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Credit Risk Management Strategy in Clothing Installment Business to Maintain Social Value and Economic Business Sustainability

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Abstract:

This study aims to analyze the risk management strategies for non-performing loans (NPLs) in informal clothing installment businesses in rural areas, focusing on the role of social values and the adaptation of the 5C theory. Using a qualitative embedded case study, research was conducted on a 15-year-old clothing installment enterprise in Padang Langkat Village serving 72 customers from vulnerable households. Data were collected through in-depth interviews, 12 weeks of participant observation, and analysis of installment records, WhatsApp chats, and collection photos. The results showed ex-ante strategies in the form of customer selection based on social reputation, evaluation of informal payment capacity, and structured manual recording. Ex-post strategies included a familial approach, phased collection, personal visits, and instalment restructuring. Social capital in the form of trust, norms, and social networks played a role in replacing formal collateral and reducing NPLs by up to 6.9%. The conceptual contribution of this research is the social adaptation of the 5C theory, with an emphasis on Character and Condition factors, while Collateral is replaced by social security, emphasizing the importance of local cultural context in the sustainability of informal micro-enterprises.

Keywords: *Bad Credit, Clothing Installment Business, Ex-Ante and Ex-Post Risk Management, 5c Theory, Social Capital, Business Sustainability, Rural Areas*

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1. Introduction

Micro, small, and medium enterprises (MSMEs) are a crucial pillar of the Indonesian economy. Their presence not only plays a role in job creation but also in improving community welfare, particularly in rural areas. However, a persistent problem in MSME financing is the high level of non-performing loans (NPLs). High NPLs pose significant risks for both formal financial institutions and micro-entrepreneurs operating informally. Therefore, the study of credit risk management is increasingly important, especially in the rural context, which has distinct social, cultural, and economic characteristics than urban areas.

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Data from the Financial Services Authority (OJK) shows that MSME NPLs have fluctuated over the past four years, with an upward trend. In the 2020–2022 period, the gross MSME NPL ratio was recorded in the range of 3.1–3.5%. Furthermore, the banking surveillance report for the third quarter of 2023 showed that the gross MSME NPL increased to 3.88% (OJK, 2024). In 2024, this ratio again increased, reaching 4.26% in April, 4.27% in May, and then slightly decreasing to 4.04% in June 2024. Although this ratio remains below the 5% threshold set by the regulator, this increasing trend indicates increasingly serious credit risk (OJK, 2024) Compared with the national banking average of 2–3%, it can be said that MSME financing is more vulnerable to the risk of default.

The reality on the ground shows that the NPL problem is far more complex when examined in informal micro-enterprises in rural areas. In clothing installment businesses, for example, the NPL ratio is estimated to reach 15–20%, or nearly five times the national average. This high figure is inextricably linked to rural socioeconomic conditions characterized by low financial literacy, limited access to formal financial institutions, and income instability for the community, the majority of whom work as farmers, daily laborers, and small traders. In situations like this, buying clothes on credit is a relevant solution, although it also carries a high risk of default (Hermelina & Sarwan, 2020).

Padang Langkat Village in Langkat Regency, North Sumatra, serves as a concrete example. The majority of residents in this village have irregular incomes, averaging less than IDR 1,500,000 per month. This encourages people to meet their clothing needs through installment plans. Mrs. Sutriani's clothing installment business, which has been operating for over 15 years, is one example. With 72 active customers, approximately 6.9% experience late payments of more than one month. The system is entirely trust-based, with no written contracts, no collateral, and no formal financial records. Collection is conducted directly from house to house or via WhatsApp messages. This simple mechanism reflects the limitations of formal instruments for credit risk management in rural areas.

The problem of default in clothing installment businesses carries not only financial but also social consequences. In rural communities, late payments can lead to shame, moral distress, and potentially disrupt social relationships among members. Thus, credit risk management in informal rural businesses is not only related to economic aspects, but also closely linked to social norms, cultural values, and community solidarity.

In an Islamic perspective, the practice of buying and selling using an installment system (bai' bi al-taqsith) is permitted as long as the contract is carried out clearly, is free from gharar (obscurity), and does not contain usury. Al-Qur'an (QS. Al-Baqarah: 282) "O you who believe, if you do not pay in cash for the specified time, you should write it down...", this verse is the basis for allowing debt transactions or buying and selling in installments, as long as it is recorded clearly so that there are no disputes. Hadith narrated by At-Tirmidhi: "The person who gives a grace period to someone in difficulty or releases him, Allah will protect him on the Day of Resurrection.", Shows the virtue of providing relief in installment payments as a form of ta'awun (mutual assistance). DSN-MUI Fatwa No. 23/DSN-MUI/III/2002 concerning murabahah buying and selling: Affirms that installment payments may be made as long as they are agreed upon in advance, and that there are no oppressive interest/fines. Emphasizes the importance of recording debts to avoid disputes. Contemporary scholars agree that installment credit is halal as long as the price and payment time have been agreed upon in advance without any additional interest or oppressive fines. Delays in payments are also tolerated if accompanied by a valid excuse, in accordance with the principle of ta'awun (mutual assistance) (Sudrajat, 2022). The practices carried out in Padang Langkat Village prioritize a family approach, flexible negotiation, honesty, and customer moral responsibility in line with the principles of Islamic muamalah which emphasize justice, welfare, and social solidarity.

