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The Importance of Lender-borrower Relationships to the Availability of Small and Micro Credit: Case Study on Indonesian Kredit Usaha Rakyat Loans

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ABSTRACT

This study aims to examine how the relationships between a borrower and his potential lender affect the decisions of potential lender whether or not to provide or extend funds to the borrower. The author explores the available literature and original fieldwork to create a framework to capture this relationship. The study employs descriptive qualitative data to analyze and examine the research questions. The result shows that borrowers who build their commercial transactions with their lender on intensive relationships are more likely to receive and extend loans. The relationship effects arise because it motivates both lender and borrower to share private resources and facilitate access to loan opportunities, but does not influence the price of loans. To sum up, the lender-borrower relationships are valuable and seem to operate through quantities, trust and the length of these relationships. Furthermore, these relationships are more appropriate to be implemented for small and micro-lending.

Keywords: Lender-borrower Relationship, Asymmetric Information, Small and Micro Business, Credit Availability, Price of Loans
JEL Classifications: G21, O16, R51

1. INTRODUCTION

Medium, small, and micro-sized enterprises perform a significant role, especially in developing countries. “Small and medium enterprises represent 99% of businesses around the world and account for more than half of all private sector employment in the OECD countries” (CGA, ACCA, and CPA Australia, 2009. p. 8, reported in Samujh et al., 2012). Furthermore, these enterprises encourage creations of new business, enlargements of employment opportunities, create ideas for product innovation, and increase the production abilities (Nitani and Allan, 2005). Indonesian medium, small, and micro enterprises are no exception. These companies are the main contributor to economic activities since they contribute around 53.49% to Indonesian gross domestic product and created jobs for 85.4 million people or 96.2% of total employment in Indonesia (Indonesian Central Bureau of Statistic, 2007). Furthermore, they have a high ability to survive in economic crises condition, as they can face sudden shock better than their counterparts from the larger companies.

However, some empirical studies conclude that small and medium business face more significant financial constraint than their counterparts from large enterprises, particularly in the developing countries (Saadani et al., 2011; Beck and Asli, 2006; Cull et al., 2007; Riding and George, 2001). The small businesses were provided with credit with a lower amount than big enterprises. According to the Indonesian Central Bank (IBI), in 2014, only about 12% of the total loans provided by the commercial banks in Indonesia were delivered to medium, small and micro businesses (Indonesia Central Bank, 2014). When accessing a fund from credit markets, the medium, small and micro enterprises deal with different opportunities because of asymmetric information problems that exist between lenders and borrowers. This asymmetric information led to a lack of information between two parties, and it means that one party is provided with more or better information than the other. As concluded by Craig et al. (2007), the asymmetric information problems are severe and then lead to a financial constraint for small-micro lending and the failure of the credit market.

Some evidence indicates that lender-borrower relationships may reduce informational friction and enhance credit availability for firms (Cole, 1998; Petersen and Rajan, 1995). The theory of financial intermediation argued that through lender-borrower relationships, the lenders generate valuable information about borrowers that could not be available in financial markets. This information is identified as "soft" information that might not be easy to observe by others, verify by others, or transmit to others because it is hard to measure and deliver through the organizational structure (Berger et al., 2001). They also mentioned that the banks seem to build a relationship with borrower intensively to deal with the existence of information problems in the small lending. This relationship has become a high interest area for the financial institution and particularly for small enterprises. The pre-existing relationship between lender and borrower that create valuable information is used to discover the creditworthiness of the borrowers over a considerable period. It is crucial for prudent lenders to look for creditworthy borrowers, where the development of the long-term lender-borrower relation is identified as an appropriate way to obtain this information, especially for opaque firms.

Therefore, the author is interested in exploring the aspect of lender-borrower relationship on the implementation of credit guarantee schemes for decreasing the asymmetric information problem in the small lending. Could this relationship increase the availability of credit for small and micro enterprises? In the preliminary fieldwork, the small and micro enterprises in Lombok Island still utilize finance from local money lenders that explore an intense relationship on their operations. From this relationship, the local moneylenders could survive on running their business in the credit market. One of Indonesian Government credit programs is known as Kredit Usaha Rakyat (KUR) loan that initiated to encourage the development of financial access for small and micro businesses. This loan may have same characteristics with the loans from the local moneylenders. Thus it is crucial to employ the same mechanism, where the lender-borrower relationships take apart to maintain the sustainability of the KUR loan.

