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Institutional Ownership and Harmonious Values in Increasing Financial Performance of Village Credit Institution (Lembaga Perkreditan Rakyat/ LPD) in Bali Province

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ABSTRACT

The research aims to explain the role of customary village institutional ownership and harmonious values as moderating variables related to credit risk and inefficiency in order to increase financial performance of LPD in Bali. 100 of 1405 companies are used as sample and Partial Least Square (PLS) is used to test built model. The examination found that harmonious values stressing on harmonious relationship between human and God, between humans and between human and environment is strengthening institutional ownership to reduce credit risk. Institutional ownership is able to reduce credit risk and inefficiency but it doesn't have significant influence on financial performance. Through credit risk reduction and inefficiency, financial performance is able to be increased at LPD. Type of non-performing loan has not been described in the research, which is become research limitation; however, the research gives color in financial management especially agency cost related to credit risk that can be reduced by the implementation of harmonious values.
Keywords: Institutional ownership, harmonious values, credit risk, inefficiency, financial performance

INTRODUCTION

One of ownership form other than firm's ownership, which is institutional that can be in form of insurance company, bank, government and other institutions, will encourage more optimal monitoring on management performance by increasing manager accountability through various monitoring tools. These institutional investors will try to use their right to create changes on management behaviour, for example by forming stockholders advisor committee having a function to re-examination company's operation results and financial and try to increase information flow between stockholders and manager. It is hoped that this monitoring able to reduce agency cost thus increasing company's value.

Relationship between ownership structure and company's performance has been an important research topic for the last three decades and made an issue in literature on company financial. Theoretical and empirical research on relationship between ownership structure and company performance was initially motivated by the separation of ownership and control identified by Berle and Means [1] and they showed that reverse relationship was observed between the looseness (concentration) of stock ownership and company's performance, in which ownership structure influenced company's performance. The analysis was focused on agency theory explaining interest conflict between the owner and stock holders, inside or outside [2][3].

Jensen and Meckling [2] argued that the relative number of ownership held by insider (management) and outsider (investor who has direct role in company's management) gave incentive to manager to be involved in activities to serve their own benefit. Their hypothesis was that company's value and performance is increasing by insider ownership level. Agency conflict between manager and the outsider stock holder tend to give an appropriate return to manager giving company's resource for their own consumption. This argument was challenged by Demsetz and Lehn [4] who argued that company's ownership structure should be considered as endogen result of decision that reflect the influence of stockholders. According to Demsetz and Lehn [4] there should be no systematic relationship between changing on ownership structure and business performance.

Western researches such as Jensen *et.al* [5] proposed that stock ownership structure can influence company's performance and value by reducing agency cost [6]. tried to evaluate ownership structure by paying attention on 1) the largest ownership percentage by a director, 2) the largest percentage by institution or company, 3) the largest ownership percentage by non institution, and 4) ownership percentage by company's employees. His examination result showed that ownership structure contributes to company's performance achievement. Other researches by Karpoff [7], Gillian and Stark [8] on banking institution suggested that a condition where there exists an increase of ownership by institution compare to individual ownership is related to monitoring power on company. Institutional ownership has its own agenda according to investment types and

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period [9] [10]. Therefore, there are investors who want to control company's management and investors who want to gain profit in short term [11].

Some researches had documented that institutional ownership shows strong influence on company's monitoring and performance. For example: Brav *et.al.* [12] conducted an examination by relating it with stock price, and result showed an increase on stock price of 5-7% above normal price and also able to increase company's financial performance (return on asset and equity). Cornett *et.al.* [13] explained that a significant relationship exists between institutional ownership and company's cash flow return and performance. It caused by owner activity to cooperate in investment, both in short term and long term. Bhattacharya and Graham [14] also found similar result that institutional ownership has significant influence on company's performance.

A stable institutional ownership is very helpful in increasing performance through three ways: first, it is able to strengthen monitoring thus suppress agency theory; second, in long term, it is able to reduce asymmetric information; and the last, it is able to increase company's governance by pressing management through incentive [15]. Another research by looking at institutional ownership proportion showed that it able to increase company's performance measured with Tobin's Q [16]. However, Woidtke [9] found that institutional ownership proportion unable to increase company's performance measured with Tobin's Q. Differences on these study results give opportunity for researcher to examine contributing factors, such as a research conducted by Cornett *et al* [13] that comparing stock proportion owned by an institution and the number of institutional investors with company's performance measured with the ability of company's asset in producing profit. The research result showed that stock proportion owner by an institution and the number of institutional investor has positive relationship with company's performance. Leech and Leahy [17] found negative and significant relationship between institutional dominated ownership and company's value and profitability. Other research by Zeitun and Tian [18] found that governmental ownership has significant influence on company's financial performance measured with ROA (*return on asset*) and ROE (*return on equity*). Ianotta *et al.* [19] stated that institutional dominated ownership has no significant influence on loan quality, such as asset risk and low risk handling by bank. Shehzad *et al.*[20] argued that institutional ownership on bank influencing bank risk measured with non performing loan ratio and capital adequacy ratio.

