

## Leadership Challenges of Regional Banks in Indonesia

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### *Abstract*

*Bank Pembangunan Daerah (BPD) or the Regional Development Bank of Indonesia is designed to be an agent for regional development with products and services that contribute to the improvement of employment, poverty, disparity, financial literacy and inclusion. However, regional government leaders often intervene with operations and decision making in the banks. To study the extent to which external factors influence leadership in the BPD, this qualitative study used secondary data from the Financial Service Authority or Otoritas Jasa Keuangan (OJK) combined with interviews with BPD leaders and stakeholders. The findings show that the interventions of the regional government leaders were highly influential and resulted in negative consequences on BPD management which directly or indirectly affected the performance of the banks. This study is expected to provide insights into measures which would promote the role of regional banks as a development agent.*

*Keywords: development agent, interventions, leaderships, Regional Development Banks*

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## **1. INTRODUCTION**

### **1.1. Background**

Indonesia (population 250 million) has 27 regional banks (with presence in 27 out of the 34 provinces). *Bank Pembangunan Daerah* (BPD) or the Regional Development Bank of Indonesia is designed to be the agent of regional development with products and services that align with the government's programs on employment and poverty, and contribute to the improvement of financial literacy and inclusion.

The performance of the BPDs and their contribution to the regional economy, however, is not satisfactory. To improve performance, the central government launched several programs, such as the BPD Regional Champion and BPD Transformation program.

Leadership is a key factor to improving the performance of a bank. However, in their efforts to improve the performances of the banks, the leaders of BPD face challenges that impede progress. The purpose of this study is to identify challenges faced by leaders of regional banks and provide recommendations to BPD stakeholders. The study is intended to contribute to the improvement of BPDs with the goal of promoting their participation in regional economic growth. To expound the problem statement and provide guidance to achieve the purpose of the study, below are research questions formulated: (1) what are leadership challenges faced by leaders of the Regional Banks in Indonesia? And how have the challenges come about? (2) In what way stakeholders could provide the necessary support for improvement to leadership performance?

## **2. LITERATURE REVIEW**

The importance of leadership to the success of an organization is well documented. Aunjum et.al. (2017) study revealed that leader's personality and attitude influence the motivation of followers to achieve organizational missions and enhance organizational performance. The leader's role model translates to trust and respect received from followers. Such leaders sacrifice own needs to improve followers' objectives and embed a vision and articulate clear expectations by setting goals and shows commitment to the achievement of goals (Ajiboye, 2017).

Belias (2014) highlights that leadership style is considered to have a direct impact on the superior-employee relations, affecting performance, job satisfaction and commitment of employees and the organization's overall coherence. Distinguishing leadership from management, Belias underlined leadership as daily interaction with employees that consists of values, standards, norms, items or issues observed in the working environment that affects employees' emotions, performance and behavior. While management focuses on ensuring order and stability, the primary role of leadership is envisioning the future and generating changes. In the complexity of business environment of banks, leadership, becomes one of the key determinants of business success and competitiveness in banks.

Adisa et.al. (2017) points out that in hypercompetitive and hyperchanging business environment of banks, it is important to pay special attention to the art of communication of banking officers with clients; leadership style correlates with job satisfaction and performance and profitability of organizations. It was also highlighted that banks with higher level of profitability was characterized by "in-group exchange," where stronger partnership between the leaders and the followers is developed, which is distinguished by reciprocal influence, mutual trust,

respect and affection, and the sense of belonging. In these banks, quality interpersonal relationships, a positive social atmosphere, a higher level of motivation and job satisfaction, and therefore a better personal and organizational performance was constructed. On the other hand, banks with “out-group exchange” where leaders showed a tendency to behave as supervisors and fail to create a sense of mutual trust, respect, and belonging to the organization, ultimately resulted in poorer personal and organizational performance.