Numerous academic studies on credit risk management have been conducted, but most still emphasize formal frameworks. Afrida & Irwayu, (2022) in "Application of Risk Management Characteristics to Minimize the Risk of Default in Home-Based Clothing Stores in Alaspandan Village" focused more on risk management in home-based clothing stores, primarily addressing general credit practices without exploring how social capital and the 5Cs of credit interact in an informal rural context. Other studies (Dewi & Sedana, 2017; Sucianty & Manda, 2022) showed that weak risk management can increase the potential for bad debts. However, these studies have not extensively examined how formal credit management principles, such as the 5Cs (Character, Capacity, Capital, Collateral, and Condition) theory, are adapted to the context of rural informal businesses. In practice, however, the Collateral principle is often replaced by social capital, Capacity is assessed informally based on reputation, and Character and Condition become the dominant dimensions in credit decision-making.

Based on this perspective, this study attempts to adapt the 5Cs theory into a socio-cultural credit analysis model. This model does not eliminate the 5Cs theory, but rather modifies it to be relevant to the rural context. The Collateral component is replaced by trust, norms, and community networks. Capacity is assessed through reputation and social information, while Character and Condition remain as the primary foundation. This adaptation aligns with Islamic financial principles, which emphasize the importance of clear, usury-free contracts and a focus on the common good. Therefore, this study seeks to bridge credit risk management theory with local practices that are socio-culturally based and aligned with Islamic values.

This research is expected to provide practical benefits for informal micro-enterprises in managing credit risk by leveraging social relationships and local values that have developed within the community. Furthermore, the results of this study can provide input for parties involved in the development and mentoring of rural MSMEs so that their programs are more aligned with local social conditions. From a scientific perspective, this study is expected to enrich the literature on credit risk management, particularly by highlighting how the role of social capital and the adaptation of the 5C principles can be effectively applied in the context of informal businesses that are not based on formal systems and collateral.

Based on the background and findings of research on Mrs. Sutriani's clothing installment business in Padang Langkat Village, this study is designed to address several key issues. These issues include how credit risk management strategies are implemented in informal, socially-based clothing installment businesses in rural areas, and how ex-ante and ex-post approaches are practically adapted in the context of micro-enterprises without formal collateral. Furthermore, this study seeks to understand the role of social values and social capital in supporting payment compliance and reducing the level of non-performing loans. This study also highlights how the 5C theory is adapted in an informal credit system based on trust and social relations. Finally, this study also aims to examine the extent to which socially-based strategies contribute to business sustainability, both financially and socially, and through the use of simple technology.

2. Theoretical Background

Risk Management Theory: Risk management is a systematic approach to managing uncertainty that can threaten business continuity (Zulfa, 2014) In the context of micro-enterprises, risk management becomes increasingly important given limited resources and high vulnerability to changing economic conditions (Dewi & Sedana, 2017) According to Zulfa, (2014), a modern approach to risk management focuses not only on financial aspects but also considers operational aspects, reputation, and business sustainability. The risk management model consists of four main components: risk identification and assessment, risk management strategy development, implementation and monitoring, and evaluation and continuous improvement (Dewi & Sedana, 2017) Risk management in the context of MSMEs encompasses systematic efforts to identify and control potential losses arising from business activities. According to (Dharma & Syarbaini, 2022)

Credit Risk Management Theory: Credit risk management is a systematic process for identifying, measuring, monitoring, and controlling risks arising from credit granting activities (Zulfa, 2014) The goal is to minimize potential losses due to the debtor's inability to fulfill payment obligations. (Dewi & Sedana, 2017) state that the implementation of risk management must involve active supervision, assessment procedures based on the 5C principles, and an internal control system. In the context of informal MSMEs, non-formal supervision such as trust and a family approach is more dominant. A creditworthiness assessment is the initial step in this process, where the financial institution assesses the debtor's character, capacity, capital, economic condition, and collateral. This assessment ensures that the debtor has the ability and willingness to repay the loan (Safitri & Tasman, 2021) Once credit is granted, credit monitoring and control are crucial to oversee debtor performance. This monitoring includes analyzing payment patterns and taking preventative measures against potential delays or defaults. With effective monitoring, financial institutions can mitigate the risk of losses due to non-performing loans (Diantasari et al., 2024) Credit risk management strategies encompass the process of identifying, measuring, monitoring, and controlling risks arising from financing activities. (Dwi