Some researchers as Prowse [21]; Master [22]; Booth *et al.*[23], and Adams and Mehran [24] were interested to examine the role of banking regulation and monitoring conducted by institutional investors. Their research results showed that both factors can be used to reduce managerial discipline level and have influence on banking industry. Research conducted by Fuentes and Vergara [25] on institutional ownership linked to banking efficiency found that institutional ownership tends to have high efficiency due to strong monitoring by owners thus suppress the agency cost; this is in line with Iannotta *et al* [19], however, it adds several variables such banks' performance and risk, and concluded that institutional ownership is able to increase performance and decrease bank risk. Banks' risk and efficiency are aspects considered important by researchers if related to company's performance. According to Shleifer and Vishny [26], tight monitoring on management is able to reduce agency cost; therefore, achieving efficiency and in turn, increasing company's performance. Research by Ang *et al.*[27] and (Fleming [28] on small companies found that agency cost incurred is different to that of large companies and it influences company's performance. Further, Tan and Wang [29] examined the relationship of efficiency to company's performance and found that efficiency increases performance as a whole and difference measurement on efficiency is related to performance. In addition, this research revealed the difference on efficiency level of a company. Company's efficiency occurred when company's profit is higher than resources used as input in the company.

It should be note that most researches on ownership institutional and company's performance has been dominated by studies conducted in advanced countries. However, awareness emerges that theory from advanced countries such United States and United Kingdom probably has been applied restrictively in developing countries. Developing countries have different characteristic such as in political, economic and institutional aspects, which restricting the application of empirical model. Recent researches on company's governance show that geographical position, tax system, industrial development and cultural characteristic as a whole will influence ownership structure that in turn will affecting company's performance and risks [30]. This research tries to justify researches conducted in developed countries on institutional ownership to be applied in non-bank financial company which is LPD.

LPD is a non-bank micro financial institution owned by institution of *lembaga desa adat* (customary village institution) or *desa pakraman* and is the only non-bank micro financial institution in Indonesia that managed by custom. The existence of LPD in Bali is arranged in Perda (District Regulation) of Bali Province Number 2, 1988, and has been renewed with Perda Number 8, 2002, with characteristics of: (1) an enterprise; (2) owned by *desa pakraman*; (3) formed and managed by *desa pakraman*; (4) executing financial institution functions of *desa pakraman* community, such as: accepts/collects fund from village's *krama*, gives loan to village's *krama* only and manages institutional finance restricted to the environment of *desa pakraman*; and (5) executing business function as an internal financial institution of *desa pakraman* or inter-*desa pakraman* (at large).

Perda Number 8, 2002, also explains that LPD is owned by *desa pakraman*; while *desa pakraman* is a group of community with unity of hereditary tradition and life guidelines manners in *Kahyangan Tiga* bond with its own territory and properties and has a right to manage its own organization (Perda of Bali Province number 3, 2003). All components of *desa pakraman* are based on *awig-awig* (rules) which based on *Tri Hita Karana (THK)* ideology, consists of: harmonious relationship between human and God, harmonious relationship between humans and harmonious relationship between human and environment [31] [32]. Furthermore, *desa pakraman* is divided into several *banjar* as the smallest community group of *desa pakraman*. Through this *banjar*, religious ritual, mutual grant, development projects, cultural group and saving and loan activities are managed in a tight social bond [33]. The focus of religious, social and economic life is *banjar*; therefore, *banjar* has two important obligations, maintaining and preserving ritual of *desa adat* and build relationship with *desa adat* control [34].

LPD's ownership viewed from capital sources used in its operational is come from two institutions, local government and *desa adat* or *desa pakraman* institutions. The amount of fund from *desa adat* institution is 73% and 27% from the government, in average (Regional Development Bank, Bank Pembangunan Daerah (BPD), 2011). LPD's ownership is dominated by *desa adat* institution, in which the fund came from *banjar adat's* cash or *desa adat's* cash. This cash is a contribution from villagers that collected through *banjar adat* and deposited to *desa adat*. This institution is supported by custom having a power to determine management direction; therefore, LPD's head is abided to rules issued by *desa pakraman* institution.

