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

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Chapter 5
THE PROFILE OF BPR AS A FINANCIAL INTERMEDIARY

This chapter addresses the first research question and will be a steppingstone to the fundamental analysis of Chapter 7. Essentially, this chapter is an exploratory analysis. That is why more of a statistical descriptive analysis is used in order to explain the profile of BPR as a financial provider under circumstances of complex and intense competition and abrupt environmental changes during the financial crisis and within diverse regulations and supervision systems. More importantly, the main interest of this chapter is to explore the role of a bank relationship, relationship marketing, and organizational learning that potentially affects the sustainability of BPR's performance in the financial market with asymmetric information. To start with, bank relationships, relationship marketing, and organizational learning per se are becoming separate disciplines recently. This study takes advantages of the cross fertilization of these disciplines and extracts their common dimensions relevant to this study as explained in section 2.11. Treating these disciplines separately is like leaving a jigsaw puzzle unresolved. The aim of cross-fertilization is to give more meaning to the jigsaw puzzle whenever each piece is placed in the right place. The language of research methodology (Chapter 4) then says the bank relationship, relationship marketing, organizational learning, etc. become the latent constructs or variables and some relevant dimensions for current BPR daily life stand for the measuring variables. Complementary variables are also integrated in the field research to enrich and give a deeper insight of BPR lives.

The sequence of the discussion to embrace all of the scopes of interest are covered in several sections. Section 5.1 reveals some aspects of ownership, management, and control that are important for reputation building and ultimately enhance fund provider relationships with BPR. Section 5.2 shows an important aspect of social and location-dependent relationships as strategic instruments of BPR. Section 5.3 details external factors that potentially affect relationships between the bank and customers. It consists of two sub-sections: 5.3.1 about the microfinance market competition and cooperation to show the dynamic complexities and sub-section 5.3.2 as an inquiry into the resistance or stability of BPR as a financial intermediary during the peak of the 1998 crisis and its aftermath in executing its primary role as a financial intermediary. A lesson from empirical studies shows a financial crisis can lead to bank fragility that can potentially reduce the supply or availability of credit to clients. Sections 5.4 to 5.6 explore some dimensions of core concepts of the study of the bank relationship, relationship marketing, and organizational learning to get some insight to explain the possible value creation of both BPR and clients. These will support Chapter 7 and ultimately some conclusions about their role to reinforce sustainable performance and possible durable relationships with clients. The last section 5.7 explains the performance measures as seen by the board of directors. The performance indicators perceived by the board of directors are certainly different with those indicators that will be used in the analysis of Chapter 7, in which they are derived from BPR's recorded financial reports from June 1996-June 2003.

5.1 Ownership, Management, and Control

This section describes the corporate governance with special attention given to ownership, management, and control. This is related to bank relationships in a broad sense that cover both deposit and lending relationships.

Ownership

Since 1995, Bank Indonesia has required BPRs to publicly inform their semi annual financial reports biannually and mention the big, dominant shareholders from one to three persons/institutions in descending rank proportion of ownership[1]. To avoid costly publications, the report can be put on the announcement board of the office instead of in the newspaper. The field survey showed that not all BPRs put the reports on their announcement boards. It is unknown whether the report was not submitted, was not affixed, or was misplaced. Ownership concentration, in this study, is defined to be the proportion of equity owned by BPR's three largest shareholders- both institutional and individual. The principal-agency relationship theory pays attention to the existence of moral hazard problems and ownership concentration is a proxy for an alternative monitoring source to minimize the problem. The purpose of the ownership disclosure is to show the stakeholders which parties control the BPRs besides the board of directors (hereafter BODs) and commissioners. Controlling parties are those who are able to make strategic decisions that have the greatest effect on bank performance. By law, any failure of the bank is primarily under their responsibility. This regulation provides an incentive for the controlling agents to act in the best interests of all stakeholders.

[1] Obviously, BOD and commissioners of BPR are listed in the financial announcements as well.

Table 5-1: Distribution of BPR ownership structure by the number of owners as of June 2003

No.	Shareholders	Number of owners per BPR	Number of BPRs	The first three ownership (concentration)
1	Local government owned			
	PD BPR BKK	3	64	100%
	PD BPR BP	1	5	100%
2	PT BPR	>3	28	72.8%
		3	14	100%
		2	9	100%
		1	4	100%
Total valid responses			124	
No data			28	

Source: Survey data

Ideally, all BPRs should provide ownership data because by law the first three BPR shareholders should have been available on the announcement board at that moment the survey took place. This is a signal that at least 28 BPRs do not announce their semiannual financial performance on the announcement board. Table 5-1 shows that 28 PT BPRs are owned by more than 3 private shareholders, but the first three shareholders, on average, own 72.8% of total outstanding shares. The other 96 BPRs are owned by three or fewer institutional and individual shareholders. The 64 PD BPR BKKs are owned by provincial, regency governments and regional government banks (BPD)[2] with a normative proportion of 50%, 35%, and 15% respectively. In fact, some directors reveal that regencies and district governments put their shares ranging from 35% to 42.5% and 7.5% to 15% respectively. In addition to this, the regency governments have 100% shares of PD BP. From the business point of view, reputable shareholders make it easier for BPRs in collecting deposits from the community. Individuals or institutional shareholders having the biggest shares are normally those who possess high reputations in terms of their businesses and political positions. They have a wide range of relationships with many people of any social economic strata that have the potentiality to establish a bank relationship.

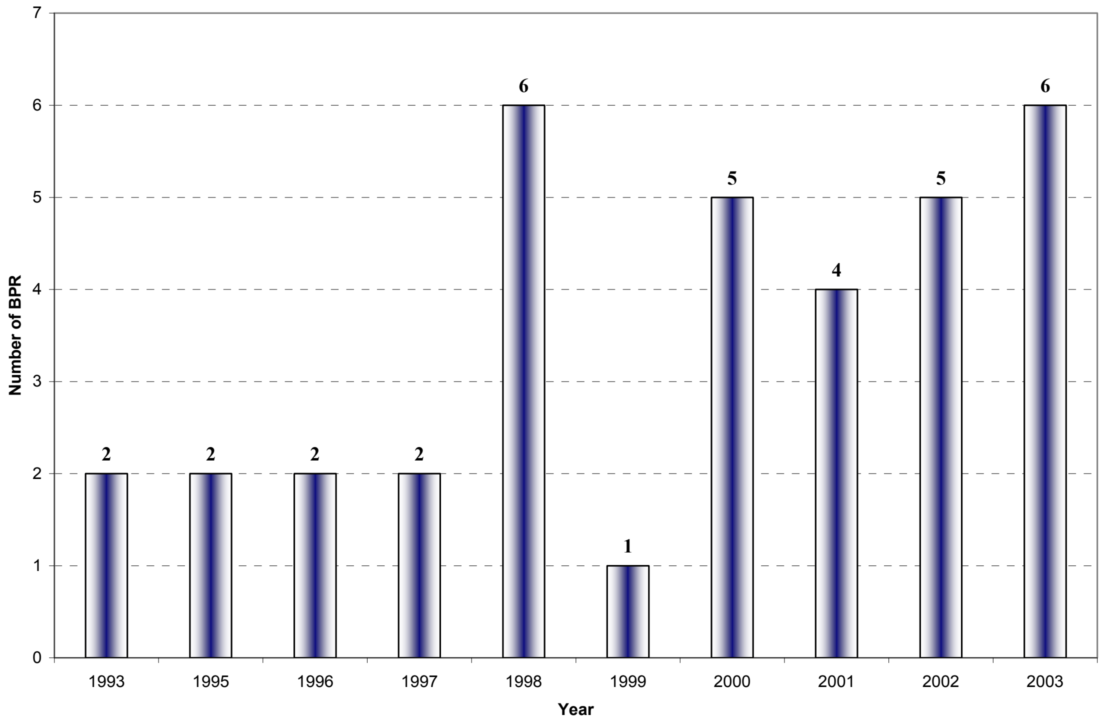
Changes in ownership

Changes in BPR ownership through takeover transactions are one of a bank's failures that need to be resolved to prevent business exit. Bank Indonesia Semarang persuades both shareholders of ailing BPRs and potential investors to negotiate about

[2] In fact, the provincial and regency governments are the BPD shareholders.

a possible takeover. This policy seems fruitful in terms of stabilizing the climate in a BPR business. The results reveal that Central Java province has the lowest exit rate of BPRs in comparison to surrounding provinces.

Figure 5-1: The number of BPRs categorized by a change in ownership or takeover event



Source: Survey data

Survey results reveal that 41 BPRs changed ownership or underwent takeovers, while 36 BPRs have not experienced any changes. The rest of 75 BPRs did not mention the changes of ownerships. There are two possible reasons from them:

(1) Particularly for 64 PD BPR BKKs and 5 PD BPR BPs, there have not been any changes since it is owned by the provincial regency/municipality government, as well as BPD. The local government owned PD BPR BKK has never been taken over by private parties. A change in ownership of PD BPR BKK might be regarded as a bad sign for local government performance. The solution offered by the local government for any unhealthy PD BPR BKK is to provide fresh money or liquidation.

(2) The 6 BPRs possibility is that the BOD does not know about the old ownership if the BOD is relatively new and did not study the history of the BPR beforehand.

Although the shareholders appoint some BODs, they may be involved during the negotiations and due delinquency processes among bidders and target shareholders. These BODs are supposed to know more about the history of the BPRs prior to the takeover event.

It is predictable that the period when many takeovers occurred was at the time after the crisis. 1998 and 2003 were two peak times for takeovers, as 6 BRRs experienced takeovers in each of these years, and the total number of takeover transactions from 1998 to 2003 was 33 out of 44 events (Figure 5-1). This sample may reflect the general situation of BPR in Central Java that in those years there were a high number of takeovers. It is important to know that several struggling BPRs and those in the process of a takeover were reluctant to fill in the questionnaire, and since there were also many incomplete answers, they were dropped from the sample. These kinds of BPRs were then considered as non-response rate.

Board of Directors

The modern finance theory suggests that separation between a manager (agent) and owner (principal) will create value for the company that will benefit the stakeholders by minimizing agency problems. This arrangement promotes a professional manager to manage a firm. Board of directors of BPRs are appointed by shareholders from either professional managers or one manager from shareholders. BPRs that are owned by the local government and a business group, shareholders tend to hire professional manager while the non-business group and privately owned BPRs tend to be owner-managers. Bank Indonesia promotes two professional managers for each BPR.

As managers, BPR's board of directors are chosen as respondents to represent BPRs. The board of directors may include one or two persons. When there are two persons, one of them will be called the Chief Director, while the other will be the Director. The questionnaires were not necessarily completed by the individuals who were supposed to fill them out, like the Chief Director or the Director, as in some cases they would ask their subordinates to do it for them. They would even ask their accounting staffs to fill in the annual financial statement questionnaires. Thus, in this explanation BPR's answers refer to the answers of the respondents, i.e. BOD. Out of 152 BPRs, 148 BPRs mentioned the name of the person in charge of answering the questionnaire, while the other four did not mention any name or position. Based on the answers given, 84 (57%) respondents mentioned the Chief Director as being the person in charge, while 64 (43%) respondents stated the Director was responsible. Most BPRs, 91 units or 62%, have only one person as the board of director while the other 54 (37%) BPRs have two directors. The average age director is 42-years-old, with a modus of 48 persons of 40-years-old. The youngest age is 25 while the oldest is 75-years-old. There are 120 (80%) males and 30 (20%) females; with an average educational level as university graduates (stratum 1).

Table 5-2: Formal educational background Board of Directors of BPR

No.	Educational background	Number	%
1	Senior high school	19	12.7
2	Associate degree (3-year diploma)	29	19.3
3	University graduate (stratum 1)	92	61.3
4	Master's degree	10	6.7
	Total	150	100.0

Source: Survey data

In 2003, Bank Indonesia made a regulation that at least 50% of the board of directors should have at least a formal educational level of an Associate degree (three-year diploma), which had been circulated 2 years previously. This forced most director of BPR who did not meet this requirement to study further at the nearest universities or at other higher educational institutions. That is why the average level of educational background is close to university graduate level. As shown in Table 5-2, 92 (61%) of the BODs are university graduates, which normally takes 4 years to complete 140- 150 course units (credits[3]).

