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The Effect of Applying the Eligibility Principle in Credit Distribution to Business Actors on MSME Performance: Case Study of MSME Actors in Malang City, Indonesia

ABSTRACT

The study titled *The Impact of Applying the 5C Principle in Credit Allocation to Entrepreneurs on Business Performance (Case Study of Entrepreneurs in Malang City)*. This study aims to analyze and identify the application of the 5C principle (Character, Capacity, Capital, Guarantee, and Conditions) in credit distribution to debtors and its impact on business performance in Malang City. This research is a quantitative analysis of the characteristics of loan distribution (5C) to entrepreneurs and their company performance. Observation, interviews gathered data, and the distribution of questionnaires to 30 respondents utilizing purposeful random sampling methods. The analysis employed linear regression and hypothesis testing. This study's findings demonstrate that credit distribution (5C) to entrepreneurs positively influences business success in Malang City. The analysis and results obtained in this study indicate several significant findings warrant attention. Specifically, credit distribution may serve as a foundation for enhancing business performance in Malang City. Recommendations for business operators in Malang City include implementing a transparent evaluation process, providing training and education, and fostering long-term relationships with Micro, Small, and Medium Enterprises (MSMEs).

Keywords: Credit Distribution, Business Performance, Malang City

INTRODUCTION

Credit allocation to corporate entities is a strategy to expedite economic development in Indonesia. As a credit allocation mechanism, banking fosters and necessitates competition among financial institutions. Financial institutions vie to secure substantial deposits and maximize their profitability. Moreover, individuals encountering financial challenges in managing their business operations or fulfilling their necessities continue to opt for banking or financial organizations to solve their problems.

Business operations in Malang City encompass various enterprises that entrepreneurs effectively handle. These enterprises may manifest as trade, industry, services, or a combination of these elements. Business entities in Malang City may also engage with the banking industry in their operations.

The banking sector is crucial in offering loans or financing to entrepreneurs. This credit allocation advantages both parties since the bank gains interest earnings while providing cash to commercial entities for their development (Utama, 2025; Ika, 2023; Husnah, Suparman & Rauf, 2023)

Data on credit provision from BPS (BPS Malang City, 2023) for various types of MSMEs in Malang City indicates a decline in loan disbursement across several sectors, including Electricity, Gas and Clean Water, Water Supply, Waste Management, Limbang and Recycling, Construction, Provision, Accommodation and

Food and Beverage, Information and Communication, Corporate Services, and Education Services. Conversely, there has been an increase in loans within the Agriculture, Animal Husbandry, Forestry, and Fisheries, Manufacturing Industry, Wholesale, and Retail Trade, Car and Motorcycle Repair, Transportation and Warehousing, Financial Services and Health Insurance, Other Services, and notably, the Real Estate, Mining, and Quarrying sector, which experienced nearly a twofold increase in loans.

In 2020, Malang City saw a Gross Regional Domestic Product (GRDP) contraction of -2.26%, reflecting the adverse effects of the worldwide circumstances instigated by the COVID-19 pandemic. In 2021, the city saw a comeback in economic growth of 4.21%, signifying the adaptability and resurgence of economic sectors. Various sectors exhibit notable economic growth, such as the Electricity and Gas Supply industry, which achieved a growth rate of 7.28% in 2022, and the Transportation and Warehousing sector, which experienced a rise of 16.65% in the same year. The Information and Communication sector also contributed significantly, achieving a rise of 4.42% in 2022. Nonetheless, specific industries encountered a substantial downturn in 2020, particularly the Trade and Car and Motorcycle Repair sectors, which recorded a growth rate of -6.30%.

Nevertheless, the sector rebounded in 2021 and 2022, achieving significant growth rates of 8.21% and 6.78%, respectively. The Other