The owner and manager of LPD has been separated and have some uniqueness that can be seen on their governance using customary rules, includes norm, social sanction, and the involvement of *desa pakraman* leader in the selection process and loan agreement enforcement that indirectly made by Central Bank (BPD). This model tends to exploit comparative advantages in law enforcement monitoring and capacity [35]. Another advantage of LPD as local institution in monitoring is that people who interacting in various non-market contexts tend to know each other. Therefore, they have more ability to monitor at each other compare to other institution. In this sense, loan provision system is based on character that effectively and precisely determined by LPD through social mechanism. It is in line with Chaves and Gonzales [36] suggestion that social pressure from local tradition is one of important factors influencing loyalty of micro financial customer in rural territories in Indonesia.

Financial performance of LPD is above 1.5%. It is significant enough to encourage LPD growth in Bali. Based on data from Bali Province Government, population of LPD in Bali at eight regencies and one municipal in 2010 is 1.405 unit LPD with employment rate of 7.396 and total asset of Rp. 5.18 trillion. LPD condition has exceeded the existed People's Credit Bank (*Bank Perkreditan Rakyat*/BPR), in which the amount of asset only Rp. 3.142 trillion in the same period, but has non-performing credit of 9.76% [37].

Phenomenon in LPD is that high non-performing credit in *karma desa pakraman* (villagers) with debt credit level above 5% [37] that can disturb the financial ability [38]. Therefore, credit provision monitoring and debt collecting need to be encouraged by LPD management. If it is connected to theory of the firm (Jensen and Meckling, 1976) [2] that not all companies having the same input will produce the same output because there are some influencing aspects: managerial behaviour, agency cost, and ownership structure.

Based on phenomena, empirical and theoretical examination, researcher wants to include harmonious values summed in concept of THK culture as a moderating variable between institutional ownership and credit risk. It was based on examination by Bartikowski *et al* [39] using Hofstede's [40] cultural values as moderating variable between company's reputation and loyalty in three countries (France, England, and the United States). Research result concluded that national culture is able to encourage consumer loyalty towards company's reputation. In relation to research in LPD that harmonious values is local culture that form national culture in Indonesia [41], the research tries to observe the implementation in encouraging company's financial performance and as a differentiator of researches relating to culture in advanced countries. This research focuses on "How institutional ownership and harmonious values have a role in credit risk, inefficiency and performance of LPD?"

MATERIALS AND METHODS

Institutional Ownership and Financial Performance

Theoretical and empirical research on relationship between ownership structure and company's performance was initially motivated by the separation of ownership and control identified by Berle and Means [1]. Jensen and Meckling [2] argued that the relative number of ownership held by insider (management) and outsider (investors without direct role in company's management) gives incentive for manager to involve in activities that serve their own benefit. According to Demset [4], there should be no systematic relationship between changing on ownership structure and on business performance [42] and conducted a research on 233 companies in the United States using Tobin's Q as an indicator of company's performance and five biggest stock percentages as indicator of ownership concentration and found that concentrated ownership has no significant influence on company's performance. Ianotta *et al* [19] argued that ownership dominated by institution has no influence on profit level gained by banks in Europe and also related to loan quality, low asset risk and low risk handling in bank.

Zeitun and Tian [18] stated that ownership structure has significant influence on company's performance both in concentrated ownership and institutional ownership. Concentrated ownership is able to increase performance by reducing monitoring cost. Shleifer and Vishny [26], Graham [42][44], Stearns [45], Itturiaga and Sanz [46] found ownership has positive relationship with company's value. Leech and Leahy [17] found negative and significant influence between institutional ownership and company's value and profitability. Institutional ownership can suppresses non performing loan ratio, conditional on supervisory control and shareholders protection rights and also has positive influence on CAR (*Capital Adequacy Ratio*) [20].

Itturiaga and Sanz [46] found positive relationship between ownership and company's value. However, it is different with Sudarma's [47] result that stock ownership structure has negative and significant influence on company's value. Lehmann [48] and Pinteris [49] argued that stock ownership concentration by institution has negative relationship with company's performance. Elyasiani and Jia [15] have seen from institutional ownership distribution related to company's performance and indicated that institutional ownership able to increase company's performance measured with ROA. Similar view also stated by Cornett *et al.* [50]; Gillian and Starks [51]; Clay [52]; Murphy and Van Nuys [53]; Kumar [54]; Juras and Hinson [55]; Himelberg *et al.* [56]; Hu and Zhou *et al.* [57] that institutional ownership able to increase company's cash flow because of experience and extensive relation of each institutions. Based on the description, first hypothesis can be proposed:

Based on the aforementioned theoretical and empirical examination, it can be developed a model of research conceptual framework as follow:

