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IMPROVING PERFORMANCE THROUGH A HARMONIOUS CULTURAL APPROACH IN CREDIT RISK

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ABSTRACT
Loan risk is important in developing the performance of a microfinance institution. The aim of the research was to analyze financial performance through a harmonious cultural approach in reducing credit risk. The research employed two data analysis approaches, qualitative and quantitative. The result of the qualitative study would be utilized to develop a questionnaire. Ninety-four (94) companies were selected as the samples by using Slovin Method. The result of the qualitative study explained that credit risk in harmonious cultural-based handling was influenced by the loan quality, the collateral quality, customary rules, traditional leaders, and the belief in *karma phala* law. Quantitatively, it was found that loan quality, collateral quality, customary rules, traditional leaders, and the belief in *karma phala* law simultaneously influenced the financial performance of the BPR (village financial institution). The research result provided a new insight in handling credit risk and improving financial performance. Managers had an opportunity to utilize local culture to develop strategy and improve performance.

INTRODUCTION
Lembaga Keuangan Mikro/LKM (microfinance institution) holds an important role as a source of funding for the societies and small businesses. There are 3,700 LKMs in 100 countries that provides non-collateral loans to 230 customers (Reed, Marsden, Ortega, Rivera, & Rogers, 2014). Non-collateral loans bear higher risk compared to collateral loans. Therefore, LKMs should pay attention to good financial performance (Armendariz de Aghion & Morduch, 2010; Banerjee, 2013; Hermes & Lensink, 2011). The performance of LKM varies as there are LKMs that are capable of generating profit, whereas others

fail to maintain their performance. Previous researches on this condition found an element of risk management. Risk management is a part of performance appraisal that is crucial to be noted by microfinance institutions since it consists of various risks such as liquidity risk, market risk, credit risk, operational risk, legal risk, owner reputation risk and last obedience risk (Rozzani, Mohamed, & Yusuf, 2017; Astawa, Sudana, & Murni, 2017; Hussain, Fareed, Saleem, Hussain, & Adnan, 2012; Churchill & Coster, 2001). The control of liquidity risk, market risk, credit risk and operational risk has positive impact on financial performance, whereas the control of legal risk, owner reputation risk, and obedience risk had no direct impact on performance (Boateng, Boateng, & Bampoe, 2015; Chandrakumarmangalam & Vetrivel, 2012; Ekunwe, Orewa, Abulu, & Egware, 2015; Vanroose & Espallier, 2013).

Loan risk experienced by microfinance institutions also has an impact on the microfinance institution industry since it could compromise the liquidity or bring up liquidity risk related to financial sustainability (Castellani & Cincinelli, 2015). Loan risk is related to the opportunity of a failure by the customers in fulfilling the obligations at the due date. Loan risk occurs from various possibilities, for example, debtors are incapable of paying their debts; bonds bought by the bank does not pay the coupon or the principal; and the occurrence of non-performance loans of all obligations between a bank and other parties. The amount of risk consists of two factors, namely, the amount and the quality of loan exposure. The amount of loan exposure is equal to the amount of the loan itself. The bigger the loan, the bigger the loan exposure. The quality of exposure is reflected by the possibility of the non-performing loans by debtors and the collateral quality provided by debtors or loan buyers. The lower the quality of the collaterals, the lower the loan quality and thus the higher is the credit risk faced (Baland, Gangadharan, Maitra, & Somanathan, 2017, Agbola, Acupan, & Mahmood, 2017).

The study results in several countries in Europe and Asia found that the factors of foreign currency risk, liquidity risk, and asset liability management held significant influence on the performance of microfinance institutions (Bruett, 2004). The risks experienced by microfinance institutions can be divided into three groups, namely, financial, operational, and strategic risks which are interrelated. Currently, microfinance institutions that serve loan have the potential to experience issues in liquidity, market condition, transaction, fraud, governance, and reputation (Khan & Ashta, 2013). Based on the previous research results, it was stated that a company's internal and external factors influencing credit risk had not clearly discussed cultural factors although it was stated implicitly. Therefore, this research filled the gap to test harmonious culture used to handle credit risk. Previous research also gave an explanation that the adaptability of resources encouraged the achievement of sustainable competitiveness (Barreto, 2010; Loasby, 2010; Helfat & Peteraf, 2003). The adaptability pace of human resources in microfinance institution to the environment gives strength in conducting the increasingly high competition. One of microfinance that was capable of adapting to the environment by practicing local cultural values referred to harmonious culture is *Lembaga Perkreditan*

Desa/LPD (village financial institution). Harmonious culture emphasizes a good relationship between a company and the cultural values (God), human, and environment. The microfinance institutions that is based on harmonious culture is different from those in various countries globally in terms of the closeness to God. in organizational culture, as stated by Schein (2004), the closeness to God is not clearly stated in a company, instead, it is only stated as the basic assumptions since the existence of God is requires no further arguments. Microfinance institutions in Indonesia that apply harmonious culture well amounts to 1,405 institutions that are located in Bali Province (Bank Pembangunan Daerah, 2016).