On the distribution of the KUR loan, an account officer (AO) has a significant part in the collection of personal information of small and micro-borrowers. The relationships are created through an interaction between the bargaining actors, i.e., AO on the one hand and the company's owner on the other side. Thus, in this study, the author focuses on investigating how the lenders (AOs) employ this relationship on distributing the KUR loans. Then, the analyses are conducted to answer two questions. First, "to what extent the relationships between lender and borrower could increase the availability of KUR loans?" Then, "whether this relationship could influence the term of KUR loans?"

2. THEORIES

The theory of financial intermediation argued that through lender-borrower relationships, the lenders generate valuable information about borrowers that could not be available in financial markets. This information is identified as "soft" information. Berger et al., (2001) mentioned that the banks seem to build a relationship with borrower intensively to deal with the existence of information problems in the small lending. This relationship has become a high interest area for the financial institution and particularly for small enterprises. The pre-existing relationships between lender and borrower create valuable information which explores to discover the creditworthiness of the borrowers over a considerable period. It is crucial for prudent lenders to look for creditworthy borrowers, where the development of the long-term lender-borrower relation is identified as an appropriate way to obtain this information, especially for opaque firms. Some empirical findings related to the existence of the relationship between lender-borrower are presented by some researchers. The lender-borrower relationships reduce lack of information and enhance credit availability, specifically for the small, micro, and young firms that are more informationally opaque (Cole, 1998; Petersen and Rajan, 1995; Berger et al., 2001; Lehmann and Doris, 2001).

The ability to collect the "soft" information is encouraged by doing a repeated business. The cost of gathering information is probably high if the lender and borrower transact only once, then the cost might be minimized by conducting repetitive transactions. Thus, the lender-borrower relationships influence the borrowing costs. Several studies found the evidence that this relationship is also significantly related to the term of a loan, for instance, the collateral requirements and loan interest rates (Petersen and Rajan, 1995; Berger et al., 2001; Cole, 1998; Menkhoff et al., 2012; Lehmann and Doris, 2001). The continual relation between lender and borrower in providing various financial services can produce valuable input for the lender to make decisions on whether to extend credit, how to cost the loans, and whether to require collateral or tie other conditions to the loan.

With a more extended banking relationship, a small firm could get a loan at a lower interest rate and does not need to provide collateral than other small businesses because a positive past relationship experience leads to a lender for expecting less risky loan. The accumulated information, which was collected during the lender-borrower interaction, is used to refine the loan contract terms. As financial intermediation, banks concern to overcome credit rationing problems of small and medium enterprises, where the level of credit rationing may depend on the strength of existing lender-borrower relationships.

Hence, the features of relation give significant impact on the quality and quantity of information provided to the lender. Uzzi (1999) investigated how the quality of relationship and the social interactions influence a small customer's capacity for getting funds and lowering the cost of borrowing. This relation will create cooperation that resulted in a continuous relation, in which both parties believe each other. As concluded by Fisman and Tarun (1999), in the lack of confidence, individuals tend to obtain more information and consider the importance of monitoring to reduce opportunism. To the extent that, preferable information flows indicate the existing of trust by understanding the other's behavior.

These relationships form individual associations cut down the long-term barrier of fear and mistrust and strengthen the habits of cooperation. As other researchers found that trust, confidence, and satisfaction act as the critical role in the enhancement of the lender-borrower relations (Uzzi, 1999; Ganesan, 1994). The trust may express from a proper work in the past that could diminish moral hazard and; thus, it could be lowering monitoring cost.

3. RESEARCH METHODOLOGY

A qualitative study was explored to investigate the lender-borrower relationships and its role to influence small firm's ability to access guaranteed loans, the term of the loan, and repayment's performance. The author conducted field research to help formulate the framework of lender-borrower relationships. The field study provides the empirical evidence for describing the proper actors, resources, and relationships. It also enabled a more refined analysis of lender-borrower relationships by focusing on the approval process of KUR loans.

This study was explored to get an overview of lender-borrower relationships by observing how they interact and communicate to formulate a framework for their relationships. This analysis was focused on how the AOs, as the leading actor on behalf of the lender. On distributing the KUR loans, the AOs have made a relationship with the borrowers before and after approving the loans through creating a continuous interaction and communication. The AO is the person in the bank who has the highest access to the soft information about the firm, owner, and community that are hard to quantify and communicate through the organizational structure. Before and after approving the KUR loans, commonly, the relationship between the AOs and the borrowers is based on individual and informal communications in which the AOs have more ability to evaluate the creditworthiness of the borrowers.