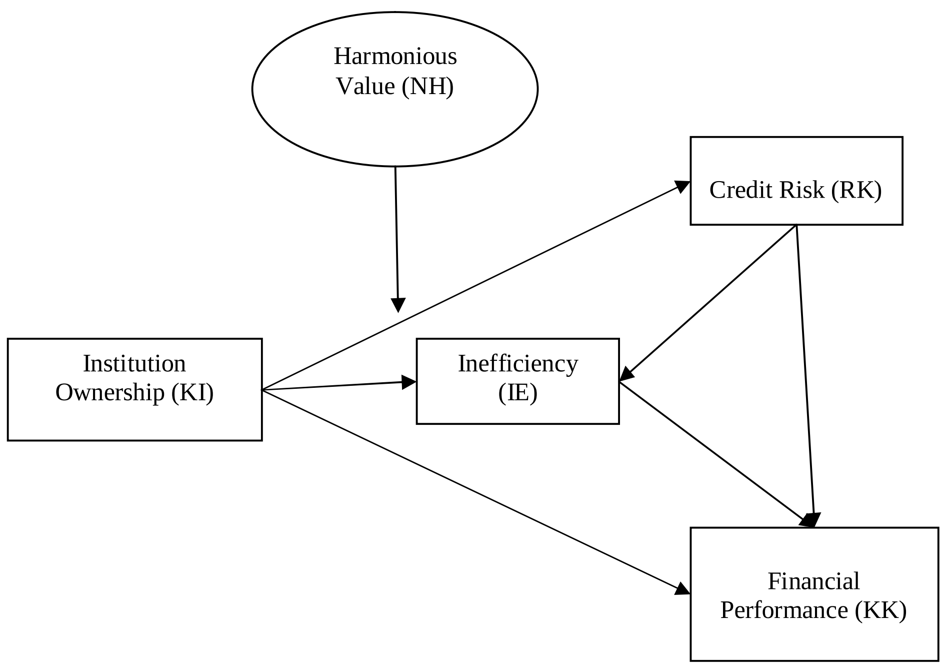

Figure 1 Model of Research Conceptual Framework

Research design of hypothesis test and causality is an explanatory research design. Research location is Bali Province with population of 1.405 units of LPD; the number of sample is determined using Slovin formula [65] with error level of 10% resulting in 94 unit minimum sample, but 6 unit is added by researcher to get 100 unit.

The research was using disproportionate sampling method with allocation on category type that appropriate to population frame. Sample distribution target of LPD consists of 79 is healthy, 9 is healthy enough, 6 is less healthy and 6 is not healthy. Sampling technique used is simple random sampling, each element of population has the same opportunity to be known and selected as subject [65].

The analysis used in the research to test hypotheses and gain a fit model is *Structural Equation Modelling* (SEM) with *Partial Least Square (PLS)* approach with help of *Smarts PLS* software application program in calculation process.

RESULTS AND DISCUSSION

Evaluation of Structural Model (Inner Model) on PLS

The use of Partial Least Square (PLS) to analyse and evaluate the validity and causality between constructs of a model in the research is using Smart PLS software. The research has 6 parts of hypothesis tests that related to structural model. Causality relationship developed in hypotheses in this model is tested with null hypothesis stating that regression coefficient of each relationship is not different to zero through t-test such in regression analysis. Following is the description of test result on 6 hypotheses in structural model proposed in the research. The use of gamma (g) symbol shows the magnitude of influence of exogenous construct on endogen construct and beta (b) shows the magnitude of influence of endogen construct on endogen. The following figure (figure 2) shows inner and outer model (full model) of institutional ownership (ownership), harmonious values (NH), credit risk (RK), inefficiency (IEF) and financial performance (KK) variables. Indicator relationship with latent construct of harmonious values is formative, while four other constructs has one indicator.