The occurring problem was related to how the harmonious culture implemented in the LPDs could be utilized to reduce credit risk and to achieve better financial performance. To answer the question, the study emphasized examining the harmonious culture implemented in loan issue to improve financial performance. The handling of loan problems in microfinance institutions, generally, refers to the loan purpose and various procedures that strictly determined (Baland et al., 2017). This research used harmonious culture to handle credit risk and it was different to previous researches, such as Baland, et al., 2017, Agbola et al., 2017, and Castellani & Cincinelli 2015, that did not include a cultural variable in their study. The research problem was how the implementation of harmonious culture in handling credit risks in improving the performance of microfinance institutions? To answer the question, the harmonious culture value in Schein's culture (2004) was utilized as a theoretical basis. The study used qualitative and quantitative methods (exploratory sequential design) developed by Creswell and Clark (2011). Further, analysis and discussion were conducted and in the end, the conclusions were drawn and implications were suggested, both theoretically and practically.

Market development will impact risk development thus building communication with customers is significantly important to be conducted through various strategies. One of the strategies is building communication with the customers and paying attention to the culture of the customers (Caesar, 2016; Astawa, Sukawati, Triyuni, & Abdi, 2016a; Astawa & Sudika, 2014; Astawa et al. 2013; Astawa, 2013; Astawa, Sudarma, Aisjah, & Djumahir, 2012). Organizational culture followed by microfinance institutions is originated from the local cultures in Indonesia called by harmonious culture. Harmonious culture gives emphasize on the harmonious relationship between microfinance institution and God (*parahyangan*) as the creator of the universe through various religious and indigenous activities (Astawa et al., 2017; Sukawati & Astawa, 2017; Astawa & Sukawati, 2016; Astawa, Susyarini, & Triyuni, 2016b). Two other harmonious relationships are maintaining the relationship between microfinance institution and the employees, customers, and environment. The harmonious culture has become an organizational culture in microfinance institution and has a significant impact on company performance (Astawa et al., 2017; Sukawati & Astawa, 2017; Astawa & Sukawati, 2016; Astawa et al., 2016b) and is used as a strategy to win the competition with general banks. The ability to win the competition is based on the ability of the companies to adjust their resources to give the best service to the consumers. The resources adjustment is a strategy to win the competition (Amir, Auzair, & Amiruddin, 2016) as well as innovation in service that hard to imitate by the competitors (Barney, 1991).

Microfinance institutions or LPDs give loan service to the villagers and operates under the law of traditional village and local government. The concept of loan service is similar to those general banks. The difference is only in the collateral, the speed and the elements of custom as well as the values of religious belief. in the current condition, LPDs compete with general banks that have strong resources, capital, and technology. Other problems, such as a slowing economic condition in Indonesia, give impact on the purchasing power of the society thus a slowdown in loan payment with an average mark of above five percent (Bank Pembangunan Daerah, 2016). The high loan problems should be overcome immediately so it would not disturb the performance.

Human capital theory gives direction on how the good use of resources could improve performance (Becker, 1993). One of intangible property of a company is organizational culture and it can be used as a competitive strategy (Barney, 1991). The result of previous research indicates that the performance of a company was influenced by organizational culture (Schein, 2004; Kotter & Heskett, 1997). One of the organizational cultures originated from local culture is harmonious culture or *Tri Hita Karana* or Green Culture. It becomes the reference in the operation of the organization in Indonesia, especially in Bali and has an influence on company performance (Surya, Kesuma, Dewi, & Sriathi, 2017). The concept of harmonious culture is highly universal and it emphasizes harmony to the values of belief in the society, harmony with other human beings, and harmony to the environment.

