# Relational Governance of Credit Risk: Social Capital and Loan Approval Decisions in Savings and Loan Cooperatives

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**Abstract.** This study explores how credit risk governance is shaped through the interaction of formal and social mechanisms in crsedit management practices within savings and credit cooperatives. Unlike conventional financial institutions that primarily rely on administrative procedures and financial assessments, cooperatives operate within social environments characterized by membership ties, trust, collective norms, and community networks that influence credit-related decisions. While previous studies have highlighted the importance of social capital in reducing credit risk and enhancing lending performance, limited attention has been given to how these social mechanisms operate in everyday credit governance practices. This research adopts an interpretive qualitative approach. Data were collected through in-depth interviews, observations, and document analysis related to credit approval, monitoring, and loan resolution processes. The data were analyzed using thematic analysis to identify patterns of interaction between formal procedures and social considerations in credit management. The findings indicate that credit risk governance is not determined solely by formal mechanisms such as credit policies, administrative requirements, and creditworthiness assessments. It is also shaped by trust, member reputation, community norms, and social networks. These social mechanisms function as a form of social collateral that complements formal guarantees in managing credit risk. This study introduces the concept of relational credit risk governance, which integrates organizational control mechanisms with socially embedded governance practices within member communities. The findings contribute to a deeper understanding of credit risk governance in cooperative financial institutions.

**Keywords:** Credit Cooperatives, Credit Risk Governance, Relational Credit Risk Governance, Social Capital, Savings, Social Collateral

## 1 Introduction

Savings and credit cooperatives (KSP) are member-based financial institutions established to expand access to financing and promote economic sustainability within communities. Because cooperatives operate within close social relationships, members are connected through trust, reciprocity, shared norms, and social networks that generate organizational social capital (Coleman, 1988; Nahapiet & Ghoshal, 1998;

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Portes, 1998). While these relationships facilitate information exchange, coordination, and social control, they may also create tensions when interpersonal ties conflict with prudential lending principles and the risk of loan default.

Credit risk in cooperatives cannot be understood solely as a technical financial issue. Non-performing loans (NPLs) affect asset quality and financial performance, and credit risk extends throughout the entire lending cycle, including borrower screening, loan approval, monitoring, restructuring, and recovery. Previous studies show that social relationships, peer monitoring, and social collateral can reduce moral hazard and strengthen repayment discipline (Besley & Coate, 1995; Cassar et al., 2005; Gallenstein et al., 2020). In addition, organizational social capital through its structural, relational, and cognitive dimensions supports information sharing and collective coordination that may contribute to lower credit risk in financial cooperatives (Nahapiet & Ghoshal, 1998; Vásquez et al., 2024; Saz-Gil et al., 2021).

Previous studies have shown that social capital contributes to loan repayment performance (Cassar et al., 2005), influences lending contract design (Iqbal & Rao, 2023), and is associated with lower credit risk in financial cooperatives (Vásquez et al., 2024). Furthermore, monitoring activities have been reported to reduce loan defaults in group-based lending programs (Ba-Tri et al., 2024). Nevertheless, these studies generally examine social capital, monitoring, and credit performance separately and provide limited explanation of how formal governance mechanisms and social mechanisms interact in the day-to-day practice of credit risk management within savings and credit cooperatives. As a result, the relational process through which trust, reputation, social networks, and community norms complement formal credit procedures across the entire credit cycle remains insufficiently understood.

Based on this research gap, this study seeks to reconceptualize credit risk governance in savings and credit cooperatives as Relational Credit Risk Governance, defined as a form of risk management that emerges from the interaction between formal mechanisms including lending procedures, organizational policies, administrative documentation, and credit control systems and informal social mechanisms, such as trust, community norms, social networks, communication, and members' reputations within member-based organizations. To clarify the theoretical position and analytical framework of this study, a conceptual model is proposed to illustrate how formal governance mechanisms and social mechanisms interact throughout the credit cycle, including the loan application stage, credit decision-making stage, and post-disbursement stage, in shaping the process of Relational Credit Risk Governance in savings and credit cooperatives. Conceptual model of relational credit risk governance can be seen in Figure 1.

