THE DEVELOPMENT OF CORPORATE CREDIT INFORMATION DATABASE AND CREDIT GUARANTEE SYSTEM

FINAL DRAFT REPORT

University of Malaya

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ABBREVIATIONS

Name	Acronyms
Association of Southeast Asian Nations	**ASEAN**
Benchmarking On-line Networking Database	**BOND**
Best Practice Network	**BPN**
Bank Negara Malaysia	**BNM**
Bank Pembangunan Malaysia Berhad	**BPMP**
Bank Pertanian Malaysia Berhad	**Agrobank**
Bumiputra Commercial and Industrial Community	**BCIC**
Bumiputera Technopreneur Development Programme	**BITE**
Commercialisation of Research and Development Fund	**CRDF**
Credit Guarantee Corporation Malaysia Berhad	**CGC**
Department of Statistics	**DOS**
Development Corporation Malaysia Productivity Corporation	**MPC**
Direct Access Guarantee Scheme	**DAGS**
Development Financial Institutions	**DFI**
Entrepreneur Development Institute	**EDI**
Export-Import Bank of Malaysia Berhad	**EXIM**
Foreign Direct Investment	**FDI**
Franchise Development Programme	**FDP**
Free Trade Agreement	**FTA**
General Agreement on Trade in Services	**GATS**
Gross Domestic Product	**GDP**
Government Linked Company	**GLC**

Good Manufacturing Practice	**GMP**
Gross National Product	**GNP**
Halal Development Corporation	**HDC**
Human Resource Development Fund	**HRDF**
Information and Communications Technology	**ICT**
Industrial Linkage Programme	**ILP**
Industry Grant Scheme	**IGS**
Institute of Rural Advancement	**INFRA**
Intellectual Property	**IP**
Information Technology	**IT**
Malaysia Venture Capital Management Bhd	**MAVCAP**
Malaysia Debt Ventures Berhad	**MDV**
Malaysia Industrial Development Finance Bhd	**MIDF**
Malaysian Agriculture Research and Development Institute	**MARDI**
Majlis Amanah Rakyat	**MARA**
Malaysian Industrial Development Authority	**MIDA**
Malaysian External Trade Development Corporation	**MATRADE**
Malaysian Technology Development Corporation	**MTDC**
Malaysia Biotechnology Corporation	**MBC**
Malaysian Entrepreneur Development Centre	**MEDEC**
MATRADE Trade Outreach Programme	**MTOP**
Multimedia Super Corridor Grant Scheme	**MGS**
MSC Venture One VC Fund	**MV1**
Mergers and Acquisitions	**M&A**
MIMOS Berhad	**MIMOS**

Multimedia Development Corporation Sdn Bhd	**MDeC**
Ministry of Rural and Regional Development	**MRRD**
Ministry of Science, Technology and Innovation	**MOSTI**
Ministry of Tourism	**MOTOUR**
Ministry of Agriculture and Agro-Based Industry	**MOA**
Ministry of Domestic Trade and Consumer Affairs	**MDTCA**
Ministry of Education	**MOE**
Ministry of Energy, Water and Communications	**MEWC**
Ministry of Entrepreneur and Cooperative Development	**MECD**
Ministry of Finance	**MOF**
Ministry of Higher Education	**MOHE**
Ministry of Housing and Local Government	**MHLG**
Ministry of Human Resources	**MOHR**
Ministry of International Trade and Industry	**MITI**
Ministry of Plantation Industries and Commodities	**MPIC**
Multinational Corporations	**MNCs**
Mutual Recognition Agreement	**MRA**
Multimedia Super Corridor	**MSC**
National SME Development Council	**NSDC**
National Tourism Human Resource Development Council	**NTHRDC**
National Institute for Entrepreneurship	**INSKEN**
Non-governmental organisation	**NGO**
National SME Development Blueprint	**Blueprint**
Ninth Malaysia Plan	**9MP**
Non Performing Loans	**NPL**

One Region One Product	**SDSI**
Pembangunan Sumber Manusia Berhad	**PSMB**
Perbadanan Nasional Berhad	**PNS**
Perbadanan Usahawan Nasional Berhad	**PUNB**
PNS Francais Sdn Bhd	**PNSF**
Public Higher Education Institutions	**PHEI**
Pusat Khidmat Perusahaan Kecil dan Sederhana	**PKPKS**
Producer Price Index	**PPI**
Research and Development	**R&D**
Small and Medium Industries	**SMIDEC**
Small Debt Resolution Committee	**SDRC**
Standard and Industrial Research Institute of Malaysia Berhad	**SIRIM**
State Economic Development Corporations	**SEDC**
Science and Technology	**S&T**
Special Fund for Tourism	**SFT**
Small Debt Restructuring Scheme	**SDRS**
SME Expert Advisory Panel	**SEAP**
Small and Medium Enterprises	**SME**
Shared Services and Outsourcing	**SSO**
Skim Pembiayaan Ekonomi Desa	**SPED**
SIRIM Technology Incubation Centre	**STIC**
SME Central Coordination Agency	**SME CCA**
SME Bank Advisory Centre	**SAC**
Skill Development Centre	**SDC**
Technical Advisory Committee	**TAC**

Third Industrial Master Plan	**IMP3**
Venture Capital	**VC**
Yayasan Pembangunan Usahawan	**YPU**
Yayasan TEKUN Nasional	**TEKUN**

INTRODUCTION

The 1997 economic crisis clearly recognised the role and contributions of small and medium enterprises (SMEs) as the backbone of economic growth in Malaysia. During the economic turmoil, many foreign investors withdrew their investments leaving the Malaysian economy in the lurch. Fortunately there were SMEs, which despite being marginalised managed to pump energy into the frail economy. Since then SMEs businesses have been placed high on government agenda. As of 2003, SMEs account for 99.2% of total establishments in three key sectors, manufacturing, services and agriculture. SMEs employed approximately 3 million workers or 65% of the total employment of 4.6 million engaged in the three sectors.

Presently the world is facing another financial crisis. Unlike the 1997 crisis, the present financial turmoil is “like a tectonic shift on a scale not seen in financial systems around the world,” according to the IMF (2008). The financial crisis, coupled with high commodity prices and the business downturn in the United States and some other advanced economies, has resulted in a slowing of growth in major economies, several of which have slipped into recession or experiencing growth far below potential. For a country that is still dependent on export, like Malaysia, effect of the crisis is beginning to hurt many sectors including the SMEs businesses and government plans and programmes for the SMEs.

How far and how long can SMEs sustain the crisis is still unknown. Notwithstanding the crisis, SMEs in Malaysia, despite its expansion, are still encumbered by various problems, ranging from financial, technical (such as ICT and innovation), new markets and rising costs. Since 2004 various efforts have been introduced to improve the SMEs and remarkable progress has been achieved but with continuous challenges from the global market, assistance to SMEs is also ever changing.

This present study intends to promote an approach towards comprehending SME challenges by way of developing a standard database for SME credit information across region. This present study is a follow-up of an earlier study on the “Development of Database of Corporate Credit Information”, 2007-2008 drawn from the earlier study, “Development of Credit Information Database and Credit Guarantee System” approved by the ASEAN+3 Finance Ministers’ Meeting in May 2008.

The broad objectives of this study are:

(1) To examine the current situation of credit registries / bureaus in the region, and the future perspectives for their development;
(2) To scrutinise adequate institutional frameworks of credit information database for firms, especially SMEs in Malaysia;
(3) To consider a regional cooperation mechanism to create a harmonised information sharing system;

(4) To review the current situation of the credit guarantee system in the region, and identify the challenges for developing the credit guarantee system;
(5) To delve deeper into the current situation of credit registries / bureaus, in the region and the future prospects for their development.

The specific objectives of this study are:

(1) To examine the state of credit registries and bureaus in Malaysia and the future prospects.

(2) To scrutinise the institutional frameworks of credit information database for firms, particularly SMEs in Malaysia;

(3) To consider a regional cooperation mechanism to create a harmonised information-sharing system; and

(4) To review of the credit guarantee system in Malaysia and the identification of future challenges.

In the light of these objectives, this report covers analyses of these following areas:

- The merits, prerequisite infrastructure, and issues to be addressed for developing a reliable and effective corporate credit information database as well as the current situation of such databases in some Asian countries;

- The possibility of developing a corporate credit information database that could contribute to the establishment / development of a credit guarantee system;

- Synergizing of the Credit Information Database and the Credit Guarantee System; and

- Development of a Corporate Credit Information Database with that of Credit Guarantee System; and

- Examination of the practicality of using the Credit Risk Database (CRD) of Japan into the existing framework of extending credit to SMEs in Malaysia.

Research Methodology

Data and information for this research are collected both from primary and secondary sources. Data from primary sources were gathered by way of interviews and questionnaires. In this process, 2000 questionnaires were sent out to small and medium enterprises country-wide. As of 30 January 2009 only 652 questionnaires were returned. Interviews were reserved for financial institutions, credit bureaus and CGC. Of the 40 financial institutions that were approached, only 14 were willing to be interviewed. Both credit bureaus have given interviews. The CGC has also given an interview and additional information via email.

Secondary information were gathered from various sources and among these were: Department of Statistics Malaysia, Bank Negara Malaysia (Central Bank of Malaysia), Credit registries/bureaus, CGC, Commercial banks, other financial institutions, SME Development Corporation, ministries and related government agencies.

Report Structure

This report consists of five chapters. Chapter 1 discusses the state of SMEs in Malaysia, inclusive of definition, its role and contribution to the national economy, its financial sources and present problems and issues confronting SMEs.

Chapter 2 discusses the roles of SME bureau within the context of Malaysia SMEs and align the analyses with the Credit Risk Database of Japan’s operational mechanism.

Chapter 3 explains the operations of credit registries and credit bureaus in Malaysia. Specifically, it examines the operations of the SME Credit Bureau, the Bank Negara credit bureau (CCRIS) and the private credit registry, CTOS.

Chapter 4 focuses on the role of Credit Guarantee Corporation as the link between SMEs and financial institutions. The chapter evaluates it history and present role in enhancing the development of SMEs in Malaysia.

Chapter 5 concludes the report by presenting policy statements based on the issues and problems presented by the financial institutions, banks, SMEs, CGC, and the relevant ministries and agencies.

CHAPTER 1 BACKGROUND OF SMALL MEDIUM ENTERPRISES IN MALAYSIA

1.1 Definitions of Small Medium Enterprises (SMEs)

Before the formation of the National SME Development Council (NSDC) in June 2002, there was no standard meaning of SMEs in Malaysia. Different agencies defined SMEs based on their own criteria usually benchmarking against annual sales turnover, number of full-time employees and/or shareholders funds. For example, the Small and Medium Industries Development Corporation (SMIDEC) (now SME Corporation) defined SMEs as enterprises with annual sales turnover not exceeding RM25 million and with full-time employees not exceeding 150. Bank Negara Malaysia (Central Bank), defined SMEs as enterprises with shareholders funds of less than RM10 million (NSDC 2005). The absence of a standard definition prevented the collection and compilation of uniform SMEs data for assessment of development needs and business performance across the economic sectors. In order to assist in the better identification of SMEs across all sectors, and for more effective targeting of SMEs with respect to the design of policies and programmes, on 9 June 2005 the National SME Development Council or NSDC (which was formed in 2004) introduced a common definition of SMEs across economic sectors for adoption by government ministries, agencies and financial institutions involved in SMEs development.

The NSDC defined SMEs based on two criteria, number of employees and annual turnover. An enterprise will be classified as an SME if it meets either the specified number of employees or annual sales turnover definition.

Broadly SMEs in Malaysia are categorised into 3 major sectors:

1) Primary Agriculture;
2) Manufacturing (including agro-based) and Manufacturing-Related Services (MRS); and
3) Services (including Information and Communications Technology and mining and quarrying sector, and construction sector).

An establishment is considered an SME in each of the respective sectors based on its annual sales turnover or its number of full-time employees as shown in Table 1.1 below. This report adopts the NSDC's definition of SMEs based on annual sales turnover for purposes of convenience.

Table 1.1: Definition of SMEs in Malaysia

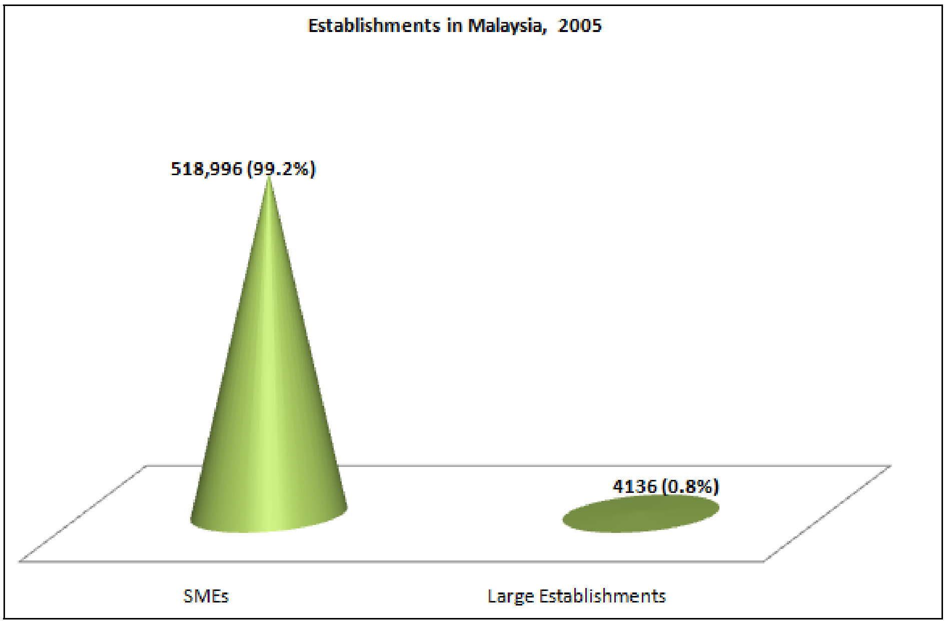
Size	Primary Agriculture	Manufacturing (including Agro-Based) and Manufacturing-Related Services	Services Sector (including Information Communications Technology (ICT))
Annual Sales Turnover			
Micro	Less than RM200,000	Less than RM250,000	Less than RM200,000
Small	Between RM250,000 and les than RM1million	Between RM250,000 and less than RM10 million	Between RM200,000 and less than RM1 million
Medium	Between RM1 Million and RM5 Million	Between RM10 Million and RM25 Million	Between RM1 Million and RM5 Million
SME	Not exceeding RM5 million	Not exceeding RM25 million	Not exceeding RM5 million
Number of Full-Time Employees			
Micro	Less than 5 employees	Less than 5 employees	Less than 5 employees
Small	Between 5 and 19 employees	Between 5 and 50 employees	Between 5 and 19 employees
Medium	Between 20 and 50 employees	Between 51 and 150 employees	Between 20 and 50 employees
SME	Not exceeding 50 employees	Not exceeding 150 employees	Not exceeding 50 employees

Source: SME Annual Report, 2005.

1.2 Profile of Malaysia's SMEs

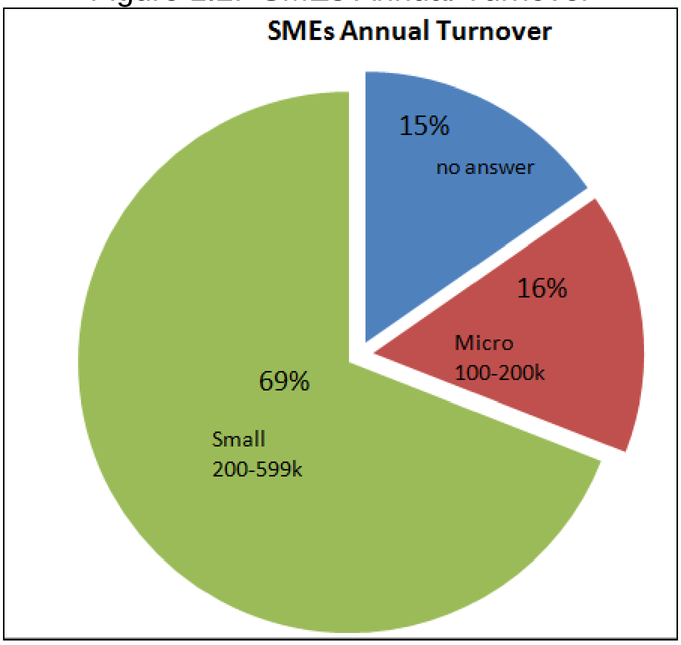
Based on the Department of Statistics (DOS) survey conducted in 2005 there were 523,132 establishments in manufacturing, services and agriculture in Malaysia. Of these 518,996 or 99.2%, are SMEs and the remaining 4,136 or 0.8% are large establishments (DOS, 2005). Micro establishments make up the highest percentage of the SMEs, 79% or 411,849, followed by small establishments constitute 18.4% and medium 2.2%. In accord with the DOS study, based on sales turnover defintion for SMEs, this present study managed to capture 16% of micro and 69% of small establishments from the sample of 652, Figure 1.1 and Figure 1.2.

Figure 1.1: Profile of Establishments in Malaysia



Source: Department of Statistics Malaysia, 2005.

Figure 1.2: SMEs Annual Turnover



Source: UM Survey, Nov 2008 – Jan 2009.

Based on economic contributions as of 2005, SMEs contributed 32% of the nation's real gross domestic product (GDP) and 19% of the total exports, Table 1.2.

Table 1.2: SMEs Contribution to the Economy

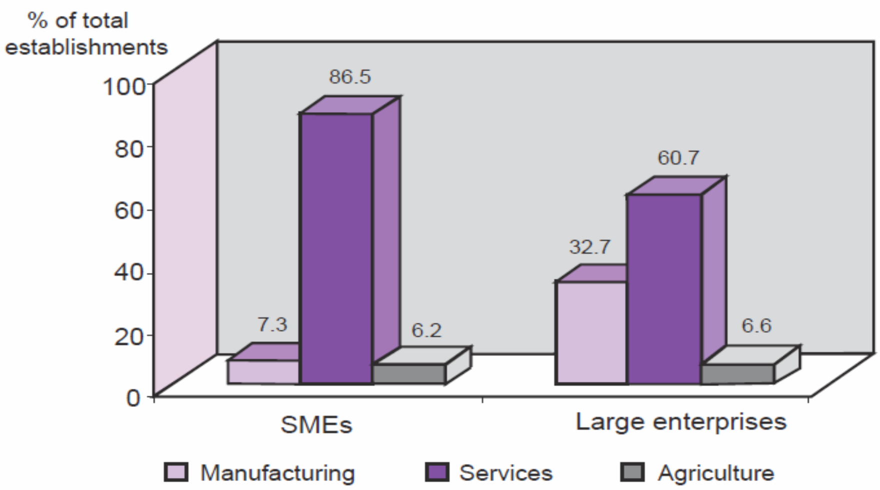
Performance of SMEs	2003 (%)	2005 (%)	2010 (%) Target
SMEs' contribution to GDP	31.9	32.0	37.0
SMEs' contribution to employment	55.8	36.4	
SMEs' share of total export	18.9	19.0	22.0

Source: SME Annual Report 2006 and 2007.

1.3 SMEs by Sectors

The services sector formed the largest category of SMEs, with over 449,004 (or 86.5% of total SMEs). The bulk of the SMEs in services sector is micro enterprises (80.4%), followed by small (17.6%) and medium (2.1%) enterprises respectively and most of the services sub-sectors are in retail, restaurant, wholesale, transportation and communication and professional services, Figure 1.3.

Figure 1.3: SMEs and Large Enterprises by Sectors



Source: Department of Statistics Malaysia, 2005.

There are 37,866 SMEs in the manufacturing sector, mostly in textile and apparel, metal and mineral products and food and beverages production. About 50% of the SMEs in this sector are micro enterprises, followed by small (39.5%) and medium (5.2%) enterprises. Meanwhile, there are 32,126 SMEs in the agriculture sector, primarily in food crops and market produce, horticulture and livestock. 93.3% of the SMEs in agriculture sector are micro enterprises.

Based on the survey conducted by this study of 652 enterprises a similar pattern appears. Excluding 22% that provided no answer, 65% of respondents were from services sector, 7.7% manufacturing and 5.1% agriculture sectors. Majority of the contribution to services sector came from the urban states of Kuala Lumpur and Selangor, 20.5% and 21.9% respectively.

Based on Department of Statistics (DOS) survey, in terms of legal status, sole proprietorship formed the largest group accounting for 68.5% of the total SMEs. This is followed by private limited (21.2%) and partnership (9.7%). The bulk of micro enterprises is in the form of sole proprietorship, while most of the small and medium enterprises are in the form of private limited (DOS, 2005).

DOS survey also shows that legal status of SMEs by sector individual proprietorship dominates, 47.7% in manufacturing, 68.8% in services and 86.8% in agrcultural sectors. SMEs are also major major employers in the labour market. The 548,267 SMEs employed over 3.2 million workers, accounting for 64.0% of employment from the three sectors. Of the total 3.2 million, 71.2% were employed in the services sector followed by manufacturing 23.8 and agricuture 4.4%. In term of full-time employees the highest was also from services sector followed by manufacturing and agriculture. In large enterprises similar pattern follows, Table 1.3 and Figure 1.3.

