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Credit Risk and Financial Stability in Supporting Local Economic Growth

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Abstract

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Bank Perkreditan Rakyat (BPR) plays a strategic role in strengthening Indonesia's financial system, particularly through its intermediation function for the Micro, Small, and Medium Enterprises (MSMEs) sector and local economies. BPR contributes significantly to enhancing financial inclusion, promoting economic diversification, and improving resilience against regional shocks. Nevertheless, the high level of credit risk remains a major challenge that differentiates BPR from commercial banks. Uncontrolled credit risk has the potential to weaken capital stability, disrupt intermediation functions, and trigger a broader crisis of confidence within the financial sector. Therefore, compliance with the Legal Lending Limit (*Batas Maksimum Pemberian Kredit*/BMPK) emerges as a crucial regulatory instrument to safeguard the financial health of BPR, prevent excessive credit concentration, and ensure long-term operational sustainability. This literature-based study aims to examine the role of BPR in maintaining financial stability, the implications of credit risk, and the importance of BMPK implementation. Findings indicate that strengthening risk management, corporate governance, and regulatory oversight is essential for ensuring the sustainability of BPR in supporting Indonesia's economic growth.

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1. Introduction

Bank Perkreditan Rakyat (BPR) is one of the important pillars in Indonesia's national financial system that has a significant role in supporting regional economic growth through its financial intermediation function. BPR focuses on providing credit to the Micro, Small, and Medium Enterprises (MSMEs) sector, which is the backbone of the domestic economy. The strategic role of BPR is not only related to expanding financial access for segments of society that have been less reached by general bank services, but it also serves as an instrument that strengthens local economic resilience. The presence of BPR in the community provides an alternative, more inclusive financing solution, especially for grassroots communities that desperately need access to capital to develop their businesses. Amidst the currents of digital economic development and the increasing complexity of the global financial system, the position of BPR remains crucial as a financial institution that prioritizes community-based financial inclusion (Rustendi, 2019).

The financial stability of BPR is a fundamental element that must be maintained, because if this institution experiences instability, it can create a domino effect that affects the regional economy (Yin & Ran, 2021). This condition will be especially felt by the MSME sector, which depends on the availability of liquidity from BPR. If BPR fails to maintain its financial intermediation role due to high credit risk, weak implementation of risk management, or a low level of compliance with regulations, especially the Maximum Lending Limit (*Batas Maksimum Pemberian Kredit*/BMPK), then public trust can decrease drastically. The decline in public trust has implications for the reduced ability of BPR to raise funds and disburse financing.

Ultimately, this condition has the potential to hinder the pace of national economic growth, given that the contribution of MSMEs to Indonesia's Gross Domestic Product (GDP) is recorded at more than 60% (Saputra & Darmawan, 2023).

One of the most prominent challenges faced by BPR is the high level of credit risk. This is inseparable from the characteristics of MSME debtors who generally have limited capital, weaknesses in business management, and relatively limited market access. Compared to general banks, credit risk in BPR’s tends to be greater because of poorly diversified credit portfolios and a relatively small capital size. Empirical studies show that credit risk has a direct influence on BPR's capital adequacy, so if not managed optimally, it can have a serious impact on the institution's financial stability (Rustendi, 2019). Therefore, strengthening the risk management system is an urgent need so that BPR’s can suppress the potential for non-performing loans. In addition to credit risk, compliance with banking regulations also becomes a determining factor for the sustainability of BPR operations.