Risk theory indicates that individual expects to strengthen the perception of risk and commitment from their physical culture as a way of life (~~Thomson, 1990~~). Based on the theory, lending activities cannot be separated from the culture of the people who borrow or the belief values of the customers. Microfinance institutions serve rural communities who have low income and mostly have no collaterals. It is a challenge for the microfinance institutions to maintain the low credit risk. Loan risk is influenced by loan quality and the collateral quality and it has a significant influence on the financial performance (Baland et al., 2017, Agbola et al., 2017). Financial performance is measured through the level of the profit achieved by the microfinance institution (Kanyurhi, Bugandwa, & Akonkwa, 2016). Loan quality is reflected by the amount of non-performing loan while the collateral quality is reflected by the value of collateral that is capable of generating profit from selling (Baland et al., 2017, Agbola et al., 2017). Based on the result of previous research, a hypothesis could be proposed that the loan quality and the collateral quality have a positive and significant influence on financial performance.

MATERIALS AND METHODS

Qualitative and quantitative methods (exploratory sequential design) developed by Creswell and Clark) were used in the research. The interview was conducted based on the list of questions prepared. The interview was on how the implementation of harmonious culture in the implementation of credit risk and it was conducted with LPD managers in Bali. Permission was obtained before to the interview and recording activities. The interview duration extended for 30-60 minutes with a further in-depth interview if the content was related to the theory being discussed in the research. A comparison was conducted between data and the existing theories (Glaser and Strauss's, 1967) and Miles and Huberman's (1994) method was employed for coding. The questionnaire was built based on the result of qualitative processing and it consisted of five dimensions: loan quality, the collateral quality, customary rules, traditional leaders, and the belief in *karma phala* law (~~Thomson, 1990~~; Baland et al., 2017, Agbola et al., 2017).

The validity and reliability of the questionnaire were tested in 40 LPDs and the test indicated that all were valid and reliable. The questionnaire was distributed to LPDs in Bali through mail and email. Sampling was conducted using Slovin formula with an error level of 10% (Umar, 1998) and resulted in 94 LPDs of 1,405 LPD population (Bank Pembangunan Daerah, 2016). The questionnaire distribution resulted in 90 questionnaires returned and they were analyzed using multiple regression analysis. The analysis was conducted to find five dimensions of credit risk related to the company performance referring to a research by Kanyurhi et al. (2016) which consisted of the rate of profit gained. The regression equation was $Y_1 = \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + e_1$. where: Y = company performance; X_1 = loan quality; X_2 = collateral quality; X_3 = customary rules; X_4 = traditional leaders; X_5 = the belief in *karma phala* law; β (1,2,3,4,5) ; = partial regression coefficient; e1 = level of stochastic disturbance.

RESULTS AND DISCUSSIONS

The education level of LPD leaders was as follows: 85 percent held bachelor's degree, 10 percent held master's degree, and 5 percent graduated from senior high school. Based on the education qualification, it was evident that LPD leaders had the ability to run the company to a better direction since the ability to understand the work depends on the level of education achieved. The respondent appraisal on each indicator was calculated based on the distribution frequency developed by Sugiyono (2008) where 1.00 – 1.74 = Disagree (TS); 1.75 – 2.49 = less agree (KS); 2.50 – 3.24=Agree (S); and last 3.25 – 4.00 = strongly agree (SS). Based on the research result, the loan quality variables consisted of five indicators, namely, customer honesty, loan appraisal honesty, respect to the religion, respect for the culture and give happiness.

The result of the average of perception from loan quality variable was 3.28 indicating strongly agree. The result of the respondents' perception of the collateral quality was 3.31, on average, which was within the interval of strongly agree. Indicators of the variable of collateral quality were: it has economic value, it does not contain a prayer room for the family, it is not the ancestral heritage, it was not *ibah* from the traditional village, and it is not in dispute. The result of respondent evaluation of customary rules was 3.30, on average, which was within the interval of strongly agree. Indicators of the customary rules variable included: it becomes the holy book, it tranquilises, it is a community guidance, it maintains the culture, and it maintains the community's harmony. The variable of traditional leaders consisted of several indicators, namely, understanding religion, understanding culture, maintaining village asset, maintaining traditional village harmonization, and serving the community sincerely. The appraisal result of respondent perception on traditional leader variable was 3.271, on average, which was within a very good interval. The result of respondent appraisal on the belief in *karma phala* law amounted to 3.38, on average, which was within the interval of strongly agree. Whereas, indicators of the belief in *karma phala* law included: not inheriting debt, afraid of being cursed, part of the way to God, and feeling happy if paying the debt.

The result of the quantitative test on five dimensions of credit risk can be explained in Table 1 as follows.

