

## Optimization of Bank Prudential Principles on MSME Loans in Batam City

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Article	Abstract
<p><b>Keywords:</b></p> <p>Economic Justice in Batam City, Legal Effectiveness, Prudential Principle.</p> <p><b>Artikel History</b>  Received: Jul 4, 2024;  Reviewed: Apr 19, 2025;  Accepted: Apr 27, 2025;  Published: Apr 30, 2025.</p> <p><b>DOI:</b>  <a href="https://dx.doi.org/10.20961/jolsic.v13i1.89777">https://dx.doi.org/10.20961/jolsic.v13i1.89777</a></p>	<p>The Micro, Small and Medium Enterprises (MSMEs) sector has a significant role in Indonesia's economic development and is considered the main pillar of the national economy. The legal umbrella has been formulated by the government to protect the existence of MSMEs in carrying out their activities such as the distribution of Micro Business Credit (KUM) and People's Business Credit (KUR). However, there are still obstacles such as bad credit or Non-Performing Loan (NPL) which is a challenge in itself, so that the principle of prudence in banking needs to be enforced to manage the risk of bad credit as regulated in Law Number 10 of 1998 concerning Banking and confirmed in Bank Indonesia Regulations in order to maintain banking system stability and realize economic justice. This research uses empirical legal research method where the main focus is to analyze the effectiveness of the implementation of prudential banking principles in the distribution of equitable MSME loans in Batam City. The result of the research shows that there is a high commitment from the banks in Batam City in implementing the prudential principle through thorough and continuous evaluation of the legality, financial capacity, and collateral of prospective debtors, as well as regular monitoring of the development of MSMEs. These measures help maintain the Non-Performing Loan (NPL) ratio and support the sustainability of MSMEs in Batam City.</p>

## INTRODUCTION

The Micro, Small and Medium Enterprises (MSMEs) sector has a very significant role in economic development in Indonesia. This is in line with the objectives of national economic development stated in the 1945 Constitution of the Republic of Indonesia (UUD NRI 1945) Article 33 paragraph (1). MSMEs have a role that has a positive impact on Indonesia's economic development, the first is labor absorption because MSMEs help overcome the problem of unemployment caused by population growth by creating many jobs, especially in the labor-intensive sector. MSMEs absorb a lot of labor at the national level, which means their activities in the country play an important role in maintaining social and economic stability. Secondly, MSMEs also play a vital role in maintaining economic stability during times of crisis, such as the 1998 economic crisis and the Covid-19 Pandemic. They were able to survive and even save the national economy by quickly adapting through digital transformation and e-commerce (Amartha, 2024: 8).

MSMEs are a representation of people's thoughts in the economic aspect, so that to realize it, a legal umbrella is needed that can guarantee its existence in the life of Indonesian society. Based on Article 1 paragraph (1), (2), and (3) of Law No. 20/2008 on micro, small, and medium enterprises, MSME credit is defined as the provision of funds by central and local governments, the private sector, and the public through banks, cooperatives, and non-bank financial institutions, in order to support and strengthen the capital of micro, small, and medium enterprises (Rundun, 2023:12). Financing channeled to MSMEs is known as Kredit Usaha Rakyat (KUR) and Kredit Usaha Mikro (KUM) (Bank Mandiri, 2024: 1). However, in its application, there are several obstacles, including the problem of bad debts or non-performing loans, better known as Non-Performing Loan (NPL) (Ismail, 2018: 102).

Parameters of credit problems in banks can be seen from the bank's NPL value. NPL is a ratio used to measure the bank's ability to cope with the risk of credit payment failure by debtors (Setiyaningsih et al., 2015: 10). Each bank has a different NPL ratio. Ideally, the NPL ratio should be below 5%. If it is above 5%, then it can be said that the number of bad loans is more than the number of current loans (Priatna, 2021: 26). NPL indicates the level of credit risk, where the lower the NPL, the lower the credit risk that must be borne by the bank. In addition, banks also face the risk of credit failure caused by macroeconomic factors as well as bank-specific factors (Utami & Silaen, 2018: 125). In this situation, banks will face bad debts that can cause losses for both banks and debtors. The greater the number of bad loans, the higher the bank's non-performing loan (NPL) value. Banks that provide a lot of credit without maintaining the quality of their credit will experience a decline in financial health, which in turn disrupts the bank's contribution to national economic development.

