visit							
3. Repayment collection	28	31	10	50	23	142	3.1

Note: These absolute figures in cells (except average score) represent the number of clients who respond to a question (method and objective of visit) in a given response category.

Source: Field Survey

The monitoring phase acts as a way of collecting the newest information and also to collect credit repayment. The average response score of whether the objective of the loan officer's visit is for repayment collection is 3.1, which implies an unclear pattern. It is important to know that generally the loan officer will behave according to local Javanese customs in that they will not directly ask for the payment, but will chat about clients' favorite topics for a while. As mentioned earlier, Javanese customs are still held highly by the lower level of the society in Central Java; for example, the hidden message is much more important than the articulated words. Thus, whenever a loan officer comes to visit and smiles to the client, it may be considered as either a signal of asking for the payment or simply to express respect to the client. This may be the source of the unclear pattern of a loan officer's visit to a client, because the purpose is for either repayment collection or just to maintain good relations based on clients' perceptions.

In addition to this information, as for the credit payment, 63 clients go directly to the bank office; 35 clients pay through a loan (account) officer, and no one performs bank transfers. Meanwhile, 38 respondents gave no answer. It is noteworthy that most client respondents live relatively near their BPR office; thus, it is still considered efficient to pay directly to the office[5]. It is common for a field loan officer to go as far as 60 km from the office, which lets clients within that distance pay the credit directly through the loan officer. They believe that the recognized loan officer will not misuse the money paid.

[5] The selection of these BPR client respondents is based on research budget efficiency. As compensation, the researcher visited clients living far away from the BPR with loan officers for 3 BPRs which were excluded in the sample, i.e. PT. BPR Phidectama Abepura which has clients in Jayapura (30 km), PT. BPR Phidecatam Biak located about 30 km from the town of Biak, where some clients live, and PT. BPR Ambarawa Hartasarana whose clients lived as far as Boyolali (60km).

The last element of monitoring is about a loan officer's turnover. A turnover is the change (rotation) of a loan officer who is in charge of monitoring the business relationship.

Table 6-8: Loan officer change (rotation) for the duration of a relationship with incumbent clients

No.	Loan officer change	Clients	%
1	Never change	53	38
2	Once	27	19
3	Twice	29	20
4	Three times	10	7
5	More than three times	23	16
	Total	142	100

Note: The average respondent score is 2.45

Source: Field Survey

Based on the above table, on average, loan officers change 2.45 times over the duration of the relationship. 53 (38%) respondents have never experienced any loan officer replacement, 27 (19%) respondents experienced it once, while the rest have experienced it two times or more. It means that during the 6.7 year duration of a relationship, loan officers change an average of two to three times. The correlation between the duration of a relationship and loan officer change frequency is R=0.415 (sig. 0.000%)

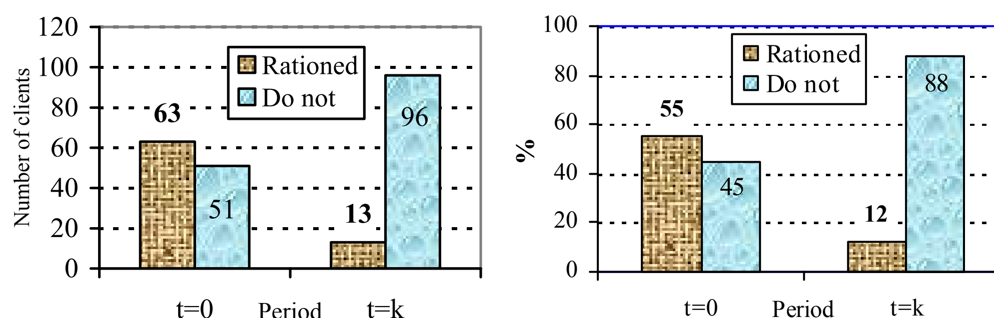
The loan officer represents BPR interests and any replacement of a loan officer may mean losing several clients' client information that are the previous loan officer's tacit knowledge ("soft information") which cannot be transferred completely to the new replacement loan officer. However, this low turnover may be a good signal for BPRs that are less likely to lose soft information from clients.