Table 1. *The Test Result of Loan Risk and Financial Performance Variables*

Models	**Unstandardized Coefficients**		**Standardized Coefficients**	**t**	**Sig.**
	B	**Std. Error**	**Beta**		
(Constant)	3.406	1.389		2.451	0.015
Loan quality	0.172	0.078	0.180	2.178	0.031
Collateral quality	0.432	0.093	0.472	4.632	0.000
Customary rules	0.416	0.097	0.219	2.210	0.000
Traditional leaders	0.352	0.088	0.480	4.178	0.029
The belief in *karma phala* law	0.272	0.098	0.280	2.778	0.021

Source: Processed Data, 2018

Based on Table 1, it can be explained that the five dimensions of credit risks had a significant influence on financial performance. It was proven by the significance marks of the five dimensions that were smaller than 0.05. The result of regression analysis on the output of Summary Model obtained R = 0.879. It means that the five credit risk dimensions had a highly strong relationship with financial performance. The adjusted R Square obtained amounted to 0.772, indicating that the five credit risk dimensions had an influence on the financial performance by 77.2 percent while the remaining 22.8 percent was influenced by other factors. The simultaneous test result obtained the value of F-count (51.975) > F-table (2.68). Hence, H_0 was rejected or the significance value (0.000) < 0.05. this means that loan quality, collateral quality, customary rules, traditional leaders, and the belief in *karma phala* law simultaneously constituted a significant influence on the financial performance of LPDs.

Loan risk is inseparable from the debtors' behavior and their growth in a diverse environment. Understanding the debtors from the cultural aspect is essential to building harmonious communication. The expectation from such a communication is the creation of business honesty. Harmonious culture is one of the cultures that put honesty first since it retains God element (Astawa &

Sudika, 2014). The culture constitutes Schein's culture development (2004) that has been implemented by Indonesian people (Astawa & Sudika, 2014) and gives a real contribution to employees' character building of a company. The fact gives an illustration that harmonious culture is required in creating productive and competitive human behavior (Astawa et al., 2016; Sukawati & Astawa, 2017).
The result of the qualitative research indicated that credit risk in harmonious cultural-based handling was influenced by loan quality, the collateral quality, customary rules, traditional leader, and the belief in *karma phala* law. The influence of loan quality and the collateral quality on credit risk is in line with the result of research conducted by (Castellani & Cincinelli, 2015; Baland et al., 2017; Agbola et al., 2017). Nevertheless, what different in terms of the applied indicators was the application of customary rules, traditional leaders and the belief in *karma phala* law. Customary rules provide binding force and are feared by the society. Therefore, debtors and creditors will not perform any fraudulence. The prevailing customary rules were related to the values of belief in the society. The people were afraid of the rules since they contained severe sanctions including being expelled from the village. Traditional leaders became a determinant factor for credit risk and played a role in loan approval. Traditional leaders actively conducted meeting with managers regarding loan or other matters related to the progress of micro financial institutions, customs, and religion. The role of traditional leaders in reducing credit risk through supervision had significant influence (Said et al., 2016; Alonso, 2015; Mitrovi, 2015; Astawa, et al., 2016; Astawa et al., 2017). An interesting finding in other indicators was the existence of belief element or a cultural value called *karma* law which means good deeds lead to good results. Hence, not paying the debt means committing a bad deed and will result in bad things. The belief has made people willingly pay their loan on time (Hassan, 2014).
The five indicators resulted from the qualitative study was quantitatively tested and indicated that they had significant influence as explained in Table 1. The simultaneous test also indicated a significant influence on performance. The research result provided a contribution to human capital theory stating that the good use of resources would cultivate productivity (GHANIA, Tarmezi, Said, & Yuliansyah, 2016; Becker, 1993). Productivity is achieved through efficiency or suppression on costs related to the occurrence of bad debt risk. If the cost is low, it could drive bigger profit. The research result contributed to risk management that employed local culture in reducing credit risk in LDPs. The research result was rare to find, thus, it provided an update in risk management developed by Castellani and Cincinelli (2015), Baland et al., (2017), and Agbola et al., (2017). The research result provided a strong encouragement to the LPD leaders to utilize harmonious cultural values to reduce credit risk.

CONCLUSIONS

Implemented harmonious cultural values could reduce credit risk. Customary rules, traditional leaders, and the belief in *karma* law strengthened the customers to obey the rules or agreement previously made. The belief and harmonious cultural values provided guidance to always do good things by obeying the commitment made to achieve happiness in life. The development of innovation also considers the condition of the society or the cultural values, hence, harmony could occur in achieving the sustainable goals of the organization.

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