Services industry exhibited considerable volatility, suffering a substantial decline in 2020 (-13.65%), followed by robust growth in subsequent years (2.79% and 13.39%). Malang City's GRDP rose from 4.42 to 5.34 in 2021, while the health services and social activities sector increased from 1.60 to 5.45 in the same year. This indicates that the five sectors encountered challenges throughout the year, culminating in a rate of 6.32% in 2022. Nonetheless, several sectors remain suboptimal, particularly in 2022: the agriculture, forestry, and defense sectors declined from 0.97 to 1.50 in 2021; the mining and quarrying sector decreased from 0.69 to 3.60 in 2021; the trade sector, including automotive and motorcycle repairs, fell from 6.78 to 8.21 in 2021; and the information and communication sector exhibited figures that adversely affected economic growth rates. This sector poses a difficulty in enhancing the performance of MSMEs in Malang. Data indicates a substantial rise in the Gross Regional Domestic Product (GRDP) of Malang City in 2022. The growth was 6.32% relative to the preceding period, specifically from 2017 to 2021. GRDP is a crucial indicator of a region's economic vitality, and this favorable growth statistic signifies enhancements in the economic conditions of Malang City. The distribution of GRDP, which has risen, also indicates an improvement in individuals' purchasing power. The augmented purchasing power is frequently associated with multiple variables, including heightened community

income, fresh regional investments, and the influence of governmental policies that promote economic expansion. Notwithstanding hurdles, including decelerating economic growth in various sectors and a probable decline, this rise in GRDP indicates optimism and the possibility for Malang City to persist in its development moving forward. By persistently observing and promoting several facets of the local economy, this growth is anticipated to persist and yield advantages for the local community. (Suryawati, Hidayah & Rohman, 2024; Ramadan, Subagja, Suherman & Ramlan, 2024; Sirait, Sudirman & Disemadi, 2024)

Nearly all transportation industries significantly contribute to the growth of GRDP in Malang City, accounting for 16.65%, while the construction industry exerts the least influence on GRDP growth at 6.96%. Central Statistics Agency of Malang City, 2021 This figure indicates that the community, characterized by a predominance of agricultural land, exhibits significant reliance on the agricultural sector. Consequently, regional development planning is crucial in formulating strategies to enhance regional resources, particularly aimed at advancing the agricultural sector with a commitment to responsible resource utilization. (Alfharobby & Prayoga, 2024; Olusegun & Festus, 2023; Patmasari & Arija, 2023)

The issue of allocating credit to MSME entrepreneurs is frequently associated with the risks encountered by financial institutions. Numerous banks and financial institutions

hesitate to extend credit to MSMEs due to their perceived elevated risk of default. This condition arises from insufficient information concerning credit applicants and ambiguity over the viability of the business operations. A deficient comprehension of credit distribution concepts may lead to erroneous loan allocation decisions, adversely affecting the performance of MSMEs.

Advancement of Micro, Small, and Medium Enterprises (MSMEs) In recent years, a favorable trend has been witnessed in developing Micro, Small, and Medium Enterprises (MSMEs) in Indonesia. Micro, Small, and Medium Enterprises (MSMEs) constitute the foundation of the national economy, generating employment and enhancing the quality of life for individuals. Governmental assistance, including improved access to funding and business training, has facilitated the expansion of this sector. Despite encountering obstacles like competition and market accessibility, the innovation and technology adoption adopted by MSMEs have facilitated their survival and prosperity. Inefficient credit allocation can severely harm MSMEs. The lack of access to money can restrict their capacity to innovate, grow their business, and enhance productivity. This condition may lead to a slowdown in business growth, ultimately impacting the contribution of MSMEs to the national economy. As stated by Iqbal (2024), implementing the 5C principle in credit allocation can enhance the confidence of financial institutions in extending credit to MSMEs while reducing the risk of

problematic financing. Research on the 5C principle indicates that numerous financial institutions have implemented this idea in the credit allocation process. The 5C principle comprises Character, Capacity, Capital, Collateral, and Condition, which are essential elements for evaluating the eligibility of a credit application for acceptance. Implementing the 5C concept enhances the quality of credit evaluations and fosters improved connections among different stakeholders. Establishing good communication and mutual understanding is crucial for enhancing cooperation, enabling all parties to collaborate more successfully and attain shared objectives between financial institutions and corporate entities. Within the realm of MSMEs, implementing the 5C concept serves both as an evaluative instrument and a framework for entrepreneurs to enhance the caliber of their enterprises. The 5C concept enables business entities to adequately prepare prior to credit applications, hence ensuring compliance with the criteria established by financial institutions. (Sahoo & Thakur, 2023; Abate & Sheferaw, 2023; Partini, 2024)