Credit Rationing

Out of 114 valid answers from client respondents, 63 of them have their credit rationed in the first application (t=0). While out of the most recent (t=k) loan contracts, only 13 out of 109 clients have their repeat loan proposals rationed. In other words, the credit rationing decreases from 55% to 12% along the duration of their relationship. The longer the duration of a BPR-client relationship, the less the rationed credit (see figure **Figure 6-1** below).

This data corroborates the existence of asymmetric information between BPR and its clients. Time t=0 is the beginning of the relationship building between a BPR and a new borrower where difficult asymmetric informational problems are inherently present

Figure 6-1: Credit rationing development of the clients at two points in time for the duration of BPR-client relationships



Source: Field Survey

. The BPR credit committee lacks information about the new borrowers. Consequently, the credit committee is unable to clearly differentiate between creditworthy and non creditworthy potential borrowers. Given that BPR has an objective function to minimize expected credit risk, it provides incentives to ration credit to the perceived high credit risks or perceived low credit quality (creditworthiness) of potential borrowers. As the credit relationship progresses, BPR accumulates more private and relevant information of its clients through loan monitoring.

The more BPR knows about a client's repayment behavior and underlying business prospects, the better the bank is in screening borrowers. In other words, attaining additional information during the course of a relationship gives BPR more discriminating power in selecting dishonest and honest repeat loan applicants through consecutive screening processes. In this survey, it happens along a time horizon after t=0 until a point in time t=k. It implies that the more the BPR learns about its customer repayment behavior, the less it will ration credit for old borrowers. The data shows a sharp reduction in rationed credit clients of about 80%, a decrease from 63 clients (t=0) to 13 clients (t=k)[6]. The asymmetric information problem can be traced from the fact that BPRs have least track record of client business prospects– hard information from clients. For the most recent loan applications, there are 95 clients who do not provide any written historical financial reports, and there are only 9 clients who were able to submit it when filling out their credit applications. The facts indicate that repeat borrowers who have relationships are considered to have good track records – fewer problems with asymmetric information, which makes BPRs more confident about their credit decisions. On the other hand, repeat borrowers have also learned not to propose loans for more than they actually need, as stated by 72 (63%) persons.

[6] The average duration of a relationship is estimated equal to the distance between t=0 to t=k, that is 6.7 years.

Table 6-9: Credit quality "migration" of clients between the beginning of the relationship, ex-ante (t=0) and recent period, ex-ante (t=k).

	Loan approval	Ex-post (t=k) Rationed	Not rationed	Unclear	Total
Ex ante (t=0)	Rationed	11	48	4	63
	Not rationed	2	48	1	51
	Total	13	96	5	114

Source: Field Survey

A further discussion about credit rationing is about the dynamics of credit quality "migration" as it is presented in Table 6-9. Incoming information from clients to BPR within the duration of a relationship is useful to revise ex-ante misclassification errors into new classifications of rationed and non-rationed clients. The Table 6-9(above) shows a revision taken by BPRs where two clients out of 51 formerly non-rationed clients "migrated" to become rationed clients. The BPR may realize its previous mistake and then make a correction of misclassification. It also happened to 48 clients that were previously classified as part of 63 rationed clients that "migrated" to become non-rationed clients. This table (above) at least proves empirical evidence that the BPR has done some corrective actions as new relevant information arrives and clients are aware of this treatment.

Compulsory versus voluntary saving

Out of the valid answers, 56 debtors (39.2%) admitted that there is no requirement to have a savings account, whereas 45 debtors (31.5%) said they were encouraged to have a savings account and the other 42 persons (29.4%) have compulsory savings accounts following a loan agreement.

Table 6-10: Voluntary versus compulsory savings as perceived by clients

		Savings category		Total
		Voluntary	Compulsory	clients
BPR category	Private-new	83%	17%	42
	PD-BPR	73%	27%	62
	Private-old	79%	21%	19
	Sharia	30%	70%	20
	Total	101	42	143

Source: Field Survey

Note: Five response categories of the question are recoded into two savings categories: compulsory and voluntary.