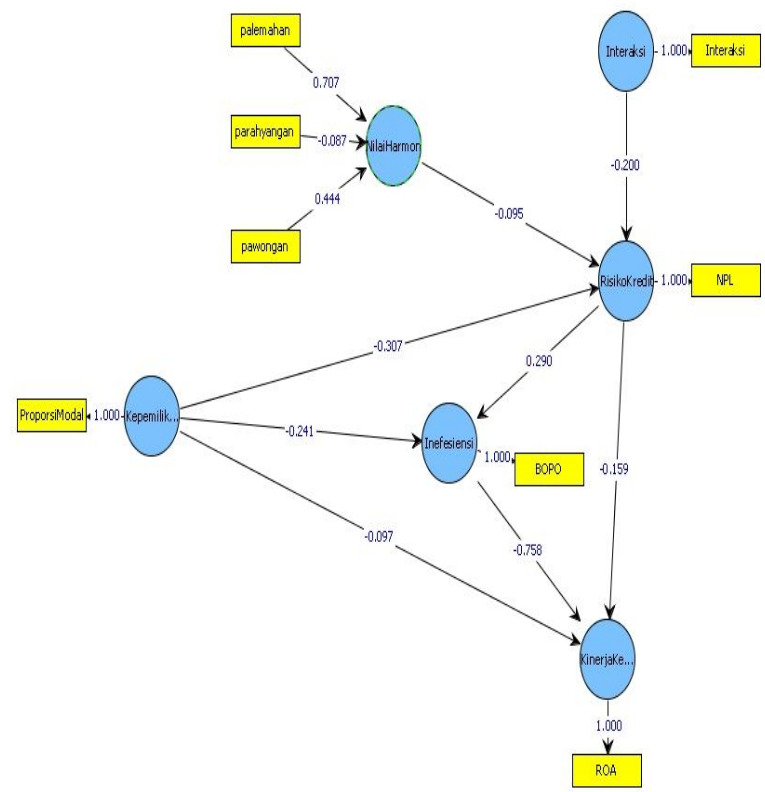

Figure 2 Result of PLS Model Test

Path coefficient test on inner model (structural model) is showed in Table 1.

Table 1. *Inner Model* Test Result

	original sample estimate	mean of subsamples	Standard deviation	T Statistic	P-value
Institutional ownership (KP)-> Credit risk (RK)	-0.307	-0.305	0.076	4.028 *	0.000
Harmonious values (NH) -> Credit Risk	-0.095	-0.153	0.092	1.040 ns	0.154
KPXNH -> Credit Risk	-0.200	-0.192	0.086	2.325 *	0.014
Institutional Ownership -> Inefficiency (IEF)	-0.241	-0.236	0.072	3.362 *	0.001
Credit Risk -> Inefficiency	0.290	0.276	0.141	2.058 *	0.025
Institutional Ownership -> Financial Performance (KK)	-0.097	-0.108	0.063	1.546 ns	0.067
Credit Risk -> Financial Performance	-0.159	-0.162	0.058	2.760 *	0.005
Inefficiency -> Financial Performance	-0.758	-0.762	0.058	13.001 *	0.000

Note: ns = insignificant (p-value > 0.05) ; * = significant on 0.05 (p-value < 0.05)

Calculation result in Table 1 explain the direct influence between variables and for indirect influence of institutional ownership on efficiency level, financial performance and credit risk with financial performance is shown in Table 2.

Table 2 Calculation Result of Indirect Influence on Inner Model

Path way	Direct Influence	Through	Indirect Influence	Description
KP -> IEF	-0.241	RK	-0.307x0.290=-0.089	Significant
KP -> KK	-0.097	RK	-0.307x-0.159=0.049	Significant
KP -> KK	-0.097	IEF	-0.241x-0.758=0.183	Significant
RK -> KK	0.290	IEF	0.290x-0.758=-0.220	Significant

Evaluation of Outer Model on PLS

Outer model aims to test relationship of each indicator on latent construct in structural model. On indicator relationship with construct that reflective in nature, a factor weight will be taken from the value of *result for outer weights*, while the formative will be taken from the value of *result for outer loadings.* In this research, latent construct is only on harmonious values and formative in nature, analysis result is indicated in Table 3.

Table 3 Test Result of *Outer Model* for Harmonious Values

	original sample estimate	mean of subsamples	Standard deviation	T Statistic	p-value
Palemahan	0.707	0.597	0.402	1.759 *	0.045
Parahyangan	-0.087	-0.059	0.431	0.203 ns	0.420
Pawongan	0.444	0.361	0.414	1.072 ns	0.147

Note: ns = insignificant (p-value > 0.05); * = significant on 0.05 (p-value < 0.05)

Model Feasibility

Model feasibility value is shown from the amount of model R^2 and *composite reliability* specifically on variable that having reflective relationship with its indicator. Indicator of model feasibility is explained in Table 4.

Table 4 Model Feasibility

Construct	R^2	Composite Reliability	Average variance extracted (AVE)
Institutional Ownership	-	1	1
Credit	0.159	1	1
NH	-	None	None
Inefficiency	0.188	1	1
Performance	0.638	1	1

This PLS model feasibility is only seen from its value of model R^2, while *composite reliability* and *average variance extracted* (AVE) can't be considered because the latent construct is formative in nature and other constructs are only measured with one indicator. As a whole, the model accuracy is:

R^2model = 1 – (1- 0.159)(1 – 0.188)(1 – 0.638)

$= 1 - 0.247$
$= 0.753$
The model accuracy level to explain five latent construct relationships is 75.3%, and the remaining is explained by other construct that excluded in the research.