The 5C concept in credit provision at BRI Gajah Mada Unit has enhanced the loan repayment rate and diminished the incidence of bad debts, signifying the principle's efficacy in evaluating credit risk. Furthermore, a study by Demonstrates that implementing the 5C principal assessment at Bank Jateng Capem Juwana has effectively mitigated the risk of problematic

financing. This condition indicates that financial organizations that regularly adhere to this guideline can achieve advantages in financial stability and reputation among consumers. Consequently, it is essential to investigate further how the implementation of the 5C principle influences the overall performance of MSMEs, consistent with the findings of Damayanti (2020), which indicate that the application of the 5C principle in micro-financing at BRI Syariah KCP Metro can diminish the incidence of problematic financing. This condition indicates that a comprehensive analysis of borrower characteristics enables financial institutions to provide loans more effectively in alignment with the requirements and capacities of business entities. Data indicates that MSMEs receiving finance informed by the 5C analysis frequently demonstrate enhanced outcomes relative to those that do not. This condition signifies a substantial disparity in the outcomes attained by the two groups. The 5C approach aids financial institutions in enhancing lending decisions while offering business entities a comprehensive insight into the requirements for obtaining financing. (Murizal, Soemitra & bi Rahmani, 2025; Meak, Herdi, Diliiana & Kolit, 2024; Sari & Fitriani, 2024)

By comprehending and fulfilling the conditions established in this principle, it is anticipated that business entities can enhance their likelihood of obtaining credit, positively influencing their business performance. A proper business plan and access to sufficient funding are important

determinants in increasing the success of MSMEs. The 5C principle comprises Character, Capacity, Capital, Collateral, and Condition. Each of these factors evaluates the borrower's qualification for credit acquisition. The implementation of this principle aids financial institutions in evaluating credit risk and offers direction for business entities in their loan preparation. PT's application of the 5C principle. BPR Bank Bapas 69, in extending credit to MSME operators in Wonolelo Village, Magelang, positively influences business performance. This research empirically examines the impact of applying the 5C concept in credit distribution on the performance of MSMEs in Malang City. This study seeks to enhance comprehension of the subject matter, elucidating how adopting the 5C concept might augment MSME access to funding and its subsequent effect on business success. This project aims to significantly contribute to policy creation that enhances MSME growth by improving access to financing by collecting data from diverse sources and comprehensive analysis.

METHOD

This study employs a quantitative methodology to analyze and ascertain the impact of the 5C principle (Character, Capacity, Capital, Collateral, and Condition) on the loan distribution and business performance of MSMEs in Malang City. The quantitative method was selected for its

ability to deliver an objective representation based on data collected from respondents. This study primarily examines two variables: the independent variable, represented by the credit distribution principle (5C), and the dependent variable, company performance.

Data collection was conducted using three primary methods: direct observation of the activities of the MSMEs under study, semi-structured interviews with various business stakeholders to understand their experiences with credit acquisition, and the distribution of questionnaires to 30 respondents selected via purposive random sampling techniques. The selection criteria for respondents were business actors who had asked for and obtained business credit and were actively engaged in business operations in Malang City. The questionnaire utilized indicators from the five 5C principles alongside corporate success metrics, encompassing financial dimensions, business expansion, productivity, and sustainability.

The data gathered were examined through simple linear regression analysis to assess the impact of the 5C principal variables on business success. Before doing the regression analysis, the data were initially assessed for validity and reliability to ascertain the quality of the measurement instrument. Hypothesis testing was conducted by examining the significant value (p-value) and the coefficient of determination to assess the impact of the 5C variables on business performance. The data analysis results indicated

that the 5C concept in loan distribution positively and significantly influences the business performance of MSMEs in Malang City. This research suggests that more effective implementation of the 5C principle correlates with enhanced corporate performance potential. This study method offers an empirical foundation for financial institutions and local governments to formulate more selective and responsible credit distribution strategies that bolster the sustainability of MSMEs.

RESULTS and DISCUSSION

This study utilizes data derived from the responses of participants who completed the disseminated questionnaires, categorized according to the duration of their business operations as follows:

Table 1. Respondents Categorised by Duration of Business

No	Length of Business	Respondents	Percentage
1	11 Years>	3	10,00%
2	6 Years to 10 Years	10	33,33%
3	1 Year to 5 Years	17	56,67%
	Total	100%	100%

Source: Primary Data processed 2024

The data indicates that among 30 respondents, 17 individuals (56.67%) have a business duration of 1 to 5 years, 10 individuals (33.33%) have operated for 6 to 10 years, and three individuals (10.00%) have been in a company for 11 years or more. It may be stated that most MSME participants with a business tenure of 1 to 5 years exhibit a relatively consistent trajectory in

business development. The duration of the business can influence its stability.