Rahmadayana et al., 2024) demonstrated that implementing strategies such as buy-back guarantees, installment blocking, and customer insurance have proven effective in reducing problem financing. Emphasizing prudential principles, such as analyzing the debtor's character and repayment capacity, is a key preventative measure in preventing bad debt. Credit is a vital component of the financial system, including at the micro-scale, such as clothing instaarch by (Marbun & Jannah, 2022) categorizes the causes of problem loans into internal and external factors. Internal factors stem from a lack of thoroughness in analyzing the debtor's creditworthiness, while external factors are triggered by intentional or unintentional events. Resolution strategies include gradual collection, a family-oriented approach, and restructuring. According to (Desda & Yurasti, 2019), credit can be classified based on the term (short-, medium-, and long-term), the intended use (consumptive and productive credit), and the sector of disbursement (micro, small, and medium-sized enterprises). Each type of credit carries its own risks, requiring appropriate management strategies. If a problem arises, steps such as credit restructuring, renegotiation, or legal action can be taken to resolve the issue. The primary goal of managing problem loans is to minimize the impact of losses and find the best solution for both parties (A'yun et al., 2023) An effective approach to credit risk management often combines formal and informal strategies. Formal strategies include clear policies and procedures, while informal strategies involve personal communication with borrowers. Furthermore, community-based social mechanisms, such as recommendations from group members, can increase borrower accountability and reduce the risk of bad debt (Hermelina & Sarwan, 2020).

Recent studies emphasize that credit risk management in micro-scale enterprises must integrate both financial prudence and social mechanisms. During economic shocks and public health crises, rural micro-entrepreneurs often depend on informal financing to sustain operations(Yang et al., 2023). Meanwhile, new approaches to credit risk evaluation such as alternative credit scoring that uses non-traditional data like mobile transactions and utility payments help financial institutions better serve informal borrowers (Adam et al., 2025). These developments complement traditional 5C analysis by recognizing that behavioral and community-based indicators such as trust, reputation, and group accountability can serve as reliable predictors of repayment performance. In rural installment businesses, this balance between formal assessment and informal trust ensures continuity even under resource constraints.

Business Sustainability Theory: Business sustainability is the ability of a business to survive in the long term by adapting to change. Bad debts can hinder the sustainability of micro-enterprises, causing a decrease in capital and difficulties in procuring stock (Ariska, 2020) In the clothing installment business, high levels of bad debts can disrupt cash flow and hinder business expansion (Dewi & Sedana, 2017). In addition to financial factors, business sustainability is also influenced by social relationships and reputation within the local community. Businesses with a good credit risk management system have easier access to formal financing, increasing their chances of long-term survival. The sustainability of MSMEs is influenced by financial inclusion, capital, and financial literacy. (Azro'i et al., 2023) shows that access to capital and financial services significantly impacts business sustainability. In practice, sustainability is reflected in the ability of businesses to retain customers despite limited digital resources. Furthermore, adapting to technology and market changes is a crucial factor in business sustainability. Clothing installment businesses that adopt digital systems can increase efficiency and competitiveness. The sustainability of home-based clothing installment businesses in rural areas depends on credit management, social relationships, and technological adaptation. With the right strategy, these businesses can survive and thrive in the long term.

Empirical findings from various countries highlight that the sustainability of rural microenterprises largely depends on access to inclusive financial systems. Digital and traditional financial inclusion strengthen financial resilience by improving cash flow stability and reducing dependence on informal, high-risk lending. In the rural context, access to social protection mechanisms such as health insurance helps micro-entrepreneurs avoid chronic poverty and maintain business continuity (Zhang & Wu, 2024). Moreover, collaborative social protection initiatives involving government and community-based groups have been proven to enhance local economic resilience (Kuntjorowati et al., 2024). A review by BMC Public Health (2025) further confirms that households and small businesses that apply adaptive coping strategies are more likely to survive financial shocks. These insights reaffirm that business sustainability in rural microcredit systems is not only financial, but also social, grounded in protection networks and community resilience (Jalili et al., 2025).

Consumer Behavior Theory: Consumer behavior in clothing installment businesses is heavily influenced by social, economic, and cultural factors. A study by (Ariska, 2020) showed that clothing purchases on credit in Adijaya Village, Pekalongan District, East Lampung, were influenced by merchant honesty and payment flexibility to maintain customer trust. Furthermore, research by (Yermitha et al., 2025) confirmed that social and economic influences significantly impact clothing purchasing decisions. Many rural customers prefer installment payments over cash payments due to limited income and consumption patterns that depend on harvest cycles or seasonal income. Furthermore, trust plays a key role in consumers' decisions to take out credit. Research shows that strong social ties with the local community can influence loan default rates. For example, research by Saida et al., (2024) found that personal trust among group members and social homogeneity are positively associated with loan repayment. Furthermore, social capital, encompassing networks, norms, and trust, can serve as a pillar in managing business funds, as revealed in a study on the implementation of social capital's role in managing Village-Owned Enterprises (BUMDes) funds. (Darmayanti & Sinarwati, 2023) thus, businesses with strong social ties to local communities tend to have lower non-performing loan rates because customers feel responsible for fulfilling their obligations. Social factors, such as proximity to the business owner and recommendations from friends or family, play a significant role in consumers' decisions to take out credit. Research shows that social factors, including reference groups, family, and the consumer's social role and status, can influence consumer behavior in making purchasing decisions (Subhan et al., 2023) Furthermore, factors such as cultural, social, personal, and psychological factors significantly influence consumer decisions in selecting a particular product or service. (Ridarta, 2023) In the context of credit, personal relationships with business owners and recommendations from consumers' social networks can increase trust and comfort in making credit decisions. Consumer behavior in the clothing installment business is also influenced by financial literacy levels. A study by (Lubis & Nurhayati, 2024) found that customers with better financial literacy tend to be more disciplined in their credit payments, while those with limited financial literacy are more vulnerable to bad debts. Therefore, a financial education approach for customers can be an effective strategy in reducing the risk of default and improving business sustainability.