The author chose the AOs from the national banks as the informants who can give the information related to how they make communication and interaction with the borrowers. These banks are Bank Rakyat Indonesia (BRI/Indonesian Civil Bank), Mandiri Bank, Bank Tabungan Negara (BTN/State Savings Bank), and Bank Pembangunan Daerah (BPD/Regional Development Banks). Then, to strengthen the qualitative results, the author is also presenting a descriptive data from the survey results with the respondent borrowers (small and micro entrepreneurs who got the KUR's loan). The following Table 1 describes the participant AOs in the in-depth interview process.

Data collection and analysis method was based on Miles and Huberman's (1994). The author employed an in-depth interview with the AOs to get exhaustive information of how the AOs made a relationship with the borrowers. The author recorded all conversations on tape and then transcribed them to create a behavioral record for each interviewee. Questions were open-ended and moderately directive. Questions focused on the nature of the credit decision, primarily access to capital (who qualifies). Then, it follows with the questions focused on the character, function, and dynamics of lender-borrower relationships. Thus, the interviews with the respondents were conducted to discover the exciting and surprising feature of these relationships. Some specific questions were: For example, "How does the bank assess the creditworthiness of a small and micro-borrower?" "What types of things do you discuss with a client to assess their creditworthiness?" "What do you typically do when you meet clients?" "What is the basis of a good relationship with a client?" "How do relationships between you and the client develop?" The responses of respondents were post-scripted with questions to enlarge the information gathered from those questions, such as: "Can you tell me more about that? "Is there anything else?"

The procedure of data analysis consisted of two steps. The first step is understanding the patterns in the data. The second is looking back at theory and the emerging framework through adding, dropping, and revising the evidence. The purpose was to explain how relationship structure influences a micro and small borrower's access to capital.

4. RESULTS

4.1. Overview of Lender-borrower Relationships to Enhance the Provision of Loans Offered to Small and Micro Business?

The small and micro-borrowers are identified as not bankable clients by the banks since they do not have any enough collateral, and their business is categorized as a traditional business that could not provide any financial report. The decision of a bank to develop credit for micro-enterprises leads to adjusting to new paradigms according to micro dimensions, using different patterns of thinking, logic, and ways that have been practiced for other commercial credits. Loan disbursement for small and micro enterprises may have to be done by transforming the practices of "rentenir" (loan sharks), cooperatives or other informal microfinance institutions. It is impossible to design a product and service of banks according to formal standards since the condition of the small and micro-communities that have weaknesses regarding all aspects of their

Table 1: Description of participant AOs

No	Institutions	Code of participant	AO's sex	Number of years in industry
1	BRI Unit Kebon Roek	BRI KR1	Male	2.5
2		BRI KR2	Female	4
3		BRI KR3	Female	4
4	BRI Unit Narmada	BRI N1	Male	5
5		BRI N2	Female	6
6		BRI N3	Male	4
7	Mandiri Bank	MB1	Male	5
8	BTN	BTN1	Male	3
9		BTN2	Male	5
10	Bank Pembangunan Daerah NTB	BPD1	Male	10

Sources: Primary data. AO: Account officer, BRI: Bank Rakyat Indonesia, BTN: Bank Tabungan Negara, BPD: Bank Pembangunan Daerah business. Thus, the products and services of banks for small and microsegment no other choice should be designed to become a more straightforward feature according to those existing situation and condition. This simplification of arrangements is predicted to create a broad range of potential risks which can directly affect the sustainability of microcredit.

Credit analysis for small and micro-borrowers should be simple, easy and quick, concerning administration. However, the key is how the AOs know personal knowledge (personal knowledge in detail) of the prospective borrowers. In this case, not only rely on financial statements, inventory records or information about his business. The AOs must be more observant to see signs, indicators, body language, tidiness in managing the business, his attitude in accepting the presence of others, family conditions, life experiences, his position in the community and others, all of which will show the identity of the prospective borrowers. Ideally, potential small and micro-borrowers are recruited based on the AOs judgment through an actual observation on candidates before the applicant applies.

Therefore, to recruit small and micro-borrowers should be done differently, in which the intangible nature of the borrower's candidate becomes very important because it is not detected by notes, documents or things that can be manipulated. Further, factor intuition and feeling will play a significant role. These kinds of ways could be identified as building a lender-borrower relationship. So that, the prospective borrowers who have been recruited will not be a problem in the future according to the possibility of default loan to happen.