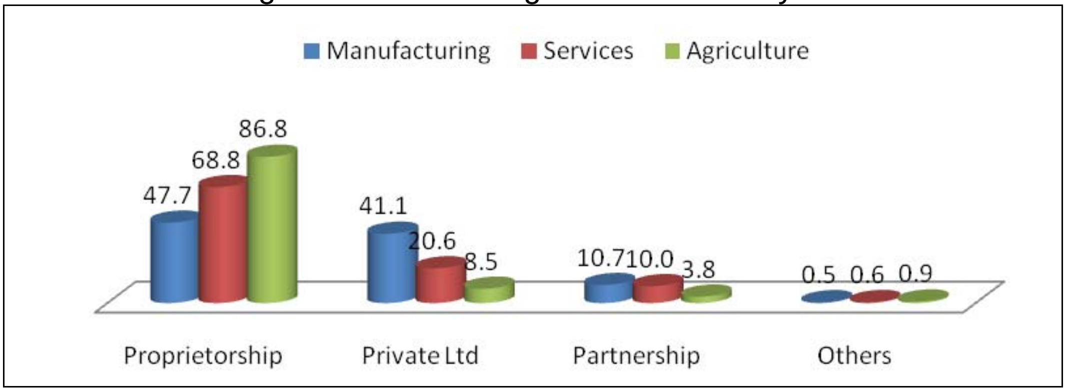
Table 1.3: Employment and Salaries and Wages by Sector, 2003

Sector	Total employment ('000)			Full-time employees ('000)			Salaries & Wages (RM million)		
	Total	SMEs	%	Total	SMEs	%	Total	SMEs	%
Total	5,038	3,223	64.00	4,225	2,461	58.30	86,075	41,900	48.70
Manufacturing	1,663	760	45.70	1,598	699	43.70	30,300	11,220	37.00
Services	3,125	2,320	74.20	2,450	1,690	69.00	53,883	29,814	56.30
Agriculture	250	142	56.80	177	72	40.70	1,892	866	45.80

Source: Department of Statistics Malaysia, 2005.

However for these SMEs despite being dominant enterprises its share in value added and output is low. This is because of the domination of micro and small enterprises as well as individual ownership of companies, Figure 1.4.

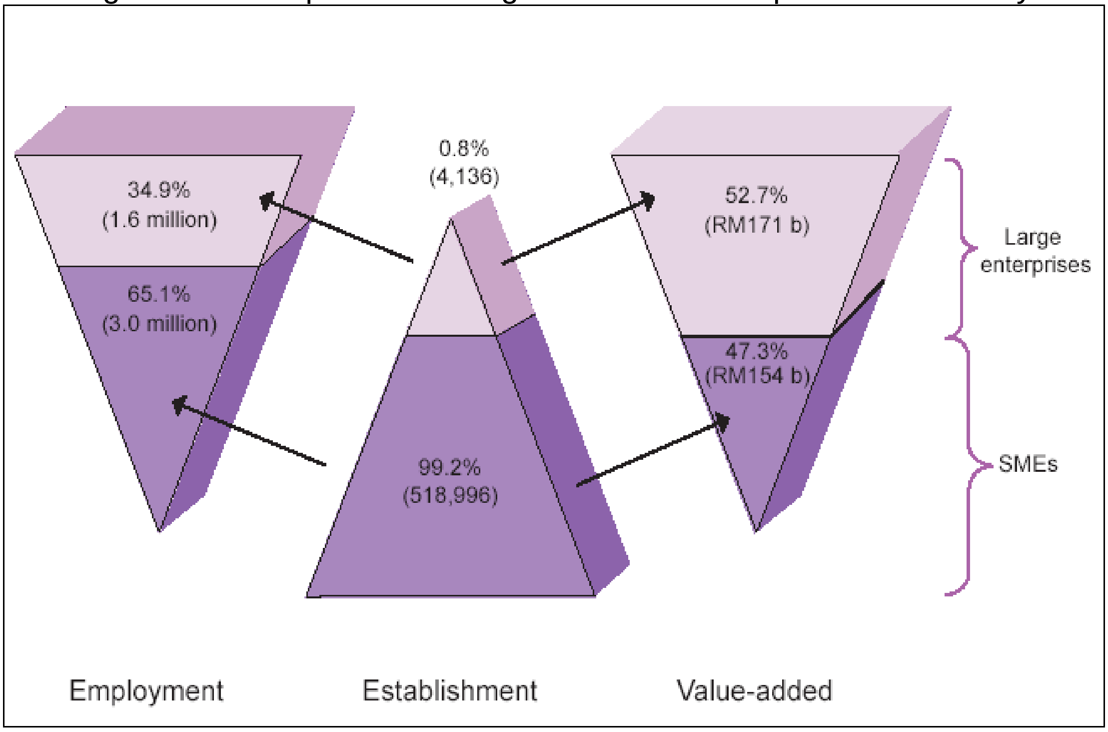
Figure 1.4: SMEs Legal Status in Malaysia



Source: Department of Statistics Malaysia, 2005.

The DOS survey showed that there were 548,267 SMEs generating a total output of RM381,253 million and value added of RM159,411 million. This translates into the productivity of SMEs by output of RM0.7 million per establishment and RM0.3 million value added per establishement. Comparatively large enterprises contributed 171 billion of valued added and 1.6 million employment (Figure 1.5).

Figure 1.5: Comparison of Large and Small Enterprises Productivity



Source: Department of Statistics Malaysia, 2005.

A closer look at SMEs by sector further based on DOS survey revealed the imbalance of productivity between SMEs and large enterprises. In the services sector SME accounted for 99.4% (477,525) of total establishments. Micro establishemetns made up 80.4% (381,585) followed by 17.5% of medium enterprises. In term of output SMEs contributed RM216,109 million or 49.5% of total (RM436,976 million) output. The contribution of medium establishments was 26.4% or RM57,075 million even though they accounted for only 2.1% of SMEs. Output of micro and small establishments were RM71,983 million (33.35%) and RM87,051 million (40.3%) respectively. A similar pattern is shown in value added. Average annual output and value added per SME were RM0.5 million and RM0.20 million respectively. Medium sized establishments recorded the highest average output and value added per establishement of RM5.7 million and RM2.8 million respectively. A similar pattern of imbalance was shown in the manufacturing and agriculture sectors.

In the manufacturing sector, SMEs contributed 29.0% or RM154,743 million of output and 27.8% or RM45760 million to value added. Medium sized establishements were the highest contributor to output and value added, 54.6% and 50.0% followed by small establishments, 42.4% of output and 46.0% value added. Micro establishments contributed only 3.0% to output and 4.0% to value added. SMEs in the agricultural sector contributed 47.9% (RM10,401) to total output of the agriculture. Micro establishments accounting to 93.1% of SMEs, generating only 22.4% of output and 21.5% of value added. Small establishments which made up only 5.6% of SMEs accounted for the largest share of output and value added at 45.5% and 47.9% respectively. Medium establishemetns made up only 1.7% of SMEs but contrubuted 32.1% and 30.6% of output and value added respectively (DOS, 2005).

Output and value added of SMEs in sectors by legal status supported imbalances within SMEs and between SMEs. Within SMEs, micro establishements were predominantly individual proprietorships while private limited companies were dominant in medium establishements. For instance, in services sector, individual proprietorship while accountring for 68.8% of the SMEs contributed only 20.4% of the output and 22.6% of the value added. On the other hand, output and value added of private limited companies amounted to 61.6% and 56.3% respectively while the number of estblishments was only 20.6%. Similarly are in the manufacturing and agrculture sectors. In the agricultural sector majority of establishments were in individual proprietorship (86.8%) followed by private limited companies (8.5%) and partnership (3.85%). By size classification, micro establishements were predominatly individual proprietorship (98.2%) followed by partnership (77.2%). However contributions to output were from limited companies accounting to 70.5%. Likewise in manufacturing sector, half of total output came from medium sized establishments which number only 5.2% and most of these companies were registered as private limited companies. While micro establishments which number more than half of SMEs establishments contributed 3.0% to output and 4.0% to value added. Many of these latter companies are registered as individual proprietorship or partnership companies, Tables 1.4,1.5 & 1.6.

Table 1.4: SMEs Output and Value Added in Manufacturing Sector

Variable	Micro	Small	Medium
Output	3.0	42.4	54.6
Number of establishments	54.6	40.1	5.2
Value added	4.0	46.0	50.0

Source: Department of Statistics Malaysia, 2005.

Table 1.5: SMEs Output and Value Added in Services Sector

Variable	Micro	Small	Medium
Output	33.3	40.3	26.4
Number of establishments	80.4	17.5	2.1
Value added	35.8	38.2	26.0

Source: Department of Statistics Malaysia, 2005.

Table 1.6: SMEs Output and Value Added in Agricultural Sector

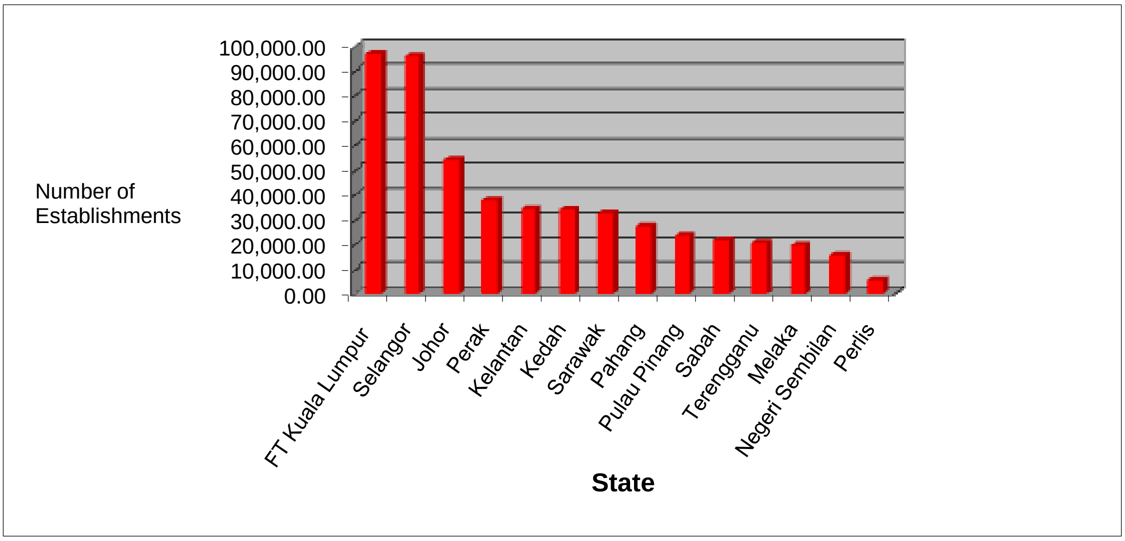
Variable	Micro	Small	Medium
Output	22.4	45.5	32.1
Number of establishments	93.1	5.2	1.7
Value added	21.5	47.9	30.6

Source: Department of Statistics Malaysia, 2005.

1.4 Distribution of SMEs

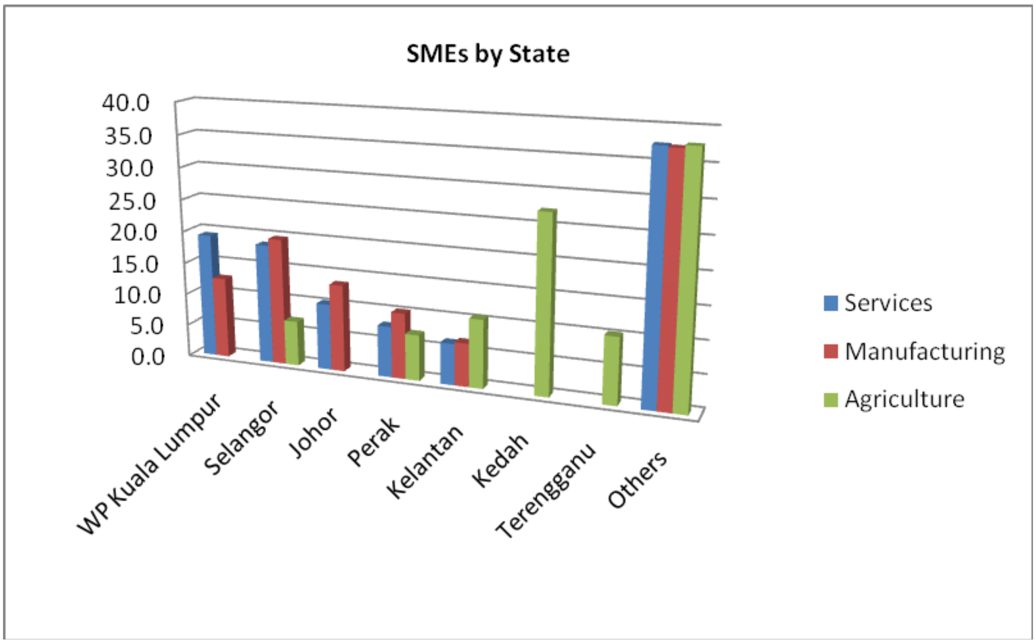
The largest concentration of SMEs is found in the Federal Territory of Kuala Lumpur with 18.6% and the state of Selangor 18.5%. However concentration of SMEs by sector varies. Agriculture sector SMEs predominated in Kedah (27.3%) followed by the East Coast states of Kelantan (10.6%) and Terengganu (10.35). Kuala Lumpur and Selangor where services and manufacturing sectors predominates contribution from agriculture is the lowest (Figure 1.6 and 1.7) (DOS, 2005).

Figure 1.6: Regional Distribution of SMEs in Malaysia



Source: Department of Statistics Malaysia, 2005.

Figure 1.7: SMEs by Sector and State of Concentration



Source: Department of Statistics Malaysia, 2005.
*Others = Combination contribution

1.5 Financial Sources for SMEs

In Malaysia there are many types of financing available for SMEs at various stages of its development. At the end of 2007, RM128 billion has been financed for 625,167 SMEs accounts. The most financing has been provided by banking institutions (BIs) and Development Financial Institutions (DFIs) (refer to Chapter 3 for classification).

Banking Institutions

There are 47 banks with 3,359 branches involved in SMEs financing. As of 2007 55.1 billion financing has been approved to 109,497 SMEs. Also during the same period there was RM114.2 billion financing outstanding to 518,446 SME accounts.

Development Financial Institutions (DFIs)

Development Financial Institutions (DFIs) are specialised financial institutions set up to accelerate the growth of strategic sectors identified by the government. A key function of DFIs is to provide financial services that are not being provided by the banking institutions. There are 6 DFIs and 677 branches that provide SMEs financing in Malaysia.

In 2007 the DFIs approved RM8.1 billion financing to 23,477 SMEs accounts. And as of the same date there is RM13.8 billion financing outstanding to 106,721 SMEs accounts (Table 1.7).

Table 1.7: Banking Institutions Main SMEs Financing Indicators

	During		
	2007	2006	2007 (% annual growth)
Applications (RM billion)	99.1	71.4	38.8
Number of Accounts ('000)	158.2	106.0	49.2
Approvals (RM billion)	55.1	40.2	37.1
Number of Accounts ('000)	109.5	83.7	30.8
Disbursements (RM billion)	141.5	134.1	5.5
Repayments (RM billion)	126.6	122.5	3.4
	As at end		
	2007	2007 (% annual growth)	2006 (% annual growth)
Financing Outstanding (RM billion)	114.2	9.1	5.1

Source: Bank Negara Malaysia, 2007.

Leasing and Factoring Companies

Another source of financing for SMEs are the leasing and factoring companies. Where previously SMEs had to buy costly equipment needed in their production process, leasing companies provide them with the option of renting the equipment, thereby avoiding the need for up-front capital expenditure. As for the funding of working capital, SMEs now have the choice of pledging their future income to factoring companies so as to obtain funding for working capital. As of end 2007 RM792.3 SMEs has obtained financing from leasing and financing companies.

Venture Capital (VC) Companies

There are 52 Venture Capital (VC) companies that collaborated with SMEs. VC companies usually financed newly established businesses, especially in the information and communications technology (ICT). Venture capitalists usually take a stake in a business in exchange for providing capital. As of end 2007 VC companies has invested RM479 million and as of the same period has accumulated outstanding investment of RM8.1 billion to 433 companies.

Bank Negara (BNM) SME Special Funds

Bank Negara Malaysia provides five special funds for SMEs. These funds are:

- Fund for Small and Medium Industries 2;
- New Entrepreneurs Fund 2;
- Fund for Food;
- Rehabilitation Fund for Small Businesses; and
- Bumiputera Entrepreneurs Project Fund.

Overall financial approval for the Bank Negara special funding is RM16.1 billion financing for 33,717 SMEs accounts. As of end 2007, RM2.7 billion has been approved to 4,859 SMEs accounts.

Government Funds for SMEs

There are also financing provided by government funds which are channeled through selected commercial banks, DFIs and relevant government agencies. RM85.5 billion has been allocated for 1.3 million SMEs accounts. As of end 2007, RM13.7 billion has been approved to 243,203 SMEs accounts. In the same period there is RM7.0 billion financing outstanding maintained by this programme, Table 1.8, 1.9 & 1.10.

Table 1.8: SMEs Financing as at end-2007

SME Financing	Number	Branches	Financing Outstanding (RM)	SME Accounts	Financing Approved	Approved Accounts
BIs	47	3359	114.2b	518,446	55.1b	109,497
DFIs	6	677	13.8b	106,721	RM8.1b	23,477
VC	52	0	8.1b	433	RM478m	433
LF			2.0b		792.3m	
SDRS					56.9m (of 324m)	141 (of 565)
CGC	1	16	14.68b	90437	4.0b	13008

Source: Bank Negara Malaysia, 2007.

Table 1.9: Financing by Banking and Development Institutions

Financing by Banking Institutions and Development Financial Institutions include:				
	Financing Outstanding (RM)	SME Accounts	Financing Approved	Approved Accounts
Bank Negara Special Funds	7.6b	33717	2.7b (of 16.1b)	4859 (of 33,717)
Govt. Funds& Schemes	7.0b	1.3m	13.7b (of 85.5b)	243,203

Source: Bank Negara Malaysia, 2007.

Table 1.10: Performance of Government Funds and Schemes as of December 2007

Type of Assistance	No. of Schemes	Allocations	Applications		Disbursed	Outstanding
		(RM b)	No.	(RM b)		
Soft Loans	64	13.25	1,254,317	81.22	77.29	5.79
Grants	22	4.52	15,674	1.92	1.23	not applicable
Venture Capital	9	1.63	155	0.93	0.50	0.37
Equity	2	0.39	138	0.69	0.56	0.36
Soft Loans & Equity	3	0.66	1,906	0.84	0.61	0.46
Total	**100***	**20.44**	**1,272,190**	**85.60**	**80.19**	**6.98**

* Including TEKUN, AIM, PNS, PUNB and MECD

Source: Bank Negara Malaysia, 2007.

1.6 SME Policy and Institutional Framework

The Malaysian Government has always encouraged entrepreneurship and has assumed a major role in its development. Overall, particular emphasis has been placed on the development of SMIs and SMEs, with the government taking steps, such as providing a positive business environment, tax incentives and various financing schemes. In the early days however, the large number of ministries, agencies and financial institutions involved in the SME and SMI development programmes faced lengthy approval times for processing applications, leaving entrepreneurs frustrated. To overcome this, the Small and Medium Industries Development Corporation (SMIDEC) was established in 1995 (renamed and revamped as SME corporation, effective January 2009).

Small Medium Enterprise Corporation (SME Corp.)

SME Corp. responsibilities include 1) promoting and coordinating the development of SMEs in Malaysia through promotional activities, establishment of regional offices. Conduct related studies and collate information into a comprehensive database; 2) provide technical and advisory support services in collaboration with other related agencies involved in SMEs through SMEs development, SMEs Information and Advisory Centre and SMEs Expert Advisory Panel (SEAP); 3) Forge industrial linkages between SMEs and large companies/ multinational corporations (MNCs) through industrial linkage programme (ILP) and global supplier programme (GLC); 4) Implement, coordinate and monitor financial assistance schemes provided to SMEs through soft loans, grants and other financial assistance such as venture capital and equity financing; 5 Collaborate with other local and international SMEs related agencies to develop SMEs through participation in international and regional cooperation meetings and for skills enhancement programmes for employees of SMEs and attachment programmes for employees of SMEs. There are various other bodies that have been instituted towards enhancing the growth SMEs in Malaysia (SMIDEC, 2006).

Ministry of Entrepreneur Development (MOED)

In 1995 saw the establishment of the Ministry of Entrepreneur Development. This ministry serves to build bumiputera entrepreneurship as well as acts as a coordinating body for entrepreneurship matters. It functions as an information and resource centre and provides training, financial assistance and subsidised business premises for qualified entrepreneurs.

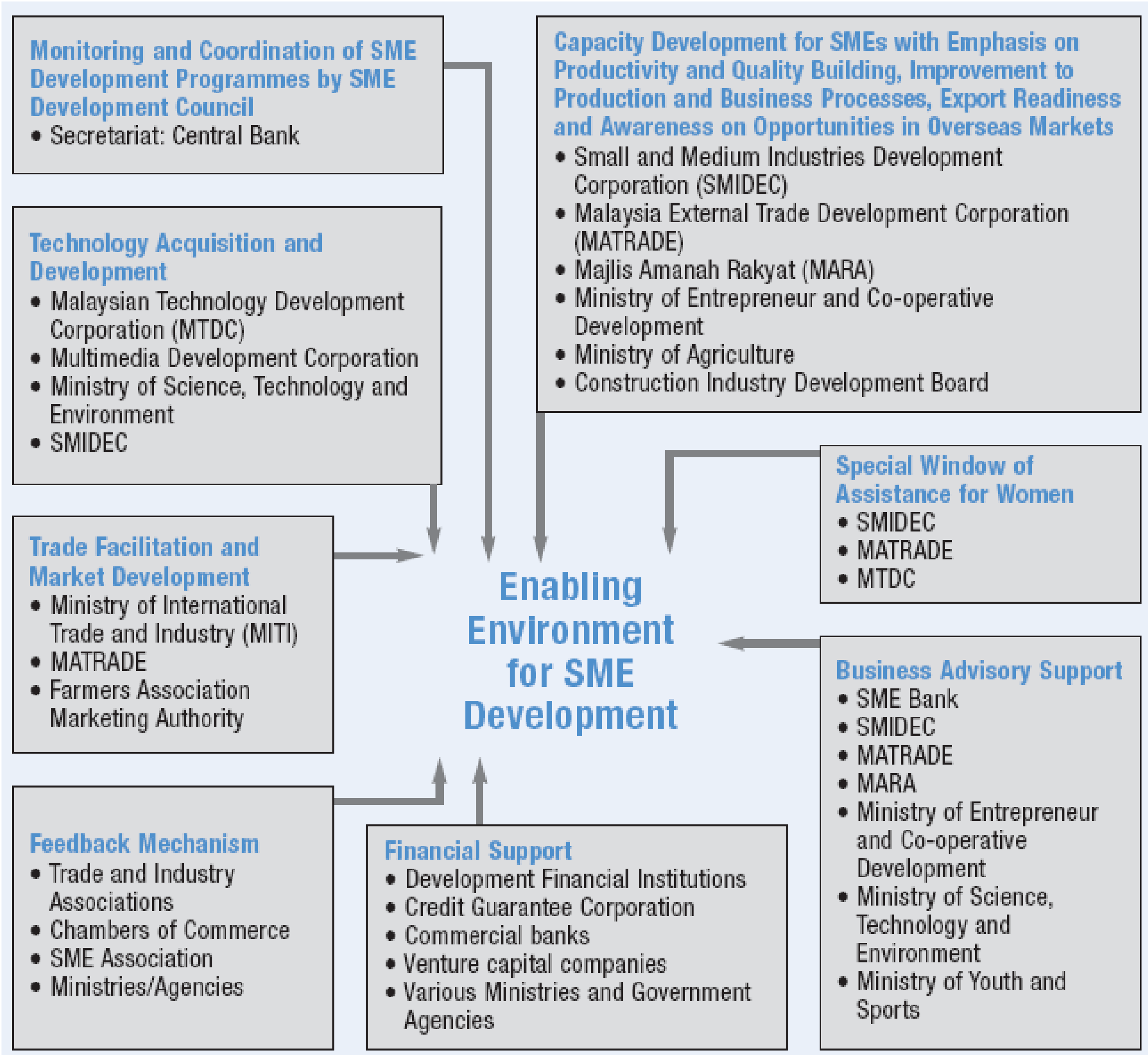
Various development programmes have also been established to upgrade the performance of SMIs. These are in line with Malaysia's industrial policy to create inter and intra industrial linkages. SMIs development programmes initiated include the Vendor Development Programme, Integrated Market Programme, SMIs Expos and Industrial airs, the Subcontract Exchange Scheme, Human Resource Development, Foreign Technical Assistance for SMIs, Product and Market Segment Study, Industrial Technical Assistance Fund (ITAF), Soft Loan for Modernisation and Automation/Soft Loan for Furniture and Food-based Products and Infrastructure Development Programme.