5C Theory in Credit Assessment: The 5Cs theory is used to assess creditworthiness based on five aspects: Character, Capacity, Capital, Collateral, and Conditions. This theory has been widely used in the banking world since the early 20th century. The 5Cs theory is a systematic approach used by financial institutions to assess a borrower's creditworthiness. The five main components of this model are Character, Capacity, Capital, Collateral, and Conditions. Character refers to the borrower's moral track record and integrity; Capacity assesses the borrower's ability to meet financial obligations; Capital refers to the financial strength or equity held; Collateral is an asset that can be used as collateral; and Conditions include external factors such as economic conditions and government policies that can affect the borrower's ability to pay (Peprah et al., 2017). The 5C model is a key foundation for credit risk management practices, providing a holistic analytical framework for a borrower's risk profile. Its application extends beyond formal banking institutions to microcredit systems and cooperatives.

Social Value Theory: Social value is a set of non-financial benefits arising from economic and social activities that impact the well-being of individuals and society. This concept emphasizes that the success of an activity is not solely measured by economic outcomes, but also by its contribution to trust, solidarity, justice, a sense of community, and the quality of life of the community (Coleman, 1988) Over time, social value can be understood through three main frameworks. First, the social capital approach, which views social value as the result of a network of trust, norms, and relationships between individuals in society. The existence of social capital strengthens social bonds and serves as a controlling instrument for economic behavior to maintain the common good (Darmayanti & Sinarwati, 2023; Saida et al., 2024) Second, the institutional and stakeholder approach, which views social value as the result of interactions between stakeholders, where local norms and rules play a crucial role in determining the legitimacy of an activity (Subhan et al., 2023) Third, the social entrepreneurship approach, which emphasizes that businesses, including MSMEs, aim not only to generate financial profit but also to produce social value through business practices based on trust, family solidarity, and protection of community groups (Yermitha et al., 2025) In the context of rural clothing installment businesses, social values manifest in mechanisms of trust, shame, and solidarity that serve as substitutes for formal collateral in credit transactions. This practice not only helps businesses maintain their sustainability but also strengthens social cohesion. Several studies in Indonesia have shown that social values derived from social capital can reduce the risk of bad debt and simultaneously strengthen the sustainability of small businesses (Darmayanti & Sinarwati, 2023; Rachmahlija et al., 2023) Thus, the theory of social value emphasizes that the success of a business depends not only on financial capital, but also on the quality of social relationships and the strength of community norms that support economic sustainability and social stability.

The social value of rural microcredit lies in its capacity to strengthen solidarity and reduce inequality through inclusive lending. Equitable access to credit among low-income households supports both business growth and community welfare (Desfiandi & Putra, 2024). In rural installment systems, credit is not merely an economic transaction but a social practice rooted in trust, kinship, and moral obligation. These mechanisms generate social value by enhancing collective responsibility, fairness, and mutual protection within the community. Thus, the sustainability of microcredit activities depends not only on capital circulation but also on the preservation of local trust networks that uphold ethical lending practices.

Social Capital Theory: Social capital theory explains how social relationships, norms, and networks between individuals can become productive resources that support collective action and the achievement of shared goals. Coleman, (1988) views social capital as an entity embedded in the structure of social relationships, which can facilitate beneficial actions within a community. Social capital can take the form of trust, norms of reciprocity, and social networks that facilitate coordination and cooperation among community members (Coleman, 1988). In addition, Putnam, (1993) emphasizes that trust, networks, and social norms are the core of social capital that strengthen cooperation and collective efficiency. He distinguishes between *bonding social capital* (strong ties within close-knit groups such as families or neighbors) and *bridging social capital* (weaker ties that connect different groups). Both forms are crucial in rural credit systems: bonding creates strong social control that reduces default, while bridging expands access to new opportunities and information. Building on this, Granovetter, (1973) highlights the importance of *the strength of weak ties*, arguing that weak ties often provide more valuable information and access to opportunities than strong ties. In the context of clothing installment businesses, weak ties with acquaintances or broader community networks can provide essential information about borrowers' trustworthiness and repayment ability, complementing the control exercised through strong ties. Meanwhile,Woolcock, (1998) integrates these perspectives by arguing that social capital operates most effectively when informal community-based networks (trust, family solidarity, reciprocity) are balanced with formal institutions (rules, legal frameworks, financial systems). In informal MSMEs such as rural installment businesses, this balance is reflected in the coexistence of trust-based arrangements (e.g., family dialogue, shame mechanisms) and semi-formal practices (e.g., written records, group recommendations). Such integration strengthens business resilience by combining social mechanisms with structured practices. In a microeconomic context, therefore, strong social capital can substitute for formal instruments like collateral or legal contracts, enabling credit systems to operate even without material collateral. This is highly relevant to rural clothing installment businesses, where borrowers' reputation, social ties, and trustworthiness often replace conventional collateral as the basis for creditworthiness.

