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The Effect of Credit System on Performance of Baitul Mal Wat-Tamwil: Case Study in Riau Province

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Abstract:

Baitul Mal wat-Tamwil is a financial institution that assists in micro, small and medium enterprises. As a financial institution Baitul Mal wat-Tamwil in some areas has not yet implemented, as in the Kampar, Kuansing and Pekanbaru areas have some weaknesses. The weaknesses experienced by this institution such as small business settlement solutions can not be achieved as Baitul Mal wat-Tamwil is inactive and disturbed. This study aims to identify the influence of the credit system applied in Baitul Mal wat-Tamwil institution towards its performance. The methodology used in this study is the case study of qualitative methods. These are three commonly used data collection methods, such as 1) open interviews in depth, 2) direct observations and 3) written documents (non-numeric data but visual data and word data). The findings of this study found that credit appraisal was too loose and no collateral credit was a weakness of the credit system applied by this institution.

Key words: Baitul Mal wat Tamwil, Credit System, SMEs

INTRODUCTION

One of the microcredit institutions that can help finance micro, small and medium enterprises is Baitul Mal wat-Tamwil. This institute assists small capital financiers with a profit-sharing system. Baitul Mal wat-Tamwil has the power to access capital from public savings products and use them for microcredit. In addition Baitul Mal wat-Tamwil ease of providing financing or credit and without collateral. One of the unique things about small traders is their commitment and their moral judgment. During the big business busy doing all kinds of commercial crimes that violate the law in order to improve the commerce and desires. In fact, small traders stick to the ethics of commerce and morals, there is no desire to take actions that can harm themselves or others. Baitul mal wat-Tamwil is the appropriate answer as an alternative to advance their business but Baitul Mal wat-Tamwil is a bit weak in supporting credit or small pension financing because of the various problems faced. The weakness of Baitul Mal wat-Tamwil has to be solved with various strategies but can be solved with maximum. Some of the weaknesses of this institution are the weakness of institutionalization, lack of competence of human resources and less than optimal supervision. This weakness resulted in the performance of this institution to be less good but on the other side of this institution is needed by small traders to help their capital.

PROBLEM STATEMENT

As an institution that supports the capitalization of small pensioners and based on the above exposure, the researcher wants to identify the effect of credit system applied in Baitul Mal Wat-Tamwil institution to its performance. Is the credit system implemented by this institution good and running properly?.

LITERATURE REVIEW

The Credit Risk Theory

Risk is the position where the actual return of an investment is different than expected return. Risk means the possibility of losing the original investment and the amount of interests accrued on it. Credit risk is the risk that a borrower defaults and does not honor its obligation to service debt. It can occur when the counterpart is unable to pay or cannot pay on time (Gestel and Baesens, 2008). The risk is primarily that of the lenders and the loss of principal and interest, disrupt losses, or as the insolvent bank is unable to return funds to a depositor. To reduce the lenders risk, the lender may perform a credit check on the prospective borrower, such as mortgage insurance or seek security or guarantees of third parties. In general, the higher the risk, the higher will be the interest rate that the debtors will be asked to pay on the debt (Owojori, Akintoye and Adidu, 2011). Credit risk according to Salas and Saurina (2002) refers to the risk that a borrower will default on any type of debt by failing to make required payments.

Credit Management

Key Credit management variables include;

1. *Client Appraisal*

The first step in limiting credit risk involves screening clients to ensure that they have the willingness and ability to repay a loan. Microfinance Institutions use the 5Cs model of credit to evaluate a customer as a potential borrower (Abedi, 2000). The 5Cs help MFIs to increase loan performance, as they get to know their customers better. These 5Cs are: character, capacity, collateral, capital and condition.

a. Character - refers to the trustworthiness and integrity of the business owners it's an indication of the applicant‟s willingness to repay and ability to run the enterprise.
b. Capacity

assesses whether the cash flow of the business (or household) can service loan repayments.

c. Capital - Assets and liabilities of the business and/or household.
d. Collateral -Access to an asset that the applicant is willing to cede in case of non-payment, or a guarantee by a respected person to repay a loan in default.
e. Conditions-A business plan that considers the level of competition and the market for the product or service, and the legal and economic environment

Inkumbi (2009) notes that capital (equity contributions) and collateral (the security required by lenders) as major stumbling blocks for entrepreneurs trying to access capital. This is especially true for young entrepreneurs or entrepreneurs with no money to invest as equity; or with no assets they can offer as security for a loan. Any effort to improve access to finance has to address the challenges related to access to capital and collateral. One way to guarantee the recovery of loaned money is to take some sort of collateral on a loan. This is a straightforward way of dealing with the aspect of securing depositors‟ funds.