The director has managed BPR for an average of 5.5 years, with the shortest amount of time being 1 year and the longest period being 34 years. It is noteworthy that the number of years of managerial experience is not the same as the experience of being a director. The director mobility may happen in inter-BPR or intra-BPR, within one group. Therefore, the experience in managing the last BPR is unquestionably less in average than the experience of being a director. For example, the director of PD BPR BKK may rotate several times, because of a promotion or lateral rotation to other PD BPR BKK. Thus, the experience of being a director BPR is more related to the experience in many BPRs, not only when becoming a director for the last BPR. Meanwhile, the average age of BPR is 21 years, ranging from 5 years as the youngest and 34 as the oldest. Those older than 15-years-old are old-style BPRs, i.e. those established before the financial and banking deregulations on October 28th, 1998,

[3] One credit unit is equal to a 50-minute class meeting.

including PD BPR BKK, which was established in the 1970s, and BPR, which previously acted as a market bank (*bank pasar*)**.** The BPRs that are less than 15-years-old are those established after the monetary and banking deregulation on October 28th, 1988, and known as new style BPRs.

The BODs are chosen to manage BPR based on corporate charter, which refers to the standard regulations of Bank Indonesia. Bank Indonesia limits the duration cycle of director members, for example 5 years, and the director may be appointed again through the annual general shareholders meeting. Therefore, there is no regulation that the director must be permanent employees of BPR. There is, however, no prohibitions regarding how many times individuals can be director, so that they can be elected continuously until retirement age. The problem that arises in changing the director is "does the newly appointed director act in the best interests of the stakeholders?" This is a typical agency quandary within the context of the principal (shareholder) -agent (director) relationship. Through organizational learning, BPR should be able to prevent this recurring problem. However, this research does not address this specific issue. The main relevant issue of this study is that the occurrence of management turnover is a potential loss to some parts of the organizational knowledge, especially the tacit knowledge in the memory of the director who is terminated or leaves her/his job. In fact, there is a low correlation ($r=0.103$; sig. two tailed, at 21.8%) between BPR's age and the duration of the director in managing BPR, which suggests that there is a tendency to replace the director several times during the operation of the BPR. This issue is a part of the organizational learning concerns for further elaboration in section 5.6.

Annual shareholder general meeting

As an instrument of control mechanism and organizational learning, the annual shareholder general meeting is a forum to present past performance, make important and strategic decisions for BPR, such as additional paid up capital plan, profit, and bonus distribution, director and commissioner election or selection, as well as organizing business plans for the future development of BPR. Shareholders will approve or disapprove of the director's annual business performance report. Shareholders learn whether the director made substantial progress during the previous year. Bonuses will be given to commissioners, BODs, and employees as long as BPR is earning a profit. This control is an incentive measure for the director to perform better for the coming year. Strategic and operational planning is one indicator of organizational learning, regardless of the degree in which decision process dynamics vary among BPRs. Table 5-3 shows how significant the annual shareholder general meeting is as one element of governance is in their business lives. Despite the fact that not all respondents filled in the questionnaires, the table (below) reveals that 84 (59%) BPRs hold regular annual shareholder general meetings, while 24 (17%) BPRs perform it almost every year. As a legal entity, the annual shareholder general meeting is a routine obligation.

Table 5-3: The occurrence of regular annual shareholder general meetings

No.	Response category	Number of BPRs	Percent of valid response
1	Never	4	2.82
2	Occasionally	23	6.20
3	Do not know	7	4.93
4	Almost annually	24	16.90
5	Annually	84	59.15
Total		142	100.00

Source: Survey data

Normally, these meetings are held in March or April. In fact, most BPRs have them between January and June, i.e. 73 BPRs, while 29 BPRs held their meetings between July and December. The more regular annual shareholder general meetings happen, the more likely it will promote good governance. One element of governance is transparency. The more transparent the BODs, the less likely they will try to conceal fraudulence and the better they will be in reputation building that can lead to better relationships with fund providers (depositors and creditors).

5.2 Social and Location-Dependent Relationships

BPR is also well known as a bank unit, a community bank and local bank in the sense that it operates independently as a business unit entity, close to the community it serves and in a limited coverage area. Locality can be seen from the geographical service coverage. By law, a BPR has a geographical operational scope limited to its administrative province. Unfortunately, the business coverage of BPR does not match with the administrative boundaries and diverse sizes of the provincial administrative areas. In fact, a wide variety in size (area) of provinces. For example, the West Papua, a single province before splitting into two of February 7, 2003, the geographical scope is 21,9% area of Indonesia or as big as Japan, while BPRs in

Yogyakarta province are located in smaller geographical coverage areas accounted for only 0,2% area of Indonesia. Meanwhile, BPRs in Central Java province is 1,7% area of Indonesia. The number of BPRs in the respective provinces are six, 590 and 60 units. In term of the size of the province, BPR in Central Java still have more possibilities to have branch offices than BPR in Yogyakarta. BPRs in the sample have a wide geographical coverage of services that are from six to 610 villages and from one to 107 districts, whereas the average number of administrative service areas is 49 villages and nine districts per BPR. However, there are BPRs that provide services for only one to three districts, i.e. 44 BPRs, while 44 BPRs provide services for 4 districts or more. The rest did not mention any area of coverage.

The main transportation vehicle for account officers[4] (AOs) is a motorbike. Credit AOs (loan officers) are generally men, who ride self-owned or BPR-owned motorcycles. The 137 BPRs provided valid answers as having an average of 6 motorcycles, 122 BPRs have from one to ten motorbikes for their AOs, and 15 BPRs have more than 10 motorbikes. Additionally, 44 BPR AO's use their own motorbikes for BPR activities, with an average of seven self-owned bikes per BPR. Generally, credit AOs have operational/working hours from 9:00 AM to 3:00 PM for the field visits to the doorsteps of their clients to either their places of employment or homes. In the morning, AOs go to their offices to plan the field assignment routes, which are for evaluating credit proposal for new applicants, loan monitoring to collect loan repayments. Then around 3:00 PM, they will submit their daily credit application results and regular (weekly, monthly) repayments or installments. However, for special cases such as delinquent credit, the AOs or team may come in the evening to see the debtors. The correlation between the total number of motorbikes and geographical coverage area is 0.921 (significant at a 0.01 level) meaning there is a strong, positive correlation. It implies that the larger the area the more AOs, and therefore motorbikes, with a larger geographical coverage area. The business scale of assets and geographical coverage area also has a strong correlation. This indicates that using motorcycles as a mobile means of transportation functions well in providing client services in their service coverage area. The credit AOs may reach a radius of 60 to 75 km[5] away from their workplaces in a day. The traveling AOs make an

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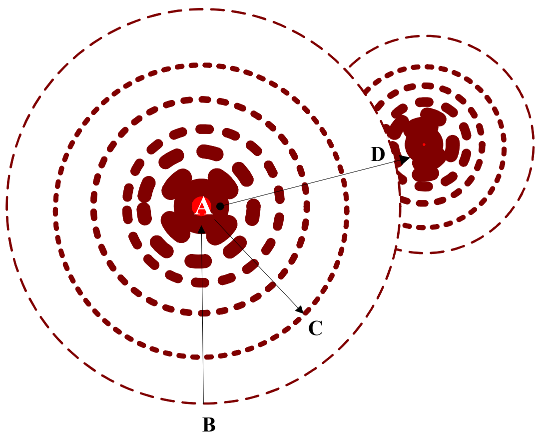
[4] AOs can either be responsible for loans and/or funds (deposit mobilization). AOs who are responsible for loans are loan officers.

[5] Since the 1990s, as BPRs consultant and commissioners of some BPRs, we have been indirectly undertaking observations ("longitudinal studies") regarding this phenomena. It can be concluded that the travel radius depends on several factors e.g. road quality, topography, vehicle quality, motorbike ownership and maintenance cost arrangements, span of control of AO to BPR clients and client concentration.

interrelated relationship network, which can be best described as a social and location-dependent relationship (Figure 5-2). The radius is a bounded range of effective activity or influence by BPR through the AOs. The farther the AOs have to travel, the less effective the activity. This will be elaborated in the Chapter 9 case study. The web implies a complex, interconnected structure of relationships and arrangements. The government and Central Bank failed to recognize this phenomenon, so that in the early stages of deregulation, they imposed location restrictions that actually went against this natural phenomenon of BPR business and hence the deregulation was less effective. The degree of closeness in a relationship between clients and BPR is not only determined by geographical distance, but also by the established social relationships of AOs and their clients' when they visit their houses or business places. For example, a BPR in Salatiga may have clients as far away as Boyolali, which is 30 km away, despite the fact that there are many microfinance institutions in Boyolali. Thus, BPR AOs in Salatiga visit their clients in Boyolali. The same trend occurs for BPR AOs in Delanggu, Klaten. They can reach clients all the way to Yogyakarta, which is 60 km away, while in Yogyakarta itself there are various microfinance institutions, such as BPR, BMT, KSP, and BRI Units.

Figure 5-2: Abstract of the social and location-dependent relationship of one BPR



Circle I (bigger web) is the head office's coverage area and circle II (smaller web) is the branch office.

a. The closer to the center (bank office), the higher the client density.
b. AOs know (have relevant information) about the local economic and social conditions; e.g. they know the "black list" enclave – which refers to the potential group of strategic defaulters due to a home of social deviant people, e.g. gangsters or head of theft, etc.
c. This spider web coverage is recently being used as a strategic tool by BPRs to expand their geographic coverage. Prior to opening a new branch, an AO is assigned to observe business opportunities within the territory or sphere, especially in the biggest growth area – client clusters. AOs normally have formal and informal relationships with local leaders, as they know more about the behavior/reputation of the majority of people in the surrounding area and have a certain degree of knowledge about economic development in the region. This does not mean that AOs always consider a leader's written reference when judging a client's characteristics in a credit investigation.

Hence, the degree of closeness between clients and a BPR can be measured by the geographical distance and social relationship. This shows the importance of studying the bank relationship process The mobility factor that separates it from commercial banks, except for the BRI Unit, is an important factor in the bank relationship. BPR pays for the transportation costs in their client visits; however, actually the clients should use their own funds to go to BPR. In business, the mobility cost is implicitly charged in the interest component. Clients of commercial banks will bear transaction costs arising form searching of lenders and repayment costs for their credit arrangements. These costs include transportation costs and opportunity costs of lost time for their businesses.

The web element includes a hub role mostly represented by a treasurer of a certain institution - a center of collection activity (a focal point of payment) who has an informal contract (relationship) with BPR[6]. The hub role is actually an extended part of an AO's function or even as "independent distribution channel" to extend loan of BPR. In return, he/she receives a fee from the bank as an extra income to himself/herself or more frequently the accumulated fees are distributed among individuals that help the job done. There is no a fixed rate of fee but rather a "black market price or fee". It depends on the negotiations between the bank and extended AO. The "extended AO" is mostly applied for consumer loans.

The extended AO phenomenon has been utilized since the presence of bank relationships through an institutional arrangement. There is a tendency for old BPRs like PD BPR BKK, etc. to have relationships with some governmental office treasurers or institutions to serve some government officials, while new BPRs establish relationships with some private businesses or social institutions.

Bank branches

As mentioned above, geographic expansion is a common phenomenon as a growth strategy of BPRs to achieve a bigger scale of business. Smart BODs do not assign their loan officers just to search for new loan applicants and monitor current borrowers but also give them leeway to seek feasible ways to open new branches to extend further their geographic coverage area. This strategy works well and even makes it easier to pass a proposal for a new BPR branch during the due diligence in Bank Indonesia recently.