Recent empirical evidence reinforces the pivotal role of social capital in shaping informal credit behavior and repayment performance. Indriani et al., (2023) found that social capital moderates repayment performance within Indonesia’s group lending model, where peer control and social ties significantly mitigate credit default risk. Consistently, Laila et al., (2025) demonstrated that social trust and networks enhance the financial well-being of micro-entrepreneurs in Malaysia and Indonesia, confirming that interpersonal trust can substitute formal collateral. Similar findings were reported in China, where informal finance and trust-based relationships influence household wealth accumulation and rural financial resilience (Li & Hiwatari, 2025). Collectively, these studies emphasize that **social cohesion functions as social collateral**, reinforcing repayment reliability and the sustainability of rural enterprises.

To strengthen the theoretical foundation, several empirical studies across regions demonstrate how social capital through trust, networks, and shared norms affects credit access, repayment behavior, and financial well-being. Table 1 summarizes key findings relevant to this study.

Table 1. Summary of Global Empirical Studies on Social Capital and Credit Performance

Region	Study & Main Findings	Relevance to Current Study
Southeast Asia / Indonesia / Malaysia	*Impact of social trust, social networks, and financial knowledge on financial well-being of micro-entrepreneurs in Malaysia and Indonesia* (2024) found that social trust and networks significantly affect micro-entrepreneurs’ financial well-being, alongside financial literacy. (Laila et al., 2025)	Highlights the dual importance of social capital and financial literacy in shaping credit behavior among micro-entrepreneurs, relevant to the rural informal context.
Indonesia (Padang)	*Social Capital on the Performance of Microfinance Institutions of Agribusiness* demonstrated that trust, norms, and social networks enhance MFI performance, including credit supervision and reduction of non-performing loans. (Analia et al., 2025)	Provides local empirical support that social capital contributes directly to credit risk management and institutional sustainability.
Africa	*Social Cohesion and Firms’ Access to Finance in Africa* (2023) revealed that all three pillars of social cohesion trust, inclusive identity, and cooperation for the common	Confirms that trust and social networks can shape access to credit, a parallel to rural MSMEs and informal financing systems.

	good positively influence access to external financing. (Walle, 2023)	
Kenya	*Gendered Investment Differences among Smallholder Farmers* (2023) showed that participants lacking mobile phones or social communication networks had weaker repayment capacity. (Jindo et al., 2023)	Demonstrates the critical role of connectivity both social and informational in ensuring repayment reliability.

Source : Data Processed by Author (2025)

These studies collectively reinforce that **social capital functions as both a screening and enforcement mechanism** in informal credit systems. In rural Indonesian contexts, such as the Padang Langkat case, these findings validate that social trust and networks can effectively replace formal collateral and enhance repayment discipline.

Ex-Ante and Ex-Post Approaches in Risk Management: The ex-ante approach focuses on estimates and expectations before events occur. In managerial practice, this translates into risk-prevention strategies such as partner selection based on social reputation, gathering information on repayment capacity, or maintaining administrative records early. Arrow emphasized the importance of rational expectations in developing strategies that theoretically maximize the long-term welfare of economic actors. In contrast, the ex-post approach serves as an evaluation tool for decisions made after the risk has been realized. This is where analysis of actual outcomes serves as the basis for identifying deviations from initial expectations and restructuring response mechanisms. Ex-post strategies can include renegotiating payment terms, providing installment flexibility, or providing credit restructuring. (Arrow, 1963) suggests that this approach is essential for accommodating uncertainty and providing a basis for learning for future policy. In the context of informal micro-enterprises such as clothing installment loans in rural areas, this framework is highly applicable. Ex-ante strategies are evident in customer selection based on social relationships and real-time installment recording. Ex-post strategies, on the other hand, are evident in family dialogue practices, persuasive approaches to collection, and informal installment restructuring. These two approaches complement each other in shaping risk management that is socially based, rather than structurally formal. Thus, Arrow's ex-ante and ex-post framework is not only relevant in the context of macroeconomics or state policy planning, but can also be effectively applied to the dynamics of small and informal businesses. This conceptual distinction helps explain how economic actors operating within structural constraints can still rationally manage risk through the integration of initial expectations and evaluations of actual outcomes.

3. Methodology

Research Approach and Design

This study employs a qualitative approach with an embedded case study design as proposed by DeVaney, (2016). The embedded case study was chosen because it allows an in-depth exploration of the main case while simultaneously examining interconnected sub-units of analysis, thus capturing the complexity of credit risk management in rural installment businesses.