Based on the literature, one of the direct effects of lender-borrower relationship is enhancing the provision and quantity of loan, especially for small and micro business. This lender-borrower relationship is identified with the collection of "soft" information continuously through interaction with the firms, its owner, and its local community on a diversity of ways and employs this information to make an approval decision of credit (Berger et al., 2001). The soft information is usually related to the creditworthiness of the borrowers, which is not easily observed and verified by others or even communicated to others in which the long-term relation takes place. The ability to collect this information through lender-borrower ties depends on some aspects, such as the capacity of a lender to communicate and interact with a borrower, and also trust between them that created by interaction over time.

4.2. Aspect of Continues Interaction on the Lender-borrower Relationship

The moral hazard problem arises in the implementation of credit guarantee schemes due to the less willing of a borrower to repay the loan after informed about a government's credit program. Therefore, to diminish this issue, the lenders employ a specific staff (AO) who directly relate to the borrower. The AOs perform a unique relationship with the borrowers which have a positive aspect that gradually develops. The primary role of the AO is deciding who is credit-worthy to get a loan that not easy to do. The integration of the business activities and the private life of the company's managers can be viewed as a vital source of performance ambiguity since the company's capital, and the owner's equity is often intertwined. Thus, the AO need to estimate how a borrower's private life influences the company's economic performance. The discussions of the individual matter have typically performed with an intense interaction in which increasing the integration of commercial transactions between borrower and bank. The author asked the AOs how they communicate and interact with their prospect borrowers. The answer of the AOs is presented in Box 1.

According to Box 1, the author resumes that the AOs build much communication with prospective borrowers. Almost all of AOs have the same opinion that they impose to collect information not only about the business but also borrower's private life from visiting the business of the customer and the customer's surrounding community. Some of the borrower's individual life may influence their ability to repay the loan regularly. The author found evidence from the interview with the AOs. A client who has a family problem, such as has a conflict with her/his spouse, tend to have difficulty in repaying the loan regularly since this issue most often reduces the ability for running well the business. Thus, the AOs should collect the "soft information" about the clients through intensive interaction that built relationships. Based on interaction theory, it considers both sides of a relationship in which individuals are actively involved (Ford, 1997). The lender and borrower's cognitive perceptions about the value of the relationship are necessary for this relationship's development.

From this interaction, the AOs need to realize what is going on with customers in which the situation is dynamic; they have to interpret the information provided by the client. This finding provides empirical support for theories of financial intermediation positing that lender-borrower relationships generate valuable private

Box 1: The interview results with the account officer of the National Banks

BRI KR2 said that:
"In the beginning, I try to get information about my clients from their surrounding community, visited their business and then have a contact and interview with them. Making many interactions with a customer create a relationship. This relationship means that I know a person very well, and you feel very close to him. In another word, the more I know a person, the more he understands why I am asking some questions. He does not feel too defensive." (Personal communication)
Then, BPD1 also mentioned that:
"You need to realize what is going on with the clients. So, we need to interpret the information provided by the customer and lead us to develop a useful and great conversation and interaction.....in that way, we can get information for evaluating the creditworthiness of borrowers. By developing this intense interaction make a "relationship." (Personal communication).
BRI KR1 said that:
"On the first meeting, I play my intuition and read the body language of clients to trace their behavior and character. By making a lot of communication and repeating the same question then analyzing the consistency of their answer, I may be able to identify the character of a customer. The more consistent the answer they give, the more honest they would be." (Personal communication)

information about the commercial prospects of the borrowers. Thus, the banks could produce information and design a proper credit agreement for small and micro-borrowers to overcome credit rationing problems in which the asymmetric information is most horrible. This finding is supported by the previous study by Lehmann and Doris (2001), the private information gathered by a bank (an AO) over time provides a valuable commitment vis-à-vis the borrower and enables low-cost renegotiations of loan contracts. Berger et al. (2001) also reported that the information gathered over time has significant value beyond the firm's financial statements, collateral, and credit score, helping the relationship lender deal with informational opacity problems better than potential transactions lenders.

The ability of AOs to build a relationship with clients could influence their capacity to trace the credit-worthiness of borrowers appropriately. The frequency or quantities of interaction (contact) between a borrower and lender/AO may affect the quality of their relationships. The survey result presents the rate of communication and interaction between the AO and respondents as the borrowers after guaranteed loan's approval. Figure 1 indicates the frequency of contact between the borrowers and AOs.