The validity test findings indicate that each item in the questionnaire possesses an r-count exceeding the r-table value. Consequently, it is determined that each question encompassed inside the many variables of this questionnaire satisfies the validity standards. This result signifies that the questions are dependable and pertinent to the objectives.

Based on the reliability test results of this research instrument, both variables, 5C Credit Distribution (X) and MSME Performance (Y), have Cronbach's Alpha values above 0.6. This shows that the instrument used in this study can be said to be reliable, namely, able to provide consistent measurement results against the indicators being measured.

For the 5C Credit Distribution (X) variable, Cronbach's Alpha value is 0.655. This value indicates that the questions in the questionnaire related to the 5C principle—which includes Character, Capacity, Capital, Collateral, and Condition—have pretty good internal consistency. Although the value has not reached the ideal high-reliability figure (>0.7), it is still acceptable in exploratory research or studies with limited respondents, such as in this study. Therefore, this instrument is considered adequate for measuring applying the credit distribution principle to Malang City MSME actors.

Meanwhile, for the MSME Performance (Y) variable, Cronbach's Alpha value was 0.757, which indicates a higher level of reliability compared to variable X. This value strengthens the belief that the indicators used to measure business performance—such as revenue growth, business continuity, operational efficiency, and increased productivity—have a strong relationship with each other. Thus, the

measurement instrument for this variable has met the requirements as a reliable measuring tool in assessing the business performance of MSME actors.

This reliability finding is important because it ensures that the results of subsequent analysis, such as regression tests and hypothesis tests, are based on valid and reliable data. Without reliable instruments, the results of quantitative data processing can be misleading and do not reflect the actual conditions in the field. Therefore, the success of this reliability test provides a strong methodological basis for continued research and supports the conclusion that applying the 5C principle in credit distribution has the potential to impact the performance of MSME businesses in Malang City positively.

The simple linear regression analysis conducted in this investigation yielded the following regression equation:

$$Y = 2,232 + 1,084X$$

This equation demonstrates that the independent variable, specifically the credit distribution principle (5C) implementation, positively affects the dependent variable, which is the performance of MSMEs in Malang City. The fixed value of 2.232 signifies that in the absence of the 5C principle (X value = 0), the fundamental measure of company performance (Y) is 2.232. This condition suggests that irrespective of the implementation of the 5C principle, MSMEs maintain a fundamental level of performance derived from external factors not examined in the study, including business experience, social networks, product innovation, or the internal operational efficiency of each business entity. The regression coefficient 1.084 indicates that each unit increase in implementing the 5C concept will enhance MSME firm performance by 1.084 units. In summary, the more effectively and

comprehensively financial institutions implement creditworthiness principles—namely Character, Capacity, Capital, Collateral, and Condition—the more significant the enhancement of MSMEs' business performance will be. This condition aligns with the rationale that an objective, transparent, and complete credit assessment procedure will mitigate the risk of problematic credit while fostering sustainable business growth. Applying the 5C principle enables corporate entities to secure finance that aligns with their operational requirements, accompanied by competitive interest rates and feasible repayment terms. These factors will facilitate the expansion of MSMEs, enabling them to hire additional employees, enhance production capacity, and access a broader market. This condition will manifest in business performance metrics, including enhanced revenue, asset expansion, profitability, and resilience to external adversities.

This discovery reinforces the premise that the 5C principle is a crucial metric in lending decision-making for MSMEs. Using appropriate principles will enhance the trust of business stakeholders to cultivate their enterprises responsibly and sustainably. This method can expedite economic turnover at the regional level and positively contribute to alleviating unemployment and enhancing community welfare within the MSMEs of Malang City, which are fundamental to the local economy.

Moreover, our findings offer significant policy implications for banking and microfinance organizations, emphasizing the necessity of a thorough feasibility investigation in the credit evaluation process. Consider not only the administrative and documentation aspects but also the comprehensive quality of the business, encompassing

the integrity of the corporate entity, market potential, and prevailing industry trends. This thorough assessment would enable financial institutions to provide credit more accurately while cultivating loyalty among MSME participants toward the lending entity.