Bank Indonesia (BI) data shows that bad credit in the Riau Islands MSME sector amounted to 1.38% in November 2022, or it can be said to be better than the previous quarter of 1.83%. Meanwhile, in November 2023 the MSME credit NPL ratio was 3.55%, an improvement compared to the previous quarter of 3.63%. However, on an annual basis, the Riau Islands NPL rate increased by 2.17%. The annual increase in the NPL rate is not proportional to MSME lending. In the third quarter of 2022 it amounted to 15.42% (yoy) and MSME lending in the third quarter of 2023

amounted to 10.93% (yoy) (BI, 2023: 1). Here it is clear that the annual increase in NPLs has an impact on the decline in lending. One of the reasons for this is the financial condition of MSMEs. Many MSMEs experienced a decline in cash flow and profits, which made them unable to meet their credit obligations on time. This factor worsened the NPL ratio even though the number of loans disbursed decreased (Freeztika, 2017: 11). Therefore, the implementation of the prudential principles of banks is a guideline in organizing banking activities.

The prudential principle is regulated in Article 2 of Law Number 10 of 1998 on Banking (Banking Law), which states “Indonesian banking in conducting its business is based on economic democracy using the prudential principle”. So it can be said that the prudential principle is one of the principles that must be adopted and implemented by banking institutions in carrying out their operations in Indonesia. This principle requires banks to always be vigilant and careful in carrying out their business activities. This means that banks must be consistent and compliant with all applicable regulations and laws in the banking sector, based on professionalism and good faith (Putrawan, 1998: 4).

The affirmation of Bank Indonesia's position (assisted by the Financial Services Authority) in implementing the prudential principle can be seen from their role in carrying out agency activities of foreign financial products delegated through commercial banks, which includes comprehensive risk assessment and strict implementation of risk management to prevent systemic risk and maintain financial integrity (Eka, 2018: 193). It is a preventive measure, or in other words, a precaution that in the context of banking includes attitudes, principles, standard policies, and techniques in risk management that aim to minimize legal problems, such as money laundering. As such, the prudential principle is designed to ensure the safety, soundness, and stability of the banking system as a whole (Wijaya & Sukranatha, 2018: 7).

The definition of the prudential principle is not officially outlined in government regulations, but is often interpreted in the 5C assessment (Character, Capacity, Capital, Collateral, Conditions) by banking institutions which aims to monitor credit development regularly and anticipate and resolve bad debts or NPLs caused by bad faith debtors as expressed in research by Mulyati, (2018: 92). The results of this study are also supported by research conducted by (Budiman & Supianto, 2020: 327). Another study examined the application of the 5C principle (Character, Capacity, Capital, Collateral, Conditions) in the specific context of Batam and its impact on MSME credit management by the local government Abubakar, (2018: 72). Further Research by Efriyenti & Janrosl, (2017: 12). The aim of this study is to identify the factors that influence credit decision-making by SMEs in Batam. This study aims to make a significant contribution in understanding and implementing the prudential principle in providing credit to MSMEs, which is a vital sector for the local economy, especially in Batam City, so this study is different from previous studies. This is because it refers to data from the Batam Central Bureau of Statistics (BPS) which shows that there are thousands of MSMEs that are actively operating and become the axis in the local economy. This figure continues to increase along with various empowerment programs and support from the government (BPS, 2022: 1).

Using a comprehensive and in-depth juridical approach, this research analyzes the effectiveness of prudential principle implementation in banking practices, particularly in the context of lending to Micro, Small and Medium Enterprises (MSMEs) in Batam City. The analysis focuses on the implementation of the prudential principle as stipulated in Law Number 10 Year 1998 on Banking, as well as its relevance in promoting financial system stability and credit risk mitigation. The study also highlights the structural challenges and operational barriers faced by banks in optimizing the principle, including limited access to internal data of financial institutions and the influence of local dynamics influenced by legal culture and the effectiveness of law enforcement officers. The limited geographical scope that only covers Batam City is one of the factors that limit the generalizability of the findings, thus further studies with wider coverage and more comprehensive data support are needed. Based on this analysis, this study formulates a number of strategic recommendations to improve the effectiveness of the prudential principle in MSME lending that is oriented towards legal expediency. Thus, it can be concluded that this research aims to examine the effectiveness of the application of the prudential principle by banking institutions in the distribution of MSME loans in Batam City.