There are 11 BPRs with 1 branch each, 2 BPRs have 2 branches each, and 3 BPRs have 3 branch offices each, 8 (62%) branch offices opened from the year 2000

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[6] It works also for commercial banks that are doing retail business. Recently, some BPRs have established relationships with motorbike showrooms to provide credit to buyers.

until 2003, while the other 5 branch offices opened before the year 2000. At the national level, a growth rate of BPRs' branch peak took place in 2001. Out of 152 sampled BPRs, 101 BPRs do not have cash posts, while the other 51 BPRs do have cash posts. The 16 BPRs have 1 cash post each, and 35 BPRs have more than 2 cash posts each. The 18 BPRs have opened their branches from 2000 until 2003. The small number of branch offices reflects the scale of the BPR. It can also be seen from the number of employees. An average number of 19 employees per BPR can be found with a modus of 9 employees for 14 BPRs, ranging from 4 to 180 employees per BPR.

5.3 External Factors Affecting the Durability of Relationships

The durability of a relationship is one of the important dimensions in the study of a bank relationship and relationship marketing described in Chapter 2. The durability of a relationship between a bank and its clients is likely to provide liquidity insurance, corporate governance, and facilitation in the availability of loans to borrowers – as sources of value for a bank relationship. The termination of a relationship implies losing these values of a relationship for both parties. The source of termination may arise from either bank failure due to a financial crisis or client exit who switches to a competing bank. Of course, BPRs are aware that some unsatisfied clients may switch to another bank because of internal factors as well e.g., unsatisfactory services. However, the following sub-section explanations are confined to some external factor dimensions that may affect the durability of the relationship: (a) competition and cooperation and (b) financial crises.

5.3.1 Business Competition and Cooperation

As mentioned above, one of the threats to the termination of a bank relationship is due to the competition in the financial or credit market. Clients may switch to a competing bank after being lured or stolen by a competitor bank, even though the clients may have been satisfied with BPR. The competitors' actions to attract good clients of an incumbent bank is done through vivid and provocative actions with direct sales promotions such as offering a takeover credit with a specific advantage. That is why an increasing sensitivity feeling according competition tension has been emerging within the BPR community. For this reason, BPRs can easily mention close competitors in their geographical working area. The following table details their common competitors.

Table 5-4: Number of BPRs and their competitors within their service area

Number of competitor(s)	Competitor name							
	BRI-unit	BPD	BPR-BKK	BPR	Pawnshop	KSP, KSU	BMT	Others
One	66	53	48	24	59	31	45	8
Two	32	6	15	16	2	21	15	1
Three	10	1	5	7	3	14	6	1
Four	2	0	3	10	0	9	3	0
Five or more	2	0	5	29	1	18	0	2
Total	112	60	76	86	65	93	69	12

Source: survey data
Note: The figures in the cells represent the number of BPRs pinpointing the number and corresponding name of close competitors.

Prior to explaining the behavior of the players in the microfinance market, the number of competitors recorded by BPR in their service areas should be observed first. Table 5-4 should be read comprehensibly; for example in the column BRI Unit, 66 BPRs each compete with one BRI Unit in their service areas, while 32 BPRs each compete with 2 BRI Units. In addition, in the BPD column, in their service areas 53 BPRs each compete with one branch office of BPD.

Table 5-5: Weight of competitors given by BPR for some selected MFIs in the BPR operating regions or service areas

		Weight of competitors			Valid responses of BPR	Average score
		Heavy	Moderate	Light		
Competing microfinance institutions	BRI-Unit	60	58	7	125	2.4
	BPD	53	6	1	60	2.9
	BPR	18	69	13	100	2.1
	KSP, KSU	8	47	49	104	1.6
	BPR-BKK	4	49	31	84	1.7
	Pawnshop	4	35	33	72	1.6
	Money lender	4	4	5	13	1.9
	BMT	1	28	53	82	1.4

Source: survey data
Note: The heavy weight of competitors means the strong advantages of competitors in comparison with the respondent-BPR. The bigger average score imply the heavier of the competitor weight

Table 5-5 also reveals that BRI Unit is the biggest (heavy) competitor for at least two reasons: (a) having national wide coverage and as the market leader, and (b) offering competitive interest rates (relatively low) compared with BPR. The 60 out of 125 BPRs, or 48% of respondent BPRs, consider the BRI Unit a heavy competitor.

It should be noted that the meaning of a service area is not the same for BPR since there are 2 interpretations: (a) the town where the head or branch office is located, or (b) all areas where the clients live. However, the answer to the question tends to refer to (a) Whenever asked about village and districts in BPR service areas, BPR tends to refers to (b) as the area.

Generally, BPR considers BRI Unit and BPD as their heaviest *and closest* competitors. BPD is a commercial bank owned by the provincial and municipal governments[7]. Meanwhile, the BRI Unit is a strategic business unit of BRI commercial bank, which is state owned. Other BPRs, including PD BPR BKK and non PD BPR BKK, as well as Pawnshops are considered moderate competitors. Moneylenders are considered competitors by BPR with a low competition level (score 1.9), whereas other microfinance institutions (MFIs) such as BMT are considered light competitors.

Up until the end of 2003 when the survey took place, the number of MFI players in the BPR service area was still considered normal by 84 (57%) BPRs. However, 40 (27%) BPRs stated that the number of MFIs in their service areas is abundant. On the other side, the saturation of MFIs' credit markets in BPR areas is considered normal by 63 (43%) BPRs. Meanwhile, 22 (15%) BPRs have felt the credit market saturation of MFIs and 38 (26%) BPRs stated it is not yet saturated; even 19 (13%) BPRs think the MFIs' credit market is still wide. The various responses from BPRs may occur due to the different intensities of competition in the different service areas. Both responses about BPR's density and market saturation were examined using a paired test for the number of cases of 42 BPRs. Although both indicators/variables have positive correlations, i.e. 0.167, it is not significant at the 0.05 level (2-tailed). Therefore, the increased number of players does not automatically increase the perceived market saturation.

Most recent competition has actually been more complex than in merely describing the players. The complexity of the competition may be seen from different points of view such as the coexistence of subsidized credit programs and commercial loans that have been distributed to same SMEs market segment. More importantly, a

[7] In the crisis, the state government performed recapitalization, which since then made the biggest shareholder the state government, and it will end whenever the local government has repurchased all the shares owned by the state government.

bank may offer subsidized and commercial loan at the same time that lead to "credit migration" from commercial rate credit to subsidized credit. According to subsidized credit program, a major regulation change occurred when act no. 23/1999 effectively began on May 17th, 1999. The act forbids Bank Indonesia from providing subsidized credit programs that were generally aimed at SMEs. Based on the regulation, there is a role switch of BI in the development of SMEs, i.e.:

1. Switching from a "Development Role" into a "Promotional Role".
2. The "subsidized loan" approach switched into an approach of research and development, training, information, and advisory assistance.

This change in BI's role made it encourage commercial banks to supply credit to SMEs. Commercial banks can interact directly with SMEs as well as through a linkage program, which provides credit to SMEs through cooperation with BPR.

As mentioned before in Chapter 3, credit extension from commercial banks directly to SMEs has created concerns among BPRs, since SMEs are their main target market. The most aggressive commercial bank is Bank Danamon, which has established Danamon Savings and Loan Units (DSPs). The DSP is a sub-branch office and in fact, Bank Indonesia grants the license easier than to BPR proposals to open a branch in terms of (a) time horizon and (b) location selection. This is why (a) the number of DSPs have increased sharply in a short period and (b) the BPR association (Perbarindo) claims that Bank Indonesia treats DSP too favorably. BPR's response towards commercial banks entering SME sectors before the Perbarindo protest letter was as follows:

Table 5-6: Perception of BPRs towards commercial banks (other than BRI-Units) joining the direct competition in the micro finance market

No.	Response category	BPR	%
1	Strongly significant	4	2.7
2	Significant	51	34.5
3	Normal	25	16.9
4	Insignificant	57	38.5
5	Strongly insignificant	11	7.4
	Total	148	100.0

Source: survey data

Table 5-6 reveals the various responses of BPR perceptions about the fact that commercial banks have penetrated directly into the SME loan market. The responses are relatively equal in mode as 51 BPRs think it is a significant problem; and 57 BPRs think it is insignificant, or not a serious problem that can shake up the micro credit market.

Related to the question is the concern of BPR towards commercial banks going into the micro credit market. By the end of 2003, the presence of commercial banks as BPR competitors in the micro credit market had not yet upset the BPR target market. 91 (60%) BPRs do not feel concerned, while 13 (9%) BPRs think they do not have to be concerned by the presence of commercial banks in the micro credit market. At that time, 37 (25%) BPRs felt very concerned. If the question was asked by the end of 2004, it may receive different answers. It is assumed that the number of concerned BPRs would increase due to the intense efforts of Bank Danamon in penetrating the micro credit market through Danamon Savings and Loan Units (DSP) or UKM Center Bank Niaga, etc.

In addition to the presence of commercial banks as a problem in the micro credit market, there is also subsidized credit. Although the subsidized credit created distortions in the financial market, 73 BPRs (52%) do not bother about it. with the 6% interest subsidized credit from state-owned corporations and local governments for SMEs. Distortions in the microfinance market exist and the switching behavior of SME clients is taken for granted in the business as usual.

BRI Units and BPDs as commercial banks get client deposits at lower rates than BPRs do. The general perception of respondents reveals that BPRs do not compete face to face with BRI Units and BPDs who have competitive (lower) costs of loan able funds. In general, BPR will compete by trying to make quick credit decisions for loan applicants, since loan officers are familiar with their clients. BPRs can make credit decisions in an average of 5 days[8]. Meanwhile, the most time or longest time used or length mode (time) of credit application process, i.e. from the application to credit decision is 3 days for 91 (98%) BPRs

Competition between commercial banks and BPR has been creating unprecedented tension. The BPR association (*Perbarindo*) has repeatedly addressed its complaints to Bank Indonesia. The association claims that Bank Indonesia does not treat BPR fairly compared with commercial banks. Bank Indonesia has launched a linkage program – a cooperation scheme between BPR and commercial banks to alleviate some of the tension. Yet, BPR has regularly cooperated with commercial banks since they were established. The survey discloses that some BPRs mentioned 1971 as the first time they started cooperating with commercial banks. Among them

[8] It includes paper work preparation such as filling loan application form, compiling copies of ID card, legal ownership letter of collateral, etc.

are PD BPR BKKs, which have been in operation since the 1970s, and BPR, which was initially established as Market Bank before 1970. In general, BPRs have had partnerships with commercial banks since 1995. At the time the linkage program was launched between commercial banks and BPR, there were some BPRs involved. The 55 BPRs out of 152 BPRs in the sample received funds ("credit") from commercial banks through one of three schemes (Table 5-7).

Table 5-7: The linkage program between BPRs and commercial banks by mode of operation schemes

No.	Mode of operation	Risk sharing	BPRs	%
1	Channeling	CB	19	34.5
2	Joint financing	CB and BPR	17	30.9
3	Executing bank	BPR	19	34.5
Total BPRs			55	100.0

Note: (1) Non-bank financial institutions, such as PT. PNM, is included in a linkage program by Bank Indonesia as well.
(2) CB = commercial bank. Practically, commercial banks tend to shift risks of all types of modes of operations arrangements.

The average interest rate borne by BPR for commercial bank funds is 15.2%, including administrative costs between 0.5% and 2%. The linkage program is a label to describe any types of loans from commercial banks to BPRs. This covers a wide range of transactions from subsidized loans – a credit program channeled through state owned banks and PT. PNM, the state owned wholesale financing company, to purely commercial loans that mostly come from privately owned banks. The credit programs have only a 7% to 11% p.a. interest rate, while commercial loans have about a 17% to 19% p.a. interest rate. Most BPRs, 34 units (59%), receive funds from commercial banks and PT. PNM under loan transactions. The rest of them show that commercial banks and non-bank financial institutions place the funds in BPRs in the form of savings. The latter implies that PT. Mitra Dana Jimbaran, a well-known wholesale finance institution that provides low interest financing to highly selective BPRs in the form of medium tem (two or three-year) savings to BPR, is also a fund provider. Some BPRs do not join the linkage program because they find it difficult to meet the requirements: 40 (59%) BPRs say that they can get cheaper funds from a third party.