One of the key rules is the BMPK provision which limits credit exposure to a certain party or business group. The main goal of this regulation is to prevent risk concentration which can lead to large losses if the debtor fails to pay their obligations. The disciplined implementation of BMPK has been proven to help BPRs reduce massive default risk, thus maintaining the financial health of the institution (Mudassir et al., 2020). Within a macroeconomic scope, BPRs are also not free from various external challenges. Regulatory changes, the acceleration of the banking system's digitalization, and global economic dynamics are factors that influence the financial stability of BPRs at the local level. Recent research emphasizes the importance of using the Capital Adequacy Ratio (CAR) and Non-Performing Loan (NPL) ratio indicators as the main parameters in measuring the health of BPR's. An adequate CAR level and a controlled NPL ratio provide a signal that BPR's are able to manage failure risk well (Ghenimi et al., 2021). With healthy and stable financial conditions, public trust in BPR's is strengthened, so that these institutions can expand the scope of financial inclusion services. Based on this description, this literature study has both academic urgency and practical relevance. From an academic perspective, this research seeks to enrich the literature on the role of BPR in the Indonesian financial system, especially regarding the relationship between credit risk, compliance with BMPK, and institutional stability.

2. Literature Review

2.1. Credit Risk at BPR's

The literature on credit risk at *Bank Perkreditan Rakyat* (BPR) confirms that one of the biggest challenges that this institution must face is maintaining the quality of credit disbursed to customers. This is crucial because the credit portfolio of BPRs is dominated by the Micro, Small, and Medium Enterprises (MSMEs) sector, so a narrow financing concentration makes BPRs more vulnerable to fluctuations in debtor businesses. This condition explains why the Non-Performing Loan (NPL) rate in BPRs tends to be relatively higher than in general banks which have a wider portfolio diversification and larger capital resources.

The research by Saputra and Darmawan (2023) highlights a similar phenomenon in sharia BPRs, where Non-Performing Financing (NPF) emerges as a dominant indicator in measuring credit risk. NPF not only reflects the level of failure in financing payments by customers, but also illustrates how strong the risk management system run by sharia BPRs is. Therefore, careful management of NPF is an important step in maintaining the health of the institution. In addition, Rustendi (2019) emphasize that credit risk has a negative influence on BPR's capital adequacy. When the ratio of non-performing loans increases, the loss reserves that must be prepared also swell, thus reducing the available core capital. As a result, the financial resilience of BPRs weakens and the potential for instability increases. Thus, controlling credit risk is an important key to maintaining the sustainability and stability of BPR operations in the long term.

2.2. Compliance with BMPK and Financial Stability

Compliance with the Maximum Lending Limit (*Batas Maksimum Pemberian Kredit*/BMPK) provisions is one of the crucial factors that plays a role in maintaining the stability and operational sustainability of *Bank Perkreditan Rakyat* (BPR). This regulation is designed to control the level of credit disbursement concentration to one party or a certain business group, so that the potential for systemic risk can be suppressed as much as possible. If the BMPK provisions are ignored, BPRs risk facing a surge in non-performing loans that will have a direct impact on the financial health of the institution and reduce public trust in the local banking system.

Mudassir et al. (2020) identified that BPR's compliance with BMPK is influenced by several important factors, including the quality of corporate governance, the effectiveness of risk management implementation, and the level of supervision carried out by regulators. With good governance and a structured risk management system, BPRs have a greater capacity to disburse credit in accordance with the precautionary principle. In addition, the role of regulators in conducting continuous monitoring is also a determining element so that the BMPK provisions can be implemented consistently.

The study conducted by Adhim (2019) confirms that an effective credit risk management strategy not only functions as a tool to reduce the potential for non-performing loans, but also has a direct implication on increasing compliance with BMPK regulations. Furthermore, maintained compliance contributes to strengthening the financial resilience of BPRs. Therefore, the literature emphasizes that there is a close synergy between the implementation of credit risk management and regulatory compliance, which together form the foundation of BPR financial stability in the long term.

3. Methods

This research uses a literature study approach as the main method to examine the role of *Bank Perkreditan Rakyat* (BPR) in the Indonesian financial system. The focus of the analysis is directed at two important aspects, namely credit risk and compliance with the Maximum Lending Limit (*Batas Maksimum Pemberian Kredit*/BMPK), both of which are directly related to the financial stability of BPR. The data used in this study comes from scientific articles published in reputable journals, conference proceedings, and relevant academic reports. The selection of literature sources is limited to publications in the last five years, with considerations of novelty, relevance, and direct connection to the issue that is the focus of the research.