This regression equation illustrates the statistical correlation between variables. It demonstrates that access to financing, when aligned with sound feasibility principles, can substantially enhance business performance growth in the MSME sector of Malang City. This study proves that the 5C principle transcends mere administrative procedure in the credit process, serving as a crucial foundation for establishing a robust and productive financial relationship aimed at long-term economic development. This study recommends enhancing the comprehension of the 5C principle among financial institutions and MSMEs to ensure a more equitable and transparent financing process, thereby directly bolstering micro, small, and medium enterprises in the regions.

This study examines the influence of 5C credit distribution on the performance of MSMEs in Malang City. The sample comprised 30 Micro, Small, and medium company participants. A linear regression analysis revealed that the 5C credit distribution variable (X) positively influenced the performance of MSMEs, the dependent variable in this study. This condition suggests that enhancing knowledge about the independent variable will substantially improve the performance of MSME entrepreneurs in the region. This discovery is significant for comprehending the correlation between credit accessibility and firm performance. The impact of 5C credit distribution on MSME performance is a reference for future research. Implementing the 5C principle in credit distribution can

enhance the confidence of financial institutions in extending credit to MSMEs while mitigating the risk of problematic financing. Research on the 5C principle indicates that numerous financial institutions have implemented this idea in the credit allocation process. The 5C principle comprises Character, Capacity, Capital, Collateral, and Conditions, which are essential elements for evaluating the eligibility of credit applicants. Implementing the 5C principle enhances the quality of credit evaluations and fosters improved partnerships between financial institutions and commercial entities.

Within the realm of MSMEs, implementing the 5C concept serves both as an evaluative instrument and a framework for entrepreneurs to enhance the quality of their enterprises. Comprehending the 5C principal aids business entities in adequately preparing prior to credit applications, enabling them to fulfill the criteria established by financial institutions. Consequently, implementing this approach advantages not just financial institutions but also the commercial entities involved.

The 5C concept in credit provision at BRI Unit Gajah Mada has enhanced the loan repayment rate and diminished the incidence of bad debts, demonstrating the approach's efficacy in evaluating credit risk.

Applying the 5C principal assessment at Bank Jateng Capem Juwana has effectively mitigated the risk of problematic financing. This condition indicates that financial organizations that regularly adhere to this guideline can achieve advantages in financial stability and reputation among consumers.

Consequently, it is essential to investigate further how applying the 5C principle influences the overall performance of MSMEs. The implementation of the 5C

principle in microfinancing at BRI Syariah KCP Metro can diminish the incidence of problematic financing. This condition indicates that a comprehensive analysis of borrower characteristics enables financial institutions to provide loans more effectively in alignment with the requirements and capacities of business entities. The data indicates that MSMEs receiving finance informed by the 5C analysis exhibit superior performance compared to those that do not.

The study's results, corroborated by theory, indicate that allocating 5C credit significantly influences MSME performance. Allocating financing will enhance the performance of MSME enterprises in Malang City, enabling them to expand and develop their operations.

CONCLUSION

The research findings and data analysis indicate that credit distribution significantly enhances the performance of MSMEs in Malang City. This research validates that implementing the feasibility principle in the credit distribution process, exemplified by the 5C framework (Character, Capacity, Capital, Collateral, and Condition), can significantly enhance the performance of micro, small, and medium enterprises. Optimal utilization of credit from financial institutions by MSME actors will yield improved business development, evidenced by enhanced productivity, profitability, and sustainability of operations. This condition indicates that access to specialized loans can enhance the capital structure, augment production capacity, and elevate market competitiveness.

Enhancing cooperation from banks and other financial institutions is essential to ensure this loan distribution's continuous and sustainable impact. A

strategic initiative involves offering training and educational programs for MSMEs. This training encompasses the advantages of credit and critical elements such as financial management, basic accounting, business planning, and marketing techniques. Enhancing financial literacy and business acumen will enable MSMEs to manage their loans more effectively, reducing the risk of improper credit utilization. Furthermore, banks need to establish enduring ties with MSMEs. This partnership encompasses financial support, consulting, technical guidance, and commercial assistance. This humanistic and collaborative approach would enhance MSMEs' trust in financial institutions and promote the establishment of an inclusive and sustainable financing system. This mutually beneficial cooperation will serve as a crucial basis for cultivating a resilient MSME sector. In the long term, it will considerably contribute to the regional economy, particularly in Malang City. Consequently, credit distribution serves as both a financial instrument and a strategic tool for economic empowerment.

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