Further emphasizing the importance of leadership in bank performance, Kehinde et.al (2012) stated that unethical practice or corruption is likely to negatively affect the development of bank and while skills, capacity and vision make for good leadership this would be almost impossible without proper ethical practices in the organization. The productivity and performance of an organization relies upon employee satisfaction, and transformational leadership is a device to develop higher level of job satisfaction and organizational commitment of employees (Zia, 2015).

Søreide (2014) studied on behalf of the World Bank and underscored that organizations of state authority in many countries involved in corrupt behavior. Corruption refers to the misuse of position for personal gain by individuals entrusted with authority to make decisions on behalf of the organization. As leading regional government bank BPD leaders make significant interactions with regional government leaders. Corrupt behavior by regional leaders could influence the leadership of BPD leaders.

For a number of year leaders of the BPDs face challenges in leading the BPDs to achieve their mission as regional development agent. The OJK Banking Report (2015) shows that although credit growth has been faster than national industry growth, the contribution to regional development remains minimal as loan purposes have not been properly aligned in terms of their contribution to the economic development of the region in question. For example, the majority of credit (70%) which amounted to IDR 382.1 trillion has been distributed for consumptive instead of productive purposes. Productive loans have been of much lower quality, with a Non-Performing Loan (NPL) of 9.01% (2018) compared to non-productive loans with and NPL of 3.32% (Akyuwen, 2018).

Bank outreach to the Micro Small and Medium Enterprises (MSME) has been limited. To improve the situation, the government and banking regulators launched the BPD Regional Champion Program in 2010 but by the end of the program in 2014, few fundamental improvements had been made. Then in 2015 the BPD Transformation Program started to be implemented. In the following three years, progress has been achieved in strategic holding, human capital, governance, risk management and compliance (GRC), product and services development, information technology and management information system (IT-MIS), and sharia deveopment (OJK, 2015). These achievements, however, have not come easily due to the challenges faced by BPD leaders.

### **3. RESEARCH METHODOLOGY**

Reports from the Financial Service Authority (OJK) were a key source of data for desktop review as they provide information on the challenges faced by BPD leaders.

Informal interviews were conducted involving Commissary and Directors of Regional Banks from six (6) regional banks representing those from the main island of Java and those outside Java. As an institution that provides support to all BPDs, the Management of the Association of the Regional Banks has also been interviewed. Informal interviews were also conducted involving OJK staff. To observe discretion of key informants, all identities of interviewees have been kept confidential.

The research planning and data collection was conducted in the period January 2017 to September 2018. Analysis and report writing was completed in one month subsequent to the data collection.

### **4. RESULT AND DISCUSSION**

#### **4.1. Findings**

Finding of the research shows that leaders of BPD faces intrinsic and extrinsic challenges in carry forward their role. The major challenges identified are discussed below.

##### **4.1.1. Local government intervention**

BPD is owned by provincial and district government, with provincial government having the largest share and thus referred to as the priority shareholder or *Pemegang Saham Prioritas* (PSP). District/City governments within the administrative region of the province have equal ownership of the remaining shares. As the 'owner' of BPDs, governor and Mayors frequently exercise their right to intervene in BPD leadership and operations.

To carry forward their programs, government leaders often ask the BPD for support with financial instruments and service facilities. They usually need loans to be disbursed to players of certain priority sectors and segments. Although this is understandable, considering BPD as major regional economic player with similar vision with the local government, however BPD resources are not always readily available as they may have been committed elsewhere.

BPD leaders often feel 'pressured' to support the program of elected local government leaders (provincial and district level). BPD is not often ready to implement such request, particularly when their strategic plan is not in line with the sector, segment and sometimes geographical location that need to be supported.

Products and services may not be readily available, resources for operations such as field staff and supporting facilities may not be in place. In pushing through the request in the absence of institutional readiness, leaders risk, jeopardizing the performance of the institution. Sometimes this will also affect employee morale, when they are overloaded or are required to do tasks beyond their expertise. Loan quality also is at risk and overall loan performance tends to decline when this occurs.