## **RESEARCH METHODS**

The research method is an absolute element in a study. This research uses empirical legal research methods. Empirical legal research method is a research method conducted by collecting and analyzing data from the implementation of laws and regulations, including legal subjects and legal substance as well as the impact of their implementation in order to obtain a more comprehensive understanding of how the law functions in its social context. The reason for choosing this method is because this research will analyze the effectiveness of law implementation, namely the application of the banking prudential principle in the distribution of MSME loans in Batam City based on Law Number 10 of 1998 concerning Banking (Disemadi, 2022: 289). The approaches used are statutory approach (juridical), conceptual approach, and empirical approach. The data used are primary and secondary data; primary data is taken through observation and interview with Bank BNI and Bank Mandiri in Batam City, while secondary data is the data used to answer the problem, where the data includes NPL reports as well as legal materials such as Law Number 10 Year 1998 on Banking, Civil Code and other regulations. Primary data collection techniques were conducted through observation and in-depth interviews, while secondary data were obtained using literature study techniques. Data processing and analysis used descriptive qualitative analysis techniques to provide a comprehensive picture of the effectiveness of implementation and factors influencing the application of the prudential principle and its impact on MSME loans in Batam.

## **ANALYSIS AND DISCUSSION**

### **1. Effectiveness of the Implementation of the Banking Prudential Principles in the Disbursement of MSME Loans in Batam City**

Article 1 of Law Number 10 of 1998 on Banking (Banking Law) states that a bank is a business entity that collects funds from the public through deposits and reallocates them in the

form of credit or other financial products. The main objective of banks is to provide banking services that pay attention to the safety and comfort of their customers. As a financial institution, the role of banks greatly contributes to the economic development of a country by providing financing to the community. Before providing credit, banks must consider various aspects. One example is the legal aspect, which includes evaluating the legality of the business entity as well as the licenses owned by the community applying for credit (Disemadi, 2022: 289). The assessment starts with checking the validity and completeness of the deed of establishment to find out who the owners are and how much capital each owner has (Tumbel, 2015: 87). While financial factors are important, the confidence that a loan will be repaid safely and profitably does not depend solely on them (Wahyuni, 2017: 15). In the realm of banking law, the prudential principle is known. This principle becomes the basis for every step taken by the bank, aiming to maintain banking stability during its operations. The implementation of the prudential principle also reflects efforts to maintain the health of the banking sector, ensuring that every action taken is in accordance with applicable norms and regulations.

The prudential principle, also known as the prudent banking principle, is a concept or norm that emphasizes that banks, in carrying out their functions and business activities, have an obligation to be prudent (Disemadi, 2022: 289). The aim is to safeguard and protect public funds entrusted to the bank (Usman, 2001: 198). The legal basis for this principle is stated in Article 2 of the Banking Law, which states that the banking sector in Indonesia, in carrying out its business activities, is based on the principles of economic democracy, with the application of the precautionary principle. This shows that the prudential principle is one of the crucial principles that must be implemented by banks in their business operations. Applying the precautionary principle in every banking activity is one of the methods or even legal acts in ensuring the health of the banking sector.

Article 8 of the Banking Law states that before granting credit, banks must conduct a thorough assessment. This is important because the source of credit funds does not come from the bank itself, but from the public. Therefore, the principle of prudence must be applied through careful and in-depth analysis, so that there is an appropriate, equitable distribution, accompanied by effective supervision and monitoring. Credit agreements must be valid and meet the legal requirements listed in Article 1320 of the Civil Code, with strong collateral and complete and organized credit documentation. The aim is to ensure that credit is repaid on time as agreed, including principal and interest. If a large amount of credit is not repaid according to the agreement, the credit quality will be classified as Non-Performing Loan (NPL) (Ismail, 2018: 56).

An important but risky bank activity is lending. Banks must conduct a careful assessment and carry out the 5C assessment which is part of the application of the prudential principle (Universalbpr, 2020:1). Character refers to the nature or disposition of the prospective debtor which aims to ensure that the bank can trust the prospective debtor. Banks evaluate character through reputation in interactions with the community, business partners, and banks, as well as consistency in relationships with suppliers and accounts payable facilities. Capacity assesses

the prospective debtor's ability to repay credit based on business management and income. Banks analyze managerial, financial and technical capacity to assess risk and repayment ability. Capital evaluates the adequacy of capital to run the business with a focus on sources of financing and capital analysis. Business prospects (Condition) assesses market conditions, past data, and future projections to understand marketing potential. Collateral as a credit guarantee serves to protect the bank from financial risk, with prospective debtors usually providing collateral to overcome possible payment difficulties (Djuarni & Ratnasari, 2022: 99).