This linking between a savings and loan policy that covers a small portion of clients accounted for only 29.4% out of 143 respondents which triggers a question. Does having a compulsory savings account apply for all BPRs in the case study or does it apply only for a specific BPR? Table 6-10 shows both compulsory and voluntary savings exist in all types of BPRs. The biggest portion (70%) of compulsory savings accounts exists only in sharia BPRs. It can be expected having a compulsory savings is applied for a certain product, for example, in-group lending and individual micro loans. From the field survey, some board of directors members treat the compulsory savings as additional collateral under the name of frozen savings.

Clients are not allowed to withdraw the savings until all loan obligations are fully paid. A micro loan is designed to assist poor clients who lack physical collateral. In addition to this, some directors believe that the poor must be taught to save, and they need to learn financial discipline. They have to learn to protect themselves against unforeseeable future risks.

For mature clients who already have a propensity to save in monetary or non-monetary ways, savings & loans are kept as separate entities, and therefore BPRs offer voluntary savings for them. BPRs can provide different types of loans appropriate for their needs.

The pattern shows that the BPR management who consider debtors as undisciplined will create a bond in credit and compulsory savings. Compulsory savings can also be treated as protection against the liquidity risk of clients and risk of default (collateral) to BPRs. Another pattern of BPR management is based on the view that clients or client candidates are in a mature stage that they can manage themselves with their cash flow; thus there is no need to discipline them. Clients are free to choose whether to open a savings account or not when they sign loan contracts.

COLLATERAL

Credit rationing acts as the first preventive measure to minimize credit risk, while collateral is similar to that but has a different role against the risk of default repayment. BPR has the right to sell any collateral that, in general, has a greater value[7]. Table 6-11 shows that land title certificates and car & motorcycle ownership certificates dominate the different types of collateral. They cover almost 70% of all collateral types. Other (the fourth) collateral types are comprised of letter of employment contracts, letter of pension contracts, kiosk right

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[7] The market value of collateralized assets is about 125% of loan principal, while a compulsory savings account is an accumulation to a certain % of monthly repayments or interest payments (e.g. BRI imposes a 25% interest rate as a credit risk protection or incentive for timely repayments).

certificates, and group collateral. In general, the first type of collateral isn't as risky as the second type, while the fourth type of collateral is the riskiest entity.

Although existing literature classifies collateralized loans as secure loans, it does not imply that it can be applied to the BPR case. For example, a land title certificate is not always owned by the borrower, as it can be owned by someone else, i.e.; owned by the borrower's family or a close friend.

Table 6-11: Types of collateral provided by borrowers for the most recent loans they have received

No.	Types of collateral	Clients	Percentage
1	Land title certificates	57	39.0
2	Car & motorcycle certificates	36	24.7
3	Combination of 1 and 2	7	4.8
4	Others	46	31.5
	Total	146	100.0

Source: Field Survey

Problems normally arise since there are weaknesses in the judicial system and law enforcement, especially in terms of uncertain time and transaction costs. The next issue deals with moveable assets, such as used cars and used motorcycles that are exposed to some risks of (a) damage and a faster depreciation of their worth; (b) their marketability is constantly threatened by new innovative cars and motorcycles and an increase in oil prices[8]; and (c) there is a possibility of some fake certificates.

Value of a bank relationship

Section 6.2 explores the value of a bank relationship under the threat of economic shock, while here much attention is given to values of a bank relationship in the aftermath of the crisis or in 2003 when economic conditions started to improve.