5.3.2 Stability of Intermediary Functions at the Peak of the Crisis and During its Aftermath

The study of bank relationship usually includes the impacts of a crisis (e.g. Brewer et al, 2002) to the possibility of credit crunch followed by a change in credit allocation and possibly bank failures. Bank failures are problematic for clients, as clients have to search for a new bank and establish a new relationship with that bank while incurring additional transaction costs that could otherwise have been avoided. The clients expect stability or resistance from BPRs' intermediary functions even when an external factor strikes, such as a financial crisis, in order to ensure the durability of the relationship. Chapter 3 has shown that aggregate BPRs have proven their resistance to financial turmoil better than commercial banks during the crisis peak period. This study is not going to investigate the symptom, but several samples of BPR's stability indicators from the crisis. The micro level effects to BPR at the time of the crisis in maintaining its intermediary function through its relationship with its clients are detailed below.

(1) The deposit of a third party

The outbreak of the financial and banking crisis had immediate negative effects on deposits, especially time deposits, for two reasons: (a) clients were afraid that their deposits would be lost in the instable and non-government-guaranteed BPRs, or (b) the interest rates in commercial banks were more attractive than in BPRs. The first reason refers to the fact that a negative image of the banking industry collapse spread throughout the country in which the government blanket guarantee was applied unevenly between commercial banks and BPRs in some aspects. The most discernable aspects were that commercial banks had been benefiting from the blanket guarantee since early 1998 while BPRs started almost one year later (see Chapter 3). During this one-year time lag, it gave direct implications that aggregate BPRs should be riskier than commercial banks. The latter condition displays a market anomaly where commercial rates were higher than BPRs. Theory of portfolio investment (business finance) predicts that the "flight to quality" phenomenon should preside, where the depositors would tend to withdraw their deposits from BPRs characterized by low returns and high risks in 1998. The following explanation will address the question of whether this phenomenon exits in the BPR sample.

Out of 149 BPRs providing answers to the questionnaires, only 16 (11%) BPRs had experienced sudden big cash withdrawals. The other 133 (89%) BPRs did not experience any sudden withdrawals in large amounts. From those BPRs that experienced these large cash withdrawals, the average deposit withdrawn was Rp. 323 million/BPR with a modus of 12 BPRs that experienced sudden cash withdrawals averaging Rp. 100 million. The average time deposit per BPR withdrawal was Rp. 621.5 million with a modus of 7 (44%) BPRs making sudden withdrawals of Rp. 500 million.

That amount of withdrawal generally did not disrupt BPR for a long term and could be overcome so that it could survive. The withdrawal rush in BPRs did not seem to create a bandwagon effect like in commercial banks, because the nature of BPRs as local banks and their closeness with their clients helped to calm down their clients. In the crisis, the time deposit interest rate was raised to an average of 32%, as shown in the answers of 108 director respondents. The 67% of BPRs set 32% as the highest time deposit interest rate. On the other hand, BPR also might have chosen not to raise the time deposit interest rate and applied a penalty for depositors who withdrew their deposits before the due date.

From the answers of 120 respondents, the average deposit interest rate was 19%. The 70% of BPRs applied the highest interest rate of up to 19%. In the time of the crisis, several BPRs did not make any revisions in the interest rate, as there was a 13.8% deposit interest rate per year during the crisis[9]. The BPR's deposit interest rate did not rise significantly, since before the crisis the deposit interest rate had not reached 16% p.a.. BPR in general realized that depositors were more interest-oriented, or that they were sensitive towards the rate revision.

Table 5-8: Interest rates on savings and time deposit accounts as per June 2003

No.	Deposit type	Interest rate (%)		Plus prize?		N
		Average	Std. Dev	yes	No	
1	Savings	12.5	4.14	73	65	138
2	Time Deposit					
	a 1-month	13.8	2.57	51	74	125
	b 3-month	14.6	2.9	54	77	131
	c 6-month	15.7	2.93	56	76	132

Source: Survey data
Note : N denotes number of BPRs

Normally BPR raised the time deposit interest rate, but not as high as those of commercial banks which almost reached a peak of 60%. Depositors in BPR normally

[9] During the crisis, a 1-month deposit was preferred more than the other longer-term deposits. The role of having a close relationship between BPR and its clients is important to prevent client exit.

concentrate on the liquidity, i.e. easy to withdraw when needed or the compulsory deposits, which cannot be withdrawn before fulfilling the credit.

In mid 2003, when commercial banks had lowered the interest rate of deposit[10] interest rate from to nearly 7% p.a., the BPR sample still had an average deposit interest rate of 12% p.a. From the side of interest rates of both periods: the crises and the aftermath, it is clear that the interest rates of commercial banks is more volatile compared to those of BPRs.

Related to the 1998 crisis, the guarantee of commercial bank deposits began in early 1998 while for BPRs it was at the end of 1998. The one-year period at the peak of the crisis without any government guarantee was an unfortunate situation for BPR. Time deposit owners, knowing that their BPR deposits were not guaranteed, increased the perceived risk of depositing money in BPR. On the other hand, BPR offered lower interest rates than commercial banks. Those facts could be a good reason for time deposit owners to switch to commercial banks. The reasons are (a) the higher perceived risk of BPR than commercial banks and (b) interest rates/returns in BPR are lower than in commercial banks.

Table 5-9: The number of BPRs receiving subsidized loans: working capital credit and micro credit projects through Bank Indonesia by the size of the credit

No.	Size of credit (Rp. Million)	Working capital credit	Micro credit project
1	0-100	17	37
2	101-200	6	12
3	201-300	6	5
4	301-400	8	2
5	401-500	0	4
6	500 up	0	2
	Total BPR	35	62

Source: Survey data
Note: these subsidized credit programs extended through Bank Indonesia to assist BPRs' liquidity and provided loans to SMEs.

However, there were also some fortunes for BPR, as Bank Indonesia offered working capital credit for BPR as well as micro credit programs at that time, sourcing from ADB. Both kinds of credit acted to offset funds whenever a deposit rush (heavy fund withdrawal) occurred in BPR.

[10] The deposit interest rate in commercial banks is very constrained and strongly correlated with the Bank Indonesia Certificate discount rate. Since commercial banks set higher rates than Bank Indonesia, the government does not guarantee the deposits.

The moderately sound and very sound BPRs were entitled to get such credits. A number of BPRs met the requirements to replace the deposits, which might be withdrawn by clients, or to have extra funds with cheap interest obligations, jumped on this opportunity. The sample BPRs that took advantage of the opportunity are shown in Table 5-9. The table (above) shows that 35 BPRs obtained working capital credit and 62 BPRs received micro credit projects. Most received credit amounts of less than Rp. 500 million, with many of them receiving credit from Rp. 0 to Rp. 100 million. On average, the amount of Working Capital received was Rp. 179.24 million and Micro Credit projects Rp. 157.53 million (Table 5-10).

Table 5-10: Credit size of BPR receiving Working Capital Credit and Micro Credit Projects (Rp. 000)

No.	Credit size	Working Capital Credit	Micro Credit Projects
1	Minimum	12,000	12,000
2	Maximum	500,000	700,000
3	Average	179,240	157,530

Source: survey data

Note: the small minimum credit might be the balance of credit, not the obtained principal. Principal is much bigger than the figure mentioned in the table. Thus, the minimum credit is not accurate to estimate the amount of principal obtained.

The average credit received for working capital credit is bigger than the average of micro credit projects. However, the average principal of micro credit projects is bigger than the principal of working capital credit.

About 50%, or 31 BPRs, of micro credit project recipients are also recipients of working capital credit. There is quite a big positive correlation, 0.684, for BPR credit recipients, significant at the 0.01 level (2-tailed). It means BPR might receive working capital credit and micro credit projects at the same time.

(2) From the point of credit distribution

During the peak of the 1998 crisis, commercial banks tightened credits, not only the requirements but also stopped new credit applications. Commercial banks preferred that their debtors made early repayments in order to prevent more troubled credits being in default and to overcome a lack of liquidity. Meanwhile, only 19 (14%) BPRs tightened their credit accessability right away, while 46 (34%) BPRs carried it out in several phases. The most frequent answer (mode) is the policy of normal credit distribution, i.e. 65 (48%) BPRs (Table 5-11). Since BPR's target is

SMEs and low-income households, of which the occupants have a relatively low level of education, it would be difficult to understand if they raised the interest rate. This is supported by the credit agreement, which does not mention any section about floating interest rates, which may be raised at any time.

Table 5-11: Tightening credit expansion during the peak of the 1998 crisis

No.	Tightening	BPRs	%
1	Right away	19	14.1
2	Slow	46	34.1
3	Normal	65	48.1
4	Loose	4	3.0
5	Very loose	1	0.7
Total		135	100.0

Source: Survey data

For those BPRs that performed tightening, there are 25 (34%) BPRs that performed it for 6 months. The second mode is 18 (24%) BPRs, which performed it for 12 months. The average credit tightening normally continued for 8 months.

During the time of the crisis, a credit decrease occurred in 34 BPRs at an average of 28%, approximately Rp. 590 million. For those BPRs that did not answer, it may mean that there was no decrease or that they had never recorded the decrease. The inspection can be done based on the existing financial reports where there was generally no credit decline in BPR. However, the quality of credit may decrease, which can be seen from the non performing loans (NPL) where 82 respondents listed their average of NPL before and after the crisis. The average of the 1997 NPL is 11.6%, while the 1998 NPL is 13.2%. For BPR, the crisis started to have effects in 1998; thus, they had not yet experienced the crisis in 1997. Whether the increasing NPL differs statistically can be answered by the average test, based on the paired sample test. The results prove there was a disparity in NPL for the period from 1997 - 1998 is -1.5952 %, located in the bracket of 95% confidence interval of the NPL difference that is between -3.5531% and 0.3627 %. This means there is no statistically significant difference between the average NPL BPR in 1997 and NPL in 1998. This fact corroborates the macro level evidence that in general BPRs were not severely affected by the nationwide financial crisis in terms of interest rate stability, quality of loans and the spread between deposits and loan interest rates. Table 5-12 reveals the proportional change of BPR setting the interest is equal to or less than 36% p.a. and more than 36% in 1997 and 1999.

Table 5-12: The average of the highest credit interest rate at the time of the crisis in 1997 and 1998

No.	Interest rates (i)	1997		1998		Difference
		n	%	n	%	
1	i<=36%	74	58.3%	60	48.4	14
2	i>36%	53	41.7%	64	51.6	-11
	Total	127	100.0%	124	100.0	3

Source: Survey data

In 1997, 74 (58.3%) BPRs put the credit interest rate equal to or less than 36% p.a., while in 1998 most BPRs, 64 units (516%), fixed the interest rate above 36% p.a. Besides that, there is a strong, positive correlation with the coefficient correlation 0.840 and significant at a level of 1% (two tailed). The correlation test means that the BPR that fixed a high interest rate before the crisis or in 1997 also set a high rate in 1998. An average interest at 36 % p.a. or approximately 3% per month is considered a normal interest rate for micro finance institutions.

The average of the highest credit interest rate before the 1997 crisis was 39.5% and 40.8% during the 1998 crisis. Both BPRs and clients considered the change in the interest rate at 1.3 % as insignificant. However, statistically the difference is significant even with the significant level of 1% (two tailed), which means that the 1998 average interest rate was higher than the 1997 average interest rate.