In 2023, Bank BNI has successfully disbursed MSME loans with remarkable achievements, exceeding the annual target of 10%-12%, as stated by Mr. Agya Aurisna Saputra, Business Team Leader of Bank BNI in Batam City, in an interview on June 3, 2024. Similarly, Mr. Arief, Loan Manager of Bank Mandiri in Batam City, in an interview on June 7, 2024, said that Bank Mandiri in Batam City has achieved its annual MSME loan target. As for the MSME loans that have been disbursed by Bank BNI, 99.18% of the loans are performing well and on time/Performing Loan (PL), while non-performing loans (NPL) amounted to 0.82%. Meanwhile, Bank Mandiri noted that as of December 2023, current loans or PLs were 99.21% and NPLs or non-performing loans were 0.79%. This data shows that there has been solid performance from both banks in supporting the MSME sector and maintaining the quality of their loan portfolios, as seen from the low NPL ratio, although there are still challenges in NPL management. With this achievement, both banks demonstrate their commitment in supporting the development of MSMEs, which are the backbone of the Indonesian economy and a manifestation of the mandate of Article 33 paragraph 1 of the 1945 Constitution of the Republic of Indonesia (UUD NRI 1945) which reads "The economy is structured as a joint effort based on the principle of kinship".

The Banking Law does not explicitly regulate the technicalities in the field so that banks have their own way of anticipating the problem. BNI Bank in Batam City has several criteria in assessing risk in lending to MSMEs. The bank evaluates risk based on the type of business financed, credit diversification, business experience, ability to repay, and collateral owned by the prospective debtor. Each of these factors is analyzed in-depth to ensure that the credit disbursed has minimal risk and has the potential to provide benefits for both parties. Meanwhile, Bank Mandiri uses the 5C principle approach in assessing credit risk per debtor. This analysis includes capacity, collateral, condition, character, capital. In capacity analysis, the bank assesses the debtor's ability to repay the loan. Bank Mandiri ensures that prospective debtors have sufficient financial capacity to fulfill their obligations. Collateral analysis, Bank Mandiri assesses the collateral provided by the debtor. Bank Mandiri evaluates whether the proposed collateral is able to cover the amount of loan requested, thus reducing the risk of loss for the bank. By analyzing the condition, Bank Mandiri ensures that the debtor's business condition is in accordance with the requirements and economic situation, and does not conflict with legal norms. The Bank assesses whether the business has good prospects and adequate stability in the implementation of credit payments. Character analysis, Bank Mandiri checks the debtor's character through BI checking, track checking, and community checking. This

aims to ensure that the debtor has a good track record and can be trusted in managing the loan. Finally, capital analysis, Bank Mandiri assesses whether prospective debtors have sufficient capital to start a business. Bank Mandiri tends to avoid providing credit to debtors who do not have initial capital, to reduce the risk of bad debts. With this comprehensive approach, both Bank BNI and Bank Mandiri have endeavored to channel credit more wisely and measuredly, so as to support the growth of MSMEs while maintaining their financial stability.

Bank BNI Batam City applies a series of strict criteria to determine the eligibility of MSMEs for credit. Firstly, the type of business being financed must not violate legal regulations which are qualified into internal and external regulations. Furthermore, prospective debtors must be recorded in the Financial Information Service System of the Financial Services Authority (SLIK OJK) with collectibility status (Col 1), which indicates no bad records related to credit. In addition, the debtor must not be listed in the National Black List (DHN) or have a negative legal record. The proposed business must have been in operation for at least 6 (six) months to 2 (two) years to ensure business stability and experience. Bank BNI Batam City also applies 5C analysis. Bank Mandiri, on the other hand, emphasizes business feasibility, repayment capacity, and credit history as the main criteria in lending and in this regard, the bank has followed the applicable legal provisions. Business feasibility is assessed based on the potential and prospects of the proposed business, while repayment capacity evaluates the debtor's ability to fulfill its financial obligations. Credit history is checked to ensure that the prospective borrower has a good track record in managing previous loans. Both banks, with the aforementioned criteria, ensure that the lending process not only complies with the applicable legal provisions but also adds extra measures to minimize risks and ensure the sustainability of MSME businesses. With this approach, both Bank BNI and Bank Mandiri strive to provide safe and effective financing, support the growth of MSMEs, and maintain their financial stability.