The research stages are carried out systematically. In the first stage, literature that explicitly discusses issues related to BPR, credit risk, BMPK, and financial stability is identified. This identification utilizes international and national academic databases to ensure adequate source coverage. The second stage is a critical evaluation of the research methodology used in the literature. This process is important to ensure the quality of the data, the validity of the findings, and the reliability of the arguments in the selected literature. After that, a comparative analysis is carried out with the aim of finding recurring patterns, points of difference, and similarities from various research results. This analysis is then summarized in the form of a literature synthesis that is narratively structured to explain the close relationship between credit risk, BMPK compliance, and BPR financial stability.

The choice of the literature study method is considered most appropriate in the context of this research. First, this method allows researchers to gain a comprehensive understanding of complex phenomena, especially on the issue of BPR stability which is influenced by many factors. Second, a literature study is relevant to use when there are limitations of empirical data or access to primary data. In addition, this approach also provides space to explore in depth the dynamics of policies, risk management practices, and regulatory compliance mechanisms applied by BPRs. This is very important given that BPRs operate in a unique local context and are greatly influenced by the national regulatory framework and regional economic conditions.

4. Results

The results of the in-depth literature study show that the role of *Bank Perkreditan Rakyat* (BPR) in the Indonesian financial system cannot be underestimated. In Indonesia, although the banking sector has experienced rapid growth in recent decades, there is still a gap in financial access, especially in remote areas. Many communities in rural areas or areas with limited infrastructure have not fully enjoyed the benefits of conventional banking services (Philip & Williams, 2019). As a banking institution that is specifically directed to serve small communities and the micro, small, and medium enterprise (MSME) sector, BPR has a real contribution in expanding financial access and strengthening the local economic base. This role becomes even more significant because not all segments of society have the opportunity to access conventional banking services which usually apply stricter administrative requirements.

BPRs are present as a solution that is closer to the needs of grassroots communities, with relatively simple procedures and products that are suitable for local conditions. Thus, BPRs occupy a strategic position in encouraging financial inclusion while also being an instrument for regional economic empowerment. Their contribution in disbursing credit to MSMEs has been proven to be one of the important factors in supporting local economic growth and maintaining socio-economic stability in various regions (Saputra & Darmawan, 2023).

However, the literature also emphasizes that behind the great contribution, BPRs face significant structural challenges. Credit risk is a dominant issue that continues to overshadow the operational sustainability of these institutions. High credit risk is inseparable from the characteristics of debtors who generally have limited financial capacity, still simple business management, and relatively high income volatility. This condition causes the ability to repay loans to often be unstable, thus affecting the health of the BPR’s credit portfolio. Research conducted by Rustendi (2019) provides a clear picture that credit risk has a negative influence on BPR's capital adequacy. When the number of non-performing loans increases, the need for credit loss reserves also increases, thus reducing the available core capital. As a result, the financial stability of BPRs can be disrupted if risk management is not carried out optimally.

These findings are reinforced by Ghenimi et al. (2021), who emphasize the importance of financial indicators in assessing the stability of banking institutions, both conventional BPRs and sharia BPRs. Two main indicators that are often used are Non-Performing Loan (NPL) and Capital Adequacy Ratio (CAR). NPL reflects the quality of the credit assets owned by BPRs, while CAR shows how strong the bank's capital is in absorbing potential losses. A high NPL ratio that is not balanced with an adequate CAR can indicate a serious financial vulnerability. Therefore, effective credit risk management is absolutely necessary so that both of these indicators can be maintained within safe limits in accordance with regulations.

In addition to challenges that originate from within, the regulatory aspect also becomes a determining element in maintaining the sustainability of BPRs.