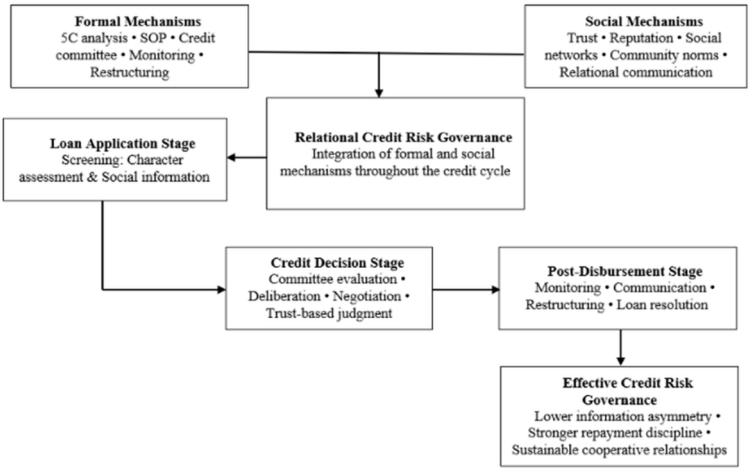


**Figure 1.** Conceptual Model of Relational Credit Risk Governance

## 2 Methodology

This This study employs a qualitative approach within an interpretive paradigm to develop an in-depth understanding of credit risk management practices in savings and credit cooperatives, particularly how they are shaped by the interaction between formal organizational mechanisms and social relationships among members. The study was conducted savings and credit cooperatives located in Badung Regency, Bali Province, Indonesia. Research sites were selected purposively based on their active provision of loans to members and the implementation of credit risk management practices in their day to day operations.

Research participants were also selected purposively based on their direct involvement in credit management and lending decision-making processes. The participants consisted of General Manager, Credit Manager, and credit officer. These participants were selected because they possessed direct authority and experience in loan assessment, approval, monitoring, and non-performing loan resolution processes. Data were collected through in-depth interviews, observations of credit management practices, and document analysis of organizational records, including credit policies and standard operating procedures. The in-depth interviews were conducted between April – June 2026, with each interview lasting approximately 45–90 minutes. All interviews were audio-recorded with participants' consent and subsequently transcribed verbatim for analysis.

The data analyzed using thematic analysis. This approach was chosen because it allows researchers not only to organize data systematically, but also to relate empirical findings to the social and organizational context in which the practice takes place (Cassar et al., 2005). The analysis process begins with the transcription of interview data verbatim to maintain the integrity of the meaning conveyed by the informant. Next, the researcher conducted an open coding process to identify the initial themes that

emerged from the data. This stage is carried out iteratively by rereading the data in depth to capture the nuances of meaning, language patterns, and the context of the informant's experience. The initial codes are then grouped into broader categories through a categorization process, which aims to organize the data into a more systematic structure. The final stage of analysis is carried out through theoretical framework-based interpretation, where empirical findings are linked to the conceptual perspectives used in the research.

# 3 Result and Discussion

## 3.1 Result

This study aims to understand how credit risk governance is shaped through the interaction between formal and social mechanisms in the credit management practices of savings and credit cooperatives. Based on in-depth interviews with three participants directly involved in credit management, three major themes emerged: (1) loan application, (2) credit decision-making, and (3) post-disbursement credit management. The findings indicate that credit risk governance relies not only on formal mechanisms such as standard operating procedures (SOPs), 5C credit assessments, credit history verification, credit committee evaluations, and loan monitoring but also on social mechanisms embedded within the cooperative context, including trust, member reputation, managerial experience, social networks, deliberation, and family-oriented communication. During the loan application stage, formal assessments were complemented by information concerning members' character, prior relationships with the cooperative, community reputation, and repayment history, suggesting that credit risk identification begins through the integration of formal procedures and social capital.