First, a progressive lending policy is one value source of a bank-client relationship. There is evidence of a 'policy' of progressive lending from incumbent BPRs. It is supported by client responses that 91 (82.0%) agree and 3 (2.7%) strongly agree with the statement that BPR has a progressive lending policy or provides an opportunity to increase the principal for the subsequent credit application. Only 10 clients perceive the incumbent BPRs as not offering progressive lending and the rest have no idea about this topic of interest. To get a better idea

[8] The price of oil is adjusted to market price in order to reduce government subsidies. For example, the price of premium oil has been adjusted over time i.e. Rp. 1,000/liter (in 2000), Rp. 1,650/liter (in 2003), Rp. 2,400/liter (in 2004), and Rp. 4,500/liter (in 2005). Each price adjustment creates a temporary shock of general price movement that hurts such markets of second hand collateralized assets.

about progressive lending, Table 6-12 shows an increase of average loan size from Rp. 3.38 million/person to Rp. 9.26 million/person or the estimate of its real value becomes Rp. 3.7 million consecutively from the first round to the most recent loans they receive.

Table 6-12: Average year and credit for first and last credit received by customers

No.	Category	Year receiving credit	
		First round	Most recent
1	Year (average)	1996	2002
2	Credit (Rp.-million)	3.38	9.26
3	Index (assumption)	100	250
4	Real credit (Rp.-million)	3.38	3.70

Source: Field Survey

It is a generally accepted implicit conditional contract ("gentlemen's agreement") that a progressive loan or loan increase is reserved for only a relatively high grade of repeat borrowers. Researchers see it as a dynamic incentive, in the form of access to bigger loans. Hence, a repeat loan can be seen from two points of views but within the same context, creating value for both BPRs and their clients. From the BPRs' point of view, progressive lending creates bigger sales opportunities and potential income. While from the clients' point of view, this arrangement is an incentive along with increasing the potential need of financing for their potential business growth. This phenomenon implies that future loan size is determined partly by recent repayment behavior. Those clients who repay regularly on time and for the proper amount will be entitled to future loans of a larger size, which will otherwise terminate the threat of them being strategic defaulters. In addition to that, Martinelly (1997) presents a simple model relating firm age with firm size and access to credit markets. The model predicts that the length of the credit history of a firm will be positively correlated to the size of the loan it can get from lenders. A new firm is risky because a lender does not have any time to accumulate observations about them. The next value sources of bank-client relationships may arise from the terms and conditions of a loan contract

Table 6-13 shows the responses of repeat borrowers upon potential value (benefits or privileges) of their relationship with BPR. Less than 25% of the clients positively responded to the first four out of seven potential sources of value. Only three sources of value are beneficial for approximately 40% of the clients. The latter includes one dimension of progressive lending, the shortest processing time, and easier negotiations. The low average scores (below 3.0) of client perception, according to all possible sources of value, implies that clients are less likely

to receive value from a certain source. Most clients do not get interest rate reductions during their loan relationships.

Table 6-13: Response of client respondents of possible value creation (privileges) on terms and conditions of credit

No.	Possible source of value	Agree and strongly agree		Valid response	Missing	Average Score
		Clients	%			
1	Lower interest rates	29	21	139	7	2.53
2	Longer tenure	25	18	139	7	2.46
3	Lower collateral	19	14	139	7	2.39
4	Flexible installments	30	22	138	8	2.55
5	Easier in proposing an addition (increase) of principal	50	36	140	6	2.82
6	Shorter processing time	56	40	140	6	2.89
7	Easier in negotiating	63	47	134	12	3.08

Source: Field Survey
Note: Point 5 is one dimension of progressive lending that has been previously explained.

As stated previously in section 6.2 about interest loans, BPRs tend to keep loan interest rates fixed at a certain level for a limited period. It looks like an interest rate smoothing phenomenon. The BPRs do not compete with other banks through interest rates, but through other means, such as speedy credit approval. No data is available to prove whether the clients are in a captured or held up position, so that an inflexible interest may reflect a rent extracted by incumbent BPRs during a decreasing cost of loanable fund. However, it is proven that in general BPRs set a fixed interest for the duration of a contract with a client. In the event of a decreasing interest rate, only newly loaned contract clients are entitled to lower rates, and it does not affect earlier loan contracts.

Most clients (88%) consider repayment schedules to be rather inflexible. If BPRs allow flexible repayment schedules, they will run the risk of being disqualified by the supervisory body, Bank Indonesia (BI). Bank Indonesia will regard BPRs as not acting according to the prudential banking principles, which among others allows clients not to pay according to the repayment schedule. For example, BPRs do not provide flexible loan installments since it can increase NPL. An NPL increase means a decrease in credit quality which threatens BPRs' survival as viewed by Bank Indonesia.