The main case in this study is the clothing installment business owned by Mrs. Sutriani in Padang Langkat Village, while the sub-units include credit risk management strategies, patterns of social interaction between owners and customers, recording and billing mechanisms, and factors contributing to bad debt. his design is considered appropriate because it not only provides contextual depth and holistic understanding of the phenomenon (Sugiyono, 2017) but also enables the researcher to analyze multiple dimensions of business practices that are socially and economically intertwined.

Data Collection Method

Data collection was carried out through three main techniques (Milles et al., 2014), namely in-depth interviews, participatory observation, and documentation study. In-depth interviews were conducted with primary and secondary informants. The primary informant was Mrs. Sutriani, the business owner, who was interviewed for 60–90 minutes over several sessions. The secondary informants consisted of eight active customers with smooth payments, five customers with a history of late or bad credit, and two local community figures. Semi-structured interviews were used to gather information about credit granting mechanisms, strategies for handling late payments, the role of social values and family relationships, and the impact of these strategies on business sustainability. Probing techniques were applied to deepen informant responses (Milles et al., 2014).

Participatory observation was conducted using the observer-as-participant role, where researchers observed the field for 12 weeks (March–May 2025), with a frequency of 2–3 times per week and 1–2 hours per visit. The observation focused on several aspects, including the transaction and recording process, social interaction between business owners and customers, billing practices and customer responses, as well as the social dynamics surrounding the business. Field notes were compiled using a structured field note format to ensure systematic data recording.

The documentation study involved collecting and analyzing several types of documents, including credit transaction log books (January 2025 – May 2025), WhatsApp chat records between business owners and customers, photos of collection activities, and customer profiles along with their delay history. The analysis used a content analysis approach to identify patterns of bad credit (Bowen, 2009). The informant criteria included active customers for at least six months, representation of payment status variations (smooth, late, and stuck), coverage of different socioeconomic backgrounds and age groups, and inclusion of community figures to provide external validation and a broader social perspective.

Data analysis was performed using the Milles Data Analysis Model (Milles et al., 2014), which consists of three main stages: data reduction, data presentation, and conclusion drawing. In the data reduction stage, open coding was used to identify initial categories from interviews and observations, axial coding to group data into related themes, and selective coding to develop theoretical propositions consistent with field findings. The data presentation stage included the preparation of a credit risk management strategy matrix, a network display of socio-economic relations, and a timeline mapping for handling late payments. Finally, in the conclusion drawing stage, the analysis referred to Robert K. Yin's case study framework, applying three main techniques: pattern matching, which aligns empirical findings with theoretical frameworks such as the 5C theory and social capital theory (DeVaney, 2016); explanation building, which constructs logical explanations linking social factors and credit risk; and cross-case synthesis, which was not used since only one case was examined.

To ensure the credibility and ethical integrity of the research, several measures were implemented. These included triangulation of data sources (interviews, observation, and documents), member checking by confirming findings with key informants, and peer debriefing with academic supervisors to minimize researcher bias. Ethical considerations were also upheld through obtaining verbal informed consent before interviews, ensuring confidentiality of personal and financial data, and anonymizing participant identities in the report. Additionally, researcher reflexivity was maintained through a reflective journal to record positionality and potential biases during fieldwork.

Table 3. Summary Table of Methodology

Data Source	**Participants / Documents**	**Duration / Frequency**	**Analytical Steps (Miles & Huberman)**
In-depth Interview	1 owner, 8 smooth-paying customers, 5 late/default customers, 2 community figures	60–90 min per session, multi-session	Coding → Thematic grouping → Explanation building
Observation	Business transactions, interactions, billing practices	12 weeks, 2–3 visits/week, 1–2 hrs/visit	Field notes → Categorization → Timeline mapping
Documentation	Log book, WhatsApp chats, photos, payment history	Jan–May 2025 (collected continuously)	Content analysis → Pattern identification

Source : Data Processed by Author (2025)

4. Empirical Findings/Result

Case Profile and Research Context
This study was conducted in Padang Langkat Village, focusing on Mrs. Sutriani's clothing installment business, which has operated for more than 15 years and currently serves 72 active customers. The business relies on informal credit practices without collateral or written contracts, using personal trust and reputation as the foundation for transactions. Customers mainly housewives, daily laborers, and small traders have irregular incomes, averaging less than IDR 1,500,000 per month. In this context, values such as *shame (malu)*, moral responsibility, and social pressure play a significant role in encouraging repayment behavior. These findings confirm earlier observations that rural informal enterprises are shaped not only by economic considerations but also by strong socio-cultural mechanisms (Hermelina & Sarwan, 2020).