The findings further reveal that credit decisions are made through a credit committee process that combines administrative evaluations, field survey results, collateral assessments, and repayment capacity with social information derived from managers' experience and members' social environments. In some cases, cooperatives negotiated loan amounts to align with borrowers' repayment capacity while maintaining applicable interest policies. Following loan disbursement, credit risk governance continued through repayment monitoring, regular communication, borrower guidance, negotiation, and loan restructuring before formal enforcement measures were considered. Overall, the findings suggest that credit risk governance in savings and credit cooperatives is fundamentally a relational process operating throughout the entire credit cycle. Formal mechanisms function as instruments of risk control, while social mechanisms reduce information asymmetry, foster trust, and strengthen cooperative member relationships. Based on these findings, this study proposes the concept of Relational Credit Risk Governance, which conceptualizes formal mechanisms and social capital as complementary components in the effective management of credit risk within savings and credit cooperatives. Table 1 summarized the research findings.

**Table 1.** Research Findings

| Aspect | Formal Mechanisms | Social Mechanisms |
|---|---|---|
| Credit risk governance during the loan application stage | 5C credit analysis, document verification, field visits, credit history assessment | Member reputation, borrower character, prior relationship with the cooperative, social networks |
| Credit risk governance during the credit decision-making stage | Credit committee evaluation, repayment capacity assessment, collateral valuation | Deliberation, loan amount negotiation, managers' experience, trust |
| Credit risk governance during the post-credit decision stage | Repayment monitoring, notification letters, loan restructuring, loan resolution | Family-oriented communication, reminders through communication channels, member guidance, loan settlement negotiation |

### 3.2 Discussion

**Credit Risk Governance Begins at the Loan Application Stage.** The findings indicate that credit risk governance in savings and credit cooperatives begins at the loan application stage through the integration of formal and social mechanisms. Formal mechanisms are implemented through prudent lending practices, including the application of the 5C credit assessment, document verification, field visits, credit history reviews, and verification using the Financial Information Service System (SLIK). At the same time, cooperative managers draw upon information related to members' reputations, social relationships, family characteristics, and previous interactions with the cooperative when assessing creditworthiness. Consequently, credit risk identification is not based solely on administrative procedures but also incorporates social information embedded within the cooperative community.

These findings suggest that economic decision-making in cooperatives is shaped not only by formal information but also by the social relationships embedded within the community. This supports Granovetter (1985), concept of embeddedness, which argues that economic actions are embedded in networks of social relationships and, therefore, are never entirely individualistic or driven solely by economic rationality. The use of members' reputations, managerial experience, and interpersonal relationships further demonstrates the role of social capital as an information resource for reducing information asymmetry. This finding is consistent with Coleman (1988), who argues that social capital constitutes a resource embedded in social relationships that facilitates collective action. Likewise, Nahapiet & Ghoshal (1998) contend that the relational dimension of social capital generates trust, shared norms, and reciprocal obligations that strengthen organizational coordination. In the cooperative context, social capital does not replace formal governance mechanisms; rather, it complements them, enabling a more comprehensive process of credit risk identification.

The findings also reinforce the concept of relational governance proposed by Zaheer & Venkatraman (1995), which emphasizes governance based on trust, long-term relationships, and repeated interactions among organizational actors. Within savings

and credit cooperatives, trust complements formal lending procedures when administrative information alone is insufficient to assess borrowers' actual conditions. The findings are further consistent with Cao & Lumineau (2015), who argue that contractual governance and relational governance function as complementary governance mechanisms. In this study, formal procedures—including the 5C credit assessment, SLIK verification, and field visits—are integrated with information on members' reputations, family characteristics, and prior relationships with the cooperative, resulting in a more comprehensive credit risk screening process. Furthermore, while the findings support Iqbal & Rao (2023) in demonstrating that social capital influences credit contract design, this study extends the literature by showing that social capital plays a role even before contractual arrangements are established, serving as a mechanism for credit risk identification from the initial loan application stage.