2. *Credit Risk Controls*

Key Credit controls include loan product design, credit committees, and delinquency management. (Churchill and Coster, 2001).

a. Loan product design

MFIs can mitigate a significant portion of default risk by designing loan products that meet client needs. Loan product features include the loan size, interest rate and fees, repayment schedule, collateral requirements and any other special terms. Loan products should be designed to address the specific purpose for which the loan is intended.

b. Credit Committees

Establishing a committee of persons to make decisions regarding loans is an essential control in reducing credit (and fraud) risk. If an individual has the power to decide who will receive loans, which loans will be written off or rescheduled, and the conditions of the loans, this power can easily be abused and covered up. While loan officers can serve on the credit committee, at least one other individual with greater authority should also be involved. The credit committee has the responsibility not only for approving loans, but also for monitoring their progress and, should borrowers have repayment problems, getting involved in delinquency management.

c. Delinquency Management

To minimize such delinquency MFIs can use the following delinquency management methods Institutional Culture: A critical delinquency management method involves cultivating an institutional culture that embraces zero tolerance of arrears and immediate follow up on all late payments. MFIs can also remind clients who have had recent delinquency problems that their repayment day is approaching.

d. Client Orientation

A logical first step toward developing a zero-tolerance institutional culture is to communicate this concept to each new client before she receives a loan.

e. Staff Incentives

Creating staff involvement in discouraging delinquency, through a staff incentives system, can be effective. Delinquency Penalties: Clients should be penalized for late payment. This could include delinquency fees pegged to the number of days late and limiting access to repeat loans based on repayment performance.

f. Loan Rescheduling

Given the vulnerability of the target market, it is common for borrowers to be willing but unable to repay. After carefully determining that this is indeed the case it may be appropriate to reschedule a limited number of loans. Only done under extreme circumstances, this may involve extending the loan term and/or reducing the installment size.

3. *Collection Policy*

There are various policies that an organization should put in place to ensure that credit management is done effectively, one of these policies is a collection policy which is needed because all customers do not pay the firms bills in time. Some customers are slow payers while some are non-payers. The collection effort should, therefore aim at accelerating collections from slow payers and reducing bad debt losses (Kariuki, 2010).

RESEARCH METHODOLOGY

To answer the above problem, the researcher uses qualitative research. According Hancock, Windridge and Ockleford (2009) qualitative research is a type of scientific research. In general terms, scientific research consists of an investigation that:

- Seeks answers to a question
- Systematically uses a predefined set of procedures to answer the question
- Sollects evidence
- Produces findings that were not determined in advance
- Produces findings that are applicable beyond the immediate boundaries of the study

Qualitative research shares these characteristics. Additionally, it seeks to understand a given research problem or topic from the perspectives of the local population it involves. Qualitative research is especially effective in obtaining culturally specific information about the values, opinions, behaviors, and social contexts of particular populations. Qualitative methods are typically more flexible than quantitative. It is the allowance of spontaneity and adaptation of the interaction between the researcher and the study participant. For example, qualitative methods ask mostly "open-ended" questions that are not necessarily worded in exactly the same way with each participant. With open-ended questions, the responses tend to be more complex than simply "yes" or "no."

In addition, with qualitative methods, the relationship between the researcher and the participant is often less formal than in quantitative research. Participants have the opportunity to respond more elaborately and in greater detail than is typically the case with quantitative methods. In turn, the researcher has the opportunity to respond to the participants by tailoring subsequent questions.

FINDINGS

After data collection and observation it was found that Baitul Mal wat-Tamwil made two weaknesses in its credit system, namely:

a. Appraisal of Credit Appeal Too Loose

This study reveals that there are still some Baitul Mal wat Tamwil admiring credit to customers who are not based on the procedure, only based on the family system, without doing proper analysis, it seems that appraisal of credit is too loose but there are also some Baitul Mal wat-Tamwil making a system of appraisal of a request or a strict analysis of credit or financing, initially rather than a proposition or application to the realization of credit or financing shall be systematized. This loan application analysis is run on the appraisal of capital, character and customer's capability in making reverse payments.