Credit Risk Management Strategy: Ex-Ante and Ex-Post Approaches
The clothing installment business implements a dual framework of risk management, combining ex-ante (preventive) and ex-post (responsive) measures in line with Arrow's (1963) welfare economics perspective on uncertainty.

a. **Ex-Ante Strategies**
   1) *Social reputation-based customer selection*: The majority of customers are selected through recommendations from trusted relatives or neighbors, or by returning as repeat customers. This practice creates a self-regulating screening mechanism that significantly minimizes default risk. Data show that 93% of customers (67 out of 72) consistently fulfill repayment obligations, highlighting the effectiveness of socially embedded trust.
   2) *Informal capacity evaluation*: Rather than relying on formal documents such as payslips, repayment capacity is assessed through observation of occupation, lifestyle, and seasonal income cycles. This aligns with local knowledge systems, where social interactions provide reliable information about financial capability.
   3) *Structured manual recording*: Although informal, systematic bookkeeping in notebooks and digital backups via WhatsApp photos reflect consistency in maintaining accountability. This demonstrates that even in resource-limited contexts, simple but structured recording mechanisms can strengthen transparency and reduce disputes.

b. Ex-Post Strategies

1) *Familial approach*: When arrears occur, collection is conducted through empathetic dialogue, often in the customer's home, reinforcing both moral obligation and social accountability. This personal approach reduces the likelihood of conflict and maintains long-term relationships.
2) *Phased billing and negotiation*: Reminders are initially delivered digitally (e.g., WhatsApp) before escalating into personal visits. This tiered approach balances flexibility with enforcement.
3) *Installment restructuring*: For customers demonstrating goodwill, payment schedules are renegotiated by extending periods or lowering installments. Such flexibility accommodates household economic shocks while sustaining repayment behavior.

These strategies show that informal mechanisms, rooted in community values, can perform risk management functions comparable to formal institutions. This extends findings by Dewi & Sedana, (2017), who emphasized structured monitoring in formal banks, by showing that rural actors replace bureaucratic mechanisms with social trust and flexible arrangements

The Role of Social Values and Social Capital

a. Social Capital as Collateral

Social capital is central to risk management in this business model. Trust replaces collateral, while community norms act as informal enforcement tools. Customers fear reputational loss and potential exclusion from community events, which creates strong incentives for repayment. At the same time, social solidarity ensures that debtors can rely on relatives or neighbors in emergencies, transforming risk into a shared responsibility. In addition, social networks are used to screen potential customers and provide informal social control over their payment behavior.

b. Social Control Mechanism

The Padang Langkat Village community has strong social control mechanisms. Customers found to be in arrears without a clear reason can be subjected to peer pressure or even ostracized from certain social activities. This type of social sanction is often more effective than formal penalties.

Conversely, the surrounding community also serves as a source of support. In emergencies, customers can seek assistance from neighbors or relatives to collectively meet their debt obligations.

This dynamic reflects Coleman's (1988) and Putnam's (1993) concepts of *bonding* and *bridging* capital. Bonding ties (family, neighbors) create strong social control that reduces default risk, while bridging ties (wider acquaintances) provide valuable information for customer screening. In practice, the coexistence of trust-based relationships and semi-formal documentation illustrates Woolcock's (1998) argument that balancing informal and formal mechanisms strengthens community resilience.

Comparatively, while Hermelina & Sarwan (2020) found that cooperatives still required collateral as partial security, this study demonstrates a stronger reliance on moral sanctions and communal trust, emphasizing how cultural context shapes credit practices in rural Indonesia.

Adaptation of the 5C Theory in Informal Credit

The findings illustrate a localized reinterpretation of the 5C model of creditworthiness:

a. **Character** is the most dominant dimension in the customer selection process. Credit is granted based on subjective assessments of a potential customer's social reputation, recommendations from existing customers, and established personal relationships. Ms. Sutriani emphasized the importance of honesty, a sense of shame, and moral responsibility as primary indicators of creditworthiness, superseding formal instruments such as credit history or official identification.

b. **Capacity** assessments are conducted informally, taking into account the customer's type of employment and income stability. Although there are no official documents like pay slips, business owners have contextual knowledge of the customer's economic situation through social interactions and daily observations. Paying capacity is evaluated based on an understanding of local income cycles (e.g., paydays, harvest seasons, or seasonal activities). So, capacity is assessed through informal knowledge of income stability and livelihood patterns.

c. **Capital** A customer's capital or assets are not a primary factor in credit decisions. Instead, Ms. Sutriani considers the customer's commitment to repaying previous installments as a form of "social capital" that reflects their ability. This demonstrates that capital in informal contexts is more symbolic than financial.So, capital is reinterpreted as prior repayment behavior and symbolic social commitment rather than financial equity.

d. **Condition** Business owners intuitively consider external conditions such as the local economic climate, fluctuations in the prices of basic necessities, and seasonal influences. Mrs. Sutriani understands that late payments can occur due to changes in a family's economic situation. Therefore, payment reminder strategies and billing schedules are designed flexibly to adapt to these dynamic conditions. So, condition considers seasonal and local economic dynamics that affect repayment cycles.

e. **Collateral** Collateral is not used in this business. Instead, social security is used: customers who fail to pay can face social pressure, lose their reputation, or be ostracized within their small village community. In this context, social pressure and emotional connections act as a form of tacit security that is quite effective in reducing the risk of default.So, collateral is entirely absent and replaced by social sanctions, reputational concerns, and emotional ties.