**Credit Decision-Making as a Relational Governance Process.** The findings indicate that credit decision-making in savings and credit cooperatives is a process shaped by the interaction between formal governance mechanisms and relational governance. From a formal perspective, credit decisions are made through a credit committee based on administrative assessments, including business feasibility, repayment capacity, collateral evaluation, and field survey results. However, these formal assessments are complemented by information concerning members' reputations, managers' experience, communication with the prospective borrowers' social environment, and members' historical relationships with the cooperative. Consequently, credit decisions are not based solely on the fulfillment of administrative requirements but also incorporate social information obtained through interpersonal relationships and managerial experience.

The findings further suggest that the decision-making process is not purely mechanistic but rather represents a social process that combines professional judgment with the family-oriented values that characterize cooperatives. When a member's repayment capacity is insufficient to support the requested loan amount, the cooperative does not immediately reject the application. Instead, it engages in communication and negotiation to determine a loan ceiling that better matches the member's financial capacity. This approach reflects a balance between the prudential principle and the cooperative's primary objective of improving members' welfare while maintaining effective credit risk management.

These findings support the social capital theory proposed by Portes (1998), which argues that social relationships generate economic benefits through trust, access to information, shared norms, and reciprocal obligations. In the context of this study, social capital not only provides valuable information regarding members' characteristics but also serves as the foundation for communication, deliberation, and negotiation throughout the credit decision-making process. Accordingly, social relationships function as an important mechanism that enhances decision quality when formal information alone is insufficient to fully capture the condition of prospective borrowers.

Furthermore, the results reinforce the concept of relational governance advanced by Giglio et al. (2020) who argue that relational governance constitutes an essential mechanism for shaping organizational structures, decision-making dynamics, and collective action within cooperatives. Relational governance enables organizations to strengthen coordination, resolve conflicts, and reach decisions through communication, trust, and shared norms. This perspective is reflected in the cooperatives examined in this study, where credit decisions are determined not only by administrative evaluations but also through deliberation, information sharing, and negotiation that consider the long-term relationship between the cooperative and its members.

The findings are also consistent with Zaheer & Venkatraman (1995), who identify trust as a central mechanism of relational governance for reducing transactional uncertainty, and with Vásquez et al. (2024), who demonstrate that social capital contributes to lower credit risk in financial cooperatives. However, this study extends previous research by showing that social capital not only influences the level of credit risk but is also operationalized directly within the credit decision-making process through deliberation, information exchange, interpersonal communication, and negotiation between managers and members. Therefore, credit decision-making in savings and credit cooperatives can be understood as a form of relational credit risk governance that integrates the formal mechanisms of credit committees with social mechanisms based on trust, reputation, communication, and community norms, thereby producing adaptive decisions while preserving long-term relationships with members.

**Credit Risk Governance Continues After Loan Disbursement.** The findings reveal that credit risk governance does not end once a credit decision has been made but continues throughout the entire loan cycle through payment monitoring, regular communication with members, member assistance, negotiation, loan restructuring, and the resolution of non-performing loans. These findings demonstrate that formal mechanisms including payment monitoring, collectability assessment, and procedures for handling problematic loans operate alongside social mechanisms such as personal communication, a family-oriented approach, deliberation, and efforts to reinforce members' commitment to fulfilling their repayment obligations.

This approach suggests that social relationships serve not only as the foundation for credit approval but also as an important mechanism for controlling credit risk after loan disbursement. The trust established during the loan application stage is maintained through continuous communication, encouraging members to honor their repayment commitments. Accordingly, credit risk management should be understood as an ongoing relationship between the cooperative and its members rather than merely a contractual relationship that ends once the loan is disbursed.

These findings are consistent with Cassar et al., (2005) , who demonstrate that social capital improves loan repayment performance by strengthening social norms, trust, and social control mechanisms within borrowing groups. Similarly, Besley & Coate, (1995) argue that social relationships can function as social collateral, a non-physical form of collateral that motivates borrowers to fulfill their obligations by preserving their reputation within the community. More recent evidence from Gallenstein et al. (2020) further shows that social capital influences risk-taking behavior in joint-liability lending

schemes. This study extends these findings by demonstrating that social capital not only shapes borrowers' behaviour but also influences the cooperative's strategies for monitoring, communication, negotiation, loan restructuring, and the resolution of non-performing loans.