Besides support for programs, 'pressure' also comes from local government leaders and sometimes members of the regional House of Representatives to provide 'special treatment' for personal loans. Aside from the issue of conflict of interest, these so-called special loans often are high risk because the loan amounts are beyond the capacity to repay, and the value of collateral is often below the amount borrowed. In accommodating such request, bank personnel are pressured to breach bank policies by conducting irregular loan analysis processes. Pressure also comes in terms of recruitment to bank positions, when BPD leaders are asked to recruit family members or relatives of government leaders or House of Representatives. In accommodating such requests, BPD leaders are put in breach of the recruitment process and risk recruiting personnel with poor capacity. Such corrupt moves create distrust and disrespect from other employees, resulting in poor working environment. As local government leaders are among the top in the corruption list found by the corruption watch commission (KPK), BPD leaders are in danger of being involved in such cases.

Leaders of regional political parties often also are source of distraction for BPD leadership. They often request support for their programs, such as funds to sponsor their events. When insufficient funds are available, BPD leaders may have to shift some of their allocated funds to this purpose, which could then lead to under-resourcing and undermining of their own internal programs. The autonomy and independence of BPD as a government owned institution could also be disturbed, as it could be seen as supporting the agenda of a certain party or parties.

It is important to note that gratification cases have been identified amongst many local government leaders. In the era of regional autonomy, the corruption of local leaders has increased. It is therefore important to take the involvement of regional leaders in the operations of BPD into careful consideration. In fulfilling the requests of regional leaders to the extent that BPD leaders are required to breach policies, they are exposed to misuse of authority, collusion and corruption.

#### **4.1.2. Central government programs**

BPDs are obliged to support central government programs related to credit to certain sectors, under particular schemes. Similar to regional government programs, the majority of central government programs are related to productive

loans in productive sectors, such as agriculture and fisheries. Such loans, however, require specific loan products relevant to the demand of the market players, and BPDs sometimes are not ready with such products. Proper delivery of such product requires the whole process of product development, starting with market assessment, prototype development, product testing, and monitoring. When leaders are co-opted to implement programs, this can disrupt the performance of the institution.

Central government program often involves the provision of non-collateral productive loan to the low-income segment. When BPDs are used to collateralized consumptive loans targeted to the middle income segment, human resources and operations may not be ready for such programs. The implementation of central government programs can risk the increase of NPLs and records shows the failure of BPD in implementing central government programs. Recent examples of government program that have not been successfully implemented in many BPDs are People's Business Loan or *Kredit Usaha Rakyat* (KUR) and branchless banking program Laku Pandai.

#### **4.1.3. Leadership capacity**

Leadership capacity is another challenge faced by the institution. Leaders have limited knowledge of local potential sectors and products and have limited capacity to develop products and services that cater to productive activities of customers and contribute to the growth of the regional economy. To reach new clients, some leaders instead choose to expand services outside their provinces which results in failure to develop their own provinces and unnecessary and often unsuccessful competition in others.

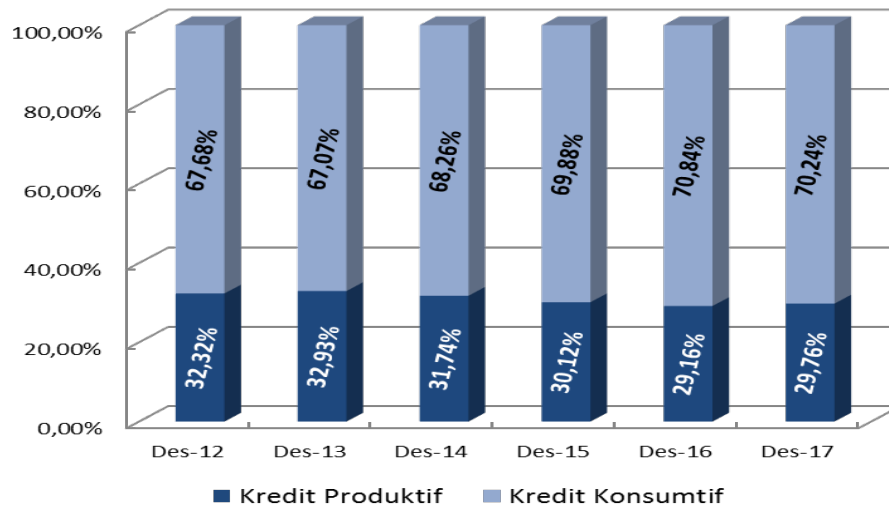
The capacity of BPD leaders to face challenges in their institutions has become a concern, particularly when this also leads to declining financial performance. When leaders failed to find solutions, replacement is the only solution. The problem is the replacement has to often come from outside the organization due to lack of leadership succession processes within BPDs.