Compared with the four sources of values, there are more positive responses to the last three sources of value. However, the positive responses are still lower than what BPRs claim. The BPRs' claims seem to reflect an over confidence where they have advantages in terms of

speedy loan delivery, are personal and flexible in negotiating when something goes wrong in implementing loan contracts, and offer increases in loan sizes to high grade clients. This gap of perception between BPRs and their clients may emerge from differences in expectations or terms of reference. Most importantly, both parties remain in close relationships where there are some possibilities to make necessary corrections of a problem in the relationship, which is beneficial to both parties.

BRI units are common BPR rivals. They have a popular strategy, i.e. interest rate reductions as an incentive for early/on-time credit payments. This strategy, however, is not imitated by BPRs as shown by the fact that 98 clients did not get any interest rate reductions for paying early or before the due date. BPR has chosen another strategy, in the form of fast processing in deciding to approve or reject a credit application. This is noticed by the client respondents. The average amount of time it takes for a decision to be made on a credit application is 3.2 days, with a modus of 69 respondents stating the processes involved in deciding on a client's credit status is 2.5 days, including the completion of the paperwork[9] and the collection and analysis of relevant information.

6.4 Relationship Marketing: Intention to Leave the Relationship

The duration of a relationship between a bank and its clients can be divided into two segments with three points in it. The duration of a relationship can explain the business cycle of clients, starting from the beginning of the relationship, the end of the relationship (for example, switching), and possibly rejoining the relationship. The first part of this sub-section is about the frequency of client switching experiences to other lenders, a client's intention to end the business relationship, a client's degree of satisfaction toward BPR services, and temptations from competing lenders and preventive efforts from incumbent BPRs.

The most prominent element of this study is about a client's intention to dissipate the business relationship, which has had little attention by researchers until recently.

Switching experience

Table 6-14 displays interesting figures. More than 81% (119) of clients have never switched to another lender during their relationship, and only 18.5% have experienced switching to another lender.

[9] For micro credit, a financial analysis of a client may be presented on only one piece of paper, either one front page or on both sides.

Table 6-14: Switching experiences of clients in the duration of a relationship

No.	Frequency of switching	Clients	%
1	Never	119	81.5
2	Once	17	11.6
3	Twice	8	5.5
4	Three times	2	1.4
5	More than 3x	0	0
	Total	146	100.0

Source: Field Survey

Most importantly, the correlation between the duration of the relationship and frequency of switching is very low and statistically insignificant (r= 0.038; sig. 0.654). It seems to contradict a previous study of survival analysis where the longer the duration, the lower the survival rate. However, it is a matter of research study methods where a survival analysis should be based on a longitudinal study of a given client cohort; and this study is based on short-term cross section data. A lesson to be learned from this data is the phenomenon of the switching and rejoining of 18.5% (27) of clients in the business relationship. A further explanation about client switching and rejoining a relationship will be explained in Chapter 9.

Beyond these 18.5% rejoining clients, a number of good clients may exit forever, for which there are no records available in BPR files.

Intention to leave a relationship

The loss of good clients due to switching to a competing lender may be driven by a failure of BPRs or loan officers to catch or ignore a client's signal about the intention to end the business relationship. The signal can be shown to BPRs directly or indirectly. Table 6-15 reveals a client's intention to leave a relationship.

Table 6-15: A client's intention to leave the business relationship

No.	Degree	Clients	Percentage
1	Low	120	83.9
2	High	23	16.1
	Total	143	100.0

Source: Field Survey

In terms of client number, almost 84 % of clients have a low intention to leave or are less likely to leave, and the remaining 16% of clients have a high intention to leave the relationship. The next section is concerned with whether past experiences of switching provoke a client's intention to leave.