This study is consistent with Pramudita and Subekti (2014) that:

1. Assessment of Capital or wealth.

Capital is something that becomes the object of financing analysis by microcredit agencies. Capital is a very important necessity for establishing a trade and becoming a commercial source of income.

2. Assessment of effort to repay debt

Customer endeavors in managing and running a trade, labor is necessary to control the trade, where the trade is very dependent on capital and funds rather than third parties such as Baitul Mal wat Tamwil, if the customer or prospect is unable to manage his business then this is where Baitul Mal wat-Tamwil has a great role and possesses a capability in controlling credit and safety.

3. Analysis of Circumstances

Assessment of the circumstances of the environment is intended here is related to the development of customer trading activities, similar circumstances there is a big risk or not, and the trade that run is the impression of the environment close together.

4. Character assessment

Talking about the character here, Baitul Mal wat-Tamwil certainly does not want to take risks, then in this case Baitul Mal wat-Tamwil will conduct studies or attention to customers or prospective customers, just as he has attitude, acts of praise or not and always well connected with anybody alone.

Aspects of assessment used Baitul Mal wat-Tamwil in credit to customers include: 1) assessment of revenue principles 2) assessment Capacity reverse payback. 3) assessment of possible risks

Following Steinwand (2012) says that what is meant by credit or financing assessment or analysis is the work that includes the provision of decomposition work rather than all aspects of both financial and non-financial. Making a credit appraisal decision decision must contain the decomposition, inference and choice of options used as a basis for making graduation rather than crediting or financing customers.

While Subekti (2014) states that credit or funding analysis has two main objectives: 1) Assist the bank to make a decision on the right of credit. 2) Help the bank to make a mistake in making credit decisions in other words do not create unhealthy credit for a bank. Banks certainly do not want the credit given to the debtor to end the problem. Outstanding loans are a disaster for the bank. In addition to experiencing financial losses, the bank will also spend less time, energy, mind and cost on resolving problem loans.

In lending (credit), Baitul Mal wat Tamwil is very cautious in evaluating the client's application of credit, because credit risk will be borne by Baitul Mal wat Tamwil obtained from loan activity (credit). If the customer fails to perform the repayment obligations, then the financing loss in this case is the failure of the customer in executing the agreed agreement in the contract (Hidayati, 2013). According to Ahmed and Rafiq (2012) and Hans (2013), credit fails to pay by the debtor causes bank funds to be non-refundable, as the funds are required to meet the obligations of the Bank to third parties, referred to as lending risks.

b. Credit without Collateral.

The occurrence of stalled repayments is a result of unsecured credit provision. Based on research sources, interviews at three Baitul Mal wat-Tamwil surveyed stated that it was forced to demand collateral for customers who were stuck in repayment of their loans, especially for clients who were known to be badly in the interest of instilling their sense of responsibility on their loans. The deposit is temporary as a binding obligation. Baitul Mal wat-Tamwil manager is not entitled to sell when the customer does not want to pay, unless it has been approved or permitted and agreed upon. Unsecured loans are offered to the public with various advantages. One of the advantages of this unsecured credit is a loan provided without collateral or guarantee will benefit the customer (Kuntjoro, 2012). In addition, in some bank loans usually without collateral are also offered for convenience to customers through lower repayments and even with agreed periods (Kasmir, 2014).

While Adinugroho (2012). Unsecured loans also have a time period, many options and can be adjusted with the ability to pay, users can make choices in determining the desired loan rates, besides that the loan can also be used for other purposes. However, unsecured credit is one of the banking products and practical solutions often become immediate funding requirements but many people complaining about bank credit approval process is difficult. In fact, bank credit approval is the easiest way to get a loan if the user understands and meets the requirements set.

Adiwarman (2013) mentions that it is possible that the bank will reject a loan application when the amount of repayment exceeds one-third of the income per month. Banks do not want customers to have difficulties paying for other needs and are forced to take part that should be used to pay off debts. That is, if the current debt amount of the customer has reached 30% of the income. This is because, if the consumer or customer has a debt liability of 30%, this will be a concern to the bank and the situation will be a problematic credit at all institutions including Baitul Wat-Tamwil.

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