The government also lends its support by creating a business environment that is entrepreneurship friendly. This is done by specifying in advance what direction the Malaysian economy will take and where major allocation of funding will be. For example, in 2000, the government announced the "Knowledge Economy Master Plan" which was aimed to create a knowledge and information-driven economy through nurturing high tech and knowledge intensive businesses. By taking heed of this information, entrepreneurs can focus their attention on specific areas that best suits their situation, thus reducing their risks in investing in future technologies.

During the 8th Malaysia Plan (8MP) (2001–2005) emphasised the development of SMEs in the manufacturing sector, and in particular the development of a competitive Bumiputra Commercial and Industrial Community (BCIC). Funding to address critical issues in promoting and developing SMEs was made available through agencies like Malaysia External Trade Development Corporation (MATRADE), Malaysia Technology Development Corporation (MTDC), Small and Medium Industries Development Corporation (SMIDEC) and Standards and Industrial Research Institute of Malaysia (SIRIM) Berhad. SMEs were encouraged to invest in R&D, upgrade their technology and improve their marketing and distribution channels.

To ensure that SME development plans are focused, in 2004 the Malaysian government set up a National SME Development Council, chaired by the Prime Minister. Regular meetings are held with agencies, ministries, banks and financial institutions that provide support for SMEs, and a reporting mechanism for monitoring outcomes of activities and providing feedback have been established. This is among the measures taken to enhance transparency and accountability amongst policy implementers. The National SME Development Council represents the highest policy-making body and charts the future direction and strategies for SMEs development. The Council is responsible for formulating broad policies and strategies to facilitate SMEs development, and for ensuring the effective implementation of the policies and action plans. There are many ministries and institutions involved to support and strengthen SMEs Development in Malaysia, Figure 1.8.

Figure 1.8: Enabling Environment for SMEs Development in Malaysia



Source: Adapted from UNDP Malaysia, 2007.

The 9th Malaysia Plan (9MP) (2006-2010) places more emphasis on training and preparing budding entrepreneurs. This is in line with the government's focus on developing human capital to generate a knowledge-driven economy and sustain economic growth. Measures are underway to instill entrepreneurial spirit and provide entrepreneurial training at various levels of education from high school levels to universities and graduate school levels. MARA is also shifting its focus from vocational training to entrepreneurial training. Its target under the 9MP is to produce 11,000 entrepreneurs covering 28 fields of business, with particular potential seen in beauty care, reflexology and automotive repair. Also included in the five- year plan is increased funding for the promotion of franchise business in Malaysia.

The 9MP also intensifies efforts at stimulating enterprise creation, with a special entrepreneurship programme established for unemployed graduates. Overall, the government hopes to educate the population on entrepreneurship, instill an entrepreneurship culture and change public perception of entrepreneurship into seeing it as a viable alternative to salaried employment

In January 2009, the framework for the formation of a dedicated SMs Central Coordinating Agency **(**SMEs Agency) was finalised. This SMEs Agency represents a major structural enhancement to the SMEs development agenda. The SMEs Agency is a one-stop agency that will undertake the overall coordination of SMEs policy formulation and assessment of the performance of SMEs development programmes across all sectors. Ministries and agencies involved in SMEs development will continue to oversee the SMEs policy formulation and programme implementation in accordance with their respective mandates. The SMEs Agency will serve as the central point of information, reference and advisory services for SMEs across all sectors and will also assume the role of Secretariat to the National SME Development Council, which has been undertaken by Bank Negara Malaysia since 2004.

1.7 SMEs Access to Financing Since 2005

Interestingly despite the promotion of various types of financing SMEs tended to use traditional approach i.e. personal savings or borrow from family and friends. This is highlighted by the Department of Statistics Malaysia as well survey conducted by this research. DOS (2005) found that most SMEs used their own internally generated funds and funds sourced from friends and family members to finance their operations. Only about 15% of SMEs indicated a reliance on financing from financial institutions (that is, banking and development financial institutions). Contrawise large businesses readily accepting financing form banking institutions (Table 1.11).

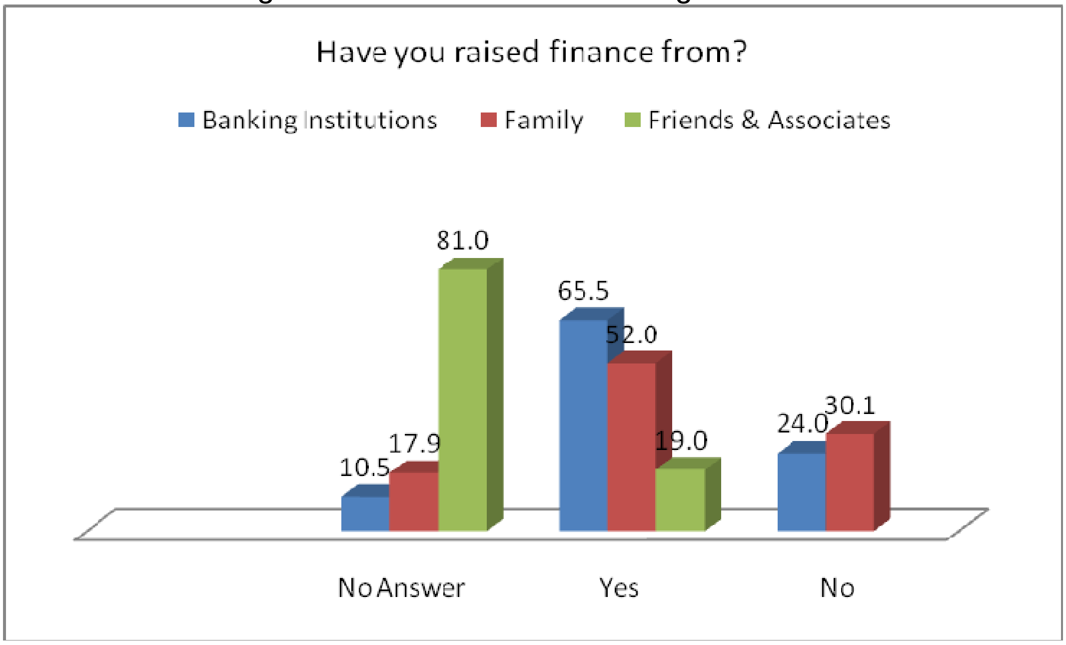
Table 1.11: SMEs Sources of Financing by Establishments

CENSUS 2005	Own	Others	Friends Family	BIs	DFIs	Total No. of Estab.
SMEs	34%	25.7%	23.6%	13.4%	2.7%	518, 996
Large	37.2%	4.7%	5.6%	47.6%	2.6%	4,136
Total No. of Estab.	177,863	133,456	122,644	71,287	14,166	523,132

Source: Department of Statistics Malaysia, 2005.

A closer look at the sources of financing of SMEs by size surveyed by this study revealed a similar trend. Financial institutions namely banks are sought for financing though it is not the main source, Figure 1.9.

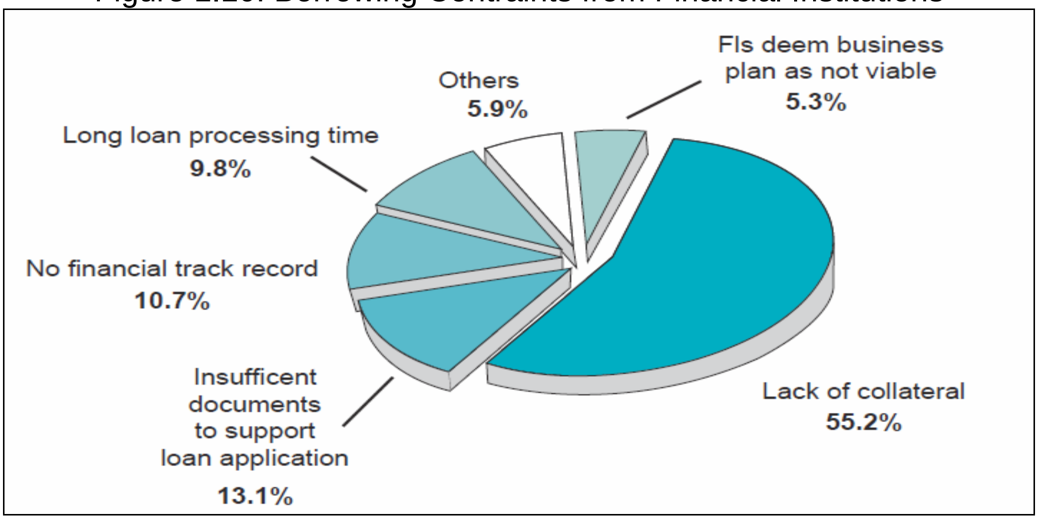
Figure 1.9: Sources of Financing for SMEs



Source: UM Survey, Nov. 2008-Jan. 2009.

The reasons for not getting financing from banking institutions or other financial institutions were mainly relating to lack of collateral (DOS: 2005). This is followed by insufficient loan documentation and lack of financial track record, as well as business viability. Almost 10% of respondents indicated long processing time as a problem, Figure 1.10.

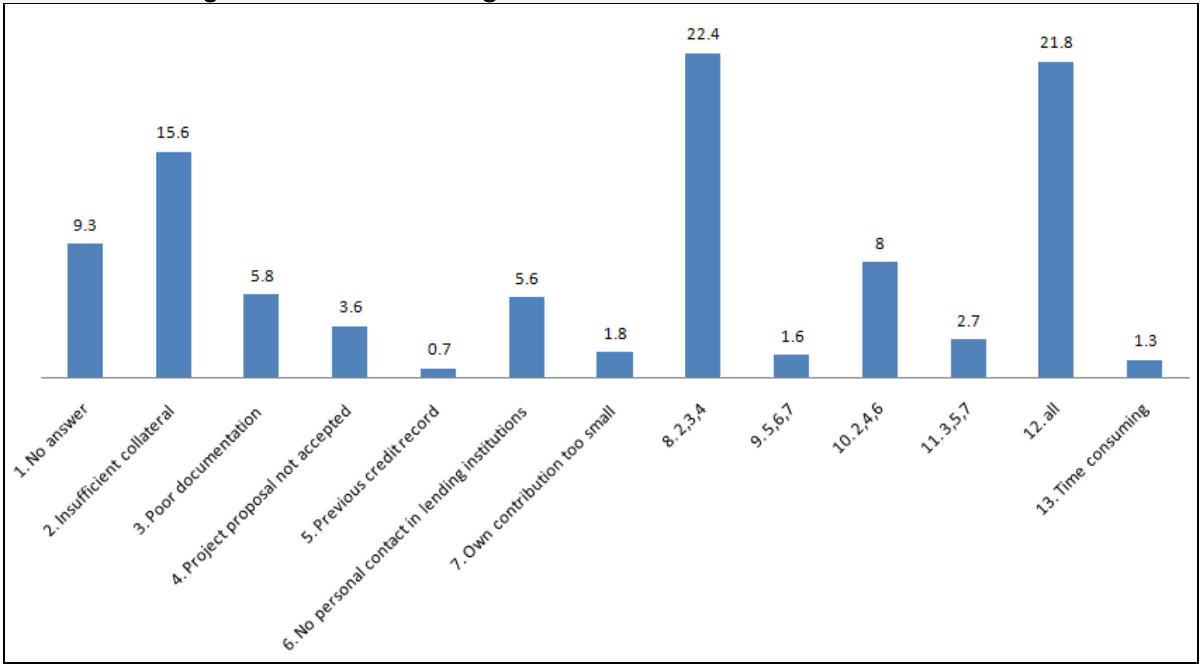
Figure 1.10: Borrowing Contraints from Financial Institutions



Source: Department of Statistics Malaysia, 2005.

The findings of this study support the census. About 22% claimed that they were confronted with many problems when requesting financial assistance. The most mentioned problem is insufficient collateral, poor documentation and bad proposal (Figure 1.11).

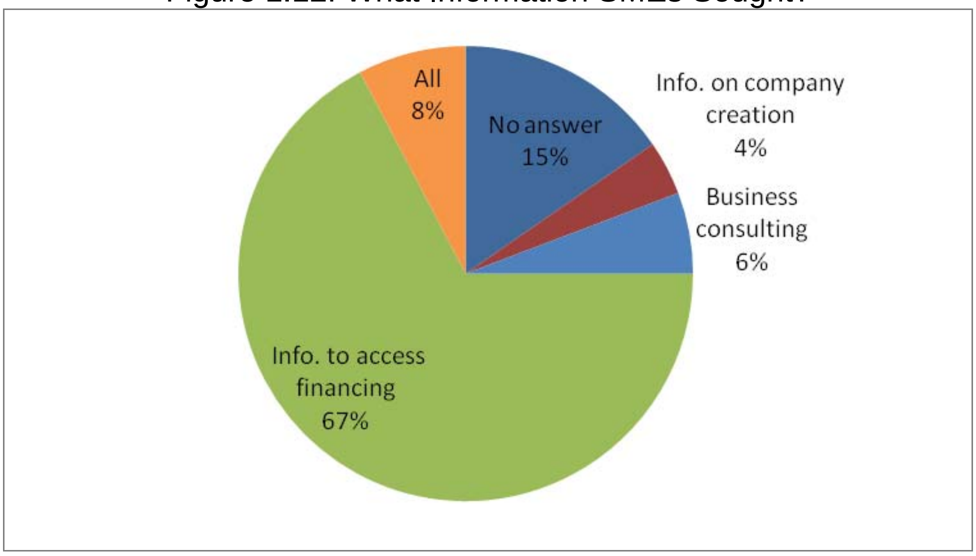
Figure 1.11: Borrowing Constraints from Financial Institutions



Source: UM Survey, Nov. 2008-Jan. 2009.

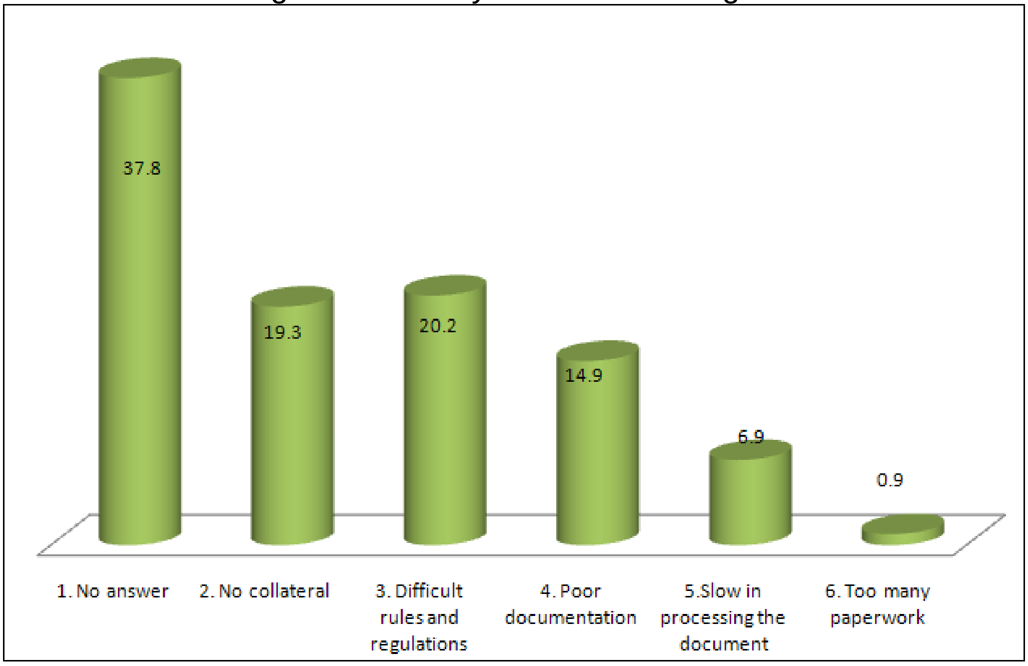
In light of the above situation we asked what information did SMEs sought, why and where (Figures 1.12, 1.13 & 1.14). More than 33% requested assistance from banking and development financial institutions and more than 20% solicit the assistance of auditors. The information they asked were mostly (67%) relating to financing access and information on company creation and business direction. In this regard banking / financial institutions officers attending to SMEs play a critical role in giving the right advice and direction. And the study found SMEs seeking advice with reasons; most came because they could not understand financing rules and regulations (20.2%) and because they have no collateral or lacking supportive documents to borrow from financial institutions.

Figure 1.12: What Information SMEs Sought?



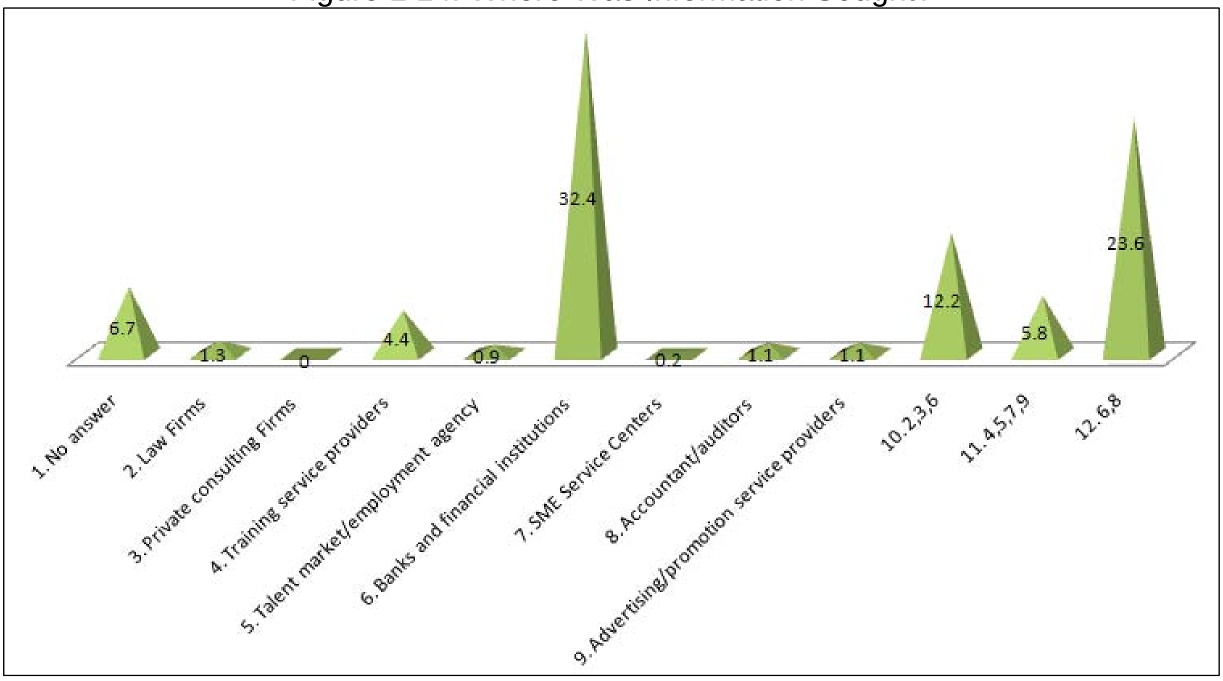
Source: UM Survey, Nov. 2008-Jan. 2009.

Figure 1.13: Why Information Sought?



Source: UM Survey, Nov. 2008-Jan. 2009.