Table 6-16: Switching experience and intention to leave 2x2 cross tabulation

		Intention to leave		
		Low	High	Total
Switching experience (recode)	No	111	5	116
	Yes	9	18	27
	Total	120	23	143

Source: Field Survey

Out of the 116 clients (Table 6-16) who have no switching experience to leave a relationship, 5 (4.3%) of them intend to leave the relationship with an incumbent BPR. They can be either unsatisfied clients or attracted by competing lenders. Out of the 27 clients who have experience in switching, 18 (67%) of them intend to leave. This group of clients may have higher bargaining power or several alternative sources of external funds. In fact, there is a small correlation between switching experience and intention to leave, which accounted for 0.25 and is statistically insignificant (sig. 2-tailed is 0.209).

Client satisfaction

Normally, marketing management will put emphasis on client satisfaction to keep the retention rate high or the dropout rate low. Relationship marketing as a strategy has dissuaded clients from leaving BPR, especially good repeat borrowers. The BPR will give services to maintain client satisfaction to keep them loyal. Client satisfaction towards BPR's services is revealed in Table 6-17 (below).

BPR has mostly favorable responses. Of all the sources of satisfaction/dissatisfaction, clients feel satisfied in the services provided (the average score $\geq$ 4.0). The clients' responses do not vary that much between the service categories. The response patterns are inclined toward satisfaction for all personnel services. Of course, these evaluations do not explain all possible sources of satisfaction or dissatisfaction, such as from product type offered by BPR.

Table 6-17: Client satisfaction towards BPR's services in their relationships with BPRs

No.	Response category	Sources of satisfaction/dissatisfaction				
		Loan officers	Front officers	Security officers	Directors	Overall
1	Very disappointed	1	0	0	0	0
2	Disappointed	1	0	0	0	1
3	Average	8	16	17	10	8
4	Satisfied	111	107	105	108	116
5	Very satisfied	19	17	17	22	17
	Total # of clients	140	140	139	140	144
Average score		4.04	4.00	4.00	4.09	4.03

Source: Field Survey

Personnel are one of the important resources in the service industry. In this case, the human factor plays the most significant role in relationship building and maintenance of two-way interaction in a BPR-client relationship.

Temptations from competing lenders

As micro finance institutions are increasingly competitive, competitors are becoming more aggressive in luring clients to switch

Table 6-18: Client awareness of a competitor's effort (move) to lure clients to switch banks through some policy instruments i.e., terms & conditions of credit

No.	Response category	A competitor's instruments to attract incumbent clients									
		Lower interest rate		Less collateral		Longer tenure		Bigger principal / availability		Speedier process	
		n	%	n	%	n	%	n	%	n	%
1	Never	75	54	96	69	93	67	83	59	95	67
2	Sometimes	48	34	27	19	34	25	40	28	33	23
3	Doubtful/unclear	3	2	6	4	4	3	4	3	5	4
4	Often	14	10	11	8	8	68	14	10	9	6
5	Very often	0	0	0	0	0	0	1	1	0	0
Total number of clients		140	100	140	100.0	13 9	100	142	100	142	10 0
Average score		1.69		1.51		1.47		1.67		1.49	

Source: Field Survey
Note : n denotes number of BPRs

. Despite the lure, the majority or more than 50% of the clients think there aren't any competitors who offer them lower interest rates, less collateral required, etc. to switch banks

Table 6-18. reveals that 75 clients have never been offered lower interest rates, but they may be offered equal interest rates of competing lenders. Meanwhile, 48 clients were sometimes offered lower interest rates. The reset of loan terms & conditions displays a common tendency that competitors do not aggressively attract BPR clients, as indicated by the low average scores ranging from 1.5 to 1.7. The low average scores of these competitor instruments to attract incumbent clients means that clients feel the competitor lure intensity was low, that is under the response category of sometimes attracted by competing lenders. However, these facts give a strong signal to BPRs that a risk of potential switching through competitors luring current clients is present. Since competition in the microfinance market is high, competitors will always welcome and make offers to any potential clients, regardless if they have built relationships with other BPRs. Some BPRs advertise their products (loans and deposits) through local newspapers and by distributing leaflets.