According to Figure 1, only 7% of total respondents had had once meeting with the AO, and 11% of total respondents had had a rare meeting with the AO. Further, 17% of total respondents employed a contact once in 2–3 months, which identified as the regular visiting by the AO. On the other hand, most of the interviewees (65% of total respondents) conducted a monthly meeting and a daily meeting with the AOs. The monthly and daily meeting is being carried out with the most AOs for micro and small borrowers since the AOs have the most significant access to these kinds of clients. The daily meeting is usually performed for the micro-borrowers who work or running a business in a traditional market. The AOs come every day to the borrower's sites of activity in the traditional market for paying the loan, saving their money, or just talking about the business.

The actors in this relationship often have an extensive ability to create a general type of understanding among the members of a network. Also, in the close relationship, the AO realizes the operating environments of a specific business of a client. It implies some indication of managerial aspects and the possibility of a trade to be successful. This aspect is described in Box 2 that based on the interview with the AOs.

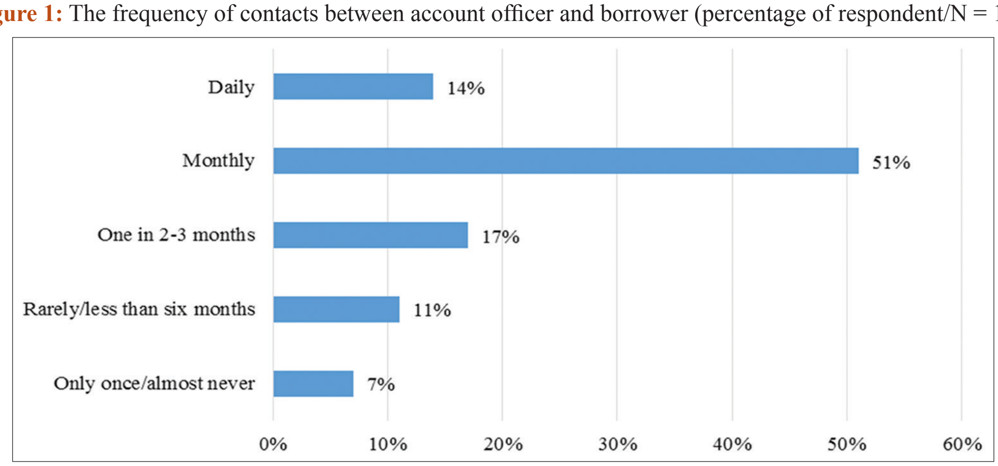
Thus, according to Box 2, officially, the AOs serve all customers in the same way. However, they will prefer to serve the well-known clients to be more comfortable to trace the creditworthiness of these customers and to conduct a restructuring of credit in the case of default. In some cases, the borrowers access a loan easier from personally known AOs, since the AOs could gather and interpret the soft information easily from these borrowers and are managed easily related to the case of default loan. If the AO give more understanding to the defaulted customers and give the concession to reschedule the repayment, the customer will respect it and give the best effort to repay the loan as soon as possible.

From the borrower's side, they feel secure to get the KUR's loans because they had a relationship with a bank's officer. Since the

Box 2: The interview results with the account officer of the National Banks

BRI KR3 said that:
"I do not doubt to serve a client whom I know well….especially who has a family relation with me…..I do not need much time to evaluate his/her credibility to accept a loan….and even, someday, he/she face a difficulty in repaying the loan, it will be much easier to conduct a restructuring of credit." (Personal communication)
Then, BTN1 explained that:
"I serve all my customers in the same way…..even with my family…. of course, I will know better if the client is my family….so the important thing is credit-worthiness of client….whoever he is….I do not want to get a trouble because of family reason." (Personal communication).
MB1 said that:
"If the client faces a difficulty in repaying the loan, I would try to give more understanding and some suggestion to solve the repayment problem than the pressure to repay the loan on time. Even, in the case of default loan, I give the concession to reschedule the repayment….As a result, once I endorse the clients, they tend to honor it and give the best effort to repay the loan as soon as possible." (Personal communication).

Figure 1: The frequency of contacts between account officer and borrower (percentage of respondent/N = 109)



Sources: Primary data (author's survey in West Lombok and Mataram) collateral is "officially" not compulsory for this loan, if they have a connection or relation with a staff of Bank, it will make the approval process for the loan is much easier. Suryani (2015) found that the small borrower could obtain a loan because of a connection with an AO of a bank and without any complex requirements. While, the evidence in the field study also showed the same thing, as stated by a respondent that "after 5 years relation with a commercial bank in Mataram city, I always can extend my credit easily in that bank since I have a good track record on repaying my debt" (Personal communication). Then, the other respondent said that "I know a credit officer of bank X. He kindly gave me the opportunity to give an extended period when I found a difficulty in repaying my debt on time. It is a kind of "a burden of the soul," so it makes me feel pushed to repay the loan regularly." (Personal communication).