The Influence of Institutional Ownership on Financial Performance

Research result shows that institutional ownership has no significant influence on financial performance but significantly influence through company inefficiency. This result supports Iannotta's *et a*l [19] thought and result that bank ownership by government, mutual banks and community in Europe has no relevancy with level of gain achievement but it is related to loan quality and low risk handling in bank. Argument supporting this statement is proposed by Demsetz dan Villalonga [42] through an examination on 223 companies in the United States with Tobin's Q as an indicator for performance, which found that the biggest institutional ownership has no significant influence on company's performance.

This research found that different institutional investors have different investment agenda. Some choose to monitor company and influence management process, while the other focus on collecting information and profit on short term trade. This result give support for investment conducted by *desa adat* and *banjar adat* that have initial agenda to help community in economic enhancement and cultural preservation [66] instead of profit oriented.

Owner monitoring on investment is limited to loan selection conducted from *banjar* to *desa adat* level and the rest is left to community member of *desa adat*. This type of monitoring will reduce monitoring cost because the communities in each *banjar adat* know each other. This condition is supported by each activity, either from the government or *from desa adat*, in *banjar* that make the intensity of community's meeting is relatively high. Another driving factor for monitoring cost reduction is from customary rules that being obeyed and prevailed for all members of community also for LPD management. One of rules that feared is being expelled from *banjar* membership; thus, eliminated all existed rights at *desa adat*.

Ownership authority in LPD is different to the one at *go public* company. In a public company, the majority stock is able to control the commissioner, CEO or manager according to Stockholders Meeting (RUPS/*Rapat Umum Pemegang Saham*). Whilst in LPD, it will be hard for something like that to occurred since LPD management is part of ownership summed in *banjar* or *desa adat* based on *awig-awig*, custom and religious dogma (Warren, 1993)[33] by setting out harmonization concept. The owner organize RUP once in a year that attended by Bendesa, monitoring agent, *kelian banjar* and LPD head to report activities result for a year and problems faced by LPD. The meeting also decides profit share and future work program.

This research result criticize agency theory assumption from Jensen and Meckling [2] that one of ways to reduce agency conflicts by giving bonus plan and part of company ownership to the management is can't be implemented. It is due to institutional ownership having character of community and operational base arranged by custom aiming to achieve harmonization between company and God, human and environment, which basically different to companies where the theory born.

The Influence of Institutional Ownership on Credit Risk

Result of hypothesis test proves that institutional ownership has significant influence on credit risk with negative direction. It means that the more capital deposited by customary institution, the more obligation that *bendesa adat* or *kelian banjar* has to control the use of fund because the fund is belong to community that collectively collected through *banjar*, thus reducing credit risk. This result is in line with Shehzad *et al* [20] that ownership is able to suppress *non-performing loan ratio, conditional on supervisory control and shareholders protection rights* and positively influence CAR (*Capital Adequacy Ratio*).

Credit risk is one of factors that being considered in determining the health of micro financial institution and it can be seen on *non performing loan* (NPL) determined by Bank Pembangunan Daerah (Regional Development Bank) of 5% maximum. This risk is occurs because of lending to community either for productive or consumptive purposes. The more loan gives to community and the wider the scope of service [38] will incurring opportunity for high credit risk and will disturb cash flow and financial performance.

Zeitun and Tian [18] support this research finding through their research on banking companies in Jordan by showing companies' condition such as high credit risk, bankruptcy, inability to pay dividend and obligation. This finding shows that institutional ownership is able to bring company to have low credit risk and increase performance. The same is happened in LPD, in which decrease on credit risk caused by increase on ownership proportion by *desa adat*. *Desa adat* in Bali is headed by *bendesa adat* that at the same time as the head of monitoring agent of LPD. *Bendesa adat* has a complex obligation, in addition to control the community in social, cultural, religious activities based on *awig-awig*, *bendesa adat* also is in touch with the government.

Bendesa adat in performing its function as community protector is protected by harmonization concept emphasizing on harmonious relationship of human with God, relationship between humans and between human and environment. This harmonization concept is known as *Tri Hita Karana* concept. This concept also used as operational base of LPD; therefore, program from *bendesa asat* has support from LPD that increasing understanding on the harmonization. The deeper the understanding on harmonious values by community, the stronger the benefit of LPD existence that felt by its customer, thus fostering a deep sense of belonging and in turn, will makes its customer feel ashamed if they don't pay the credit. This condition is one of elements that able to reduce NPL in LPD.