#### **4.1.4. Performance**

Overall financial performance of BPD shows positive growth, with growth of assets, deposit, credit higher than industry growth at 14.1%, 17.17%, 9.09% respectively. Growth of profit is at 8.26%, which is lower than the industry growth at 23.10%. Financial performance of BPD shows manageable condition, with gross NPL lowered to 3.23%, liquidity ratio (Loan to Deposit Ratio-LDR) at 87.62%, profitability ratio (Return on Asset-ROA) at 2.40%, and capital ratio (Capital Adequacy Ratio-CAR) at 21.65%.

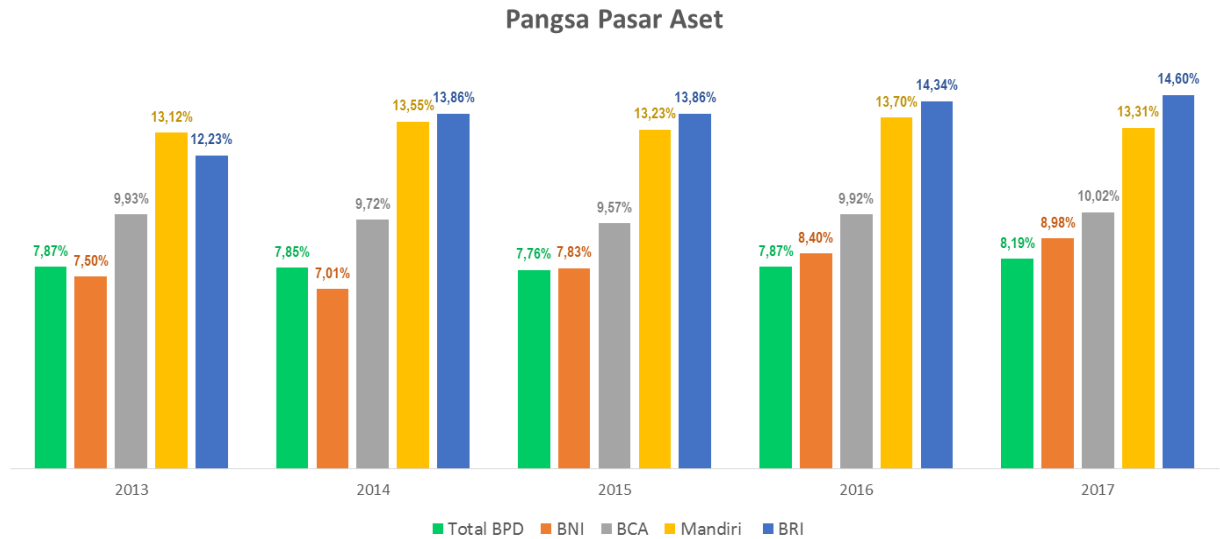
Indikator	Des-12	Des-13	Des-14	Des-15	Des-16	Des-17	Growth BPD (yoy)	Growth Industry (yoy)	Sharethd Industry
Total Aset	366.685	389.964	440.691	475.696	529.746	604.820	14,17%	9,77%	8,19%
Total DPK	278.535	287.709	335.957	356.600	383.531	449.389	17,17%	9,35%	8,50%
Total Kredit	218.851	264.541	301.456	328.759	357.859	390.372	9,09%	8,24%	8,24%
Laba Bersih	8.946	10.733	9.720	10.595	11.487	12.436	8,26%	23,10%	9,48%
% Krd Prod	32,32%	32,93%	31,74%	30,12%	29,16%	29,76%			
Dana Pemda*)	30,95%	26,68%	28,11%	22,26%	18,19%	15,86%			