Based on the interview result above indicate that the relationship with the borrower seems to influence the approval decision by an AO, while the borrower loves to apply for a loan through the AO that they have known well. It means the personal relationship between AOs and the borrowers would influence the effectiveness of commercial transactions between them. If the assessment of borrower's creditworthiness is hard, then it could be measured through personal networks. Both parties (lender and borrower) do not only depend on impersonal sources but also count on people they know. Therefore, through this relationship, the lender (AO) and the borrower try to get their desired goal by applying the appropriate actions. This finding is supported by the previous evidence that the relationships between lender and borrower supply a point for recognizing the borrower's necessity and resources, where both sides could improve their understanding of each other because of the provided information (Lehmann and Doris, 2001). Also reported by Ennew and Martin(1995) that a mutual understanding of both partners are crucial defended on the flow of information, and then the informal aspects of a lender-borrower relationship influence the extent to which small and micro-borrowers feel constrained.

4.2.1. The aspect of trust on the Lender-borrower relationship

The financial intermediation function of a bank depends on trust between borrower and lender/AO. Trust is the keyword that created through lender-borrower relationship and then leads to transfer their private resources. By the continued relationship, the AO knows the clients very well and then create a trust with each other and finally gets valuable information especially about the creditworthiness of the clients. A good relationship is beyond the products and interest rate, and a connection with the customer should be created based on the emotion since it is critical to have for trusting each other. The interviewed AOs described how trust takes place in the relationships that described in Box 3.

According to Box 3, trust is a crucial aspect of building a relationship, which then delivered to be a commercial transaction. The lender-borrower relationships will be constructed efficiently if the lender and borrower trust each other, respect each other, and then the relationship is done based on humility for which both parties feel comfortable with sharing information about everything, especially about the business. Further, the AOs imply that trust could be created if they come as a friend rather than as a person from the bank and should share information about them as a person and make the borrower understand and see the AOs like themselves. Therefore, the borrowers disclose their private information to the AO which then helps the AO to trace the creditworthiness of borrowers. Further, the AO can interpret information around the clients and is willing to share his company's services for the borrowers by giving a sign of approval decision. Finally, the AO also feel secure to provide information about their products and making a right credit decision for the borrowers, by sharing information means that getting information back and it is a kind of a "quid pro quo." This finding is consistent with the theory by Fishman and Kanna (1999). They conclude that trust arises when a party has enough information about the other to accurately predict its behavior and each party has fully internalized the other's preferences.

Box 3: The interview results with the account officer of the National Banks

As BPD1 mentioned that:
"I think a good relationship is a relationship based on mutual trust, respect, and humility so that it can create a long-standing relationship….it will be a satisfaction to me as an AO if I can help the clients to obtain a loan and they become more advanced on running their business." (Personal communication)
MB1 said that:
"I share information about me as a person, I make them understand and see me like I am, and then share with them my company's services" (Personal communication).
BRI N1 also explained that:
"The clients are more welcome if I come as a friend rather than as a person from the bank, so the borrower showed no overt signs of his condition. Without trusting each other, we could not transfer a valuable information for making a commercial transaction…. By trust, I chat with the customer about everything and open his information…. Hence, I can interpret information around the client and trace if he is trustworthy for getting a loan then I also feel more secure to give a sign of approval decision….. This process is known as 'know your customer'……it means that treat them as good friends in a positive way, but still, there is a limit." (Personal communication)

4.2.2. Aspect of length of relation on the lender-borrower relationship

It is proper to conclude that the longer a relationship happens between a borrower and an AO the more significant the information flow between them and the more crucial the relationship becomes. The length of relationships between AOs and the borrowers affect the skill of AOs to gather and interpret the soft information from the borrower. The AOs generate the valuable private information about its customers quickly. Then, the AOs are more likely to extend credit to an existing client who has a pre-existing relationship with them, since the new ones need a thorough evaluation and consideration that are costly. As explained by an AO (BRI KR1) that: "I prefer to serve a loan application for the existing clients and a customer who has a pre-existing relationship with me….I ensure to approve a loan for this kind of customers." (Personal communication, June 2015). Another AO (BRI N3) mentioned from the other aspect that:

"I can get a new client based on a recommendation of my existing customer, whom I have known for long enough…. I can gather information about him/her, such as information about who her/his supplier is and who her/his fixed customer is….so that I can assess the feasibility of her/his business and I can offer her/him to get a loan for her/his business." (Personal communication,).