The concrete steps taken by Bank BNI Batam City to ensure the application of prudential banking principles in lending to MSMEs are basically in accordance with the provisions of Article 29 paragraphs 2 & 3 of the Banking Law. The first step is to verify the business legality and collateral of prospective debtors, which includes checking legal documents and the validity of the collateral provided. Furthermore, Bank BNI analyzes account mutations at banks to assess the financial flow and stability of the debtor's business. Cash to cash cycle analysis is also conducted to understand the business financial cycle in depth, including how the business manages cash flow from daily operations. In addition, the bank conducts call memos or periodic visits to business locations to monitor business development and conditions directly. On the other hand, Bank Mandiri implements comprehensive measures that include thorough risk assessment, periodic monitoring, and credit policy adjustments in line with current economic conditions. A thorough risk assessment involves a detailed evaluation of the various business and financial aspects of a prospective borrower. Regular monitoring is conducted to ensure that businesses remain on a safe path and are able to fulfill their credit obligations. Bank Mandiri also adjusts its credit policies dynamically to follow changes in economic conditions,

to ensure that policies remain relevant and effective in the face of economic challenges. Both banks have demonstrated a high commitment to prudent banking through structured and sustainable measures. With a systematic and proactive approach, Bank BNI and Bank Mandiri not only ensure the safety of lending, but also effectively support the sustainability and growth of MSMEs.

Bank BNI Batam City also implements several special strategies to reduce the risk of bad debts in the midst of economic fluctuations. First, the bank extends credit to “diamond clients,” which are SOE partners such as Pertamina, PLN, PDAM, and Perhutani. These partners are considered to have high stability and legal awareness resulting in lower credit risk. In addition, Bank BNI focuses on lending to customers who have already transacted with BNI, as a good transaction history provides a clear picture of their financial viability and stability. The bank also avoids credit brokers to ensure that the lending process is transparent and in accordance with established procedures. Meanwhile, Bank Mandiri channels credit to sectors that are considered profitable and have good prospects. Within the Bank, there is an “industry class” concept that categorizes industries based on their level of risk and profit potential. By focusing on favorable sectors and avoiding high risk industries, Bank Mandiri is able to manage its loan portfolio more effectively and reduce potential losses in the midst of unstable economic conditions. With a prudent and structured approach, Bank BNI and Bank Mandiri are able to maintain their financial stability while providing safe, beneficial and equitable credit services to MSME customers.

Mr. Agya Aurisna Saputra, Business Team Leader of Bank BNI in Batam City, explained that Bank BNI carries out the supervision and monitoring function of approved MSME loans in several ways. Firstly, the bank monitors the credit disbursement results to ensure that the funds are used in accordance with the proposed needs. Debtors are required to channel their financial transactions through Bank BNI, so that the bank can monitor the cash flow and financial activities of debtors more effectively. In addition, the bank conducts call memos or visits to business locations every 3 to 6 months to see business development firsthand. Debtors are also required to submit annual business financial and tax reports to the bank, and conduct rechecking through OJK's SLIK to verify their credit status. On the other hand, Mr. Arief, Loan Manager of Bank Mandiri in Batam City, explained that Bank Mandiri uses Credit Analysis Notes for supervision and monitoring of MSME loans. This memorandum covers the 5C analysis and ensures that prudential principles are applied from the beginning of the loan disbursement process. The credit disbursement process is carried out by different officers in accordance with their respective authorities, so that there is a clear separation of duties and responsibilities, reducing the risk of errors and improving the accuracy of supervision. Bank BNI and Bank Mandiri are considered to have ensured that the prudential principles continue to be adhered to as long as the credit agreement is still valid (the principle of consensualism), maintaining the stability and financial security of banks and supporting the sustainability of MSME businesses with justice as a form of people's economy based on the provisions of Article 33 paragraph 1 of the 1945 Constitution of the Republic of Indonesia.