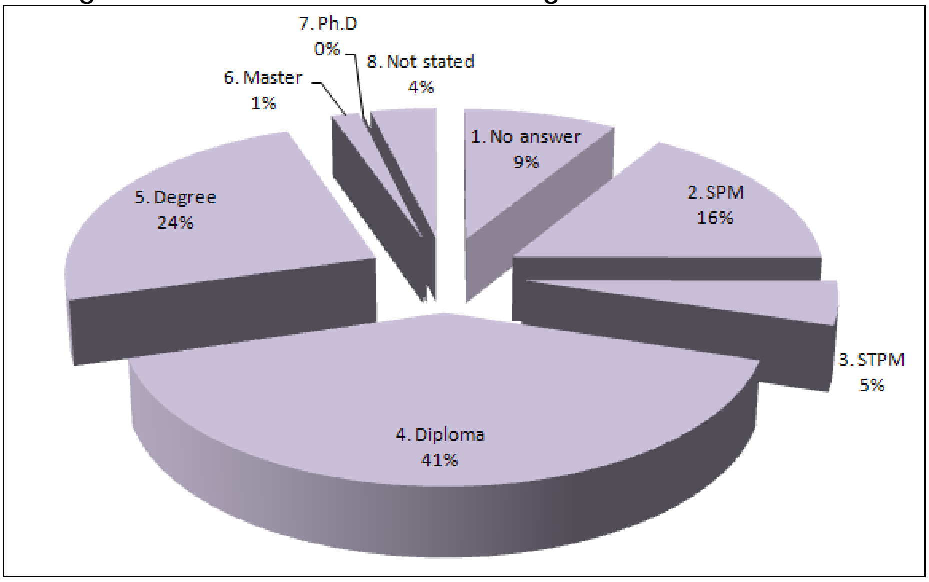
Figure 1.14: Where Was Information Sought?



Source: UM Survey, Nov. 2008-Jan. 2009.

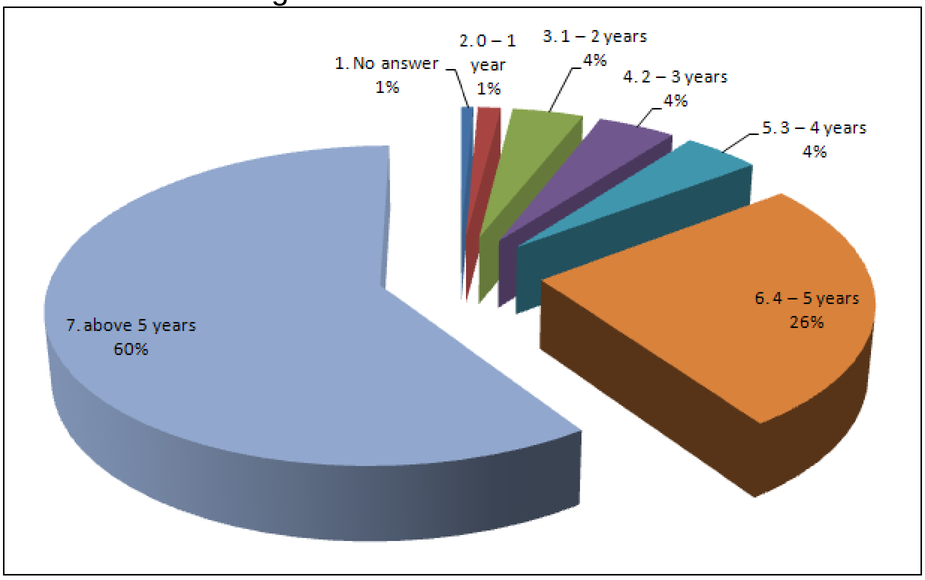
This study also found that many of the SMEs owners/managers are relatively educated and also experienced business person (Figure 1.15 & 1.16). Therefore have had ideas of their business direction and possibly have gone through the stages of business ups and downs. Banking and development financial institutions officers therefore have to have extra knowledge to share with the SMEs' owners.

Figure 1.15: SMEs Owners/ Managers Level of Education



Source: UM Survey, Nov. 2008-Jan. 2009.

Figure 1.16: Years in Business

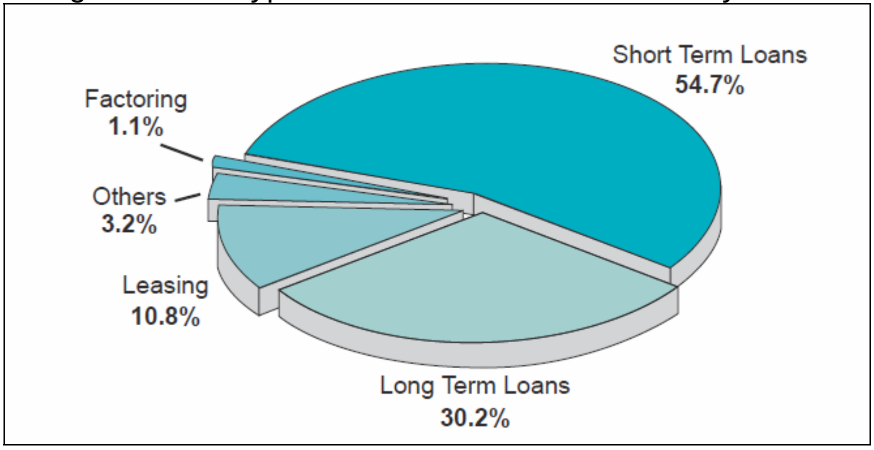


Source: UM Survey, Nov. 2008-Jan. 2009.

1.8 Credit Facilities and Business Expansion

Generally as SMEs grow in size the financial sector source of funds become more important to SMEs than self-financing or borrowings from friends and families. According to the census (DOS, 2005) a significant number of micro enterprises (57%) use short-term financing compared to 48% of medium enterprises. The use of leasing as a financing option appears to increase with size of business, with 9% of micro, 14% of small and almost 17% of medium enterprises using leasing to fund their operations. In terms of sectors, SMEs in the agriculture sector (64%) had the highest use of short-term loans, while accounting for over 51% of SMEs in the manufacturing and services sector. About 30% of SMEs across all three sectors use long-term loans. Almost 14% and 11% of SMEs in the manufacturing and services sector respectively use leasing while only 4% of SMEs in the agriculture sector use leasing as a financing option (Figure 1.17).

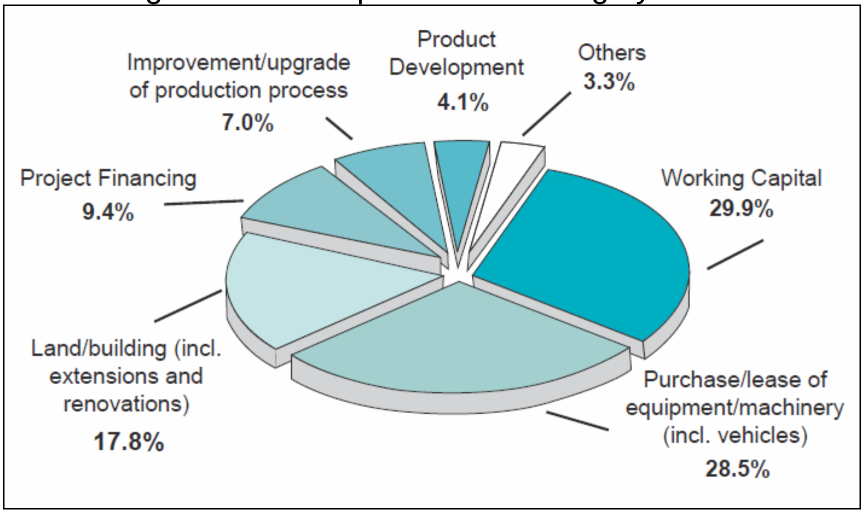
Figure 1.17 : Types of Credit Facilities Utilised by SMEs



Source: Department of Statistics Malaysia, 2005.

With regard to purpose of financing the census showed 30% of SMEs indicated that the main purpose of financing was for working capital requirements, followed by the requirements to purchase/lease of equipment/machinery. The census results indicated that working capital requirements are greater the smaller the size of the establishment. Working capital was the main purpose of financing for 34% of micro enterprises, while 23% of small and 18% of medium enterprises require working capital financing. Over 33% of small and medium enterprises cite purchase/lease of equipment/machinery as the main purpose of financing. Relatively more medium enterprises require financing for project financing and improvement/upgrade of production process compared to small and micro enterprises, Figure 1.18.

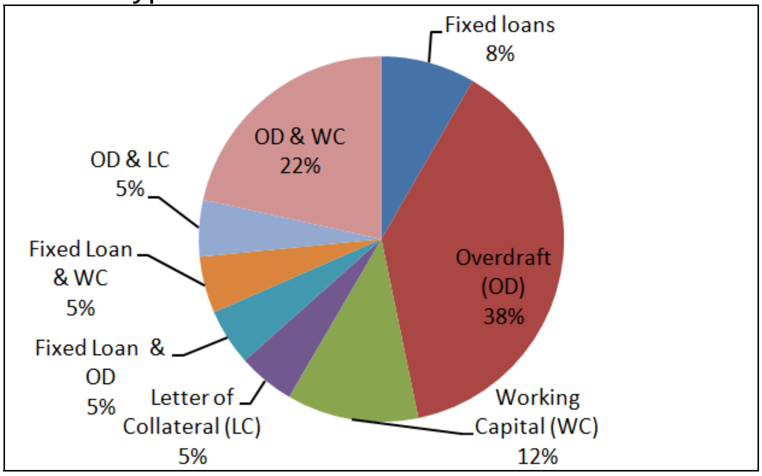
Figure 1.18 : Purpose of Financing by SMEs



Source: Department of Statistics Malaysia, 2005.

The UM study also found that main purpose of financing for SMEs are for working capital and overdraft facility to meet immediate business expenses. The situation indicated the state of instability for some SMEs (Figure 1.19).

Figure 1.19: Type of Loans Received from Financial Institutions



Source: UM Survey, Nov. 2008-Jan. 2009.

The situation highlights the ciriticality of assistance other than banking institutions to support SMEs' growth. One initiative that has been introduced to bridge the financial gap of SMEs is the approval of a comprehensive microfinance institutional framework by the National SME Development Council (NSDC). Within this framework, banking institutions, DFIs and credit cooperatives have been identified to provide microfinance products to complement existing Government sponsored microfinance programmes such as Amanah Ikhtiar Malaysia (AIM) and Yayasan TEKUN Nasional (TEKUN) (Bank Negara, 2007).

Further to enhance the role of DFIs as microfinance providers, Bank Simpanan Nasional has been mandated to provide micro-finance and Bank Rakyat to provide microfinance to members of co-operatives while Agro Bank is to provide microfinance to micro enterprises in the agriculture and agro-based sector. In addition, efforts are being undertaken to encourage banking institutions to provide microfinancing. Participation of the banks is key in view of their large funding and network of branches, which are critical to ensure wide outreach of microfinance. With the introduction of the microfinance framework, a growing number of banks and DFIs have already launched microfinance products to provide fast, flexible and convenient access to financing to individuals and micro enterprises for their business activities (Bank Negara, 2007).

Micro-finance products offered by the financial institutions typically have the following key features:

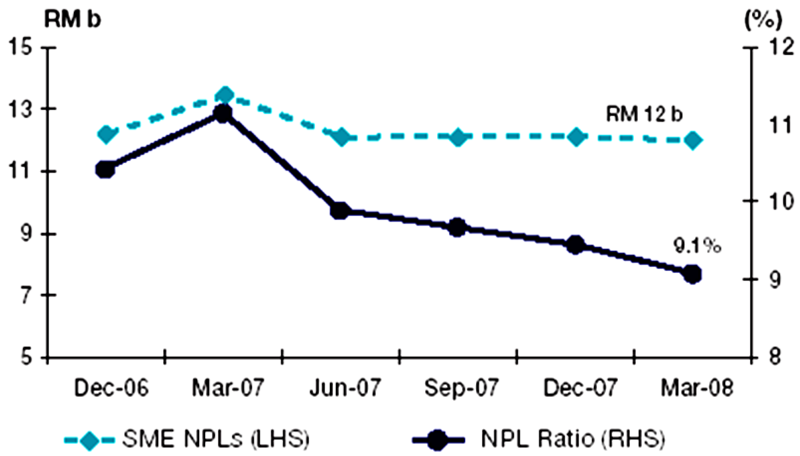
- Small loans ranging from RM500 to RM50,000;
- Flexible collateral requirements;
- Flexible loan tenure ranging from one month to five years;
- Simple loan procedures allowing for fast disbursement; and
- Incentives to encourage good repayment practices.

A common microfinance logo is being developed as an avenue to provide a prominent identity, and to create awareness and understanding of microfinance. Financial institutions that offer microfinance facilities as well as their recipients are to encourage to display this logo at their business premises. In addition to microfinance offered by financial institutions, several ministries and agencies are to provide microcredit schemes. The Ministry of Agriculture (MoA) and Agro-Based Industry for example, has an allocation of RM30 million for its Food Production Credit Scheme which aims to increase the source of income for small and micro entrepreneurs involved in food production. Helping to promote Bumiputera micro entrepreneurs, MECD has made a RM50 million financial commitment to provide microcredit financing for start-ups under TEKUN and has also set aside RM70 million as working capital for Majlis Amanah Rakyat (MARA) business loans and RM150 million for SME Bank business loans. MRRD, through Lembaga Kemajuan Kelantan Selatan (KESEDAR), with RM220,000 to help rural micro enterprises in manufacturing, services, agriculture and tourism, is running its ongoing *Pinjaman Industri Luar Bandar dan Bantuan Ekonomi Sampingan*. In collaboration with SME Bank and Bank Rakyat, the Financing Scheme for Rural Economy (SPED) does not require SMEs to have a guarantor or collateral. In 2007, SPED aims to provide 300 borrowers with up to RM37 million in loans (Bank Negara, 2006 & 2007).

Rehabilitation Scheme

As the UM study has shown, in the duration of doing business, some establishments started to have problems due mainly to bad financial management. For example, some SMEs do not differentiate between the company's money and their own money. This state of affair is becoming too rampant, efforts have been intensified to assist SMEs to properly manage their finances. To assist this affair Bank Negara Malaysia has established the Small Debt Resolution Scheme (SDRS). The purpose of the scheme is to facilitate the restructuring of nonperforming loans (NPLs) of SMEs with viable on-going businesses. Under SDRS, a Small Debt Resolution Committee undertakes an independent assessment on the viability of the businesses, loan restructuring and financing requirements of the SMEs, Figure 1.20.

Figure 1.20 : SMEs NPL as at end of March 2008



Source: Bank Negara Malaysia, 2007.

As of end April 2007, SDRS had received 582 applications with NPLs of RM423 million. Of these, 450 applications have been approved for restructuring, involving NPLs of RM278 million. A total of RM20 million in new financing was approved to 39 applications. The performance of the scheme indicates that the restructuring of NPLs continues to be the mainstay in supporting the viability and sustainability of financially distressed SMEs, with new financing being selectively provided mainly to SMEs with new projects in hand.

In addition, with the constantly changing needs of SMEs, various initiatives have been undertaken to strengthen existing providers of financing and widen avenues of financing SMEs. Among these are prioritising provision of financing to SMEs and offering comprehensive financing solutions. Initiatives to improve SMEs access to financing at various stages of their business lifecycle. For 2008 the Government intended to allocate RM70 billion in loans for 140,000 SMEs accounts.

As of 2007 the government has already strengthen financial service providers for SME development and financing include, among others, the restructuring of SME Bank, the corporatisation of Agro Bank and established the Malaysian Cooperative Societies Commission. The promotion of microfinance by Bank Negara Malaysia saw six commercial banks and three DFIs offering financing to more than 26,000 micro enterprises. In addition, the Direct Access Guarantee Scheme Start-up (DAGS Start-Up) was introduced by the Credit Guarantee Corporation to help new SMEs which have difficulties in obtaining bank financing (more details in Chapter 4). The initiatives above are complemented by financial advisory services to SMEs provided by Bank Negara Malaysia, SME Bank, and commercial banks.

As a result of these initiatives, access to financing by SMEs improved further in 2007. By the end of 2007, financing outstanding to SMEs stood at RM128 billion to over 625,000 SMEs by the banking institutions and DFIs. The share of SMEs financing against total business financing also remained high and stable with SMEs financing accounting for 44.3% of total business financing by the end of March 2008. To further enhance SMEs access to financing in 2008, banking institutions and DFIs have targeted a total of RM70 billion as financing to 140,000 SMEs accounts. There are now 625,167 SMEs accounts in Malaysia (maintained with banking institutions and development financial institutions) worth RM128 billion as at end-2007 (Table 1.12).

Table 1.12: Banking Institutions and the Main SMEs Financing Indicators

	During		
	2007	2006	2007 (% annual growth)
Applications (RM billion)	99.1	71.4	38.8
Number of Accounts ('000)	158.2	106.0	49.2
Approvals (RM billion)	55.1	40.2	37.1
Number of Accounts ('000)	109.5	83.7	30.8
Disbursements (RM billion)	141.5	134.1	5.5
Repayments (RM billion)	126.6	122.5	3.4
	As at end		
	2007	2007 (% annual growth)	2006 (% annual growth)
Financing Outstanding (RM billion)	114.2	9.1	5.1

Source: Bank Negara Malaysia, 2007.

Stages of Financial Assistance

The UM survey also found SMEs approached financial institutions at various stages of their business cycle. But most SMEs sought assistance before and during the process of setting up their companies (Table 1.13).

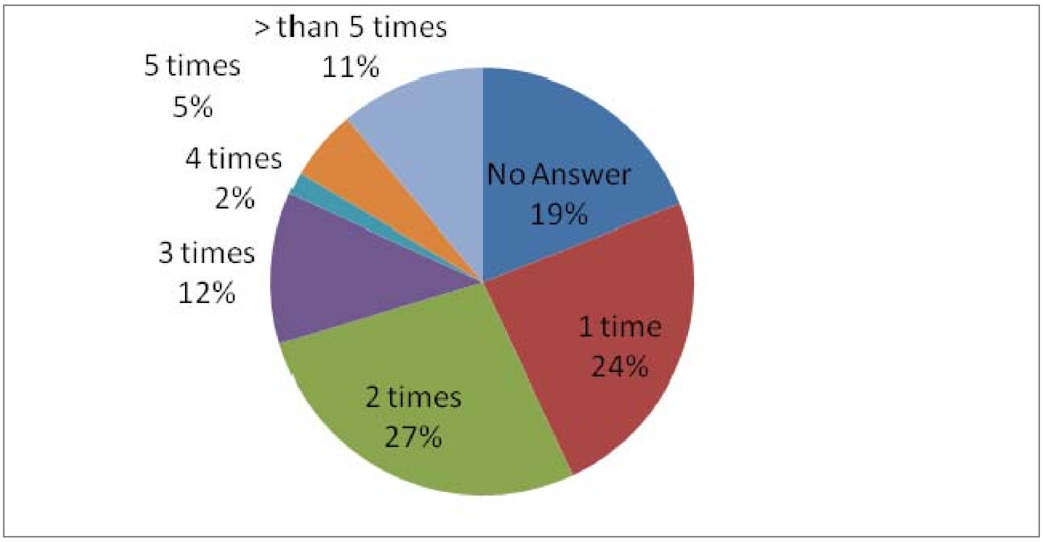
Table 1.13: Stages of Seeking Financial Institution Support

	Answer	Percentage (%)
1	No answer	17.0
2	Before creating a company	10.8
3	During the process of company set-up	8.5
4	When my company started to grow	10.2
5	When my company started to have problems	9.7
6	2,3	10.2
7	3,4	7.7
8	4,4	7.4
9	All	12.2

Source: UM Survey, Nov. 2008-Jan. 2009.

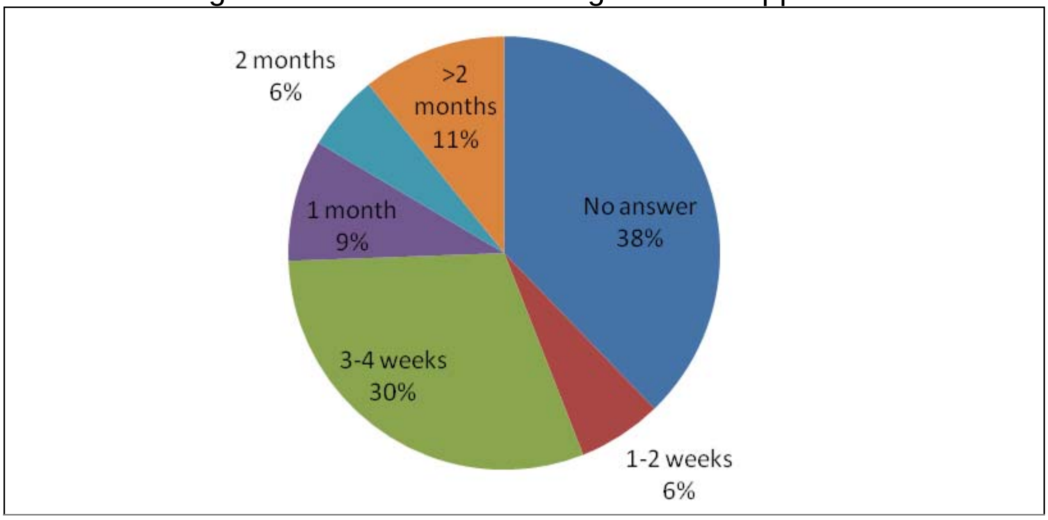
The UM survey also found 74% of those who had applied for assistance from financial institutions, more than half (57%) had their loan approved. 24% indicated they made only one attempt and 11% had made more than 5 attempts. The period of waiting was reasonable; majority had their loans approved within 3 to 4 weeks (Figure 1.21 and 1.22).

Figure 1.21: Frequency of Loan Applications



Source: UM Survey, Nov. 2008-Jan. 2009.

Figure 1.22: Period of Waiting for Loan Approval



Source: UM Survey, Nov. 2008-Jan. 2009.

Financial support to start a business going is evident. This point has been accepted by the government and Bank Negara. In fact, the need has been met through the introduction of start-up programmes. One of the significant providers of funding for start-ups are VC funds, DFIs and the government through grants and soft loans. According to Bank Negara (2007) the total available funds for VC investments increased by 27.8% to RM3.3 billion in 2006, up from RM2.6 billion in 2005. These funds were invested in 460 companies compared with 380 companies in 2005.

Bank Negara Malaysia together with two banking groups have also established two VC funds of RM150 million each for the technology sector in 2000. The purpose was to provide equity financing to support the development of the technology sector, with a focus on the ICT, advanced manufacturing and life sciences sub-sectors. By the end of 2006 a total of RM244.3 million had been invested in 83 companies.

Various attempts have been undertaken by government through its ministries and agencies to enhance the development SMEs. Yet there are still areas that SMEs think could be improved. Through the survey of this research SMEs were asked to indicate the barriers to the development of SMEs in Malaysia and to suggest areas for improvement.