Table 5-13: The average credit interest rate by the end of June 2003

No.	Interest (% p.a.)	BPR	%
1	24.0	22	16.1
2	30.0	52	38.0
3	36.0	32	23.4
4	Other	31	22.6
	Total BPR	137	100.0

Source: Survey data

Table 5-13 reflects the tendency for most or 52 (38%) BPRs that have credit interest rates at 30% p.a. The average credit interest rate is at 29.5% p.a. with a standard deviation of 6.04% p.a. From 1997 to 2003, loan interest rates decreased up to 10% for a few possible reasons: (1) the decrease in deposit interest rates from 19% to 14% and (2) the price competition in loan market became prevalent pushing the interest rates down. However, the prevailing loan interest rates remained high. Even when the deposit interest rates decreased from 18% (2002) to 12% p.a. (2004), the credit interest rate of BPR was still around 2 % p.m. to 2.5% p.m., or around 24% to

30% p.a. . Meanwhile, in commercial banks there was a drastic reduction of credit interest rate from nearly 35% p.a. at time of the crisis to nearly 12% p.a. It shows that the credit interest rate of commercial banks is more volatile compared to that of BPR. In other words, BPR has a lower risk of fluctuating interest rates than commercial banks.

It is noteworthy that BPRs in general do not apply the same interest rates for all clients for various reasons. The low interest rates may be applied due to a government subsidized credit program whose highest interest rate is limited (interest ceiling). For example, BPR applied a general flat credit interest rate of 1.8% p.m. together with a flat interest rate of 1% p.m. for clients receiving credit programs financed from government bond The cost of this program's credit to BPR is 11% p.a. and the BPR may sell it at a maximum interest margin of 9%, or the highest credit interest rate is 20% p.a. The credit program interest rate is based on the ceiling rate set by the government. Sometimes BPR applies a mixed pricing strategy, that is the market price and cost plus pricing. Almost 59 BPRs apply a market rate strategy in deciding the credit interest rate. Another 40 BPRs use a cost plus pricing strategy. The director of BPR or loan officer usually collects information about the prevailing market interest rate in the loan market for their segment.

The increase of both credit and deposit interest rates can affect BPR performance. Commercial banks experienced a considerable loss because of the negative interest margin or spread that is the credit interest rate is lower than the deposit rate. In 1998, commercial banks offered an exorbitant interest rate for deposits up to 60% p.a., while the credit interest rate only reached 40%. For the sample BPRs, 123 units (88%) did not experience negative interest margin or spread, while 17 (12%) BPRs experienced it, and the other 12 BPRs did not provide any information.

The economically disadvantaged BPRs in the sample experienced an average loss of Rp. 317.7 million from 17 BPRs having negative spread, and two BPRs having positive spread. Chapter 3 shows another possible cause of loss is due the increasing cost of loan loss provisions due to an unusual increase of NPL.

The asymmetric information problems faced by BPRs started when they wanted to perform credit investigations. However, BPRs in general already have a generic frame of reference to guide them in information collection during credit investigation. The frame of reference, among other, known as five generic credit investigation factors. The BPR can assign a weight of each generic factor in the credit evaluation. Below is the average profile of weight of five generic investigation factors for credit evaluation (Table 5-14).

Table 5-14: Average weight for five generic investigation factors for credit evaluation and client screening

No.	Credit investigation factor	Weight (%)		Valid answer (BPR)
		Average	Std. Dev.	
1	Character	30.0	14.1	133
2	Capacity	25.3	10.6	125
4	Collateral	19.2	10.4	129
3	Capital	14.9	7.4	118
5	Condition	10.7	5.4	96
	Total	100.0		

Source: Survey data
Note: the higher the % of the weight, the more important the investigation factor.

After sorting the weight, it is clear that character has the biggest weight at 30.0% out of total weight of all credit investigation factors 100%. Meaning of this of willingness of clients to repay (good character) is most important factor. The second biggest weight is the capacity or ability to repay. Both the willingness and ability to repay factors have obtained a total recoded weight averaging 55.3%. When a debtor has a fund source (ability) and willingness (good character) to repay, then the credit will not become delinquent, and for the BPR there will be no risk of NPL. This is not possible due to the uncertainty factor. The ability to repay may get better or even worse from time to time, as may a person's character. To measure one's character is not easy. A character is the manners and mental attitude that reflect a potential borrower's willingness to pay and should be traced back and retrieved from a "social memory" containing historical proof of that individual's attitude toward obligations and responsibility. There are 143 (95%) BPRs that perform investigations into a candidate's character through neighbors who are prominent public figures, established clients' references, etc.

Collateral is protection from the risk of delinquent credit and gets the third biggest weight. Another factor, capital and business and economic condition are related in evaluating the ability of a prospect's or client's capacity to repay.

5.4 Bank Relationships

As stated in section 2.3, the meaning of a bank relationship is the connection between a bank and its clients that goes beyond the execution of simple, anonymous, financial transactions. Most of bank relationship studies focus on relationship lending. From the MFIs' (here BPRs') point of view, the funding side is as important as a lending business within the framework of asset and liability management (ALMA).

The bank relationship in conjunction with the BPR role as a financial intermediary is explained in the subsequent section.

(1) Deposit relationships

The policies and strategies used to collect deposits vary among BPRs according to the local profiles of fund owners, the competition in the funding market, and the reputation of the BPRs. The PD BPR BKK group has a distinctive approach in its funding strategy, i.e., maintaining a close relationship with local governmental institutions and their civil servants, holding regular raffles to select prizewinners among depositors, and wooing institutional depositors that are considered as prime (big) customers. Prize incentives of saving deposits are commonly available in privately owned and "high class" or big size BPRs that they either provide themselves or in a joint cooperation with independent BPRs. One well-known incorporated prize incentive for savings account holders that is available in 29 BPRs in Central Java and Yogyakarta province is named TARA (*Tabungan Rakyat*, people's savings). Recently, the top prize was a minibus family car. Despite having prize incentives, most BPRs continue to offer higher interest rates than commercial banks. The average deposit interest rate offered by BPR ranges from 12.5% to 15.7% (Table 5-15). While at the same period, commercial banks offer rates as low as 7% to 8% and the almost homogeneous rates among them comply with the anchored rate of Bank Indonesia certificate to avoid being disqualified from the blanket guarantee scheme.

Table 5-15: Deposit interest rates as per June 2003

No.	Deposit type	Interest rate (%/p.a.)		Prize incentives
		Avg.	Std.	
1	Savings Deposit	12.5	4.14	73
2	Time Deposit			
a	1 month	13.8	2.57	51
b	3 month	14.6	2.90	54
c	6 month	15.7	2.93	56

Source: survey data

Table 5-15 also confirms that more BPRs (73 units) included prize incentives with savings rather than with time deposits. As a matter of fact, those prize incentives are mostly carried out by banks in the PD BPR BKK group.

Table 5-16: Rank of efforts to maintain or foster relationships and negotiations with depositors or funding partners.

Rank	Association	Hobby	Shareholders and commissioners	Informal leader	Prize, special rate
1	21	9	36	23	37
2	25	25	18	26	28
3	18	34	15	32	13
4	20	24	30	17	15
5	24	17	13	18	21
6	5	4	3	3	2
Total BPR	113	113	115	119	116
Average score	3.1	3.2	2.8	2.9	2.7
Rank	2.0	2.5	1.8	2.1	1.7

Source: Survey data

However, a savings deposit likely consists of a large number of account holders but with smaller deposit balances than time deposits. The survey discloses how the BODs cultivate close relationships with primary depositors, those having relatively big deposits and are loyal, through the following approach (Table 5-16). It shows the normal strategy of BODs to nurture relationships/partnerships with depositors or funding partners is based on the following priorities (ranks): (1) providing gifts, or special rates, (2) shareholders and commissioners (3) association: e.g. Perbarindo, (4) local informal leader and (5) informal approach in shared activities: hobbies, e.g. sports events for the Independence Day anniversary.

Table 5-17: Institutional rank as a BPR financial source, where one BPR can receive from multiple sources

No.	Institutional source of fund	BPR	Rank Avg.	Rank Std.	Since
1	KMK-PT.PNM/BI	38	3.2	2.74	1998
2	PKM BI/Bank Mandiri	68	2.0	1.43	1997
3	PT. Mitra Dana Jimbaran (Jakarta)	28	4.3	2.36	1998
4	PT. UKABIMA (Jakarta)	16	3.8	2.17	1997
5	Oikocredit (Jakarta, Netherlands origin)	8	5.1	2.17	2002
6	Pension Fund	14	4.7	1.82	1993
7	Linkage Program	44	2.8	1.85	1997
8	BPR	70	3.1	1.98	1992
9	Provincial/District Government	53	2.4	2.27	1975

Source: Survey data

Note: Some institutions such as PT. PNM, PT. Mitra Dana Jimbaran, Oikocredit, and PT.UKABIMA act as financial wholesalers to MFIs.

Big depositors or funding providers to BPRs are not only institutions but also individuals. There is a tendency for funding AOs to handle more small depositors, while middle or top-level management takes care of bigger ones. However, the personal approach is applicable to any kind of deposit holders.

Recently, some popular institutions, wholesalers or financial institutions, provide funds to BPRs. The survey asked the BODs to rank their fund suppliers and the results are shown in Table 5-17

The bigger the amount of funds entrusted by deposit clients in a particular BPR, the better BPR's reputation is which makes clients have more trust in it. Institutional clients normally deposit ample funds, while most individual clients start with a minimum amount of funds and increase it whenever they have greater trust in the BPR. For example, the trust can be proven when the bank has the funds available whenever the client wishes to withdraw them.

(2) Lending relationships

- **Individual versus group lending**

Although the worldwide accepted joint liability micro or small credit system has been a "trademark" of the Grameen Bank in Bangladesh recently, it was actually introduced in Indonesia by De Wolff in the early 1900s to MFIs in Indonesia (Steinwad, 2001). The joint liability of credit was adapted from the Javanese culture "*tanggung renteng stelsel* " (simply means joint liability). Hence, the term of "*tanggung renteng*" is easily recognized by most Javanese people until now, especially those who reside in the rural areas of Central Java, Yogyakata, and East Java. This group lending technology was reinforced in 1970 through the instant credit scheme (*kredit candak kulak*). Several pieces of evidence prove that this approach is not viable as shown in some studies (Lont, 2001; Steinwad, 2001; Ravicz, 1996). Nevertheless, considering the uniqueness of this lending approach that demonstrates the application of the bank relationship concept in SME financing, Bank Indonesia keeps this approach intact in promoting SMEs within the program "linking banks and self-help groups" supported by GTZ. This program devotes a group-lending approach to induce social collateral or joint liability.

. The field survey reveals the mixture of individual and group lending Table 5-18 reveals that group credit is for 88 persons per BPR and only occurs in 37 BPRs.

Meanwhile, the average individual credit is 1.674 persons per BPR. It means that only 24% of BPRs in the sample provide group lending and the number of clients in group lending accounted for only 5% of the total clients.

Table 5-18: Subjects credit recipients based on client and outstanding loan categories as per June 2003

No.	Client Category	Clients		BPR	Outstanding loans (Rp. million)		BPR
		Average	Std. dev.		Average	Std. dev.	
1	Individual	1,674	2,854	107	4,374	5,840	97
2	Group	88	156	37	600	2,060	30
3	Group number	17	37	33			
	Clients/per group	5	-	-			

Source: survey data

Although one BPR may have individual and group credits, many only give individual credits. In one group there are about five members with an average credit of Rp. 600 thousand (approx. € 55), while for individuals it is Rp. 4.37 billion (approx. 7.5 times more than group lending per client). Group lending with social collateral tends to only be able to survive when outstanding credit per client is small. Additional discussion about group lending is presented in chapter 9.

Asymmetric information and its implications

The existing study of bank relationships usually does not contain details information about clients business condition. Instead, some researchers mention information, such as, about the cash flow, prospects of the business or "soft information". In banking, the information is commonly divided into the management function as in Table 5-19. In general, the table (below) discloses that most BPRs admit that they only have limited information on new debtor candidates. For example, only 89 BPRs stated that 0%-20% of new clients possess financial reports. For most SMEs, BPRs do not expect a neat accounting report; instead it is mostly just a simple bookkeeping about cash-based financial transaction information, instead of an accrual basis of accounting. This information condition reflect the potential source of asymmetric information.