This adaptation diverges from Peprah et al. (2017), who emphasized financial indicators, and instead supports Putnam's (1993) framework that economic actions are embedded in social norms. It shows that rural informal credit systems restructure the 5C model into a socially embedded mechanism where Character and Condition dominate while Collateral is substituted by social capital. This finding strengthens the argument that the 5C theory can be applied flexibly in specific socio-cultural contexts, with adjustments to prevailing trust structures and social relationships

5. Discussion

The socio-cultural foundation of credit risk management plays a crucial role in ensuring business sustainability at multiple levels—financial, social, and technological. From a financial sustainability perspective, the social-based approach implemented by Mrs. Sutriani has proven highly effective in reducing non-performing loans and maintaining business stability. Field observations and transaction records during the research period show a payment success rate of 93%, meaning that 67 out of 72 active customers paid their installments on time without significant delays. This figure, calculated using Corefy's (2023) formula for payment success rate, demonstrates the strength of social capital as an informal risk control mechanism. In this system, trust, moral responsibility, and community-based social controlfunction as substitutes for formal collateral. Many customers maintain close personal relationships with the business owner—as neighbors, relatives, or long-time acquaintances—creating a strong sense of moral obligation and "shame" that discourages late payments. These dynamics foster repayment discipline and consistent cash flow. Moreover, personalized communication methods, such as WhatsApp payment reminders and home visits, help sustain repayment regularity. When delays occur, Mrs. Sutriani's family-oriented approach reinforces customer commitment without creating conflict. Interviews revealed that customers who faced temporary financial difficulties usually responded positively to gentle reminders, repaying soon after. Therefore, the 93% repayment rate not only signifies financial success but also reflects the effectiveness of social capital as a form of "moral collateral" in sustaining repayment behavior and ensuring micro-business sustainability in informal rural credit systems.

From a social sustainability standpoint, Mrs. Sutriani's strong reputation as a trustworthy businesswoman has fostered deep customer loyalty and stimulated word-of-mouth expansion. In this context, social ties serve not only as instruments of risk management but also as organic marketing strategies. Customers' positive experiences are shared within the community, generating new business opportunities without promotional costs. This demonstrates that social relationships can serve as dual tools—maintaining repayment discipline and promoting business growth.

In terms of technological adaptation, the use of WhatsApp for payment reminders and documentation indicates an early yet meaningful step toward digitalization. This hybrid system—combining simple digital tools with traditional social mechanisms—illustrates how rural entrepreneurs can adapt technology to their context. This finding aligns with Azro'i et al. (2023), who emphasized that long-term business sustainability depends on a balanced integration of financial literacy, social capital, and technological adaptation. Despite limited access to formal infrastructure and low financial literacy in the community, this balanced approach between social and financial strategies has proven vital for sustaining the business.

Overall, the study's findings reveal that managing credit risk in Mrs. Sutriani's clothing installment business relies on a socio-cultural approach that diverges from conventional credit risk management theory. Her strategy represents an adaptation of the 5C theory (Character, Capacity, Capital, Condition, Collateral) to an informal context, in which character assessment—based on trust and reputation—replaces collateral as the dominant factor. This adaptation supports Saida et al. (2024), who argue that social capital—through trust, social norms, and social networks—can effectively minimize bad debt risk. The findings confirm that social mechanisms serve as stronger informal control systems than formal contracts, aligning with the observed 93% repayment rate. Furthermore, the family-oriented approach employed in managing delinquent payments ensures the balance between financial and social objectives, which is essential for micro-enterprise sustainability in rural areas.

The research contributes both theoretically and practically to the field. Theoretically, it refines the 5C framework by demonstrating its flexibility in informal economies, showing that cultural adaptation—where trust and social reputation replace collateral—is key to its relevance. Practically, it offers a model for rural entrepreneurs to mitigate credit risk without relying on formal financial instruments, offering valuable lessons for microfinance design in low-literacy, low-infrastructure contexts. From a policy perspective, the study suggests the potential of developing hybrid microfinance models that integrate formal financial institutions with local community networks. By leveraging trust-based relationships for creditworthiness assessment (OJK, 2024), such collaborations could enhance financial inclusion and reduce persistently high non-performing loan (NPL) ratios in rural microcredit sectors.

6. Conclusions

This study shows that non-performing loan (NPL) risks in rural clothing installment businesses can be managed effectively through socio-cultural mechanisms that substitute formal collateral. Ex-ante strategies such as customer selection based on reputation, informal evaluation of repayment capacity, and structured manual recording, combined with ex-post approaches like family-oriented collection, phased reminders, and flexible restructuring, resulted in a 93% repayment rate. These findings indicate that trust, moral responsibility, and community norms serve as effective safeguards for both financial sustainability and social harmony.

Theoretically, the research refines the 5C credit assessment model by emphasizing Character and Condition while replacing Collateral with social capital, thus enriching credit risk theory in informal microfinance contexts. Practically, the study offers insights for entrepreneurs, microfinance actors, and policymakers, showing that sustainable credit systems can be built on trust-based mechanisms even in low-literacy and low-infrastructure settings. Moreover, the findings suggest the potential of hybrid models where formal institutions collaborate with community networks, reducing rural NPL risks while strengthening financial inclusion and long-term busines

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