Among the challenges that SMEs highlighted were:

Limited knowledge acquisition and shortage of skills for the new business environment due to a general lack of knowldge and information.

1) Among SME owners, many began in backyard industry working through expereince to reach the present level of entreneurship. More than 50% of SME owners and executives do not believe in networking at conferences and seminars organised by big vendors. There is thus an information gap about new ideas and products that could transform thier operation or increase productivity.

2) Difficult to comprehend information on government schemes because of the confusing information disseminated by financial institutions.

   From the interviews with commercial banks, officials engaging in sub-lending for government financial schemes complain that public financial schemes are so diverse in content and eligibility and those officers at commercial banks cannot fully understand all schemes.

3) Having limited capability to meet the challenges of market liberalisation and globalisation, specifically from foreign producers such as China.

   Malaysia’s SMEs were to some extent protected through tariff and non-tariff measures that enabled them to garner significant market share in the country. But this is no longer the case. Malaysia SMEs can no longer orientate their business merely towards the domestic domain, but must seek opportunities in the global market. The proliferation of free trade agreements bilaterally, regionally and multilaterally has brought about trade rules that are complex and difficult for SMEs to follow. The lack of understanding often creates a feeling of being marginalised by such arrangements. Increasingly tariffs are being reduced and trading procedures altered causing concern to domestic players. Meanwhile trade impediments in the form of trade conditionalities and other non-tariff measures, such as labour, social, security and environmental issues continue to complicate market access to exporters worldwide.

4) There are too many agencies or channels for SMEs without effective coordination.

   Given the ad hoc manner in which the needs of the SMEs have been recognised over time, policy reactions have to some extent also lack coherence. There has been some duplication among agencies and a lack of clarity among SMEs.

5) A high level of bureaucracy in government agencies hinders more efficient and productive business operations.

   Due to too many agencies handling SMEs, there is confusion among SMEs regarding the agency that oversees a particular incentive scheme. Despite the existence of many agencies dedicated to helping SMEs there are shortcomings in the delivery system.

6) Difficulties in accessing loans and other forms of financial assistance.

   The reason is linked directly to bureaucratic maze and the vast amount of information sought before assistance is given and the slow processing period.

7) Limited capacity for technology management and knowledge acquisition.

   Most SMEs have not installed an internal IT infrastructure, such as LAN due to high cost of software and maintenance. Additionally the recurring costs of ownership, such as annual licence and maintenance fees, are also burdensome.

1.9 Conclusion

Firstly, government efforts toward enhancing the capability and capacity of SMEs as the country growth engine has been remarkable. Continuous multi-types assistance has been introduced for all levels of SMEs. Broadly success has been evident but not in all areas. Firstly, institutional issues relating to comprehending the various schemes and identifying implementing agencies that run the schemes have confused not only SMEs but also financial institutions.

Secondly, SME is dominated by micro enterprises. Demands and needs of micro enterprises may differ from small and definitely with medium enterprises. Therefore despite various efforts being introduced to enhance SMEs complaints are abound because the needs of micro enterprises have not been understood and therefore not met. For example, micro enterprises which started as cottage industries seldom have financial documentation to support their financial application and some have limited or no knowledge of the various financial schemes provided by government or financial institutions.

Thirdly, the changing global environment has seen a mushrooming of of SMEs in Malaysia. The government has been developing and promoting SMEs but the results have been mixed, partly because policymakers were late in classifying the different needs and characteristics of micro, small and medium enterprises. The developments of diverse and internationally competitive SMEs are central towards achieving sustainable economic growth. SMEs have a key role to play in the wider development agenda, especially in relation to poverty eradication and equitable development among the various ethnic groups in Malaysia.

CHAPTER 2 SME CREDIT BUREAU AND CREDIT INFORMATION DATABASE

2.1 Introduction

In Malaysia, the Malaysian version of the Japanese Credit Risk Database (CRD) is called the SME Credit Bureau. Like the Japanese CRD which is incorporated into the Credit Guarantee Corporation of Japan, the SME Bureau was established and fully owned by Credit Guarantee Corporation Malaysia Berhad (CGC), a subsidiary of Bank Negara Malaysia and supported by Dun & Bradstreet (D&B). Since its operation in June 2008 it has collected 16,000 corporate databases from all economic sectors in Malaysia (which is small in comparison to Japan CRD which covers 2.4 million databases of corporations and sole proprietorships companies).

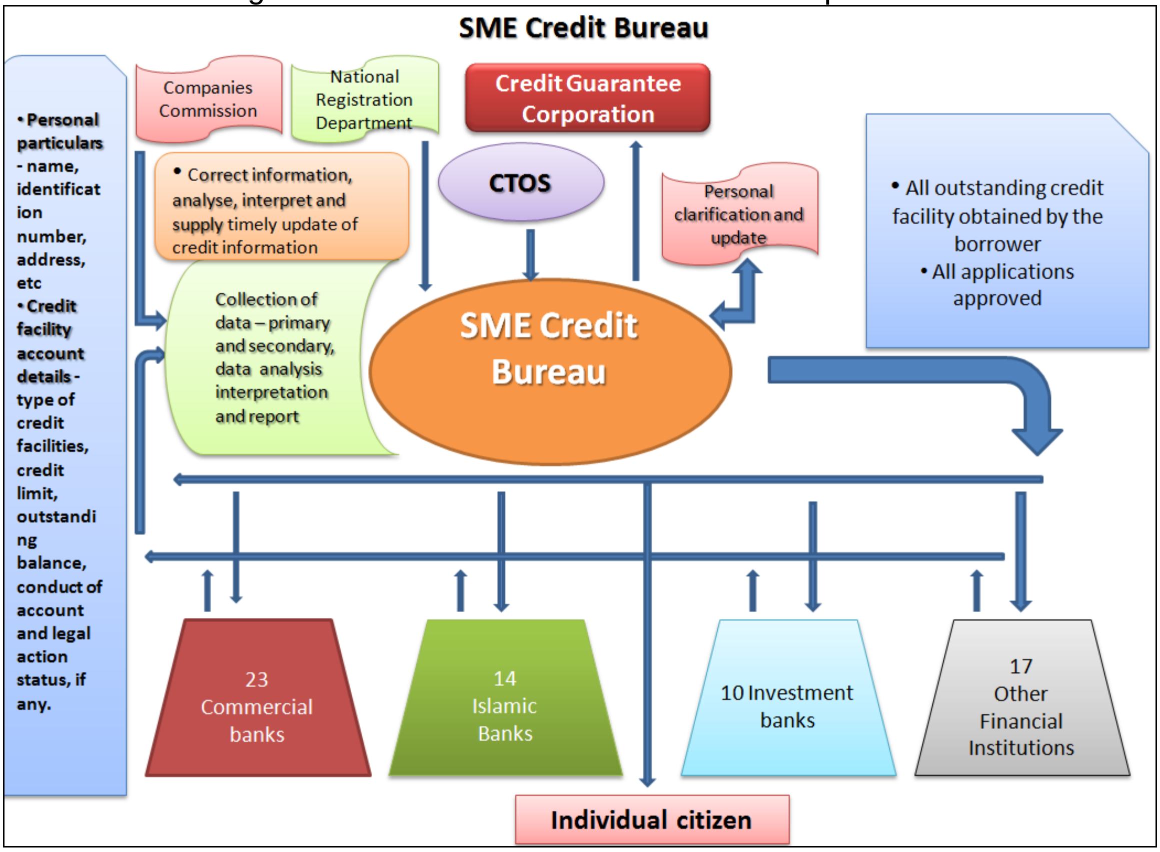
Nonetheless, SME Credit Bureau is becoming a leading provider of credit reports on SMEs in Malaysia, essentially a one-stop facility for the exchange of credit information on SMEs among subscribing members.

The Bureau assists financial institutions and business organisations to make critical credit and business decisions in a timely and consistent way to benefit the development of SMEs in Malaysia. It also provides relevant information on SMEs to subscribers who are credit grantors so as to facilitate their credit evaluation and credit decision-making. Indirectly, the Bureau's products and services are assisting SMEs to obtain wider and faster access to financing.

Specifically the Bureau credit rating helps to assess a firm's credit standing by collating available key information of the firm’s performance and payment history to provide an overall evaluation of the firm's creditworthiness. This process is streamlined into the Bureau's applications to improve the efficiency of the credit assessment information flow (Figure 2.1).

The credit rating used by the Bureau is based on D&B's statistical analysis and risk modelling. The risk model calculates a rating that provides an indication of a firm’s creditworthiness - based on information obtained from a range of business databases, credit histories and payment trends. The payment trends aims to predict the likelihood that a commercial entity will default within the next 12 months.

Figure 2.1: Model of SME Credit Bureau Operation



This Probability of Default (PD) is calculated using statistically valid models developed specifically for the Malaysian commercial landscape. Historical data from a range of business and credit information sources are combined and analysed to determine key attributes which are statistically the most significant factors for predicting default. In addition, the SME Credit Bureau also develop proprietary sets of key scores that uses more information gathered from additional data sources to present a broader and further unbiased view in aid of predicting creditworthiness.

The SME Credit Bureau information is only available to members only, i.e. financial institutions, SMEs and other enterprises. Membership is given with annual subscription fee of RM5000 for financial institutions, RM300 for SMEs and RM300 for other enterprises. Membership application could be obtained and submitted on-line via the Bureau's Enterprise Portal, mailed or faxed to the Bureau. However acceptance of application is subject to a due diligence check by the Bureau.

Subscription membership also comes with rights and obligations. As the SME Credit Bureau operates on the principle of reciprocity, members are required to contribute data to the centralised database. In return, members will be entitled to access the information made available by themselves and others. Bureau report could be retrieved on-line and in real-time in two ways: Browser-based application and B2B interface, for higher volume retrievals. In addition, subject to user requirements, the reports could be received by e-mail, fax and surface mail.

Among the information available for members are:

- Business Information Report (BIR) which include registry information, statistical information (i.e. availability of trade credit information and number of enquiries on the subject).

- Business Information Report Premium (BIR Premium) which include registry information (on-line extraction) and statistical information (availability of trade credit information and number. of enquiries on the subject).

- Business Review Report (BRR) which includes SME Credit Risk Rating, registry information, trade credit and enquiry details.

- Credit Risk Report (CRR) for financial institutions only which include SME credit risk rating, registry information, banking information, trade credit and enquiry details.

- Credit Risk Report Premium (CRR Premium) for financial institutions only which include SME credit risk rating, registry information (on-line extraction), banking information and trade credit enquiry details.

The above information are compiled from a number of sources, including SME profile, trade credit, loan financing, financials (where available), credit ratings and enquiry details (Figure 2.1). The contents of different reports vary according to the information. These data are also subject to validation checks and scrubbing procedures. In addition, data analyses are conducted to check on the stability of data. Processes are in place to ensure that prompt action is taken to rectify confirmed errors or inaccuracies.

Rating Model

The rating process and procedure starts from the point a credit score or rating is requested up to the point the rating is given. The rating model is developed based on the population of the bureau database. The modelling process assesses many attributes of the credit file to establish which attributes can be used as a predictor of risk. Once the model is defined, weightings are built into a scoring engine on the bureau platform. Each enquiry that is processed is then passed through the scoring engine in order to calculate the rating real-time.

Perspectives on SME Credit Bureau

For purpose of this study interviews were conducted with financial institutions and SMEs with regard to importance and performance of SME Credit Bureau to SMEs development.

Financial Institution’s Perspective

Financial institutions placed high praise on SME Credit Bureau. They claimed that with the establishment of the Bureau, the banks processing time for SMEs’ application has reduced. Some banks noted experienced a more than 100% time saving in the loans processing time. However banks are still uncertain on the level responsibility the Bureau is willing to share with the financial institutions that rely on its rating.

SME’s Perspective

SMEs loan applicants also welcome the development of credit bureau especially because of its ability to reduce application processing time. Nonetheless SMEs are concerned about the data base building process. What happens when the Bureau does not have the database for some bank applicants?

Bank Negara Malaysia’s Perspective

Bank Negara Malaysia saw the development of credit bureau services as another milestone towards enhancing financial institutions credit services to SMEs. It has moved the information services provision from that of raw information provision to the processed information particularly the rating effort. According to Bank Negara,
a good credit information infrastructure can contribute significantly towards assisting SMEs' access to capital. SMEs firms with access to credit bureaus have a higher chance of obtaining a loan in comparison to firms without access to credit bureaus. Therefore, significant opportunities exist to increase lending activities to SMEs in Malaysia with the establishment of an SME credit bureau. Further, the Bank Negara believes that the SME Credit Bureau would effectively consolidate the fragmented information. This convergence of data from various sources would be enhanced, resulting in a convenient, timely and efficient access to SMEs information and credit ratings to assist the potential lenders to make a more objective evaluation of loan applications. The Bank hopes that the SME Credit Bureau will become an integral component towards enabling SMEs to gain access to financing.

Bank Negara asserted that the SME Credit Bureau is distinct from CCRIS. The SME Credit Bureau aims at promoting greater transparency, professionalism and sound credit culture among SMEs. SMEs can be assured that their good track records would be captured and evaluated by an independent third party, which in turn, would assist them to increase their financing and business opportunities. The credit reports would serve as a convenient tool for SMEs to carry out a self evaluation in identifying areas that needs improvement.

2.2 Conclusion

SME Credit Bureau is the SME version of the rating agency's activities conducted on public listed companies in Malaysia. It will be the ultimate version of the credit reference service in the future. The information provided by the Bureau includes recommendation and direction of decision. The question that remains unanswered is whether their recommendation can be held as binding - in the case of negligence and wrong advice. Normally accountants and financial consultants are the most conservative group of professional that will never commit to a decision. Therefore the advice that they give are always very vague and rarely accurate and hence their analysis are also less meaningful to the users.

Unless the SME Credit Bureau could offer their services at a competitive rate or secure all the information from CCRIS and CTOS, users will choose to continue using the CCRIS and CTOS to run credit analysis.

This study however believes that a day will come when SME Credit Bureau will be lifted into full fledge international credit bureau through the assistance from D&B. This is expected to happen because currently financial institutions and SMEs are heavily relying on the credibility of D&B Malaysia Sdn Bhd (a global operator and provider of credit bureau, risk management solutions, market intelligence and receivables management), a subsidiary of New York-based Dun & Bradstreet Corporation.

Thus far D&B have information on more than 100 million companies worldwide. The company also offers data rationalization and management services where they help clean up database to enhance the power of the Bureau information. Importantly D&B have a reputation for having a sound credit decisions in the offering of up-to-the-minute, in-depth information and exclusive risk indicator scores available through their wide variety of reports.

CHAPTER 3 THE OTHER CREDIT REGISTRIES/BUREAU IN MALAYSIA

3.1 Introduction

In Malaysia, SMEs generally view credit bureau and credit registries as hindrances to obtaining financing. This is because these institutions slow down SME loan processing or at times, block accessibility to financing. Nevertheless, to the financial providers, credit bureau and credit registries are seen as helpful entities because they provide vital information necessary in mitigating risk against bad financing. However, in some cases the information provided by credit bureau and registries may not be conclusive and complete to base decision upon.

3.2 The Malaysian Credit Bureau System

There are several credit bureaus operating in Malaysia, these are Central Credit Reference Information System or CCRIS, Credit Tip-Off Service Sdn Bhd (CTOS) and Information Services Sdn Bhd or BRIS. With the exception CCRIS, these institutions operate as commercial venture that impose fees for providing information to their clients.

This chapter has been written based on information provided by each of the credit reference institutions in Malaysia and Bank Negara via interviews, questionnaires and secondary literature namely web sites and news information.

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Central Credit Reference Information System (CCRIS)

CCRIS has been in operation since 1982. It was established under the Central Bank of Malaysia Act 1958. CCRIS essentially collects credit information on borrowers from lending institutions and furnishes the credit information collected back to the institutions in the form of credit report via an on-line system known as Central Credit Reference Information System (CCRIS).

CCRIS plays an important role in credit risk management and in promoting sound credit culture in the financial system of a country. The existence of CCRIS has made it easier for financial institutions to make informed and responsible lending decisions in a timelier manner.

The information reported to CCRIS is housed in a computerised database system known as the Central Credit Reference Information System (CCRIS). At present, the database system contains credit information on about 7 million borrowers in Malaysia. CCRIS automatically processes the credit data received from the financial institutions and synthesises the information into credit reports, which can be made available to the financial institutions upon request.

CCRIS collects only credit information on individuals, businesses (sole proprietors and partnerships), companies, and even government entities borrowers. It collects both positive and negative data. The participating financial institutions in Malaysia source the credit information collected by the credit bureau. These financial institutions include all licensed commercial banks, Islamic banks, investment banks and several other financial institutions. In addition, reference information on the particulars of borrowers is sourced from the National Registration Department (Jabatan Pendaftaran Negara) and the Companies Commission of Malaysia (Suruhanjaya Syarikat Malaysia) for purposes of verification against the particulars provided by the financial institutions. The data providers on a regular basis update the data.

All information collected from the financial institutions will be stored and archived for as long as it is necessary. So far, all information collected by CCRIS from the day it was incorporated until this day has been kept in the CCRIS archive.

For each and every borrower, the financial institutions are required to report to the CCRIS the following types of data:

1. Personal particulars of borrower such as name, identification number, address, etc
2. Credit facility account details such as type of credit facilities, credit limit, outstanding balance, conduct of account and legal action status, if any.

CCRIS is dependent on financial institutions to provide correct information to it. However, CCRIS accepts the duty to take all possible measures to check data quality. Quality control checks are built in at every stage of CCRIS from the collection of data, through data capture, loading into the CCRIS database and during its use. The accuracy of credit information is also dependant on correct information supplied by the financial institutions as well as a timely update of credit information by the financial institutions.

Critical particulars like MyKad (the national identity card) and name supplied by the financial institutions are compared and verified against the official records of the National Registration Department and the Companies Commission of Malaysia. Any anomalies and inconsistencies would be raised to the financial institutions and the authorities concerned. Credit information provided by the financial institutions is a copy of their own records. When submitted to the CCRIS database, the information is subjected to data integrity tests to seek out inconsistencies or errors. The financial institutions are required to rectify the inconsistencies and errors within two weeks.

One of the greatest challenges to Bank Negara Malaysia in providing credit bureau services to the financial institutions is the need to ensure and maintain the confidentiality of information on borrowers while promoting a strong credit culture. Towards this end the CCRIS adopts stringent procedures that are guided by legal provisions in the Central Bank of Malaysia Act 1958, the Banking and Financial Institutions Act 1989 (BAFIA) and the Islamic Banking Act 1983 (IBA).

The legal provisions set limitations governing access to the information and imposes severe penalties to deter unauthorised access, abuse or misuse of the information. In this regard, authorised access is limited to the purpose of credit evaluation. Disclosure to third parties is strictly prohibited. The credit information provided by CCRIS to a financial institution is classified and confidential. As such, the financial institution is required to observe the banking secrecy provisions in the BAFIA and the IBA. These laws prohibit the financial institutions from divulging the affairs of their borrowers except in legally permitted circumstances such as in the course of any court proceedings between the borrower and the financial institution or when the disclosure is authorised under any Federal law.

In line with the law, CCRIS can only furnish personal credit information to a financial institution for the purpose of assisting the financial institution to evaluate a credit facility application or for a periodical credit review if the person is an existing borrower. The financial institutions are not allowed to access credit information for purposes other than evaluating credit facility application or credit review. For example, financial institutions cannot use the credit report to market their financial products or services.

The usage of credit reports in the financial institutions is strictly regulated by guidelines issued to the institutions by Bank Negara Malaysia. In addition, information security is protected by the use of smart card and other secured technologies. To deter access for unauthorised uses, the CCRIS database keeps a record of all requests for credit reports from the financial institutions, detailing which financial institution and its officer whom has accessed to the database as well as the time of access. This would allow CCRIS and the internal auditors of the financial institutions to see know who has sought information on any particular borrower at any particular time.

CCRIS provides information to the financial institutions in the form of a credit report, Figure 3.1. The credit report is used by the financial institutions as one of the ways to make assessment on the credit facility application. The financial institution is required to inform the applicant, in writing that a credit check is to be conducted under the applicant's name and the credit facility application will be reported to the Credit Bureau. Reference to the Credit Bureau will be made by the financial institutions periodically to obtain updates on an existing borrower. Types of institutions that participate in CCRIS, Table 3.1.