The effectiveness of the implementation of prudential banking principles in the distribution of MSME loans in Batam City is in line with the 3 (three) main components in the legal system theory proposed by Lawrence Meir Friedman, namely legal structure, legal substance, and legal culture. First, in terms of legal structure, Bank BNI and Bank Mandiri have built institutions that support the implementation of prudential principles supported by BI and OJK. This structure includes a special unit in charge of credit evaluation and continuous monitoring of debtors. This unit ensures that the lending process is carried out in a systematic and orderly manner, in accordance with applicable regulations. Furthermore, the legal substance applied by these two banks, especially in the context of Article 2 and Article 8 of the Banking Law, emphasizes that every loan disbursement must go through a strict and careful evaluation process. This substance is implemented in various internal bank policies that regulate risk assessment procedures, verification of business legality, and debtor capability analysis as a form of application of the prudential principle. The criteria used in this evaluation, as explained by Mr. Agya Aurisna Saputra from Bank BNI and Mr. Arief from Bank Mandiri, include character, capacity, capital, business condition, and collateral analysis (5C analysis). By applying clear and measurable rules, banks can minimize the risk of bad debts and ensure smooth loan repayment. Furthermore, legal culture in the context of banking in Batam City also plays an important role in relation to the effectiveness of prudential implementation. This legal culture encompasses the attitudes and values adopted by banking actors in carrying out their obligations, these values are based on the principle of good faith where parties execute contracts solely to prevent improper behavior. Both banks actively build a culture of trust and discipline through continuous education and communication with customers. For example, Bank BNI requires debtors to submit financial reports and annual tax returns on a regular basis, and conducts regular visits to business locations to monitor progress directly. This helps to build a culture of high transparency and accountability among business actors.

The implementation of prudential principles at Bank BNI and Bank Mandiri also reflects the commitment of both banks to support the growth of MSMEs while maintaining their financial stability. Strategies implemented include lending to stable SOE partners, focusing on customers with good transaction history, and avoiding credit brokering practices that could potentially create new problems. Bank Mandiri, for example, categorizes business sectors based on the level of risk and profit potential, ensuring that credit is channeled to specific sectors that are considered to have good prospects and manageable risks. With this approach, both banks are expected to maintain healthy and sustainable credit portfolios in order to improve the national economy, and can serve as an example for other banks in implementing the provisions of the Banking Law and other bank regulations.

Data disclosed by both banks regarding MSME loan performance shows positive results. In 2023, Bank BNI recorded 99.18% of MSME loans that were in good standing (PL) and only 0.82% were categorized as NPLs. Meanwhile, Bank Mandiri recorded 99.21% Performing Loan and 0.79% NPL. This data shows that despite the challenges in managing NPLs, the majority of loans disbursed managed to fulfill their obligations on time. This is an indicator of

the effectiveness of the prudential principles applied by both banks, ensuring that the public funds entrusted to them are managed properly and safely. Data disclosed by both banks regarding MSME loan performance shows positive results. In 2023, Bank BNI recorded 99.18% of MSME loans that were in good standing (PL) and only 0.82% were categorized as NPLs. Meanwhile, Bank Mandiri recorded 99.21% Performing Loan and 0.79% NPL. This data shows that despite the challenges in managing NPLs, the majority of loans disbursed managed to fulfill their obligations on time. This is an indicator of the effectiveness of the prudential principles applied by both banks, ensuring that the public funds entrusted to them are managed properly and safely.

## **2. Challenges and Obstacles Faced by Banks in Optimizing the Precautionary Principle towards MSME Loans in Batam City**

Interviews with Mr. Agya Aurisna Saputra from Bank BNI and Mr. Arief from Bank Mandiri in Batam City revealed various challenges faced by banks in implementing the prudential principles of the Banking Law in lending to MSMEs. Mr. Agya Aurisna Saputra, as Business Team Leader of Bank BNI in Batam City, highlighted several obstacles faced in the process of lending to MSMEs. One of them is “the frequent occurrence of MSME loan applications that are not completed with the necessary requirements”. This creates a bottleneck in the process of evaluating and finalizing the loan application, as the bank has to make further approaches to request and verify the required information before it can make a final decision. This delay in decision-making can slow down what should be a quick and efficient loan disbursement process, and increases the risk of errors or incomplete information that could affect the overall loan decision. In addition, Mr. Agya also revealed that there is the issue of “credit arrears” which is a serious challenge for Bank BNI. These arrears are serious because they can disrupt the bank's liquidity and affect the overall quality of the loan portfolio. The impact could worsen the non-performing loan ratio (NPL) which could potentially harm the bank's finances in the long run.