Preventive efforts

It is argued that a client's intention to switch banks can be prevented if a loan officer anticipates this by negotiating the terms and conditions of the loan. The problem is whether a loan officer or BPR will do it or not.

Table 6-19: Loan officer efforts in preventing switching by negotiating instruments, i.e., terms & conditions of a loan and others as perceived by clients

No.	Response category	Negotiating instruments											
		Interest rate		Collateral		Tenure		Principal		Free to leave		Personal approach	
		N	%	n	%	n	%	N	%	N	%	n	%
1	Never	131	94	134	96	137	98	133	96	133	91	99	69
2	Occasionally	8	6	4	3	1	1	3	2	3	2	16	11
3	Doubtful	0	0	1	1	1	1	2	1	2	1	2	1
4	Frequently	0	0	0		0	0	1	1	1	1	27	19
5	Always	0	0	0		0	0	0	0	0	0	0	0
Total clients		139	100	139	100	139	100	139	100	139	100	144	100
Average score		1.06		1.04		1.02		1.07		1.07		1.7	

Source: Field Survey

Table 6-19 reveals that the clients tended to refuse a loan officer's efforts to initiate negotiations. The majority of the clients chose to answer: "never" in the response category of all negotiating instruments. This phenomenon discloses some possible conditions, such as: (a) the fact that the client respondents mostly (approx. 80) do not have experience with switching and about 84% do not have any intention to switch; and (b) BPRs may simply ignore switching or let clients switch as long as the number of clients and outstanding credit increase day by day. The BPRs may consider the switching behavior to be still at an acceptable level. However, if the switching behavior surpasses the acceptable level the BPRs may start making barricades and efforts to prevent it. This has started to be true since the emergence of Danamon Simpan Pinjam (DSP) – a commercial sub-branch bank of Danamon that has moved into the microfinance market. As a result, most of the regional chiefs of BPR associations made outcries to Bank Indonesia to protect BPRs, so their clients would not switch to DSPs. With increasing competition, it is possible that commercial banks and microfinance institutions will enter the sector, which would most likely result in a shift of clients' answers which would put BPR at risk.

6.5 Conclusion

The client respondents are owners-managers, self-employed persons with an average age of 44-years-old. Most of them have managed their own micro or small businesses since the businesses were established. A one-year discrepancy between business establishment and beginning to manage signal there are some inherited businesses from their predecessors.

Either clients or BPRs can actively initiate their relationships. It seems a bigger proportion of clients in the sample initiated the relationship due to the closer distance between the client's business site and the BPR location. However, it does not necessarily eliminate the uniqueness of the direct marketing approaches used by BPR through a loan officer by going up to the doorsteps of the clients, especially during the monitoring stage. After a client's business is in operation for a number of years, an average of 7 years, either clients or BPR will initiate a relationship. This time lag between the year of establishment and the beginning of the relationship is a start up period and perceived as a risky period for the client's business with a high probability of failure. However, some BPRs may apply practical guidance when a relationship starts after a client's business age is at least two years. Hence, clients who are lucky enough can sign a loan contract earlier than the 7 year time lag.

During the peak of the 1998 economic crisis, most clients felt that there was no credit tightening, with less volatile interest rates than those in commercial banks. It looks like a loan smoothing policy to help clients intentionally. However, it may simply be that BPRs have not

been applying floating interest rates for a given contract as opposed to commercial banks that applied floating interest rates for borrowers since the first episode[10] of the financial crisis in 1991.

BPR may adjust interest rates for newly signed contracts for either new clients or repeat borrowers. Clients consider a decline in market demand of their businesses to have a bigger impact on their businesses rather than a lack of credit.

The average beginning of the bank-client relationship was in 1996; the earliest was in 1982, and the most recent was in 2002 through a credit contract rather than deposit. It does not automatically verify the existence of "credit hungry" clients. Clients will try to minimize their risk of losing money from their deposits to BPR by first checking on the reputation of BPR before they begin their relationship.