Thus, for production and marketing data, although available, it is not in the ready-to-use informative report form. In addition, a business plan may refer to a mere note on a business development plan, not a systematic feasibility study. Despite its simplicity, smart clients or SME owners are verbally able to explain their business plans. The tacit knowledge of SME owners, or clients in general, may be the cause of the asymmetric information. With limited information, BPR has to make risky credit decisions.

Table 5-19: The percentage of new debtor candidates having written information

No.	Availability of recorded information (best estimate)	Information category		
		Financial Reports	Prod & Market	Business Plans
1	0%-20%	89	70	79
2	20%+-40%	24	23	20
3	40%+-60%	17	15	19
4	60%-80%	7	25	12
5	80%-100%	2	4	6
	Total	139	137	136

Source: Survey data

Note: Best estimate means that these estimated figures are from loan officers and BODs estimation based on their experiences.

Having asymmetric information, the next point about a bank relationship is the clients' tendency to mention overstated credit, i.e. credit that is beyond what is really needed. They may intentionally conceal some information, so that they can propose a higher loan principal to anticipate possible credit rationing. By doing so, most likely they expect to receive the amount of the loan that matches their actual needs. According to BPR estimates, on average 21% of new clients proposed overstated credit. It means BPR found only a relatively few number, less than 25%.,of clients took advantage of asymmetric information.

There are various opinions about credit rationing, which is approving credit for a lower amount than what is proposed on the application form. 28% of BPRs disagree or strongly disagree with credit rationing for new clients, while 63% of BPRs agree or strongly agree with credit rationing. Of this amount, 75 (51%) of BPRs tend to agree and 17 (12%) of BPRs strongly agree with credit rationing. Mostly they agree with credit rationing for new clients. Therefore, credit rationing is the implication of adverse selection of loan applicants because asymmetric information is acknowledged by most BPRs.

Table 5-20: Estimated percentage of rationed new debtors

No.	% Rationed Debtors	BPR	Prop %
1	0.0 – 20.0	37	30.8
2	21.0-40.0	21	17.5
3	41.0-70.0	21	17.5
4	>71.0	41	34.2
	Total	120	100.0

Source: survey data

Table 5-20 shows the estimated number of rationed debtors with average rationed debtor is 48% of total applicants and standard deviation reaching 30.98%. It means that (a) the range of percentage of rationed debtors between one BPR and the other – is big, and (b) the percentage of rationed debtors far more than the number of proposing overstated credit clients. It implies that there are rationed clients who in fact do not have overstated credit.

The perceived risk (or adverse selection) as a result of asymmetric information is not only prevented through credit rationing, compulsory saving but also collateral. Compulsory saving is an additional guarantee for debtors since the risk of new clients is high. However, there are BPRs that require both new and repeated borrowers to have compulsory savings. The 82 (54%) of BPRs demand borrowers to have compulsory savings, so that they can use accumulated saving to repay the credit whenever they face financial difficulties. The other 70 (46%) BPRs do not require their borrowers to have savings, but 38 (25%) of those BPRs encourage their clients to have savings, while the other 32 (21%) of those BPRs let the clients decide by themselves.

(3) Value of relationships

The result of the empirical study described in Chapter 2 has elaborately discussed the bank relationship, which creates values for both clients and the bank. However, there are other studies, which do not see any relationship value or even negative (destructive) value. A number of calculations, which are sources of value of a relationship, are discussed in the following part.

First, the value of a relationship will expand as the duration of a relationship progresses. The first value of a relationship is the privileges given by a BPR to debtors, especially repeat borrowers who have a longer duration of a relationship than new debtors. Repeat debtors should have more privileges compared to new debtors regarding the terms and conditions of a loan.

Table 5-21 resulted in a grand average of 3.0, which may mean inconclusive. However, the average of the terms and conditions of each loan varied. For the components of processing (delivery) time, loan principal, and negotiation they have scores of greater than 3. This is logical, since the three components give wide autonomy for BPRs, which are less controlled by Bank Indonesia or market competition. The privilege of processing time, which is faster for existing clients than for new clients, is consistent with the existing research about the bank relationship. As the course of a relationship progresses, BPR can access information that is more private.

Table 5-21: Sources of value of relationships: giving privileges to repeat borrowers compared to new ones

No.	Response category	Sources of value: terms and conditions						
		Interest rate	Tenure	Collateral	Processing	Principal	Repayment	Negotiation
1	Strongly disagree	11	10	18	7	5	12	4
2	Disagree	62	74	105	22	22	89	39
3	Doubtful	7	11	11	3	18	15	20
4	Agree	57	48	11	98	92	28	72
5	Strongly agree	10	3	1	22	13	3	11
	Total BPR	147	146	146	152	150	147	146
	Average score	3.0	2.7	2.1	3.7	3.6	2.5	3.3

Source: Survey data

The asymmetric information problem is lessened, since BPR has better and more relevant information, which enables them to make faster credit decisions. Even from the aspect of competition, the faster decisions are made, the fewer opportunities competitors will have for luring clients. That is why the value of a relationship is not only for clients but also for BPR. In a discussion forum between BPR directors, they normally would pay more attention to loan delivery, i.e., the fast credit decision process as a strategic tool in competition with other financial institutions.

For processing time, 98 BPRs agree to give a privilege to repeat borrowers in the form of faster processing time, and 92 BPRs agree with a flexible amount of principal for repeat borrowers. Thus, the average score of the answers is 3.6 or close to 4 (agree). When both privileges are combined the aspects of credit availability for repeat borrowers for the time and amount dimensions are more guaranteed. It proves that BPR will focus on both factors instead of just interest problems.

Repaying in terms of the timetable and the amount of money is relatively rigid for two reasons: (a) repaying reflects a client's discipline in punctuality of time and money and (b) any late payment causes a bad credit or non-performing loan (NPL) which risks lowering BPR's healthiness score with Bank Indonesia. BPR is required to report credit classification based on its quality on a monthly basis to Bank Indonesia. Credits have a big influence in the CAMEL rating system in Bank Indonesia, i.e. 30%. Discipline in loan repayments is an important lesson in credits.

Table 5-22: Value of a bank relationship: privileges given to exclusive debtors compared to new ones

		Sources of value: terms and conditions						
No.	Response category	Interest rate	Tenure	Collateral	Processing	Principal	Repayment	Negotiation
1	Strongly disagree	13	12	14	7	8	13	10
2	Disagree	78	78	115	44	52	97	58
3	Doubtful	15	18	10	10	23	19	16
4	Agree	39	41	9	78	64	20	56
5	Strongly agree	4	1	1	10	3	1	5
	Total BPR	149	150	149	149	150	150	145
	Average score	2.6	2.6	2.1	3.3	3.0	2.3	2.6

Source: Survey data

Table 5-22 reveals that exclusive debtors only receive small privileges in BPR, as shown by the average score that is less than 3.0. Meanwhile, the terms and conditions of a loan, which has an average score of more than 3.0 is an aspect of the shorter processing time in deciding whether to grant credit. The rest have similar scores or even below 3.0 (most doubtful BPRs disagree with granting established clients privileges, unless it is for a faster processing time). Exclusive debtors, or those who deal with only one BPR, can indicate the existence of (a) a holdout or captured client, i.e. inertia client for their low bargaining power to switch to other finance institutions probably due to the high clients' switching costs to other financial institutions.

Progressive lending (Table 5-23) is a general tendency of BPR policy, which has indicator values of a bank relationship, i.e. average score around 4.0 for the three categories of terms and conditions. Since the average score is approximately 4, it means that BPRs tend to agree with progressive lending. This supports the evidence that a bank relationship has value created by the improved information availability for creditworthy clients (repeat borrowers and current/non delinquent clients; repayment prospects and collateral sufficiency) and protection towards credit risk, in this case collateral adequacy.

Table 5-23: Value of a bank relationship: chances of a progressive lending policy to debtors is subject to some conditions

No.	Response category	Terms and conditions: Current repeat borrowers	Repayment prospect	Collateral adequacy
1	Strongly disagree	6	4	5
2	Disagree	2	3	10
3	Doubtful	1	6	8
4	Agree	97	118	111
5	Strongly agree	44	20	15
	Total	150	151	149
	Average score	4.1	4.0	3.8

Source: Survey data

High repayment rate is an important indicator of high credit quality. Hence, a discipline in repaying is the most important educational element in granting credit. Besides the penalties given by Bank Indonesia to BPRs who have many undisciplined clients (meaning high NPL), BPRs also face the loss of loan write-offs or an increase in the provisional cost of delinquent credit. BRI gives incentives for punctual clients by offering interest discounts at maturity. But BPRs do not replicate the strategies/policies of a BRI Generally BPRs tend not to give interest discount incentives; instead, they provide progressive lending policies and speed up the processing (delivery) time in loan disbursements. An interesting fact from the findings is that although a BRI Unit is considered as BPR's biggest competitor, BPRs have their own strategies and do not replicate a BRI Unit's Strategies.

(4) Monitoring

Monitoring is a bank activity, which is the focus in a bank relationship and relationship marketing. As part of a bank relationship, monitoring is a method used in BPR-clients interactions to collect additional information to lessen asymmetric information problems; whereas as part of relationship marketing, monitoring is an instrument to maintain a long-term relationship with clients. Thus, monitoring is located in the intersection scope of a bank relationship and relationship marketing. Table 5-24 gives a description that the intensity of monitoring visits is focused on delinquent loans or clients. Visits are made to good clients approximately 1x per payment period, while for delinquent clients it may be 3x per payment period. Visiting an average of 3 times does not mean they always meet delinquent debtors. There are several possibilities, such as: (a) they can only meet the client one out of the three scheduled visits, (b) they can meet two out of the three visits, and (c) always meet for three visits. The problem is when there is more than one meeting in one payment period, (e.g. one month), it is possible that in the first meeting the AO will experience a delay of payment. Then on the second visit, the AO may experience another unfulfilled repayment promise.

Table 5-24: Frequency of Monitoring Per Repayment Period (times per repayment cycle)

No.	Debtors by delinquency		Average	Std. Dev.	BPR
I	Debtors in general				
	a	Current (best)	1.20	0.69	115
	b	Delinquent	3.00	1.89	140
II	Repeat borrowers				
	c	Current (best)	1.30	1.30	118
	d	Delinquent	3.10	2.07	132

Source: Survey data
Note: a payment period may be weekly or monthly

There is a significant distinction between making visits to good debtors and delinquent debtors, whether in categories of debtors in general and repeat borrowers – that is for pairs a-b and c-d. The paired sample tests show that there are significant mean-differences of both pair a-b (-1.9) and c-d (-1.87) within a 95% confidence interval – two tailed, sig. 0, 00 %

Table 5-25: More frequent visits are made to delinquent borrowers than to good ones

No.	Response category	BPR	Proportion %
1	Strongly disagree	0	0.0
2	Disagree	3	2.1
3	Doubtful	0	0.0
4	Agree	77	53.8
5	Strongly agree	63	44.1
TOTAL		143	100.0

Source: Survey data

For visits to good debtors, there are no distinctions between categories of debtors in general and repeat borrowers – that is for pair a-c and b-d.

The paired samples test is supported (Table 5-25) by the statement of an average score of 4.4, meaning that BPRs agree that AOs make more frequent visits to delinquent clients than good ones.