Figure 3.1: A Model of CCRIS Operation

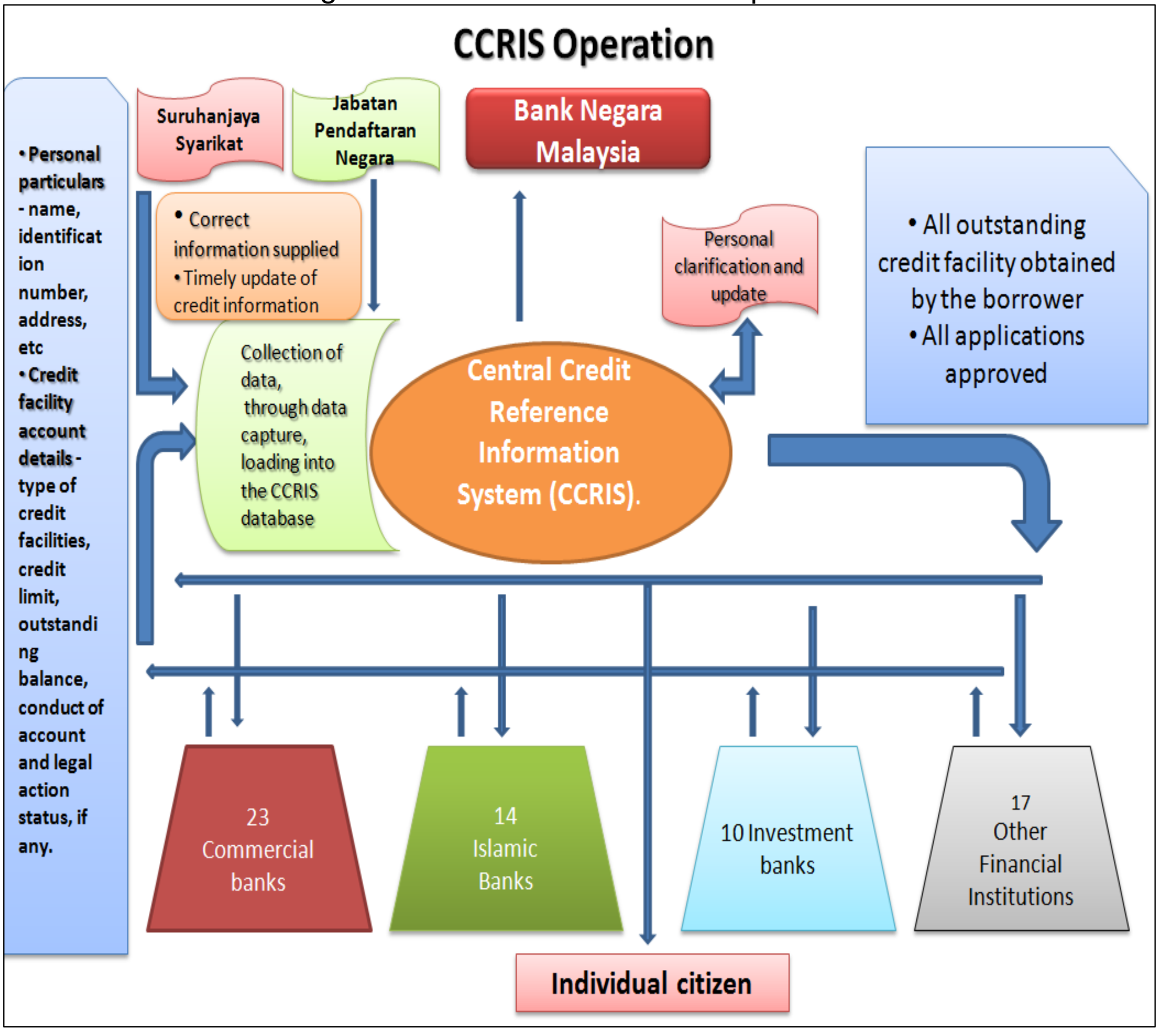


Table 3.1: Institutions Participating with CCRIS

Commercial Banks	**Investment Banks**
ABN AMRO Bank Berhad	- Affin Investment Bank Berhad
- Affin Bank Berhad	- Alliance Investment Bank Berhad
- Alliance Bank Malaysia Berhad	- AmInvestment Bank Berhad
- AmBank Berhad	- Aseambankers Malaysia Berhad
- Bangkok Bank Berhad	- CIMB Investment Bank Berhad
- Bank of America Malaysia Berhad	- MIDF Amanah Investment Bank Berhad
- Bank of China (Malaysia) Berhad	- MIMB Investment Bank Berhad
- Bank of Tokyo-Mitsubishi (Malaysia) Berhad	- Public Investment Bank Berhad
- CIMB Bank Berhad	- RHB Investment Bank Berhad
- Citibank Berhad	- Southern Investment Bank Berhad
- Deutsche Bank (Malaysia) Berhad	
- EON Bank Berhad	

- Hong Leong Bank Berhad - HSBC Bank Malaysia Berhad - JP Morgan Chase Bank (Malaysia) Berhad - Malayan Banking Berhad - OCBC Bank (Malaysia) Berhad - Public Bank Berhad - RHB Bank Berhad - Standard Chartered Bank Malaysia Berhad - The Bank of Nova Scotia Berhad - United Overseas Bank (Malaysia) Berhad	
Islamic Banks - Affin Islamic Bank Berhad - Al Rahji Banking and Investment Corporation (Malaysia) Berhad - Alliance Islamic Bank Berhad - AmIslamic Bank Berhad - Asian Finance Bank Berhad - Bank Islam Malaysia Berhad - Bank Muamalat Malaysia Berhad - CIMB Islamic Bank Berhad - EONCAP Islamic Bank Berhad - Hong Leong Islamic Bank Berhad - HSBC Amanah Malaysia Berhad - Kuwait Finance House (Malaysia) Berhad - Maybank Islamic Berhad - RHB Islamic Bank Berhad	**Other Financial Institutions** - AEON Credit Service (M) Sdn Bhd - American International Assurance Company Limited - Bank Kerjasama Rakyat Malaysia Berhad - Bank Pembangunan Malaysia Berhad - Bank Perusahaan Kecil Dan Sederhana Berhad (SME Bank) - Bank Simpanan Nasional - Borneo Development Corporation (Sabah) Berhad - Borneo Development Corporation (Sarawak) Berhad - Credit Guarantee Corporation Malaysia Berhad - Diners Club (Malaysia) Sdn Bhd - Export-Import Bank (Malaysia) Berhad - ING Insurance Berhad - Malaysia Alliance Assurance Berhad - Malaysian Industrial Development Finance Berhad - MBF Cards (Malaysia) Sdn Bhd - Prokhas Sdn Bhd - Sabah Development Bank Berhad

Based on interviews conducted by the UM study, below are some of the views on the prospective of CCRIS in Malaysia

SMEs' Perspectives

SMEs regarded CCRIS as part of the regulatory mechanism built up by the banking system in Malaysia to create transparent information about all potential borrowers. SMEs do not complaint much about CCRIS's services as they are seen to be fair in presenting their credit reference on the financial transaction (for the last 12 months). SMEs were also given the opportunity to check their credit reference issued by CCRIS by way of requesting the credit reference themselves from CCRIS. SMEs are also given the opportunity to complain for inaccuracies in the credit reference report issued by CCRIS. Generally SMEs feel CCRIS as fair and democratic.

Financial Institutions' Perspectives

Financial institutions regard CCRIS services, on one hand, as integral in their business with SMEs because it provide applicants' cash flow information, i.e. to a period 12 months. Yet on the other hand, financial institutions also see CCRIS information as too raw. Because of this, financial institutions often complement CCRIS information with other references, namely CTOS which offer detail information on creditors and also is easily available.

3.3 CTOS – Credit Tip-Off Services

CTOS is an independent body that holds credit track and personal information about debtors in Malaysia via online system. It was established as a private limited company in 1988 to conduct a business of credit reference information services provider. Frequently it is also referred for leads and information about debtors' performance during loan or credit card processing.

Banking and financial institutions in Malaysia regard CTOS as a successful Malaysian version of Dun & Bradstreet (D&B), a US-based credit risk information services with databases networked globally. CTOS is used by anyone who allows payment on credit terms. In short anybody who extends credit i.e. allows payment on credit terms such as suppliers is a CTOS customer. Banks are however its prime customer.

CTOS database is only accessible to approve subscribers, i.e. having reason to check on a particular person or company - usually because of a need in their normal course of their business. Core users of CTOS system are bankers, financiers, traders, securities firms, insurance companies, credit and charge card companies and legal firms. In general, any business that exposes itself to financial risks particularly through the extension of credit facilities will find CTOS system useful.

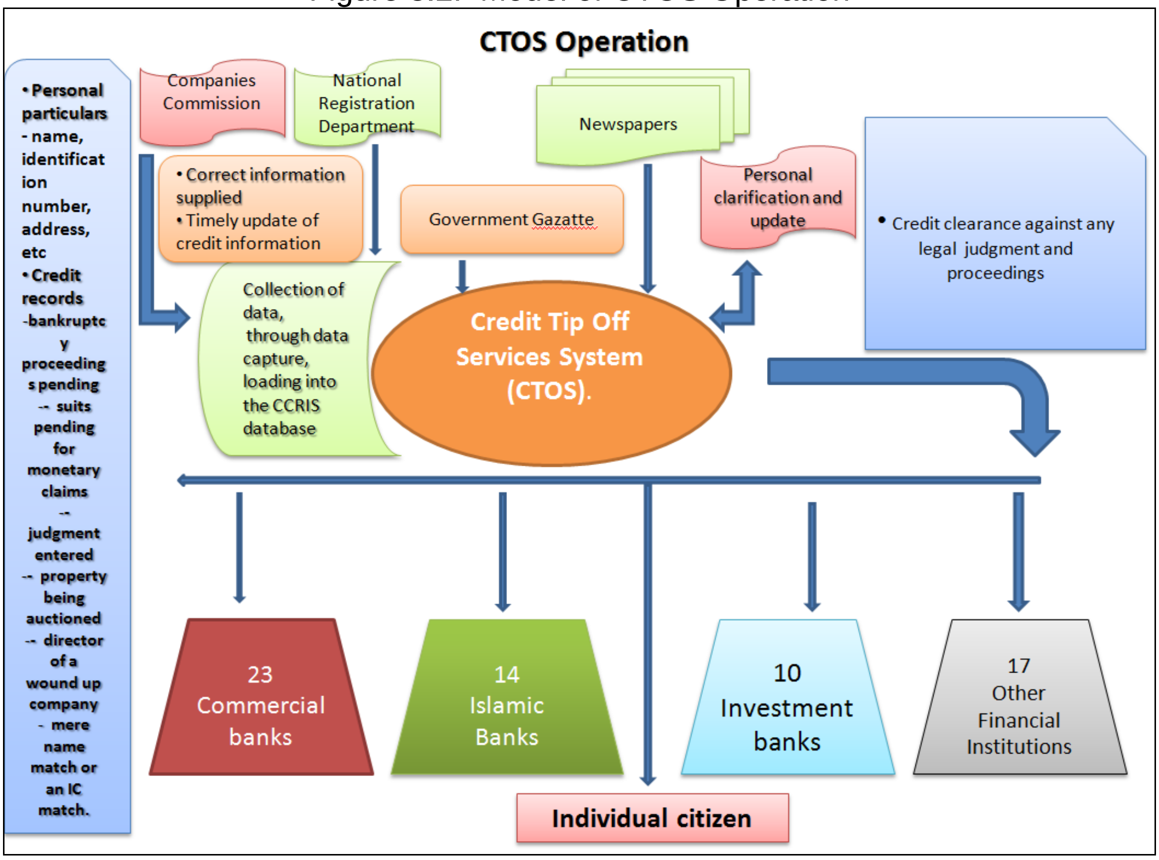
CTOS services are designed to operate as an electronic archive of published information which are already available in the public domain (Figure 3.2).

That is, it is an archive of public records. CTOS collected its information from factual but publicly available sources including Government Gazettes, the Companies Commission of Malaysia (CCM), Insolvency Department and from information published in the Malaysian newspapers. CTOS information does show current status of legal cases, searches, etc.

Like all Credit Reference Agencies (CRA) around the world, CTOS provides key businesses, including commercial firms, banks and finance institutions, with factual public information to assist them in making informed business risk decisions. It provides information to customers as a part of their decision-making process. The final decision depends entirely on the credit grantors strategies, policies and risk appetites.

CTOS does not rank, rate or give opinions as to the credit worthiness, integrity, character of the subject being inquired. It merely provides information that are historical that credit grantors want in their bid to know more about their customers better, past track record, etc. For example, when an SME apply for loans, credit cards, hire purchase or leasing facilities, etc in Malaysia, the chances are the credit grantor will make an enquiry in the CTOS system for information leads.

Figure 3.2: Model of CTOS Operation



According to CTOS credit evaluations are made not based on a single factor but upon how an applicant matches up to a set of lending criteria laid down by the credit grantor. These lending criteria inherently reflect the risk attitudes and risk tolerance levels of the credit grantor concerned. In short, these criteria reflect how the credit grantors want to do business, their business policies, strategies, their risks propensity etc.

The risk attitudes, tolerance, business philosophy, policies and strategies however vary from one credit grantor to the next. What one credit grantor find unacceptable may well be within tolerable limits of another. Ultimately, credit grantors will only assume risks that they find it comfortable and acceptable within the limits set by their organisation. CTOS specified that it plays no part in defining these criteria or the factors considered by them. The basic philosophy of CTOS in its business of supplying credit information are evaluate, monitor and recover.

According to CTOS, good borrowers should not be asked to subsidise bad ones. The interest rate that borrowers pay on their loans reflect the bank's cost of funds as well as the risk premium (generally the risk premium is based on industry numbers). So if borrowers default on their loans with no future consequences, it means that good borrowers will bear the cost of that. Also, banks are custodians of public funds and should do all they could to protect those funds. Naturally depositors do not want their funds to be lent out to people who have no intention of repaying the loans.

Information that CTOS keep in its database are: bankruptcy proceedings pending against a person (for e.g. bankruptcy notice, creditors petition or Adjudicating order/Receiving order), suits pending against a person for monetary claims (usually by financial institutions, judgment entered against a person which are being executed, property being auctioned off, director of a company which has been wound up (sometimes as you might imagine, bad borrowers may hide behind a corporate veil, so this is to alert to the fact that you may have used a company to borrow money and defaulted).

CTOS gather the above information from public sources such as public advertisement in newspapers. Generally borrowers when they default or ignore legal documents from the banks, banks will advertise the service of those documents in the papers (substituted service). CTOS goes through these notices make a search of these notices with the Companies Commission.

3.4 Perspectives of CTOS

SMEs' Perspectives

Most SMEs are very suspicious of the CTOS database and its operations. They feel that CTOS is in operation only to garner profit. Hence SMEs believe that CTOS will try to dig as much negative credit references of individuals, irrespective of its inaccuracy. In short SMEs regard CTOS as an evil institute. Generally these views were given by respondents who had passed the CCRIS screening yet failed the CTOS.

Financial institutions' Perspectives

Financial institutions regard credit reference information from CTOS as valuable because it complements CCRIS basic credit reference information. They say that although information provided by CTOS are public information yet it provides good background history of individuals. In particular information regarding legal matters which CCRIS has ignored. As such financial institutions are open to the idea of turning CTOS services into a government entity. This will improve the credibility of CTOS and the information it provided.

Bank Negara Malaysia Perspectives

Bank Negara Malaysia has indifferent stance towards CTOS's services. BNM regards CTOS as a harmless private information provider which is assisting financial institutions to mitigate risk. Therefore BNM prefers not to interfere with the CTOS operations because it has not negatively affected the credit reference information in the market.

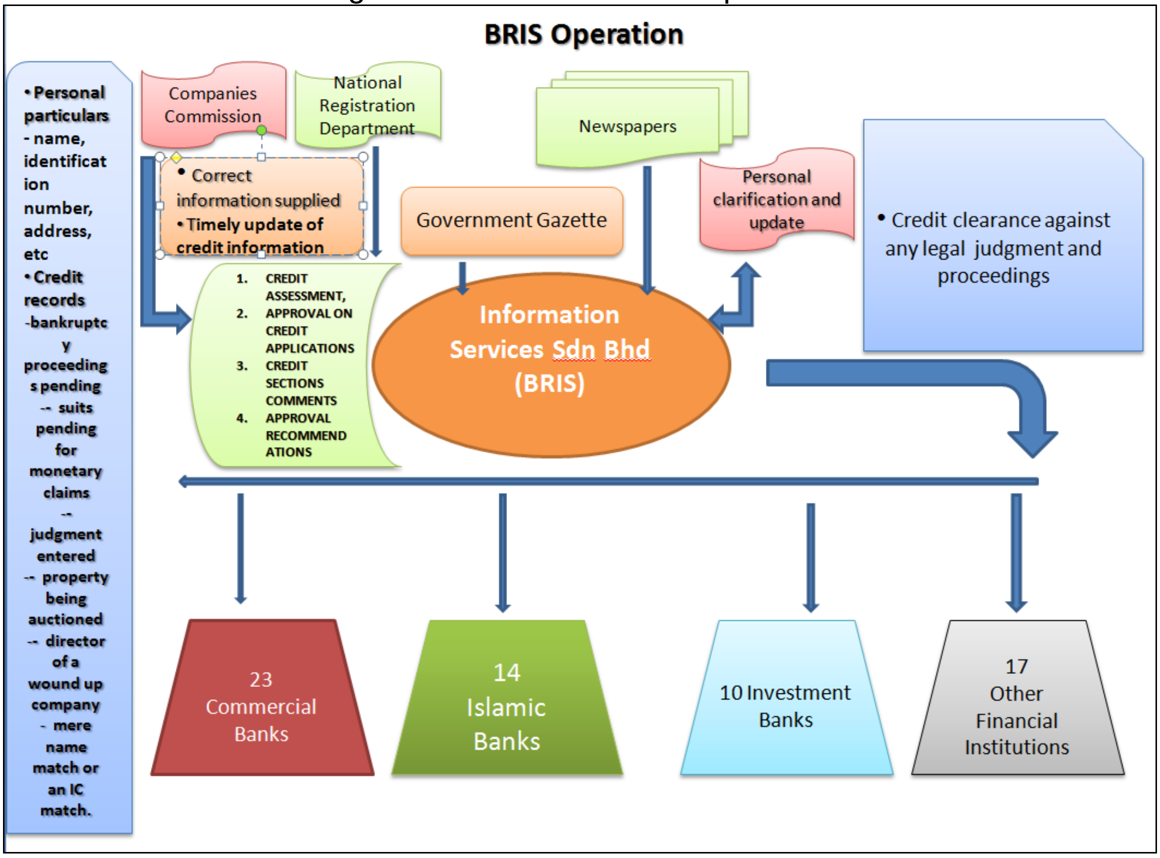
3.5 Information Services Sdn Bhd (BRIS)

BRIS Information Services Sdn Bhd (BRIS) is Malaysia's oldest private and independent credit registry. Its shareholders include Basis Holdings Sdn Bhd who has more than 23 years of experience in the provision of credit information, DP Information Network Pte Ltd (DP Info) Singapore most established information and rating bureau has been in operation in Singapore for more than 25 years, and Rating Agency Malaysia Bhd (RAM) the premier rating agency in Malaysia.

BRIS conducts credit assessment and approval on credit applications, add credit section/comments and recommended approval for merchants ranging from SMEs to global multinationals. BRIS ensures credit approval and administration is in compliance with prevailing credit policies and guidelines. In this process it liaises with various parties to consider various risks in approval. BRIS also conduct regular reviews and monitor portfolio quality on an ongoing basis and recommend rating and collateral actions, make recommendations on how to improve the quality of portfolio. BRIS also prepares comprehensive credit reporting, portfolio database management, manage post approval recording/monitoring and general risk portfolio management and assist in streamlining process and look for improvement in effective credit risk controls (Figure 3.3).

BRIS's vision is to develop into a full-fledged corporate and consumer credit and information bureau, contributing significantly towards making Malaysia a transparent credit society. They envision a day when credit checks become a norm in daily business transactions and where companies and individuals with good credit standing will be able to access credit faster and at better terms. Towards this objective, BRIS will be introducing new services and initiatives from time to time.

Figure 3.3: Model of BRIS Operation



3.6 Conclusion

CCRIS is seen as part of the regulating institution to help facilitate loans analysis for financial institutions operating in Malaysia. It is there to set a minimum standard of risk mitigation mechanism of all financial institution operating in Malaysia. BNM provides the minimum financial information of potential clients as a way to pitch a benchmark on the credit management mechanism. All financial institutions are obliged to use the information in their day to day credit management and this will be audited periodically by BNM. CCRIS normally keeps clients financial information for 25 years but will release for usage to financial institutions information for the last 12 months of activities only. This format has not limited financial institutions in evaluating their potential clients risk profiles. Overall, most SMEs past and potential loan applicants have no serious qualms with CCRIS.

CTOS is a success story of the private operation version of credit reference services. For over 17 years in operation, CTOS has been accepted as the necessary complement to the official credit reference services provided by CCRIS. This means it will never substitute CCRIS nor can it be replaced immediately by CCRIS because of the different nature and objectives of their operations.

Notwithstanding the acceptance by financial institutions, SMEs regard CTOS as their deterrence in their effort to obtain financial facilities. Time will tell whether CTOS would continue to exist or be abolished. But as for now, CTOS will remain active until another government agency will be willing to take the role of compiling public financial information of individuals to be made available to the general public.

In the case of BRIS, it has all the muscle and the networking to be move aggressively into a full fledge credit bureau. Yet BRIS is lagging behind other credit bureaus, namely the newly established SME Credit Bureau.

In the final analysis, despite complaints about layers of bureaucracy and regulatory issues, generally SMEs in Malaysia are able to get access to the maximum financial assistance (Table 3.2 and 3.3). But the bulk of financing still comes from public agencies. This concern will be elaborated in Chapter 4.

Table 3.2: Main SME Financing Indicators

	2007	2006	% change
Applications (RM billion)	99.1	71.4	38.8
Number of Accounts ('000)	158.2	106.0	49.2
Approved (RM b)	55.1	40.2	37.1
Percentage of approval	55.6%	56.3	
Number of accounts ('000)	109.5	83.7	30.8
Disbursements (RM b)	141.5	134.1	3.5
Repayments (RM b)	126.6	122.5	3.4

Annual growth 2007 to 2006

Financing outstanding	RM114.2	9.1%
5.1%		

Source: Bank Negara Malaysia, 2007

Table 3.3: Profile of Financing to SMEs in Malaysia, 2007

1	Credit Guarantee Corporation • Guaranteed RM39.1b financing • 373,665 SME's • Outstanding RM14.68b to 90,433 SMEs
2	Banking Institutions • 47 banks with 3,359 branches • RM114.2 b financing outstanding • 18,446 SMEs • In 2007 RM55.15 b approved to 109,497 SMEs
3	Development Finance Institutions • 6 DFI's with 677 branches • RM13.8b financing o/s to 106,721 SMEs • In 2007 RM8.1b loans approved to 23,477 SMEs
4	Venture Capital • 52 VC companies • RM1.8b o/s investment to 433 companies • In 2007 RM479m invested
5	Leasing and Factoring • RM2.0b loans outstanding • In 2007 RM792.3m approved
6	Five Bank Negara Special Funds • RM16.1b loans approved to 33,717 SMEs • RM7.6b o/s at end of 2007 • In 2007 RM2.7b approved to 4,859 SMEs
7	100 Government Funds and schemes • RM85.5b loans approved to 1.3m SME's at end of 2007 • RM7.0b loans o/s at end of 2007 • In 2007 RM13.7b approved to 243,203 SMEs
8	Small Debt Resolution scheme • Restructured NPL's to 565 SME's amounting to RM324b • In 2007, restructured 141 SME's amounting to RM56.9m

Source: Bank Negara Malaysia, 2007.