**Figure 1** Financial performance of BPD (2012-2017)



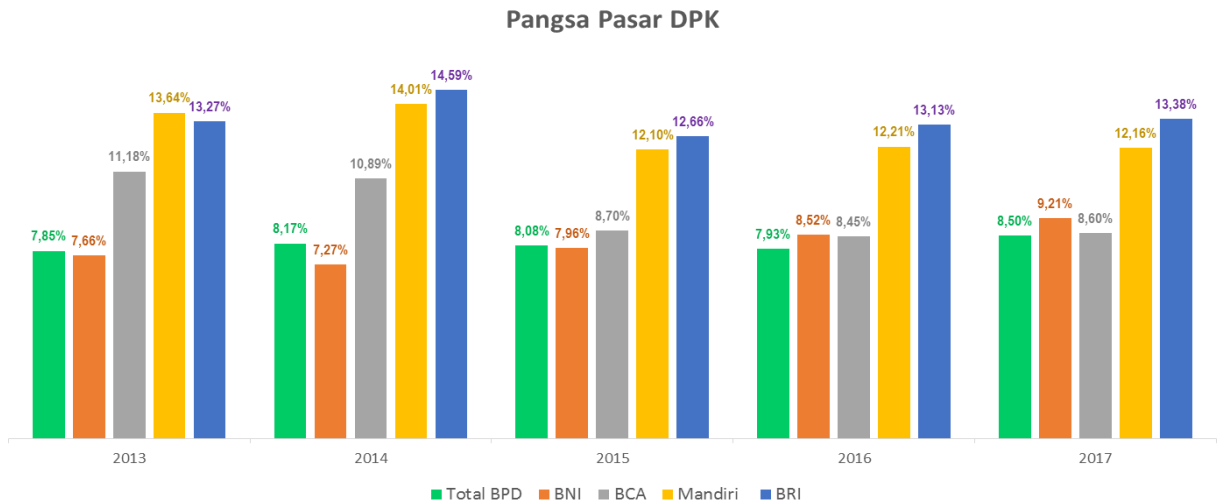
**Figure 2** Proportion of productive and non-productive loan to total loan

Contradictory to improvement in financial performances, indicators to productive economic growth does not show satisfactory growth. Proportion of productive loan to overall loan is shows decreasing trend from 32.32% in 2012 to 29.76% in 2017.



**Figure 3** Market share in Asset, 2013-2017

Market share of BPD only slightly improved. The 27 BPD is only ranked fifth with 8.19% share in Assets, 8.50% in Deposit, and 8.24% in Credit; far behind national state-owned banks (Bank BRI, Bank Mandiri, Bank BNI) and private bank (Bank BCA).