The above monitoring stage is focused more on activities to collect repayment. In addition to that, Table 5-26 describes the wider functions of monitoring – that is a launching pad to collect more information in anticipating repeat borrowers and those at risk of default. Hence, information gathering during the monitoring stage is valuable in reducing asymmetric information problems. Respondents are questioned about monitoring activities beyond repayment collection, including:

(1) the methods of debtor monitoring after credit is granted: (a) formal: routine, scheduled visits and the AO writes a report and (b) casual: irregular, unscheduled visits, with or without a written report
(2) the purpose of double monitoring: (a) collecting a debtor's progress report and (b) encouraging a debtor to repay punctually
(3) during the monitoring visit, repeat debtors are evaluated for their potential to receive credit for upcoming credit applications, so that the bank can make credit decisions faster – whether to accept or decline the applicants

Table 5-26: Dimensions of monitoring of BPR clients beyond the loan repayment

No.	Response Category	Method		Purpose		Decision
		Formal	Casual	Information gathering	Repayment only	Anticipative
1	Strongly disagree	4	7	0	0	0
2	Disagree	20	42	0	0	4
3	Doubtful	20	23	1	0	3
4	Agree	61	54	57	58	110
5	Strongly agree	39	13	24	25	30
	Total BPR	144	139	82	83	147
	Average Score	3.8	3.2	4.3	4.3	4.1

Source: Survey data

The monitoring method describes the formal and causal approach: informal / personal approach aspects, which together with an average score weight, can be seen as the average score to determine the rank. The average scores are 3.8 for the formal method and 3.2 for the casual method. These facts indicate that BPRs tend to agree with both methods of monitoring. However, the figure shows there are variations in answers among them ranging from strongly agree to strongly disagree.

For the two purposes of monitoring in terms of the information gathering and repayment collection functions, the division between the BPR answers is more definitive, which are only agree and strongly agree. The average scores are 4.3 for each measurable variable: information gathering and repayment collection only.

Meanwhile, the function and duty of information gathering and anticipative action are acknowledged as an important stage for BPR. This is the evidence that the bank relationship takes form. The loan officers and BODs agree to use information acquired during the monitoring stage to anticipate client behavior: for repeat loan applications and/or assessing client risk.

In both bank relationship and relationship marketing concepts, the role of an account officer is very important, since through an account officer the BPR-client relationship is built on a daily basis. However, there are two distinct opinions about an AO's job description[11] in providing client services. About 85 (57%) BPRs agree and 18 (12%) strongly agree that AOs may have double roles in performing their credit related duties as well as collecting funds in the form of deposits and savings. The other 47 (31%) BPRs disagree with the duel roles.

5.5 Relationship Marketing

There is a tendency for respondents to agree with the relationship marketing concept, i.e. making long term relationships with clients (deposit owners and debtors/borrowers) is important as shown in the average score of 4.1 (agree) for the questionnaire's alternative options. This is supported by 79 (53%) BPRs that agree and 55 (37%) that strongly agree with the long term relationship concept. For the personal approach in acquiring and maintaining clients, almost all BPRs agree: 98 (65%) and 49 (33%) BPRs strongly agree, while only 3 (2%) who are doubtful and refuse.

About 80 (57%) BPRs agree and 10 (7%) strongly agree in making a distinction between clients based on the funds they put in a BPR. Meanwhile, 20

[11] Some BPRs introduce a more specialize role of AOs that is either as a "surveyor" or "collector". It means that an AO performs only some parts of a credit cycle: credit investigation ("surveyor") or credit monitoring ("collector"). These specialization tasks imply that the AOs assignments are totally separate from deposit gathering.

(14%) BPRs do not agree and 10 (7%) BPRs strongly disagree about this discrimination. Besides those opinions, 20 (14%) BPRs are neutral. The strategy of a bank relationship tends to take the form of separation between repeat borrowers and new ones.

Loyalty or length of time in becoming a client is also used to differentiate them. The 74 (53%) BPRs agree while 25 (18%) BPRs strongly agree with this. The 11 (8%) other BPRs disagree and 11 (8%) more BPRs strongly disagree. The remaining 20 (14%) BPRs are neutral.

There are various opinions on client differentiation based on institutions and individuals. The 60 (47%) BPRs agree and 5 (4%) BPRs strongly agree. Those BPRs having opposite opinions are 25 (20%) that disagree and 8 (6%) that strongly disagree. In other words, the second group tends to treat their clients equally, for both institutions and individuals. Among them, there are 30 (23%) BPRs that stay neutral. The opinions reflect the tendency in making distinctions between individual and institutional clients.

The attitude in differentiating clients, whether based on the amount of savings, loyalty and institutions have positive but low correlations. For example, the correlation between the amount of savings in a BPR and loyalty is 0.599 (sig.- two tailed 1%). Even the correlation for the other two combinations of client differentiation is much lower at 0.344 and 0.351. The correlation is based on the amount of funds and institution, and institution and loyalty. In general, this can be interpreted that respondents have consistency in the relatively low scores of the answers. This can happen since the attitude is in the thought process and have not yet been applied in BPR policies, or even are not applied consistently.

When a BPR executes relationship marketing, it will monitor their clients so as not to switch to other banks. 51 (37%) BPRs often monitor their clients, while 23 (17%) BPRs always monitor clients who probably move to other BPRs or financial institutions.

The dangerous drop out of a bank relationship is switching from an incumbent bank to a competitor from being lured by a commercial bank (18.8%), BRI unit (19.2%), or another BPR (21.3%). Another danger is due to disappointment with a BPR (10.5%).

For those who drop out because of a legal lending limit (16.8%), it is a graduation process. BPR cannot provide any more credit as prevented by the maximum limit allowed by Bank Indonesia.

Table 5-27: Estimated proportion of BPR drop out clients with reasons in the last year

No.	Reasons	Estimated exit rate		N
		Average	Std.	
1	Credit beyond the legal lending limit	16.8%	18.4%	48
2	Being lured away from BPR by:			
a	Commercial bank	18.8%	15.4%	51
b	BRI Unit	19.2%	12.6%	45
c	Other BPR	21.3%	14.4%	48
3	Disappointed with BPR	10.5%	16.1%	28
4	No need for more credit	55.9%	35.2%	103

Source: Survey data

Note: percentage value is % of total clients per category, not total categories

This situation can be seen from 2 points of view: (a) BPR has helped improve the standing of the client and (b) as a loss for BPR since clients of a long, good relationship are entrusted to bigger banks when they have progressed.

Meanwhile, drop out clients that have no more need of credit are pretty high (55.9%); they may have a re-joint relationship. Based on the data, there seems to be a void in the existing studies of bank relationships. The duration of a relationship which has been considered continues, practically may be intermittent relationship.

From the aspect of a client's historical-record availability, a client's classification is considered important. 144 BPRs distinguish repeat borrowers from new clients, but 6 BPRs do not. New clients with references and those without references are also differentiated by most BPRs i.e., 103 and 94 BPRs respectively. Repeat borrowers have better positions viewed from information availability, social relationship, and business as an investment. Out of 125 BPRs providing answers, on average 64% are repeat borrowers, though the range is quite wide (std. dev. 22.4%).

Table 5-28: An AO's monitoring of clients' intention to switch to other institutions

No.	Response category	Valid response of BPR	Proportion %
1	Never	16	11.5
2	Occasionally	44	31.7
3	Doubtful	5	3.6
4	Frequently	51	36.7
5	Always	23	16.5
	Total	139	100.0
Average score		3.2	

Source: Survey data

Monitoring has been discussed in the previous section. This monitoring section focuses more on the early warnings of possible defection or the possible switching to a competing bank. This survey reveals two main groups of BPRs, i.e. one group (43%) which has never done monitoring or only sometimes performs monitoring, and the other group (53.2%) which often and very often does monitoring.

Although some BPRs (Table 5-28) try to monitor a client's intention to switch to a competing bank (an average score of 3.2), it seems the prevention through several approaches is relatively small (Table 5-29). Little effort is shown by the score average between one and two, i.e. never and occasionally to prevent the switching of a client to a competitor.

Table 5-29: The extent of effort made to prevent a client from switching in conjunction mainly with the loan terms and conditions

No.	Response category	Terms and conditions; approach					
		Interest rate	Collateral	Tenor	Principal	Let client switch	Informal & personal approach
1	Never	37	57	29	56	26	61
2	Occasionally	42	42	51	84	44	46
3	Doubtful	3	9	5	3	3	19
4	Frequently	46	26	47	5	60	7
5	Always	16	5	12	3	11	6
	Total	144	139	144	151	144	139
	Average	2.7	2.1	2.7	2.9	1.9	3.9
	Std. Dev.	1.42	1.24	1.33	1.32	1.08	1.13

Source: Survey data

This evidence reflects that more BPRs just let the clients switch to a competing bank and BPRs search for new clients to offset the balance as long as the net clients increase over time.

5.6 Organizational Learning

Until recently, the nationwide banking industry has not incorporated bank-relationship and relationship marketing concepts as growing new approaches to create strategic advantages as part of the curricula in staff development regardless of who runs the training and development programs. However, according to some organizational learning studies, it is stated that any organization is a learning organization and learning need not be conscious or intentional. Retaining and codification of information in an organization is also an important part of organizational learning. Generally, a BPR has a good filing system in specific aspects e.g., the files that hold client information are based on the debtor's name. 80 BPRs agree and 56 strongly agree with this system (Table 5-30). There is a contradiction, however, that several debtors' information is collected in one period-based file.

Table 5-30: Information codification and corporate memory

No.	Response category	Filing system		Rolling AO	
		Periodic	Debtors	Abuse of authority	Private information
1	Strongly disagree	8	1	3	56
2	Disagree	59	5	5	84
3	Doubtful	1	2	3	3
4	Agree	49	80	84	5
5	Strongly agree	28	56	56	3
	Total BPR	145	144	151	151

Source: Survey data

This system will be difficult to retrieve. Dealing with this, BPR tends to make use of a loan officer's memory or ask specific information again to the debtor. For example, if there is a collection of ID card copies of repeat borrowers based on a one-week transaction, an AO may have difficulties in retrieving one particular copy. Therefore, an AO would ask the related client to submit another ID copy. This phenomenon indicates a potential problem for BPRs to implement an ideal organizational learning.

The policy of AOs' rolling (or rotation) in their service areas in order to avoid misuse of privilege is strongly supported by 56 BPRs (Table 5-30). The study leads to the conclusion that the policy tends to eliminate a client's private information, which is still in the form of tacit knowledge in the rotated loan officer's memory without any systematic knowledge transfer process.

The computer codification and retaining process in BPR are related to the availability of hardware and software. Although all BPRs in the survey have computers, not all of them filled in the answers. Out of 139 BPRs who answered, the average number of computers owned is 3, ranging from the fewest number being 2 computers to the most 30 computers. There is, however, a low association between the number of computers and networking, even though χ^2 = 20.96 (sig. 0.00%) coefficient of association C is only 0.36 far from the strong association ± 0, 70.

BPR's ability in making use of clients' information is also inhibited by the non-tailor made software application. Based on the answers, there are three kinds of application software (Table 5-31). First, a worksheet application (e.g. MS Excel) is a multi-purpose software. It is flexible but less productive than the second software, dBase Software (visual FoxPro, MS Access, etc).

Table 5-31: Software applications in data processing for BPR

No.	Type of software	BPR	Proportion %
1	Worksheet	127	83.6
2	dBase software	10	6.6
3	Special purpose (BPR)	15	9.9
	Total	152	100.0

Source: Survey data

The third is a special purpose, tailor made software for BPR. Although tailor-made for BPR's needs, the software has a general standard. It is the most productive but also the most expensive. It is about Rp. 35 – Rp. 50 million plus the annual maintenance costs. This software normally provides client ratings of historical repayment performances. This information gives additional signals to BPR as an early warning and to anticipate future possible credit commitment. From the sample, only 15 (10%) BPRs have this special purpose software, while the others use worksheet software.

BPR as a learning organization is vulnerable due to (a) director and loan officer mobility, and (b) the accumulated information of the clients, which resides in the memory of loan officers is not systematically codified in knowledge applications to improve bank performance. According to information sharing, Table 5-32 reveals a good sign, i.e. routine coordination meetings. Most, or 78 BPRs, with an average score of 4, perform information sharing though coordination meetings between middle managers and loan officers or in a credit committee.