The findings also reinforce the study by Ba-Tri et al. (2024), which reports that monitoring activities contribute to reducing default rates in group-based lending programs. However, this study demonstrates that monitoring in savings and credit cooperatives extends beyond administrative procedures. It is also carried out through interpersonal communication, visits to members, and family-oriented interactions that reflect the cooperative's organizational values. Consequently, monitoring functions not only as a supervisory mechanism but also as a means of rebuilding members' commitment to meeting their financial obligations.

Finally, these findings support the work of Zeng & Wan (2024), who argue that contractual governance and relational governance in cooperatives are complementary mechanisms. Formal governance strengthens relational governance by enhancing communication, transparency, and trust, whereas relational governance reinforces members' commitment to the organization, particularly under conditions of uncertainty. This complementary relationship is evident in the cooperatives examined in this study. Although formal procedures remain in place for monitoring and managing non-performing loans, cooperatives prioritize personal communication, deliberation, negotiation, and family-oriented approaches before resorting to legal action or collateral execution. These findings suggest that the effectiveness of credit risk governance depends not only on compliance with formal organizational procedures but also on the cooperative's ability to develop and sustain relationships built upon trust and continuous communication with its members.

**Theoretical Extension: Relational Credit Risk Governance.** This study extends the existing literature in three important ways. First, while social capital theory emphasizes the role of trust, norms, and networks in facilitating coordination and reducing opportunistic behaviour, this study demonstrates that social capital also functions as an integral component of credit risk governance, not merely as a determinant of repayment performance. This finding suggests that social capital should be understood as an active governance resource that shapes decision-making processes in credit allocation and risk control. It also highlights that trust and social relations are embedded in formal financial practices rather than operating outside institutional structures.

Second, previous relational governance studies have primarily examined trust-based coordination in interorganizational relationships. This study extends relational governance theory by showing that relational mechanisms operate within member-based financial organizations and are embedded in formal credit management processes. In this context, relational governance is not limited to external partnerships but is also crucial in internal organizational settings such as cooperatives. Moreover, it demonstrates that member interactions, shared norms, and community-based accountability directly influence how credit policies are implemented in practice.

Third, existing credit risk management literature generally treats formal control mechanisms and social mechanisms as separate analytical domains. The proposed

concept of Relational Credit Risk Governance integrates these mechanisms into a unified governance framework that operates throughout the entire credit cycle, including loan screening, credit approval, monitoring, restructuring, and loan resolution. This integrated perspective provides a more comprehensive understanding of how credit risk is managed in practice. It also shows that effective risk governance emerges from the continuous interaction between institutional rules and social embeddedness across all stages of lending activities.

## 4 Conclusion

This study demonstrates that credit risk governance in savings and credit cooperatives is inherently relational and operates throughout the entire credit cycle, including loan application, credit decision-making, and post-disbursement management. The findings show that formal mechanisms such as credit analysis, operational procedures, credit committees, monitoring, and non-performing loan management operate together with social mechanisms, including trust, reputation, social networks, communication, and cooperative values. These findings indicate that effective credit risk governance depends not only on compliance with formal procedures but also on the cooperative's ability to build and maintain strong social relationships with its members.

From a theoretical perspective, this study extends social capital theory by demonstrating that social capital functions not only as a determinant of loan repayment performance but also as an integral component of credit risk governance. It also extends relational governance theory by showing that relational mechanisms are embedded within formal credit management processes in member-based financial organizations. Based on these findings, the study proposes Relational Credit Risk Governance as a unified framework integrating formal organizational controls and socially embedded relational mechanisms throughout the entire credit cycle. Practically, the study suggests that cooperatives should strengthen both formal control systems and organizational social capital to improve credit risk governance. Nevertheless, the study is limited to a small number of cooperatives and informants; therefore, future research is encouraged to examine the proposed model in different cooperative contexts and to employ quantitative or mixed-methods approaches to test the relationships among its dimensions.

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