Moreover, a small firm that has a more extended relationship with the lender/AO should have more excellent ability to get a loan. As an AO (BRI KR2) explained how she keeps relating to her client:

"I do much interaction with my clients after loan's approval….it is a kind of great relationship….Sometimes, I also help my client to promote their business….You know this is very effective for me to maintain my trustworthy clients….since it will be harder to find new credit-worthy client rather than keep this kind of clients." (Personal communication).

The other aspect of the advantage of the long-term relationship between AO and borrower is motivating the AOs to bet their reputation in the bank on the borrower's behalf. It does not necessarily attempt to affect the credit's feature. Instead, the AOs use their name to impress the assessment of the credit decision makers regarding a borrower's creditworthiness. The author describes below the description of the AOs regarding how these factors can influence a loan's deal for a small firm in which its creditworthiness is unclear (Box 4).

Another aspect of emphasizing the lender-borrower relationship is the lenders must overwhelm more lending authority to their AOs. Therefore, the AOs have a crucial role in recommending the loan approval process as they know each borrower's characteristic very well. As concluded by the previous study, firms with more extended relationships and more sources of financial services are more likely to be extended credit, and their loan applications are less likely to be declined (Ono et al., 2013; Riding et al., 2007). However, the adverse impact of this authority may happen, in which the agency problems between the AOs and the bank as a whole could worsen because of conflict of interest between both of them. AOs are likely to have a motivation to approve more for new loans rather than evaluating existing loan of small and micro-borrowers because the remuneration is based on short-term revenue. Friendship with the borrower also could be the reason for credit officer to hide a worse condition of the borrower.

Box 4: The interview results with the account officer of the National Banks

BRI KR3 referred that:

I could not provide a loan for Mr. X because of some reasons, so I recommended him to get a loan from another AO in the same office with me or other AO from the difference office.....Thus, that client would not go to another bank...no matter what, for the prospective client I will try to serve him to get a loan….I have to make my institution as the 'one stop shopping' for our customers." (Personal communication)

In addition, MB1 suggested that

"I ensure to recommend to a client whom I have known for a long period…. even though my recommendation could not change the term of loan….just it could be used by my chief officer for making the approval loan decision….since I know my clients better." (Personal communication)

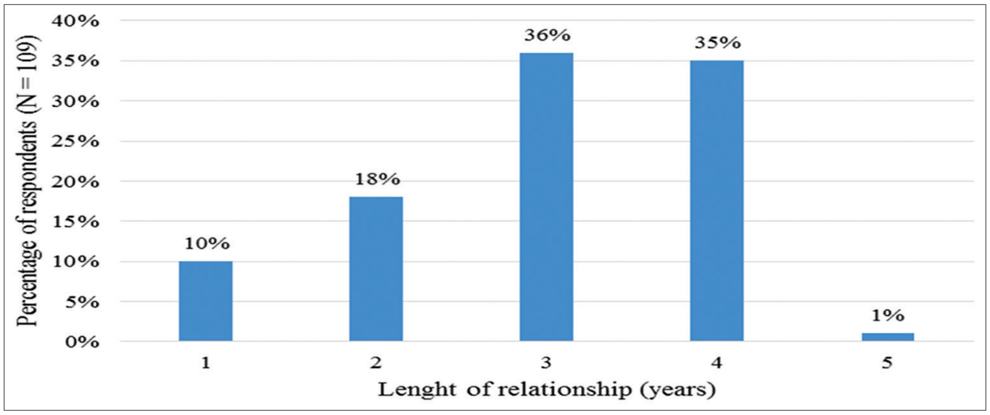
Thus, the author concludes that the banks might require more resources monitoring that addresses the agency problems between the bank and the AOs, in that the bank relies more on personal interaction for the loan approval process. Further, the bank uses a more discretionary approach and rely more on a pre-existing relationship that leads to information about the character of the borrower. Therefore, the banks impose more in controlling and evaluating the performance of their individual AOs' by employing the review function of the loan. The survey results of this study indicate that the more extended lender-borrower relationship relates to the size of the loan was provided by the lender. According to Figure 2, most respondents (72% of total respondents) have 3 years and more of relationship with a particular bank, whereas the rest of them (28% of total respondents) have 2 years and less of relationship. Also, the customers who have a relationship about 5 years and more were likely to be able to get a loan with the amount until 2 billion rupiahs. These respondents have a develop business and a more extensive size of firms. Thus they are categorized as the credible and creditworthy clients by the lenders. Whereas, the respondents with 3 years until 4 years of relationships got a loan more than 50 million rupiahs. Moreover, the respondents with 2 years and less of relationships got a loan max 30 million rupiahs.