CHAPTER 4 THE CREDIT GUARANTEE CORPORATION (CGC) BERHAD

In the wider context of Southeast Asia and East Asia, credit guarantee companies were established as early as the period 1947-1949 in Japan, followed by South Korea in 1961. Next, Indonesia created ASKRINDO in 1971 and Taiwan followed suit in 1974. It was not until 1981 that the Philippines founded its credit guarantee institution and Thailand formed one in 1991. It is interesting to note that all of these credit guarantee establishments were initiated by the respective governments.

Although credit guarantees “are an important part of corporate financing in Asia, especially for small and medium-sized enterprises (SMEs)”, it has to be pointed out that “government provision of credit guarantees has the potential to distort incentives and diminish efficiency.” Nevertheless, the evolution and growth of the CGC in Malaysia deserves an examination.

4.1 Historical Background

Within the framework of SME financing in Malaysia, the CGC is one of the oldest institutions, formed in 1972 as a limited company under the Malaysian Companies Act 1965, with Bank Negara Malaysia and all the commercial banks as its shareholders (see Table 4.1 below). Since 1994, it augmented its coverage to include medium-sized enterprises. CGC works closely with both Bank Negara Malaysia (BNM) and the Ministry of Entrepreneur and Cooperative Development (MECD) in terms of its operations and progress. However, from 2006, the CGC has come out of the MECD’s administrative orbit, in line with the CGC Transformation Plan (to be discussed below).

CGC’s paid-up capital is as follows: USD510.6 million (BNM’s contribution is USD404.9 million and USD105.7 million comes from the financial institutions). Its authorized share capital is USD936.6 million and as at 31 December 2007, its net worth was reported to be USD846.1 million, Table 4.1.

Table 4.1: CGC’s Shareholders

	% Shareholding
Bank Negara Malaysia	79.3%
Commercial Banks & Finance Companies	20.7%

The objective of the CGC is to assist small and medium enterprises (SMEs), especially those with inadequate collateral or without collateral or track record to gain access to loans from the participating financial institutions. It also supports the Government's efforts in promoting and developing business sectors which are important to the economy. It is the only credit guarantee entity in the country, making it a monopoly. CGC is also classified as a Development Financial Institutions (DFI). The 3- year Business Transformation Plan for CGC was introduced in 2004. But it was implemented in 2005. Basically, it was created to make CGC more financially sustainable. CGC is expected to generate new sources of income, apart from its current stream of revenue from guarantee fees and interest earned from investments. Its ultimate aim under this plan is to be financially independent and it would probably take about 5 years to do so.

Some of the new products and services that CGC has identified and initiated are, for example, securitization and collateralised loan obligation (CLO), geared to the capital market. These avenues will enable investors in the capital market to also indirectly support SMEs as well as the financial institutions in Malaysia. The rationale is to transfer the credit risk that is undertaken by CGC to the capital market. In 2007, it launched into the synthetic securitization of SME loan deal with Maybank, the first such exercise in Malaysia, which contributed RM600 million to the total loan guarantee of RM4.6 billion in the same year.

The government does not provide direct financial assistance to CGC. Instead it receives financial injections from BNM and the other participating financial institutions. Currently, CGC has 16 branches in the country and as at the end of May 2008, it has a total staff strength of 434 employees. Recently, the SME Development Framework, which is a part of the Financial Sector Master Plan (developed by BNM and the Ministry of Finance), has identified CGC as an important credit enhancer to help SMEs gain financial standing, particularly for new and start-up SMEs

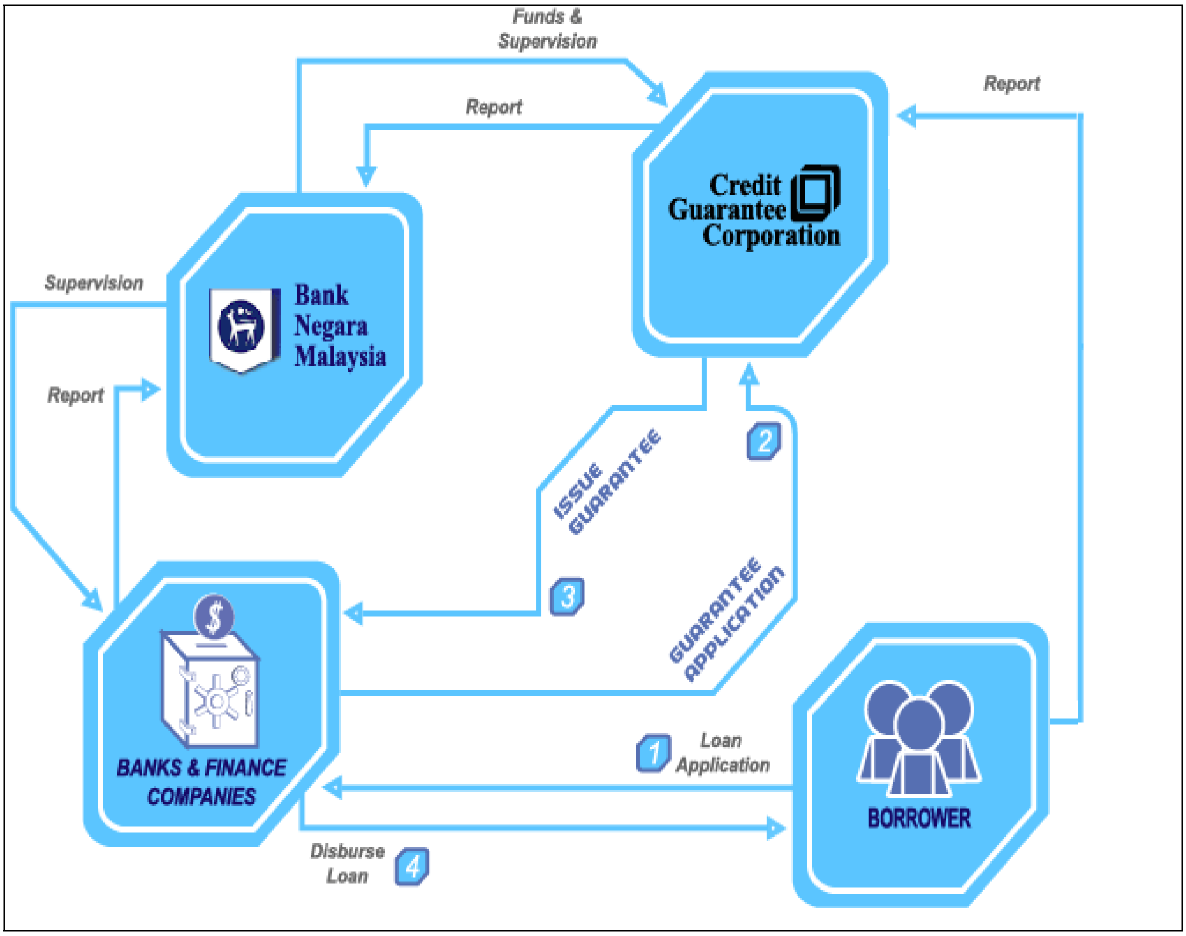
The main role of CGC is to formulate and manage viable credit guarantee schemes together with its partners (lending institutions).Through the network of all branches of the commercial banks and finance companies currently operating in the country, CGC helps SMEs by providing guarantee coverage for partly secured as well as unsecured credit facilities of up to RM9 million. The various CGC guarantee schemes help to secure financing up to the amount required. It is pertinent to note that the CGC provides both conventional and Islamic guarantee schemes, reflecting the Malaysian financial sector landscape (Figure 4.1).

CGC has also diversified into closely related fields like equity funding. In this venture, it has tied up with Aureos Capital, a leading global player in SME private equity funds, leading to the incorporation of Aureos CGC Advisers Sdn Bhd. It central aim is to “mobilize capital for private equity investments in identified SME companies.”

An important aspect of CGC’s Transformation Plan was the formation of the SME Credit Bureau in June 2008, via a strategic partnership with Dun and Bradstreet Malaysia Sdn Bhd (this has been examined extensively in Chapter 3). This development further extends the comprehensive coverage of CGC’s range of products and services.

Apart from the guarantee fees charged on loans guaranteed, the other sources of income of GCC come from interest income from investments and the interest arbitrage earned on loans provided by the government and BNM. Earnings from the interest arbitrage are used to augment reserves to meet CGC’s claims contingencies (Refer to Figure 4.2 to 4.8 and Table 4.1 to 4.4).

Figure 4.1: Model of CGC Works



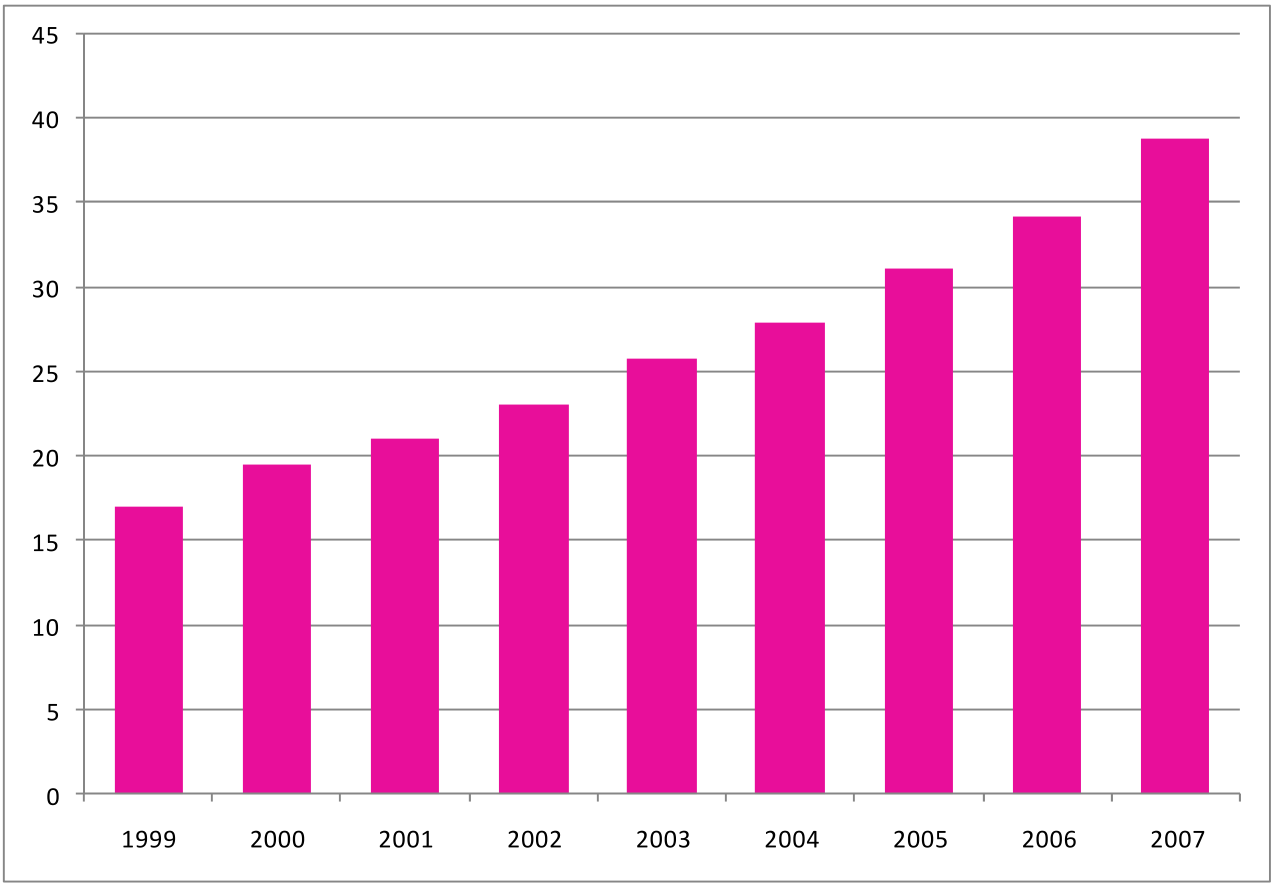
4.2 CGC's Operational Results, 1999-2007

Table 4.2: Cumulative Number and Value of Loans under All Schemes, 1999 -2007

Year	1999	2000	2001	2002	2003	2004	2005	2006	2007
Number	297,240	313,911	320,748	328,025	336,115	349,356	357,923	365,446	378,450
Value	17.1	19.5	21.1	23.1	25.8	27.9	31.2	34.2	38.8

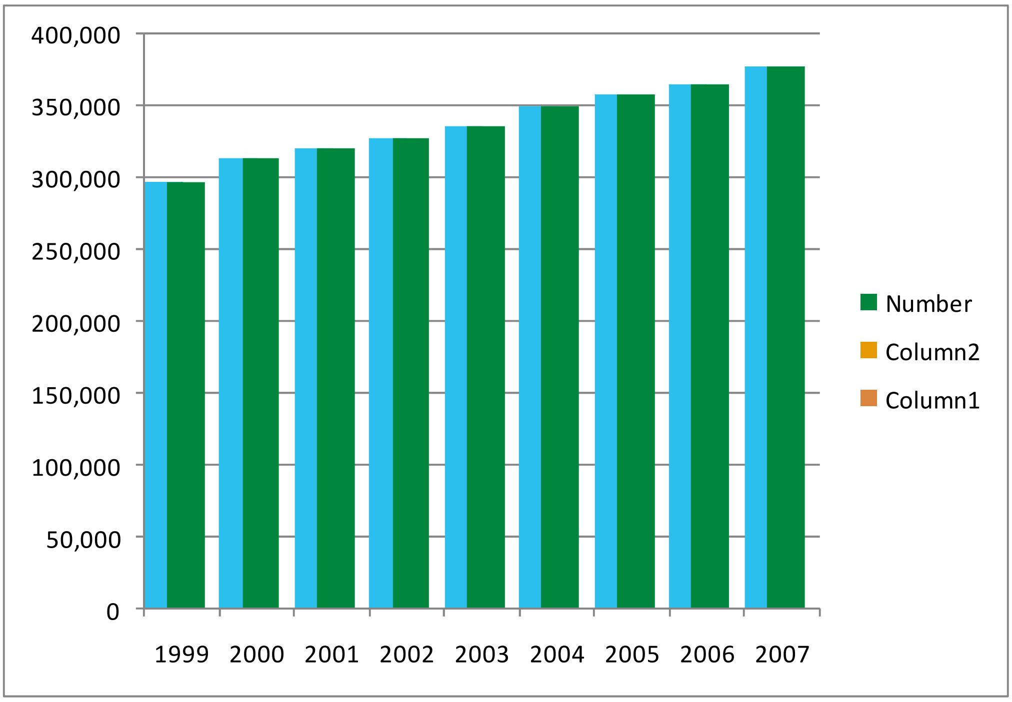
Source: CGC Annual Reports, 2003-2007.

Figure 4.2: Cumulative Value of Loans under All Schemes (RM Million),1999 -2007



Source: CGC Annual Reports, 2003-2007.

Figure 4.3: Cumulative Number of Loans under All Schemes, 1999-2007



Source: CGC Annual Reports, 2003-2007.

Table 4.3: Range of Loans Size Guaranteed under All Schemes (2000)

Range of Loans Size (RM)	No	%	Value(RM Million)	%
1,000 - 50,000	9,433	56.6	172.0	7.0
50,001 - 100,000	2,118	12.7	179.80	7.3
100,001 - 250,000	2,466	14.8	439.50	17.8
250,000 – 500,000	1,642	9.8	622.30	25.3
500,001 - 1,000,000	703	4.2	521.20	21.2
1,000,001 - 10,000,000	309	1.9	528.40	21.5
Total	16,671	100	2,463.20	100

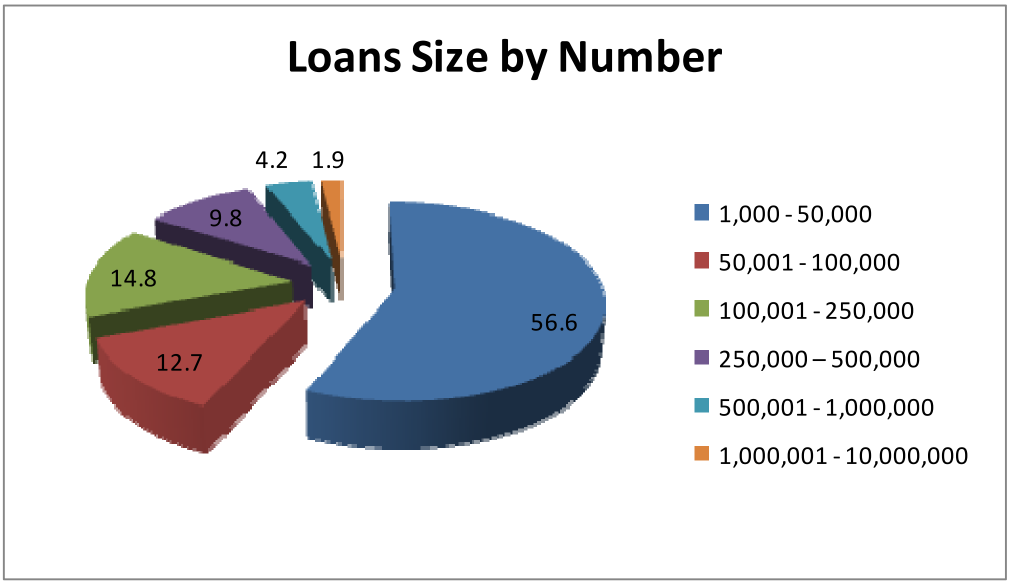
Source: CGC Annual Report, 2003.

Table 4.4: Range of Loans Size Guaranteed under All Schemes (2007)

Range of Loans Size (RM)	No	%	Value(RM Million)	%
1,000 - 100,000	5,692	43.8	282.23	7.1
100,001 - 250,000	2,882	22.1	531.82	13.4
250,001 - 500,000	2,496	19.2	973.95	24.6
500,001 - 1,000,000	1,269	9.8	973.82	24.5
1,000,001 - 10,000,000	665	5.1	1,204.58	30.5
Total	13,004	100	3,966.40	100

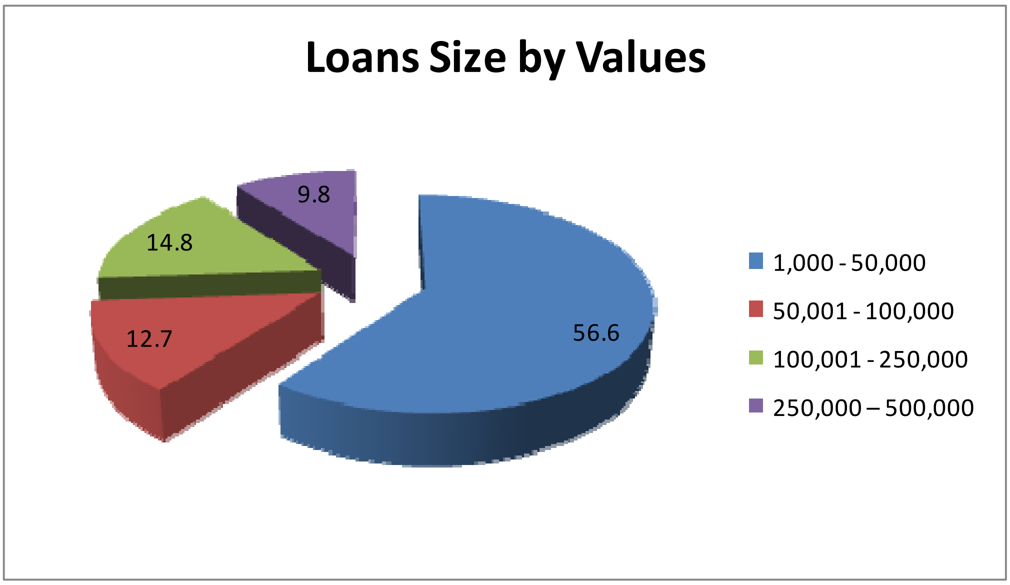
Source: CGC Annual Report, 2007

Figure 4.4: Loans Size by Number (2000)



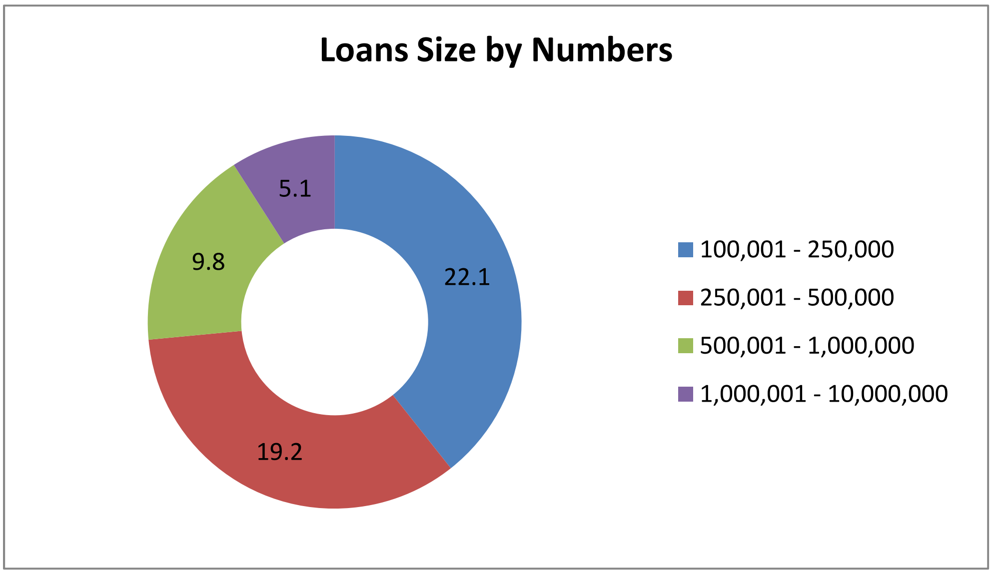
Source: CGC Annual Report, 2003.