Table 5-32: Information sharing in a BPR office

No.	Response category	Measurement		
		Routine coord. meeting	Incidental coord. meeting	Written report
1	Never	2	1	12
2	Occasionally	8	17	34
3	Doubtful	19	26	21
4	Frequently	78	73	39
5	Always	42	28	32
	Total	149	145	138
Average		4.00	3.80	3.30
Std. dev.		0.87	0.92	1.31

Source: Survey data

The majority of BPRs, scoring 3.8 almost frequently perform incidental coordination meetings. Both conditions reinforce decision-making. It may be concluded as meetings, which are not recorded, but are enough to complete unwritten information, and is important in credit decisions.

Table 5-33: Recorded debtors' information in BPR files

No.	Response category	BPR	Proportion (%)
1	Insufficient	1	0.7
2	Less	24	16.7
3	Doubtful	7	4.9
4	Adequate	97	67.4
5	Complete	15	10.4
	Total	144	100.0
Average		3.70	
Std. dev.		0.89	

Source: Survey data

The "soft information", which is mainly in the memory of loan officers is then partly kept in an archival record by 127 BPRs, for the improvement of risk management, and specifically 48 BPRs use it to trace suspect transactions, such as borrower may diverting use of loan that does not conform to the initially proposed use.

In general, Table 5-33 shows that most or 97 (67%) BPRs perceive they have sufficient information on their clients. Even 15 (10%) BPRs think they have very adequate information about their clients, though there is loan officer resigned that likely losing valuable tacit information.

5.7 Performance Measures As Seen by the Board of Directors

Business performance has many measurable instruments. Chapter 2, section 2.9 shows how diverse and almost unlimited the number of MFI performance measures that are available. This fact implies rich innovations but at the same time increases complexity, and may be lacking of parsimony that can leads to confusion, especially among the BODs of BPRs who run relatively simple businesses of intermediary financial institutions. For this reason, the performance measures of this study are split into two categories. The first category is about the performance measures as seen (perceived) by the board of directors in reference to their BPR's performance. This category is discussed in this section. The second category is about the performance measures, which have been discussed in Chapter 4, section 4.2. The performance measures consist of six financial ratios/indicators, i.e., (1) asset growth, (2) loan growth, (3) loan to deposit ratio, (4) spread, (5) return on assets, and (6) return on equity. This category will be used for hypotheses testing in Chapter 7.

The underlying reason to disclose the BODs perceptions about BPRs' performance is that up to the operational level, there are different interpretations and instruments used in determining what is meant by performance.

Table 5-34 below is the BPR excellent performance measurement according to the director.

Table 5-34: The BPR excellent performance measurements according to the director's perceptions

No.	Performance measures	BPR			Total BPR	Prop
		I	II	III		
1	Camel rating	48	1		49	29%
2	Management, authority, professional personnel, vision, etc.	25	3	1	29	17%
3	Profitability, ROE, EVA, etc.	11	8		19	11%
4	Asset quality, NPL	12	3	3	18	11%
5	Rate of growth in assets, loans, clients, etc.	16	2		18	11%
6	Reputation, funding	1	7	2	10	6%
7	Compliance, follow the rules and procedures, prudential	6	1		7	4%
8	Liquidity sufficiency	3	2	1	6	4%
9	Service excellence	4		1	5	3%
10	Intermediary (optimal LDR)	4			4	2%
11	CAR		2	1	3	2%
12	Target achievement	1			1	1%
	Total	131	29	9	169	100%

Source: Survey data

Table 5-34 is the extract performance measures according to the director, where they put it in simple statements (e.g. only the word EVA, CAR) as well as in long ones. The explanations in the long sentences are summarized and classified into 12 categories, by which BPR may make 1 – 3 performance measurements.

About 49 (29%) respondents mention Camel Rating, Management and Authority as a BPR measure of performance. The next measurements are professional personality, vision, etc., which appear for 29 (17%) BPRs. Meanwhile, profitability, ROE, EVA, etc., as well as Asset Quality, NPL, and rate of growth are in the third and fourth positions, as seen by the frequent occurrence in the BPR statement.

Table 5-35: BPR response to the CAMEL rating and performance announcement

No.	Response category	CAMEL is complicated	CAMEL is a good performance measure	Announce performance publicly
1	Strongly disagree	10	1	3
2	Disagree	105	3	13
3	Doubtful	10	3	8
4	Agree	20	110	93
5	Strongly agree	4	31	32
	Total	149	148	149
	Average	2.30	4.10	3.90
	Std. dev.	0.89	0.60	0.89

Source: Survey data

Bank Indonesia measures BPR performance using a CAMEL rating with many quantitative and qualitative instruments, although the results are not announced. BI classifies this as ‘confidential’ and gives it to the Board of Directors and Commissioner.

Table 5-35 shows that most or 105 BPRs disagree with CAMEL as a complex method. This is reasonable since Bank Indonesia provides BPR with simple software from worksheet excel to calculate the total score of BPR performance, which is identical to the BPR health level score.

BPR generally agrees that the CAMEL Rating is an excellent performance measurement (average score 4.1), and 93 BPRs agree while 32 strongly agree that BPR performance should be informed publicly, which is opposite to BI preference in promoting financial transparency

5.8 Conclusion

The first research question deals with what are the characteristics of BPR as a financial intermediary from different/various aspects of relationships, organizational learning, and change in business environment. One of the intersection elements out of the cross fertilization, multi-disciplinary concept of a bank relationship, relationship marketing, and organizational learning is the durability of a relationship. A durable relationship is a long-term relationship between a bank and good clients that creates benefits for both parties and stakeholders at large. The durability of a relationship is a function of (a) the relationship value along with a decrease in asymmetric informational problems, (b) exogenous factors that affect the fragility or stability of BPR, among others, arising from competition and external shocks such as a crisis that threatens the continuation of credit availability, and losing clients who switch to a competitor, and (c) how a company can improve by adapting external changes through a learning process. It is about an intention to mainly explore the core concepts underlining the study, which this Chapter 5 analysis has produced the following conclusion:

BPR as a community, unit, and local bank depends heavily on the developmental progress of its surrounding area. It employs the opportunities through the deployment of its resources to support the mobility of loan officers to go to client doorsteps as far away as possible from the BPR office. There is a significant correlation between motorbikes used by AOs and their coverage area. The closeness of clients in their relationship with BPR depends upon the geographical distance and social relationships with mostly the director and loan officers. Therefore, the BPR as part of MFIs has peculiarity in terms of social and location-dependent relationships to achieve higher and sustainable performance.

The BPRs cannot diversify their loan portfolio geographically as is done by BRI through the nationwide investment in BRI units. Even so, surprisingly BPRs can maintain intermediary function amid the heavy financial crisis. The stability of its intermediary function is most likely supported by the ability of BPR to maintain close relationships with the clients of both borrowers and depositors. The concept of “survival of the fittest” motivates BPR to keep interest rates relatively stable compared with commercial bank interest rates as demonstrated by inter-temporal differences during the crisis and in its aftermath. There was only a minor threat to the durability of the BPR-client relationship during the financial crisis, in which a disruption in the supply of credit was almost non-existent.

BRI units and BPD branches are the heaviest and closest competitors of BPRs, in which they actually have employed different strategic tools. The first two banks have better pricing advantages and lower interest rates as strategic tools to maintain their relationships with their clients, while BPRs are able to offer speedy delivery of credit and provide progressive lending incentives to clients. Each of them has their own clientele segments. However, there are always some intersection areas where to some degree BRI Units and BPDs can imitate BPRs' strategies or vice versa. They have been operating in the same market together for a long period where mutual understanding has been built among them and, therefore, there is less tension among them in serving the same market segment.

In 2003, there was a mixed perception among BPRs concerning the threat of competition, especially from some commercial banks entering a segment within BPR's domain. Those BPRs that operate in urban areas tend to see a real threat from these commercial banks, while those BPRs that operate in rural areas do not. The outcry from the BPR association, Perbarindo, about the threat of clients switching to these commercial banks has been increasing recently. This most recent situation as seen by Perbarindo could modify the perception of BPRs, as an increase in competition could be underway. Cooperation between BPRs and commercial banks under the linkage program scheme can not reduce the tension of competition.

The underlying assumption of the linkage program is that BPR is in a position where they lack funds, whereas actually macro financial data shows otherwise. More BPRs in the survey do not need such linkage programs or have difficulties to meet the requirements, especially those subsidized credit program where most of the BPRs are in favor of low cost of fund. Naturally, most BPRs have to open deposits (a) for liquidity smoothing and (b) to facilitate the transfer mechanism for inter-bank transactions and to receive fund transfers from client loan repayments.

Credit rationing is an implications of adverse selection because asymmetric information is acknowledged by most BPRs. Most BPRs ration credit to clients who are inclined to overstate their loans. Time constraints in executing speedy delivery and lacking available information from new clients is a driving force to engage in credit rationing.

Although the worldwide accepted joint liability system of the micro or small credit market has been a “trademark” of Grameen Bank in Bangladesh recently, it was actually introduced in Indonesia by De Wolff in the early 1900s to MFIs in Indonesia (Steinwad, 2001).

However, the small number of BPRs providing group lending and small amounts of outstanding credit for group lending implies that BPRs tend to favor individual lending rather than group lending. Group lending methods used to solve the adverse selection and moral hazard problems in the financial market with asymmetric information (Besley and Coate, 1995; Stiglitz 1990, and Ghatak 1999) may not be seen as promising business by BPRs.

Inhibiting factors of relationships value creation to clients offered by BPRs are regulations of prudential banking practices. The sources of value in a relationship potentially come from the terms and conditions of a loan contract ranging low loan interest rates, long tenure (loan duration), less pledge collateral, progressive lending (availability and higher principal), relaxing time interval and amount of repayment, easy in negotiations during client financial distress, etc. Regulations say that changes in terms of conditions may affect or increase the NPL, resulting in penalties for BPRs, which will potentially reduce their healthiness. However, BPRs do provide benefits to those clients who have long and good relationships with BPRs from selected terms and conditions that are free from punishment.

Unanimously BPRs agree that long-term relationships are extremely important for both clients and BPRs. In other words, they are in favor of maintaining long-term relationships with good clients. However, they do not show firmly to implement some basic instruments of relationship marketing such as monitoring a client’s intention to leave to prevent clients from switching to competing banks. The number of drop out clients that no longer need credit is relatively high. However, they may reestablish their relationship at some point in the future. Based on the data, there seems to be a void in the existing studies of bank relationships. The duration of a current relationship can become an intermittent relationship. The monitoring stage has two dimensions: (a) collecting loan repayments and (b) collecting updated information to act as an early warning sign in detecting client risk and to anticipate repeat loans in the future. Obviously, the AOs devote their time for repayment collections and they spend 2 to 3 times more in resources on delinquent clients rather than on the good ones. The second dimension cannot be easily be interpreted since the information collected and transformed into company knowledge to improve the decision process of the credit cycle involves complex elements. An elaboration of this dimension is discussed in Chapter 9.

Every organization is a learning organization, including BPRs. The organizational learning of BPRs is susceptible to the high turnover rate of AOs and BODs, the lack of an information sharing mechanism, too much emphasis placed on banking techniques for human development, the underutilization of the relationship as a company asset, and the lack of ability of a firm to acquire knowledge and transform it into a real competitive weapon, such as by reducing transaction costs while speeding up loan delivery.

Performance is a simple word and when this word becomes a concept, an almost unlimited number of potential indicators can be derived from it. The BODs have their own perceptions about how to measure their BPRs' performance. The BODs have about 12 performance indicator categories that they believe should be measured. This perception gives a clear picture that there is no single common measure of BPR performance agreed upon among them. Regardless of the diversity in the perception about how to measure performance, a further analysis will use five performance indicators derived from the availability of annual financial reports from June 1996 – June 2003.