The Influence of Institutional Ownership on Inefficiency

Institutional ownership has significant influence on inefficiency with negative direction. This result describes that the larger the contribution of desa adat through capital amount paid-in to LPD, the lower the inefficiency or it can be said, it increase efficiency. More paid-in capital means high responsibility that encourage *bendesa adat* to actively ask for activities result reports to LPD leaders every three months. This quarterly meeting is one of monitoring form of owner on management performance to reduce agency conflict. At the meeting, plan realization, problems faced and suggestion are delivered by LPD leader to *Bendesa Adat*, monitoring agency and *kelian banjar*.

A collective ownership monitoring in LPD surely able to reduce fraud conducted by agents because costs that less useful for business development that incurred by agent will be identified earlier. Result from this type of monitoring activity will reduce inefficiency or increase efficiency in LDP. Another factor that drive the creation of low inefficiency is LPD governance that included in *awig-awig* (rules) of *desa adat* or *desa pakraman* which obeyed by all members of *desa adat* even they are afraid to brake it.

High efficiency in LPD is caused by two factors. First is low transaction cost. This situation is due to a loose implementation of rule by LPD in lending mechanism. LPD is a local financial institution owned by it user, which is the member of *desa adat*. Its operation territory is limited to *desa adat*; therefore, management has deep knowledge on its customers and utilize social control mechanism in selection process and contract enforcement. Second is a relatively low salary cost. Payroll system is based on local life cost, profit and instalments loan returned to LPD.

This empirical examination is in line with Bonin's *et al*. [58] thought and research result conducted in 225 banks in developing countries. The result found that ownership by foreign institution is able to increase efficiency of 9%. This result also in line with arguments of Fuentes and Vergara's [25]; Tan and Wang [29] that ownership by institution is able to increase company's efficiency and performance because the owner applies stright monitoring on managers and give compensation relevant to level of achievement.

Compare to examination by Bonin *et al* [58], Fuentes and Vergara [25], Tan and Wang [29], this examination result has some interesting element to reveal such as monitoring conducted in LPD on management outlined in *awig-awig* of *desa adat,* whilst in western companies, it is outlined in work contract. It can be shown in high compensation gave due to achievement by agent in prospering the owner; however, in LPD, instead of achievement for the owner, there exist mutual achievement to increase economic and preserve culture through the implementation of harmonization concept. It can be concluded that institutional ownership is able to give benefit from cost reduction for the owner but the difference is on monitoring type, one is based on materialistic and the other is based on custom and spiritual.

Harmonious Values and Credit Risk

Harmonious values give emphasize on harmonious relationship between human and God (*parahyangan*), harmonious relationship between humans (*pawongan*) and harmonious relationship between human and environment (*palemahan*). These harmonious values are used in this research as moderating variable for relationship between institutional ownership and credit risk. Research result explained that harmonious values variable moderating the relationship between institutional ownership and credit risk. These moderating harmonious values strengthen the relationship between institutional ownership and credit risk. In other words, the better the owner implementing harmonious values in LPD will reduce credit problems. It is believed by every individual owner or customers that maintaining harmonization relationship of these three dimensions of harmonious values is an expression of devotion to God; thus will be encouraged to do a good thing. This statement is confirmed by Suhardhana [67], he was stating that if we close to God, we will feel protected, far from fear and will be lead to the right and save way.

This empirical result is a development of Bartikowski's *et al* [39] research on the use of culture as moderating variable between company's reputation and consumers' loyalty. In this research, the culture used is Hofstede's [40] and the result found that culture is able to promote consumers loyalty toward increase on company's reputation. Oswari [60] develops Hofstede's [40] research using culture variable as contingency variable in banking companies in Indonesia related to bank risk, the result is that the variable is able to reduce bank risk. Other research developed is Riana's [59] research using THK culture that consist of harmonious values element that colouring organizational culture as free variable related to company's performance and the research found that THK has significant influence on performance of companies in Silver Craft Small and Medium Industry in Bali. It means that THK culture has important role in achieving company's performance.

This empirical result also gives input on the use of debt collector in handling credit problem who usually used by banking or other micro financial institution. Through the implementation of universal harmonious values, activity such as forcing debtor due to the late payment of their credit will be reduced. Harmonious value practice is by touching heart, so it is rightly to give service with heart not with violence. The existed banking rules, nowadays, assume all debtors as bad then standardization on collecting debt is made without any tolerance. In LPD, the rules exist but the implementation is forced by harmonious values that makes the rules is soft and touching.