Compliance with the Maximum Lending Limit (BMPK) provisions is one of the important policies set by regulators to minimize the risk of credit concentration. BMPK is designed so that BPRs do not disburse too large a portion of credit to one debtor or a certain business group, because if that party fails to fulfill its obligations, the losses borne by the BPR can be very significant. In this regard, the research of Mudassir et al. (2020) identified that BPR's compliance with BMPK is influenced by a number of factors, including the quality of corporate governance (Good Corporate Governance/GCG), the effectiveness of internal supervision, and the competency of the risk management implemented. With good governance and a strong internal supervision system, compliance with BMPK can be carried out more consistently, so that the risk of credit concentration can be suppressed.

From a practical perspective, the implementation of BMPK has been proven to have a positive impact on the financial health of BPR's. Compliance with this regulation not only reduces the possibility of risk concentration, but also maintains liquidity, strengthens capital reserves, and increases public trust in BPRs. In other words, regulations are not just an administrative obligation, but an instrument designed to ensure the stability of banking institutions in the long term. Other literature studies also highlight that credit risk management practices in BPRs still need to be strengthened to be more adaptive to modern economic challenges. Adhim (2019) emphasize that an appropriate risk management strategy will have implications for improving the quality of BPR assets and competitiveness. This includes the application of a stricter credit rating system, diversification of credit portfolios so as not to focus on certain sectors, and the use of technology to monitor credit quality in real-time. Digital technology can help BPRs in collecting historical debtor data, conducting algorithm-based risk analysis, and identifying potential non-performing loans earlier. These steps will strengthen the effectiveness of risk management and lower the non-performing loan rate.

In addition to internal aspects such as risk management and compliance with BMPK, the literature also emphasizes the importance of adequate external policy support and regulation. Christiana and Syaflan (2022) confirm that capital adequacy is the main foundation of BPR financial stability. Although the research was conducted before 2020, its relevance remains high to this day, because the issue of capital is still a major concern for regulators in an effort to strengthen BPR resilience. Without adequate capital, BPR's will find it difficult to meet prudential provisions, face credit risk, and disburse a significant amount of financing.

Furthermore, the study conducted by Sari et al. (2022) shows that good corporate governance (GCG) has a close relationship with the effectiveness of risk management in BPR's. GCG not only concerns the transparency and accountability of management, but also includes a supervision mechanism that is able to reduce opportunistic behavior. With the implementation of solid governance, the risk of abuse of authority can be suppressed, so that the quality of credit management increases. This shows that strengthening governance is an integral part of the strategy to maintain BPR financial stability. If a common thread is drawn from the various literatures that have been reviewed, a consistent pattern can be identified. First, BPRs have a large contribution to expanding financial inclusion and encouraging regional economic growth. Second, BPRs are very vulnerable to credit risk because of the portfolio concentration in the MSME sector which has a high level of vulnerability. Third, compliance with BMPK, strengthening of governance, and the implementation of effective risk management are key factors in maintaining the financial resilience of BPRs. Fourth, external regulatory support, especially regarding capital adequacy, supervision, and governance policies, needs to be continuously strengthened so that BPR's can face the increasingly complex dynamics of the financial system. In addition, the literature study also provides a signal that regulators need to be more proactive in increasing supervision of BPRs. This is not only to protect the public as service users, but also to ensure the sustainability of BPRs as an integral part of the national financial system. Given that the contribution of MSMEs to Indonesia's Gross Domestic Product (GDP) reaches more than 60% (Saputra & Darmawan, 2023), the stability of BPRs which support the liquidity of MSMEs also indirectly contributes to the stability of the national macroeconomic economy.

Thus, the success of BPRs in maintaining their stability is not only important for the local community, but also for the Indonesian economy as a whole. Conceptually, the results of this literature synthesis enrich the academic understanding of the close relationship between credit risk, BMPK compliance, risk management, and BPR financial stability. Meanwhile, from a practical perspective, this study provides strategic recommendations for regulators, banking practitioners, and policymakers to continue strengthening the capacity of BPRs through strict supervision, improving the quality of governance, and capital policy support. Therefore, this research confirms that BPR stability is not just an internal technical issue, but also a strategic issue that requires joint attention to create a healthy, inclusive, and sustainable financial system.