Another issue highlighted was “Bank employees who are not fully capable of applying prudential principles”. Employees who are not fully proficient in conducting credit risk analysis may result in a less in-depth and accurate evaluation of prospective borrowers. This has the potential to increase credit risk that is not properly detected, such as the risk of default or bad credit which can be detrimental to bank finances in the long run. Furthermore, Mr. Agya also conveyed challenges related to “internal bank partiality towards one of the prospective debtors”. This phenomenon shows the potential for bias in the credit evaluation process, where the decision to disburse funds can be influenced by subjective factors or certain internal interests that are not always in line with objective and transparent criteria that should be the main basis for decision making. This kind of favoritism can reduce fairness in lending and is potentially detrimental to both banks and borrowers, because it does not guarantee that each credit application is evaluated in a manner with integrity and based on objective consideration of risk and repayment ability.

Mr. Arief, as Loan Manager of Bank Mandiri in Batam City, explained that one of the challenges faced is “the big target that must be achieved by the sales team”. These big targets are often the main focus in the effort to achieve the desired revenue and business growth. However, in the process, this pressure can cause some sales or sales teams to ignore the precautionary principle in credit assessment, making it seem as if what is prescribed by the Banking Law is just a formality. They tend to prioritize achieving sales targets over conducting an in-depth evaluation of the feasibility and risks of the proposed credit. As a result, there is a risk that approved loans are not optimal and affect the NPL ratio, as well as being more vulnerable to the possibility of becoming non-performing loans in the future.

The constraints that have been described show that the implementation of the prudential principle in lending to MSMEs is not as easy as one might think. Despite the existence of a legal umbrella, namely the Banking Law, it still requires coordination and goodwill between various departments within the bank, continuous development of Human Resources (HR), and consistent law enforcement to ensure that these principles can be applied effectively in every aspect of bank operations. These measures are important to maintain the financial stability of the bank and support the sustainable growth of the national economy, particularly the economy of the MSME sector in Batam City.

### **3. Improving the Effectiveness of the Implementation of the Prudential Principles of Banking in the Disbursement of MSME Loans in Batam City in order to Achieve Legal Expediency**

Bank BNI and Bank Mandiri in Batam City face various obstacles in implementing prudential banking principles in lending to MSMEs. The obstacles faced by banks in implementing prudential banking principles in lending to MSMEs are the incompleteness of credit application requirements by prospective debtors, causing the lending process to be hampered. In addition, the ability of credit analyst employees to conduct accurate and objective credit assessments must always be monitored and improved. Finally, the existence of large sales targets often makes sales ignore the principle of prudence and even override the legal requirements of the agreement (agreement, capability, certain things and halal causes), which risks increasing non-performing loans.

Another effort that is no less important to make in minimizing these obstacles is to establish a data collection plan from debtors who will apply for MSME loans. The data here are in the form of data types, data sources, and how to obtain data. The data obtained will be used as an assessment material for providing credit facilities according to the debtor's ability. Based on internal information with Bank BNI and Bank Mandiri (related to company secrets, so it cannot be attached), the types of data received include the debtor's identity (KTP, NPWP, KK, etc.), business legality such as business licenses tailored to the type of business, financial data, and collateral data such as proof of ownership of SHM. Data sources can be obtained from the debtors themselves by coming to the bank themselves and the bank coming to the debtor's business location. The way to obtain data is usually called the Business Cycle of the

prospective debtor's business. This Business Cycle is assessed by looking at the debtor's business including the categories "Starting, Growing, Stable, Mature, Reinvation (rise / bankruptcy)". After all the data has been collected, the party will verify the data and documents. Then there are points that should not (don't) be done during the data collection process, including considering the data obtained is sufficient (without verifying its validity), ignoring document irregularities and data inconsistencies without further verification, considering confirmation to the debtor as a verification stage, fully trusting (100%) the debtor's information, and finally, wanting a fast credit process without verification.

The bank must also assess the quality of the debtor's earning assets as a very valuable asset. Article 10 of BI Regulation /7/2/PBI/2005 stipulates that earning assets are investment products that can generate profits periodically for their owners. According to the Financial Services Authority (OJK), earning assets are investments of funds by banks with the aim of earning income, which can be in the form of loans, securities, equity investments, and other forms of investment. Meanwhile, Bank Indonesia states that earning assets are funds channeled by banks to earn income (OCBC NISP, 2023:1). Meanwhile, according to Article 11 of PBI Number 7/2/PBI/2005 banks are required to assess and monitor the quality of assets, both productive and non-productive, on an ongoing basis. Banks must assign the same quality to several earning asset accounts used for one debtor. Credit quality assessment is carried out by analyzing business prospects, debtor performance, and ability to pay, which includes various components such as growth potential, market conditions, management, and affiliate support (Astuti, 2016: 119).