5. CONCLUSION

The results of the previous studies show that credit availability and firm's ex-post performance increase if the loan availability especially to the small-micro business, and also the young firms. In 2014 KUR's loan could be provided for more than 12 million of small and micro firms around the nation. The KUR's loan has a significant role in supporting financial access for these small and micro businesses that lack enough collateral and require a simple term. However, since the KUR's loan is a "credit program" that created by Indonesian Government leads to the moral hazard problem that comes from the borrower, where the borrowers will be less incentive to repay the loan properly.

The national and regional Banks have created many small branch offices and terrace offices to be able to serve a lot of small and micro-borrower in accessing the KUR's loans. In these offices, the AOs are worked. They serve many small and micro firms not only in the office but also by coming to the location of these enterprises. The AOs can transact on the spot, without requiring the customers to come to the office. These loans are delivered by employing an intensive interaction to evaluate the creditworthiness of a borrower. Therefore, to recapitalizing the amount of outstanding loan of KUR's loan, the lender is trying to assess precisely the feasibility of a customer by building a good relationship with the borrowers. Through employing the lender-borrower relationship, these banks can maintain the performance on distributing the KUR's loans with non-performing loans (NPL) of 3.9% below to 5% (standard maximum for NPL). They could reach a significant amount of small and micro-borrowers (more than 12 million of small and micro firms).

Figure 2: Percentage of respondent, loan size and length of relations between the account officers and borrowers



Sources: Primary data (author's survey in West Lombok and Mataram)

Most of the KUR's borrower is small and micro-entrepreneurs; thus, the lenders also employ a difference strategic on processing KUR's loan approval to these clients. Creating an intense lender-borrowers relationship is believed as one of the useful methods for this credit skim. As the frontline officer, the AOs create a connection with the customers by making much communication with the potential borrowers, and they intend to collect information not only about the business but also borrower's private life. By this relationship, they may be able to identify not only the business but also the characters of the borrowers. Measuring the character of borrowers is the most challenging task in the process of credit. Some AOs mentioned that besides the continuous visiting and observing the clients, using intuition is also essential to assessing the character of borrowers. By this step, the banks could produce information and design a loan agreement to deal with credit rationing problems of small and micro firms in which asymmetric information is most awful.

On the other hand, the AOs indicate a tendency to provide a loan to a borrower, who has a strong relationship with them, such as family, relatives, friends, and even acquaintance. These should surely be a negative side of a lender-borrower relationship. Since the AO should reach a specific level of NPL for his loan, it makes the AOs officially serve all customers in the same way. Furthermore, they tend to serve the well-known clients who are more accessible to measure their creditworthiness and to conduct a restructuring credit. In fact, the personal relationship between AOs and the borrowers would influence the effectiveness of their relationship regarding reaching their purpose. To the extent, if the assessment of borrower's creditworthiness is hard, then it could be measured through personal networks. The lender and borrower relationship supplies a basis for understanding the borrower needs and resources, where both sides could improve their understanding of each other because of the provided information.

The lender-borrower relationships will be efficiently built if the lender and borrower trust each other that lead to transfer their private resources. The borrowers disclose their private information to the lender (AO) that helps the AO to trace the creditworthiness of borrowers. Then, the AO also feel secure to provide information about their products and making a right credit decision for the borrowers, by sharing information means that getting information back, and it is a kind of a "quid pro quo."

A small firm that was having a long relationship with the lender/AO should have more excellent ability to get a loan. The AO would tend to approve the extend credit for an existing client, especially for the customer with a right loan's track record since the new ones need a thorough evaluation and consideration that are costly. The long-term relationship between AO and borrower is motivating the AOs to employ their name at the bank on the borrower's behalf. This recommendation does not necessarily attempt to affect the credit's features, slightly influence the expectations of the credit decision makers regarding a borrower's creditworthiness.

Another aspect of offering relationship lending is that banks must provide more lending authority to their AOs. The AOs have a crucial role in recommending the loan approval process as they know each borrower's characteristic very well. However, this authority may worsen agency problems because of different incentives between the AOs and the bank. Thus the banks tend to rely more on controlling and evaluating the performance of AOs individually through the loan review function.

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