The implementation of harmonious values in LPD has forced customers to pay credit well because the existence of element that related to God in the implementation of harmonious values which is believed to give positive stimulate for the success made in the world. For Balinese who believe in legal action or *karma phala* will reconsider every time they want to do something that will harm other people. Therefore, they will try to fulfil their obligation on time because it is believed that it is one of expression of devotion to God.

The Influence of Credit Risk on Inefficiency and Financial Performance

Result from hypothesis test shows that credit risk has significant influence on inefficiency with positive direction and has significant influence on financial performance in negative direction. It means that the more LPD has non-performing loans will result in an increase in inefficiency and on the contrary, will reduce financial performance. This result supports Berger and De Young's [61] research that more non-performing loans proxies by NPL will increase company's inefficiency and reduce company's performance. Furthermore, Konimune [62] and Konimune [63] state that more NPL is a sign for deterioration in company's financial performance.

The Influence of Inefficiency on Financial Performance

Empirical result found that inefficiency has significant influence on financial performance of LPD with negative direction. It means that the highest the cost incurred by LPD can reduce LPD ability to gain profit. This result is in line with research from Tan and Wang [29] who found that low inefficiency is able to increase company's financial performance. It means that it is appropriate to reduce expenses to gain profit in order to reach high efficiency. Other cost incurred in model analysis in LPD is that cost related to credit problem. The more the NPL surely will bring inefficiency in operational; therefore this problem get more attention from *bendesa adat* through procedure of loan application.

From agency theory perspective that triggered by information asymmetry in which when customers sign a contract with principal (LPD) it will raise moral hazard and usually accompanied by agency cost, this condition is strictly monitored through LDP governance by using customary rules consists of norm, social sanction and the involvement of *desa adat* leaders in selection process and loan agreement enforcement. This mechanism gives an advantage for LPD and in accordance with Chaves and Gonzales-vega [36] that social pressure from local tradition is one of important aspects in influencing micro financial customers' compliance in Indonesia.

IMPLICATION AND LIMITATION

This research result criticizes agency theory assumption that looking at human as always realistic, opportunistic and selfish that not proven in LPD governance. This examination also able to develop empirical studies by Hofstede [68] by identifying four basic problem areas that can be considered as cultural dimension, one of them related to uncertainty, which in LPD it is packed in Harmonious practice. Other theoretical contribution can be developed from relationship model between research variables of Iannotta's *et al* [19] and Shehzad's *et al* [20] research by adding harmonious values variable as moderating variable and also act as the development of research from Bartikowski *et al*[39] by using culture as moderating variable.

Credit problems faced by LPD are not yet described based on credit type gave to the public; therefore make this analysis sharper. A synthesis is not yet conducted in the calculation of harmonious index in LPD, thus an appropriate examination method is needed to gain formula for harmonious values with accurate credit risk.

CONCLUSION

Ownership by *desa adat* institution on LPD is able to increase financial performance by reducing cost related to agency cost by monitoring and implementation of *awig-awig* of desa adat by *bendesa adat*. A dominated ownership by *desa adat* institution on LPD has opened the space for a strict implementation of monitoring and *awig-awig* of *desa adat* on credit service process to *krama desa adat* so as to reduce non-performing credit. Ownership covered with custom, religious, culture and *awig-awig* has caused the emergence of monitoring that feared by agent which raised caution in every expenses related to agency cost that in turn makes LPD more efficient.

Harmonious values practice that well implemented by *desa adat* institution is able to generate trust on *krama desa adat* on the existence of LPD that raised sense of belonging and maintains that LPD still exist and growth through activities of obligation fulfilment. Harmonious values practice emphasizing on harmonious relationship between human and God (*parahyangan*), harmonious relationship between humans (*pawongan*) and harmonious relationship between human and environment (*palemahan*) has been well implemented in LPD, and it can be used to reduce credit problems and increase efficiency. More credit problem will result in debt collecting cost and uncollectible loan cost that became a burden for LPD and resulting inefficiency in operational that in turn will reduce financial performance.

Key success in increasing financial performance in LPD is lies in the success of owner and management in efficiency and in reducing agency cost related to credit problems.

SUGGESTION

Based on research result, some suggestion can be submitted to parties having relationship with LPD. First, he owner and management are suggested to retain the implementation of harmonious values or even increase it through activities related to environment. Second, the customary sanction and procedure are suggested that for lending arranged by *desa adat* institution need to be improved in its implementation to reduce credit problems by owner and monitoring agency.

Local government should be involved in protecting harmonious values implemented in LPD from the threat of modernization and globalization and help *desa adat* institution in regulating *palemahan* which pressed by investors so that *desa adat* will be more harmonious through a strict and transparent implementation of existed spatial rules.

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