It is also necessary to improve the quality of human resources in conducting credit assessments, for example by conducting periodic training. This is generally also regulated in Article 11 of the Labor Law. Based on field observations, Bank BNI and Bank Mandiri have been consistent in providing training to officers and sales that deal with MSME loans. This training can be conducted online or offline, depending on the policies of each bank. In addition, each officer is also given a pretest periodically which serves to evaluate the officer's ability to assess credit. This is certainly very useful so that officers are consistent in implementing the prudential principle. Finally, there is a need to impose sanctions on officers who ignore the prudential principle. The Banking Law does not regulate the application of sanctions against bank officers so that each bank has its own way. In general, bank officers who are negligent in granting credit may be subject to various sanctions, which depend on the bank's internal policies and corporate regulations of the bank. Some of the sanctions that can be applied include warnings in the form of verbal warnings, then up to written warnings (SP1 to SP3) given to negligent bank officers (Hernita, 2018). This aims to give the officer a chance to correct their mistakes. Demotion is necessary if the offense is serious or repeated, so the bank can demote the officer concerned as a form of sanction and prevention of similar mistakes in the future. Salary or Bonus Deductions are often carried out if the officer is proven to be negligent so that punishment in the form of salary or bonus deductions can be considered as financial sanctions. This is done to provide a deterrent effect as well as compensation for losses

that may be caused by the negligence. Termination of Employment (PHK), In cases of very serious negligence, the bank may terminate the employment of the officer concerned. Termination of employment is usually carried out if the negligence causes major losses to the bank or violates applicable laws, usually related to banking crimes such as money laundering and document forgery.

In conclusion, if all of the above has been done and fulfilled, and if there is still congestion or failure, of course, efforts must be made to rescue bank loans. According to Bank Indonesia Circular Letter Number 26/4/BPPP dated May 29, 1993, the ways to rescue non-performing loans include rescheduling, reconditioning, and restructuring. Rescheduling refers to changes in credit terms that only include adjustments to payment schedules and/or extensions of time periods, including grace periods, as well as modifications to the amount of credit installments. This policy does not apply to all debtors, but only to debtors who show good faith as regulated in Article 1338 of the Civil Code paragraph (3), which explains that good faith is reflected in honest character, and willingness to pay. Reconditioning is a modification of part or all of the credit terms, which includes an agreement on the payment mechanism, but is also not limited to adjusting the payment schedule, extending the period, changing the interest rate, as well as postponing payment of part or all of the interest, and changing other provisions. Restructuring is a rescue measure by changing the credit terms, which includes additional funds from the bank, transferring all or part of the outstanding interest into new credit principal, or converting part or all of the credit into company and bank equity. This action can be done with or without rescheduling or reconditioning (Indonesia, 2018: 13). If all of these efforts are still unsuccessful, then court action can be taken.

## CONCLUSION

The application of the prudential principle is basically not explained in detail in the Banking Law. However, each bank has its own way of lending to MSMEs in Batam City in order to realize the improvement of the national economy. However, such efforts are often faced with several challenges, including incomplete loan applications, loan arrears problems, and lack of employee competence in credit risk analysis. In addition, the potential for internal bias and the pressure of high sales targets can also override the precautionary principle. Therefore, inter-departmental coordination, human resource development, and consistent rule enforcement are required to maintain the bank's financial stability and support the equitable growth of MSMEs in Batam City.

Bank BNI and Bank Mandiri demonstrate a high commitment to applying the prudential principle through a thorough evaluation of the legality, financial capacity and collateral of prospective debtors, as well as regular monitoring of debtors' business development. Then Bank BNI and Bank Mandiri also carry out a comprehensive debtor data collection plan, improve human resource capabilities through periodic training, and enforce sanctions for negligent officers. This needs to be done in order to improve the quality of banking services. Assessment of the quality of debtors' earning assets also needs to be carried out continuously in accordance with the provisions of Bank Indonesia Regulations. These measures help maintain a low Non-Performing Loan (NPL) ratio and support the sustainability of MSME businesses. However, if credit failure or arrears still

occur, credit rescue can be carried out through rescheduling, reconditioning, and restructuring as well as court proceedings as a last resort.

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