5. Discussion

The results of the discussion from the literature study show that *Bank Perkreditan Rakyat* (BPR) faces a number of quite serious structural challenges in maintaining financial stability. The most dominant challenge is the high credit risk inherent in BPR operations. This is natural because most of the BPR credit portfolio focuses on the Micro, Small, and Medium Enterprises (MSMEs) segment which has limited capital access, weaknesses in business management, and a relatively high level of income volatility. With such conditions, BPR's have to deal with a greater risk of default compared to general banks which have a more diverse customer base. Nevertheless, the literature also confirms that the existence of BPRs still has a vital role because it is able to provide financial access for segments of society that have not been served by general banks. This means that although there are significant risks, the function of BPR as an agent of financial inclusion cannot be replaced. Therefore, a risk management strategy is a determinant of the operational sustainability and resilience of BPR's in the long term (Darwis Harahap & Sulaiman Efendi, 2022).

The practical implication of these literature findings is the need to strengthen the credit risk management system within BPR's. This strengthening can be done in several ways, including improving the creditworthiness assessment mechanism with more comprehensive instruments, increasing the capacity of human resources in terms of credit analysis, and adopting financial technology (fintech) to support the credit monitoring system in real-time. Technology adoption not only helps increase the accuracy of the assessment, but also speeds up the process of identifying potential non-performing loans. This is in line with the findings of Adhim (2019) who emphasize that a proactive strategy in dealing with credit risk will strengthen the quality of BPR assets and increase its competitiveness in the banking sector. In addition to internal factors, the discussion also confirms the importance of external regulations as a safety fence for BPR stability. The Maximum Lending Limit (BMPK) provisions, for example, have been proven to be able to reduce the potential for high-risk credit concentration. With this limitation, BPR's are not allowed to provide too large a credit to one debtor or a certain business group, so that the risk of losses due to large defaults can be minimized.

The findings of Mudassir et al. (2020) reinforce this view by confirming that the implementation of BMPK not only functions as a regulatory control instrument, but also as a mechanism for overall BPR financial stabilization. In other words, the regulation provides preventive protection against systemic vulnerability that may arise. From a public policy perspective, the discussion shows that the role of the government and monetary authorities is no less important. Support can be realized through increasing supervision capacity over BPRs, including the digitalization of reporting systems, strengthening the function of internal auditors, and providing financial education for customers so that they better understand the obligations and risks of debt. With these steps, credit risk can be minimized while increasing public trust in BPR's. This becomes very relevant considering that BPRs have a significant contribution to financing MSME's which are the backbone of the national economy (Prijadi et al., 2020). Thus, this literature discussion emphasizes that BPR stability is determined by a combination of various factors. Not only strong internal management in managing credit risk, but also consistent regulatory support, effective supervision, and government policies that favor strengthening regional financial institutions. The synergy between compliance with BMPK, strengthening of governance and risk management, and regulatory support is the key to the sustainability of BPRs in facing the dynamics and challenges of the modern economy.

6. Conclusion

This study concludes that *Bank Perkreditan Rakyat* (BPR) has a vital role in the Indonesian financial system, especially in supporting financial inclusion and regional economic empowerment through MSME financing. However, high credit risk is the main challenge that can threaten the financial stability of BPR. Uncontrolled credit risk has an impact on the decrease in capital adequacy, weakens the intermediation function, and reduces public trust. Compliance with the Maximum Lending Limit (BMPK) has been proven to play an important role in preventing risk concentration and maintaining the financial health of BPRs. The literature confirms that BMPK compliance, supported by good governance and an appropriate risk management strategy, is able to strengthen the financial stability of BPRs. Therefore, strengthening credit risk management, implementing effective governance, and complying with regulations must be the main priorities of BPRs. On the other hand, regulators and the government also need to strengthen supervision capacity and provide policy support to support BPR resilience. With this strategy, BPR's can continue to contribute to national economic growth while maintaining the stability of the Indonesian financial system.

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