During the development of the relationship, most clients (around 80%) have exclusive relationships with one incumbent BPR only. There is a strong correlation and statistical significance between exclusiveness and intention to leave, where the higher the exclusiveness the lower the intention to leave the relationship. This may signal that the clients have limited sources of external funds, lower bargaining power with BPRs, and higher switching costs. During the 6.7 year average duration of the relationship, clients received an average of 5.2 repeat loans or loan renewals on almost a yearly basis. The monitoring stage plays an important role in loan renewal, especially about the opportunities of BPRs to reduce asymmetric information problems and to improve credit granting of repeat loans accordingly. Most clients have seen that loan officers visit either their homes or business sites, with a mixed approach of formal and informal visits for either information gathering or repayment collection. On average, a loan officer is replaced two or three times during the course of a relationship between BPR and clients

From BPR's point of view and a secure lending perspective, credit rationing and having a compulsory savings account and collateral are considered as layers of protection against credit risk regardless of whether the client is aware of it or not. From the beginning to the most recent bank-client relationship, credit rationing decreases from 55% to 12% of clients. Repeat borrowers have better track records in their businesses, or softer, private information transfers to BPRs. This allows BPRs to reduce asymmetric information that eventually increases BPR confidence and increases discriminating power to distinguish between creditworthy and non-creditworthy clients. This leads BPRs to make a revised misclassification error where there is a migration of some rationed to non-rationed clients or vice versa. Repeat borrowers learn not to apply for more credit than they actually need. According to clients, compulsory savings accounts are present in all types of BPRs but in a lower proportion than voluntary savings

[10] Occurred during tight money policy, and the second episode of financial crisis was in 1997-1998.

accounts, except in sharia BPRs. Collateral mostly (around 70%) consists of land title certificates and car and motorcycle ownership certificates.

Repeat loans are one of the long term bank client relationship characteristics and it should be driven by values of their close ties. However, only small portions of clients gain value from lower interest rates, longer tenure, and lower collateral requirements and flexible loan installments. Bigger portions of clients benefit from progressive lending policies, speedy credit delivery, and easier negotiations during clients' hard times. The latter do not match with most BPR claims, in which they claim speedy delivery, easier negotiations, and progressive lending are prominent BPR strategies to embrace clients. Most importantly, both parties remain in close relationships where there are some possibilities to make necessary corrections of inconvenience relationship which promote more benefits for both parties.

Finally, approximately 18% of the clients have switching experience and rejoin the relationship to incumbent BPRs. They are client rejoinders ("returnees"). Some clients should exit permanently regardless of what their reasons are. Nevertheless, there is not any data or studies about the magnitude of client exit. The clients also have a low (about 16%) intention to leave the relationship. However, there is a statistically low insignificant correlation between switching experience and an intention to leave a relationship. From a relationship marketing point of view, a high retention rate is one of the successful measures in maintaining long term relationships with high grade quality clients. The clients tend to be satisfied with BPR services and a lack of competitor intensity to lure clients may induce both to have low intentions to leave a relationship and the emergence of client rejoinders. By seeing these facts, the small efforts of switching prevention undertaken by loan officers can be justified.

END NOTE

[a] The empirical and theoretical point of view (chapter 2) provide two possible impacts of economic shocks on bank-client relationship. The economic shock may disrupt supply of credit to clients; hence it is a threat of the durability of bank-client relationship. This would be likely to happen when systemic banking failure lead to credit crunch. Ultimately, bank-dependent firms face a risk of financial distress. While other evidence show the other way around. Loan rate smoothing as one of the distinctive features of relationship lending by bank in response of economic shocks. provide empirical evidence that banks smooth loan rate in response to interest rate shocks (Berger and Udell,1992)

[b] It is comparable with the phenomenon that is described in relationship marketing literature (Jackson, Brabara: 1985 in Dwyer 1997) where customers consist of two major categories (a) always-a-share and (b) lost-for-good customers. The former category addresses to customers who fulfill their need from several vendor. They share their wallet to several vendors. This is identical with multiple bank relationship. The lost-for-god customers have made long-term relationship and commitment to a vendor. This is identical with exclusive bank relationship. These difference terms imply they are used in difference underlying transactions between parties.