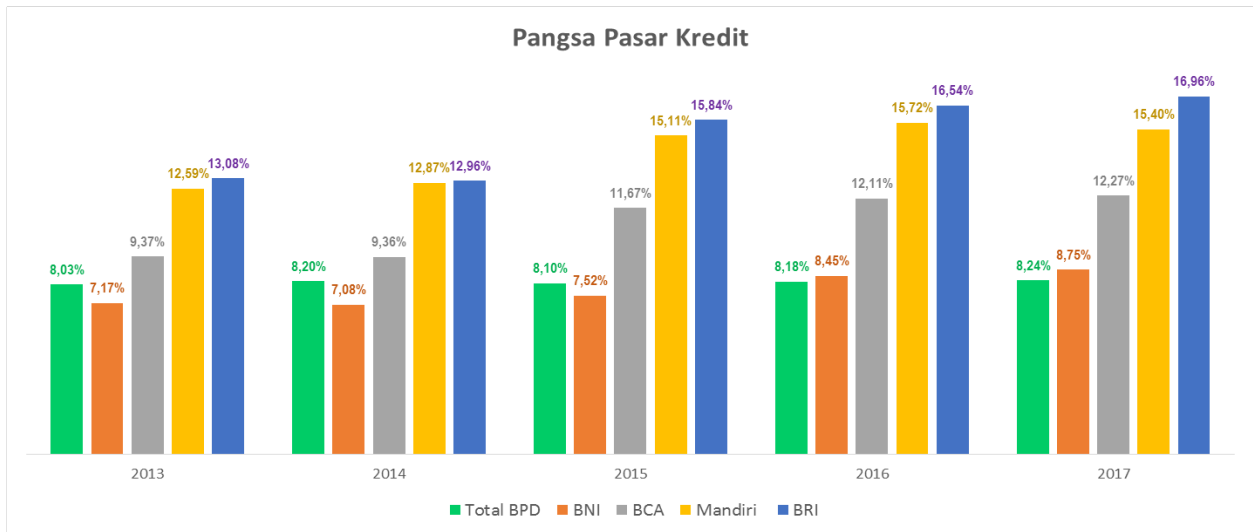


Figure 5 Market Share in Credit (2013-2017)

Overall nominal capital of BPD is still low, with only 69.380 trillion rupiahs in total. Six (6) BPD is still at the category of BUKU 1 (principal capital lower than one (1) trillion rupiah)

No	BPD	Modal Inti (Rp Milyar)	BUKU
1	BJB	8.906	III
2	BPD DKI	7.715	III
3	BPD JATENG	6.322	III
4	BPD JATIM	6.103	III
5	BPD KALTIM	4.318	II
6	BPD SUMUT	2.827	II
7	BPD RIAU KEPRI	2.826	II
8	BPD BALI	2.732	II
9	BPD PAPUA	2.649	II
10	BPD SUMSELBABEL	2.555	II
11	BPD SUMBAR	2.493	II
12	BPD SULSELBAR	2.378	II
13	BPD KALBAR	2.021	II
14	BANK ACEH SYARIAH	1.723	II
15	BPD NTT	1.710	II
16	BPD KALSEL	1.538	II
17	BPD DIY	1.398	II
18	BPD SULUTGO	1.369	II
19	BPD KALTENG	1.343	II
20	BPD NTB	1.305	II
21	BPD JAMBI	1.184	II
22	BPD SULTRA	849	I
23	BPD MALUKU MALUT	791	I
24	BPD LAMPUNG	636	I
25	BPD SULTENG	620	I
26	BPD BENGKULU	603	I
27	BPD BANTEN	466	I
	<b>TOTAL</b>	<b>69.380</b>	

Figure 6 Principal Capital of BPD

## **5. CONCLUSION**

Leadership in the BPDs face extrinsic and intrinsic challenges that directly or indirectly impact the performances. Local government leaders, regional House of Representative members, and political parties are among those that often put pressure on the BPD leaders. They expect BPD leaders to support their program and also fulfil their personal interest for financial support in terms of loans, grants and recruitment of people of their choice in BPD position. When pressured to fulfill those requests, BPD leaders risk declining performance of the institution, and make themselves vulnerable to breaching policies or even corruption.

Central government programs are other challenges that BPD leaders face, because often the BPD is not ready to implement those programs. BPD leaders often lack the capacity to align loan programs with support to the regional economy. The knowledge of regional capacity and to develop products and services that match the demand is still lacking.

BPDs need strong leaders who will not put the organization at risk in order to please local government leaders. Proper assessment of institutional capacity in supporting local and central government programs needs to be conducted. The bank's policies needs to be implemented at all costs and the leaders need to be made aware of the risks of being involved in corruption. BPD leaders need to be engaged in continuous learning and personal growth, particularly in the understanding of the market and in the development of products and services.

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