Figure 4.5: Loans Size by Values (2000)



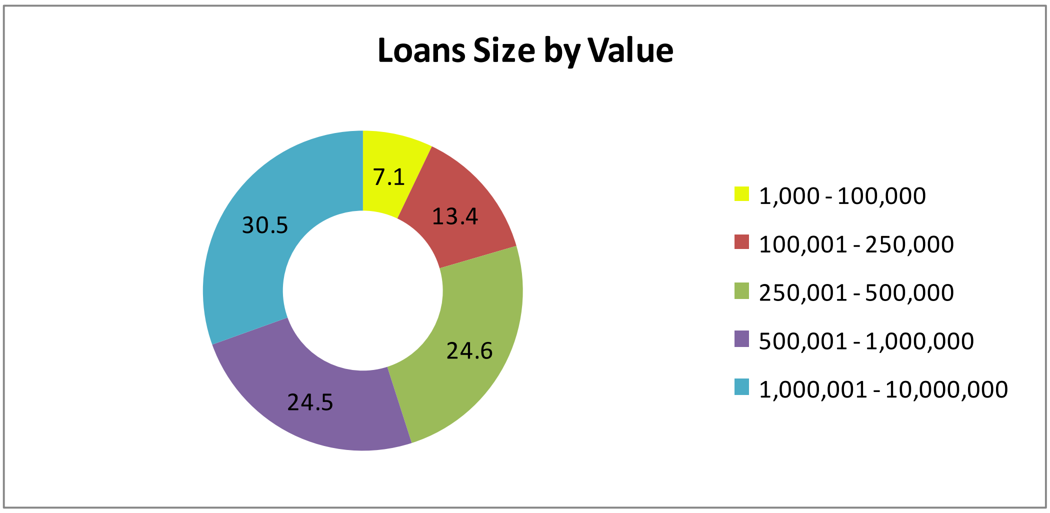
Source: CGC Annual Report, 2003.

Figure 4.6: Loans Size by Numbers (2007)



Source: CGC Annual Report, 2007.

Figure 4.7: Loans Size by Values (2007)



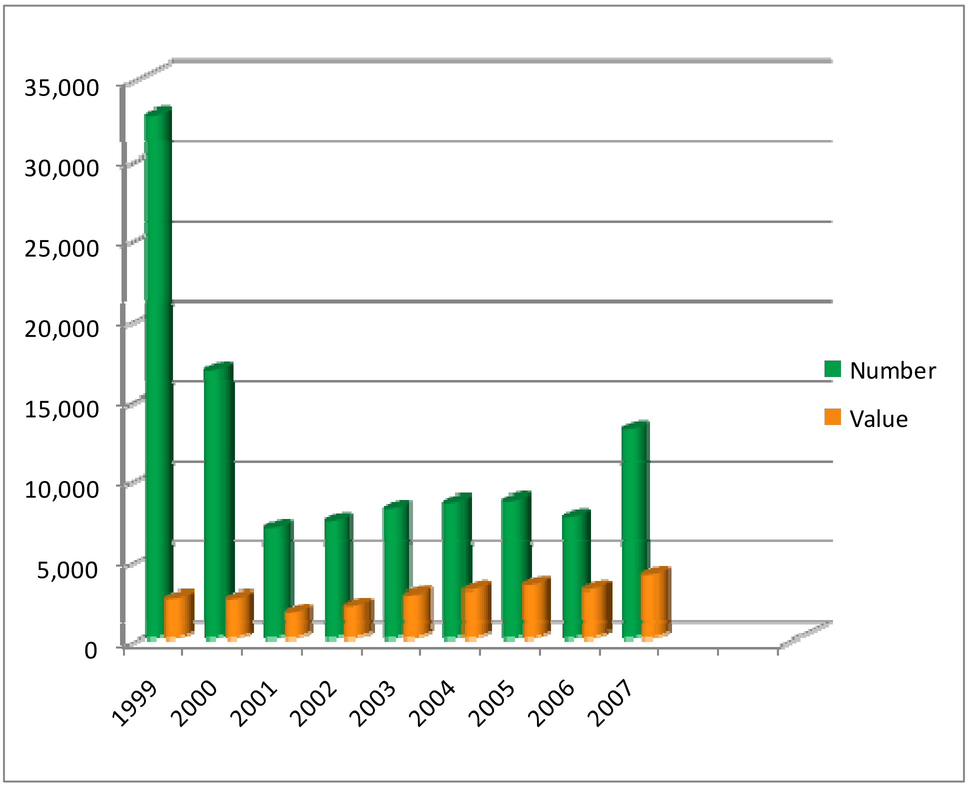
Source: CGC Annual Report, 2007.

Table 4.5: Loans Guaranteed (by Number and Value of) under All Schemes, 1999-2007

Year	1999	2000	2001	2002	2003	2004	2005	2006	2007
Number	32,586	16,671	6,837	7,277	8,090	8,452	8,567	7,523	13,004
Value	2,497.6	2,463.20	1,587.5	2,003.50	2,683.58	3,007.60	3,309.64	3,019.46	3,966.40

Source: CGC Annual Reports, 2003-2007.

Figure 4.8: Loans Guaranteed (by Number and Value of) under All Schemes, 1999-2007



Source: CGC Annual Reports, 2003-2007.

A noteworthy feature gleaned from figures and diagrams above is the impressive growth in the quantum of loans and the amount guaranteed. In 2007, CGC managed to achieve its loans growth target of RM4.6 billion. It extended its SME outreach in the same year by initiating strategic partnerships with 11 Islamic banks and DFIs in view of the increasing demand for alternative sources of SME financing. Investment income also rose from RM146.9 million in 2006 to RM164.1 million in 2007. At the time of writing, CGC's Annual Report for 2008 has not been released. But from available information, the trends for 2008 looked dismal as compared to 2007. A major reason for this decline has been the tightening of credit given out by the financial institutions, in line with their prudent and cautious lending policies. This is directly the result of the deepening effects of the current global financial crisis on the Malaysian economy, particularly the financial sector.

Facing the current challenges, many financial institutions are expected to request for more CGC guarantees in order to minimise potential lending risks to SMEs. At the same time, more SMEs would seek financing facilities to navigate the difficult times and to ensure that their businesses do not collapse. This is when both the CGC and the banks have to exercise not only extra caution but also flexibility and discretion.

On the outlook for SME activity for 2009, the CGC views growth in the sector will not be as strong as in previous years due to the gradual economic slowdown in Malaysia. Despite an expected reduction in loan applications, approvals and guarantees, the general view of the financial sector is that the SMEs would remain an important driving force for the economy.

The CGC also added that the access "to financing in 2009 will be in greater demand under micro-enterprises as well as in Islamic financing". And with "BNM's recent reduction in the statutory reserve requirement from 4% to 3.5%, this will contribute towards greater liquidity position in the market, and we are confident that the banking sector will continue to provide financing to deserving SMEs."

But SMEs in the construction, transportation and the retail export sectors are expected to experience sluggish growth. The CGC, during this economic downturn, expects steady growth in the domestic sector including retail trade, services and agriculture. It also anticipates that in 2009, the majority of loan guarantee applications would come from these sectors.

An important part of the government's strategies to mitigate the impact of the global economic slowdown on the Malaysian economy, especially in relation to the SMEs, is the introduction of a new scheme through BNM. This is the establishment of a RM2 billion SME Assistance Guarantee Scheme (SAGS) to ensure that viable SMEs adversely affected by the current economic downturn can still have access to adequate financing. With the guarantee cover, it is envisaged that access to financing to viable SMEs will be enhanced and at a lower cost.

Eligible SMEs can obtain financing of up to RM500, 000 per SME under this scheme for a duration of up to 5 years. The CGC will provide an 80% guarantee cover for financing approved under this scheme. The guarantee cover will be provided free of charge and the cost of the guarantee will be fully borne by BNM. Financing obtained under this scheme is only for new financing. It should be used for business purposes, such as working capital, project financing and capital expenditure.

Apart from the usual commercial and Islamic banks, SME Bank, Agrobank, Bank Rakyat, EXIM Bank and Bank Simpanan Nasional will also be participating in this scheme. These financial institutions will determine the lending or financing rate to be charged. The applications for this scheme will commence from 3rd February 2009 until 31st December 2009 or when the financing limit of RM2 billion has been fully utilised.

4.3 Costs and Fees for Using CGC Guarantee Schemes

1. *Processing Fee*

   - The processing fee is paid only once, either to the participating financial institution (where the client obtained the business loan) or to CGC. In the case of DAGS, the fee charged is determined by CGC and borrowers should make payment directly to CGC branches. For non-DAGS, the individual participating financial institution will determine the fee to be charged.

2. *Interest Rates*

   - The interest rates imposed on the loans approved to borrowers are determined by the participating financial institution based on the prescribed rates of the various types of CGC's schemes.

3. *Guarantee Fee*

The guarantee fee payable to CGC varies depending on the guarantee facility granted to the client. Payment of the fee is made in advance annually by the participating financial institution. The participating financial institution will subsequently debit the client's account for the fee paid on the client's behalf. CGC schemes' guarantee fee range from 0.5% to 3.5% of the guarantee cover

- The guarantee fee payable to CGC varies depending on the guarantee facility granted to the client. Payment of the fee is made in advance annually by the participating financial institution. The participating financial institution will subsequently debit the client's account for the fee paid on the client's behalf.. However, the guarantee fee imposed under the Flexi Guarantee Scheme will be borne by the participating financial institution granting the loan. This is to ensure that the borrower can continue to enjoy the loans under the various funds at the respective prescribed rates.

  CGC can guarantee a maximum secured loan of RM9 million and the range of guarantee cover is between 30% - 100%, "depending on the individual guarantee scheme features." The maximum guarantee cover is RM3 million for the unsecured part.

All guarantee products include a “risk- adjusted guarantee fee structure where the guarantee fee charged to a borrower is determined according to the risk profile rating of the borrower.”

The CGC also provides the Business Advisory Services Entity (BASE) with the following objectives:

• To improve the turnaround time in processing and avoid delays in processing due to incomplete submission of documents.

• To assist the SMEs in taking appropriate measures to safeguard and further improve their businesses. The SMEs can subscribe to the services of BASE for a small fee and the payments are made directly to BASE.

•The engagement of the services of BASE by the applicant is not an assurance that CGC will approve the loan application. The fees charged by BASE will vary depending on the services required, which may include the preparation of working papers for the loan application, site visits to the business premises, site visits to inspect the collateral offered, preparation of financial projections, market analysis and quarterly monitoring and reporting (for the first year only). The fees for these services generally do not exceed RM3,000.

Presently, there are 10 guarantee schemes provided by CGC:

- Direct Access Guarantee Scheme (DAGS)
- DiAGS - Islamic
- Direct Bank Guarantee
- DAGS – Start Up
- Enhancer
- Enhancer – Islamic
- Flexi Guarantee Scheme
- Small Entrepreneur Guarantee Scheme
- Franchise Financing Scheme
- SME Assistant Guarantee Scheme

It is pertinent to note that in 2007, out of the 10 schemes above, the DAGS and the Enhancer were the most subscribed ones, accounting for 37.2% (4,842 accounts) and 53.8% (RM2.5 billion) respectively in terms of loans guaranteed and value. The sectoral breakdown of loan guarantees obtained from the CGC in 2007 was as follows: (1) Wholesale sector (36.2%) (2) Manufacturing sector (21.5%) and (3) Retail sector (13.4%).

4.4 iGuarantee: Online Application via CGC Website

iGuarantee provides a convenient one stop centre for SME loan applications. In iGuarantee, a client can submit his/her loan application through CGC’s portal by completing the application form provided in the portal. The client’s loan application will be posted on CGC's portal, which can be accessed by all participating financial institutions. The participating financial institutions can contact the client to seek further information before they decide to approve the client's application.

iGuarantee can help the client to save both time and money as he/she does not have to travel to different financial institutions and complete multiple loan applications. In addition, the client will be able to obtain competitive offers on his/her loan applications.

4.5 CGC: Issues and Problems

1. Being a public credit guarantee institution, CGC has capitalized its monopolistic position in the SME financial market. In terms of capitalization and continuous funding, BNM and the financial institutions have always backed it. Without competition, it is able to completely control the credit guarantee market. This is unhealthy, particularly in terms of an effective check and balance.

2. The usual complaints from the participating banks is that the CGC is slow to process its guarantee covers and that the guarantee fees that it charges are, on the whole, too high. This is on top of the processing fees charged by the banks and CGC (in the case of the DAGS) and the interest payments.

3. CGC's response to the above is that the guarantee fee it charges is not a burden, considering the fact that it is covering 80% of the risk as compared to the 20% risk carried by the banks. The guarantee fee is one of the sources of income for CGC. CGC states that this issue needs to be corrected and resolved immediately through a negotiated policy decision.

4. Many SMEs have voiced their grievances on the long bureaucratic time for CGC to arrive at its decisions for the guarantee covers. There have been cases where documents already submitted have either been misplaced or lost. On the issue of delays in processing the loans and guarantees, the CGC states that this is often due to the submission of incomplete documents and late submission of documents or information by the applicants.

5. From the CGC's perspective, this asymmetrical information is mainly due to the inexperience and an inadequate understanding by the SMEs in preparing loan documentation process. The CGC also stress that the business proposal from SMEs must be viable and based on its internal 5Cs criteria - Credit, Character, Capacity, Collateral and Condition.

6. Additionally, to improve the information flow in the application process, CGC suggests that this could be done by expanding advisory and hand-holding services. One avenue would be leveraging on the services of the SME Credit Bureau, which serves as a one-stop centre of information on SMEs. But this would take some time since the SME Credit Bureau which is owned by CGC only started operations in 2008.

7. There have also been cases where the participating banks have approved the loans (non-DAGS) of some SMEs but were finally rejected by the CGC. No concrete reasons were given for the rejections.

8. The public image of the CGC and its employees is not that good. This could be due to its complacency as a monopolistic public guarantee provider. It has rarely communicated well with the public. To this criticism, CGC mentions that it has a well-packaged on-going corporate communication programme including road shows and media coverage, except television.

4.6 Possible Routes of Developing the CGC in Malaysia in Meeting SMEs' Financing Needs

1. It would be possible to have another credit guarantee provider to cater for the large number of SMEs which require financing. This could be a financially sound and stable private entity with a well-established credit bureau. The rationale for this is to generate competition so that the credit guarantee companies, both public and private, can provide better products and services. The goal is to strive for greater effectiveness and efficiency in the critical areas of operations, delivery systems and customer service levels.

2. If that is not possible, then another way is to eventually turn CGC into a fully independent private entity. A hint of this is already evident in CGC's transformation plan. However, this would have some major policy implications, particularly regarding ownership and control. The question is to what extent would BNM reduce its dominance in CGC, bearing in mind the political and social dimensions in the larger SME framework and the total financial sector in Malaysia. The intellectual challenge would be to strike a right balance between government intervention and free enterprise.

3. Being a partner and supporter of the SMEs and an important link between the SMEs and financial institutions, GCG's role and functions would definitely become more complex and multi-faceted. As it makes forays into new and exciting areas like securitization and equity financing and possibly other sophisticated financial instruments in the future in line with its aim to become financially sustainable, it must not lose sight on the increasing significance of micro-financing of SMEs. In the context of CGC, the range of loan size guaranteed between RM1,000 -100,000 could indicate the micro-financing. However, it is interesting to note that although the number of loans guaranteed in this bracket was the highest (2007), reported as 5,693 or 43.8% of the total, but in terms of value, it was the lowest, recording only RM282.2 million or 7.1% of the total facility. Since BNM has indicated a trend towards an expansion in micro-financing in the near future, the challenge for CGC is to improve and strengthen its micro-financing component and to find creative and innovative ways to smoothen the risk management aspect of micro-financing. One possible solution would be to establish a subsidiary which could focus on providing an array of less cumbersome guarantee schemes to really assist the SMEs that actually need micro- financing.

4. Currently, the policies pertaining to the CGC's functions and roles are well in place. But in the larger SME framework in Malaysia, the CGC is also classified as a Development Financial Institution (DFI). There is no clarity about CGC's functions and responsibilities as a DFI. Can a public credit guarantee company at the same time be a DFI? Do they have the same roles, functions and responsibilities? Logically, it means complexity and haziness. If the CGC is mandated to be a DFI, then it should publicly explain and clarify this issue, to avoid confusion.

CHAPTER 5 Policy Discussion, Future Development of SMEs and Credit Guarantee Cooperation

Broadly this study examines the current situation of the credit registries and bureaus in Malaysia, and the future prospects for their development; to scrutinise adequate institutional frameworks of credit information database for firms, especially SMEs; to consider a suitable regional cooperation mechanism to create a harmonised information sharing system; to review the current situation of the credit guarantee system, and identify the challenges for developing the credit guarantee system.

Accordingly, we have surveyed 652 SMEs and interviewed the Credit Guarantee Corporation (CGC), the SME Credit Bureau, selected commercial banks, development financial institutions and government agencies. These surveys and interviews may be subject to various limitations, bearing in mind the time and financial constraints. Nevertheless, the policy suggestions that we put forward for consideration regarding the future development of the credit registry/ bureau and the credit guarantee system in Malaysia are aimed at enhancing and strengthening the SMEs in Malaysia.

In line with the ASEAN blueprint which encourages synergy between private and public sectors in enhancing SMEs development, commercial banks, DFIs and government agencies in Malaysia are rigorously collaborating with, guiding and financing for SMEs development. The blueprint is confirming the improvement that has been made by SMEs within a period of less than five years (this is based on DOS survey of 2003 and Bank Negara Report 2007). Nevertheless for reasons explained in this report, (Table 5.1) many SMEs are still dissatisfied with services provided to them. One can look at this discontent from two perspectives. On the one hand government agencies, financial institutions have succeeded in educating and exposing the SME of available opportunities. Indeed some have taken the challenge even to the extent of exploring the possibility of entering the international market. On the other hand, some, due to technical and social reasons, simply cannot keep pace rapid development of SMEs. The gap is incrementally been bridged as discussed in this concluding chapter.

Table 5.1: Issues Highlighted by SMEs

• Having weak business plans • Having no and insufficient collateral • Poor and incomplete documentation • No previous credit track record • No proper and clear marketing plans • No personal contacts in lending institutions • Difficult rules, regulations and procedures • A high level of bureaucracy in government agencies that hinders more efficient and productive business operations • Inadequate data and information on the development of Malaysian SMEs. • A general lack of knowldge and information • Inability to be in the mainstream of industrial development • Difficulties in accessing loans and other forms of financial assistance • A substantial orientation towards the domestic rather than the international market • Competition from other producers (e.g. China and India) • Limited capability to meet the challenges of market liberalisation and globalisation • Limited capacity for technology management and knowledge acquisition • Low productivity and quality output • Low level of R&D development expenditure • Shortage of skills for the new business environment • High cost of infrastructure • A high level of bureaucracy in government agencies that hinders more efficient and productive business operations. • Inadequate data and information on the development of Malaysian SMEs. • A general lack of knowldge and information. • Inability to be in the mainstream of industrial development • Difficulties in accessing loans and other forms of financial assistance • Higher labour cost

In light of of the above issues, the team would like to highlight some modifications and improvements to be introduced into the existing SME framework.

5.1 Business Challenges of SMEs

Most SME owners and managers believe they have limited capability to meet the challenges of market liberalisation and globalisation. For example competition from other producers such as China.

5.2 Suggestions and Recommendations

Challenges faced by SMEs owners and managers are closely linked to the ability to move up the value chain and the ability to adopt new ways of management. In order to compete with giant like China, SMEs must have quality, cost, reliability and speedy delivery in the global market. SMEs must reap economies of scale. This in turn calls for a shift in focus from the domestic market towards a niche in the world global supply chain. SMEs must also adapt to technological progress. Strong ICT capabilities are crucial because global corporations are relying increasingly on internet-based business-to-business (B2B) community portals to source intermediate inputs and services.

Most SMEs owners/managers also have limited knowledge of acquisition and shortage of skills for the new business environment due to a general lack of knowldge and information.

Many SMEs owners/managers began in industry as apprentices, lacking global business exposure. Hence, many do find conferences and seminars organised by big vendors as unnecsssary for their businesses. There is thus an information gap about new ideas and products that could transform their operation or increase productivity. Relevant SME agencies should work towards changing the mindset of owners and managers not only from the perspectives of financing access but also ways to add add value to their exisitng products by way of networking internationally.

5.3 Credit Registries and Credit Bureau

CCRIS

CCRIS is part of the regulatory mechanism built up by Malaysia banking system to provide transparent information about all potential borrowers. Generally SMEs find CCRIS services (especially in providing record of financial transactions for the last 12 months) as very fair, valuable measure of financial ability, credibility and viability of the applicants.

Financial institutions also regard CCRIS services as part of the financial institutions' regulation and procedures. Thus all financial institutions in Malaysia have make CCRIS reference service as a compulsory item in processing of loan applications. Though at the same time financial institutions also regard CCRIS as too basic and raw. Therefore financial institutions besides using CCRIS as credit check also rely on third party information services such as from Credit Tip-off System (CTOS).

Bank Negara Malaysia (BNM) is in full support of CCRIS because it believes CCRIS is able to improve and up-lift the risk mitigation mechanism of commercial banks and financial institutions in Malaysia. In short, CCRIS is expected to provide the minimum financial information of potential clients as a way to pitch a benchmark on the credit management mechanism. All financial institutions are obliged to use the information which is audited in periodical interval by BNM in their day to day credit management.

In the view of some SMEs and commercial banks however, CCRIS is only an information compiler and gatherer. CCRIS does not rate potential clients and influence financial institutions on loan decision. In other words, it only screens but does not decide. As such most SMEs do not have serious qualms with CCRIS. They could pass the CCRIS screening most of the time, despite having inconsistent cash flow, but often will be rejected after screened by CTOS.

CTOS

CTOS is a private provider of credit reference agency. SMEs see it as a non-credible institution because it collected and kept general and outdated information. This information then is sold to the requester (banks and individuals) to check on the credibility of loan application. Because of its outdated information many SMEs have failed to pass CTOS screening despite passing CCRIS screening. Many SMEs conclude that CTOS is in operation only to make profit out of the clients' credit information. CTOS also does not delete outdated information or legal cases that have been fully settled.

However, financial institutions regard credit reference information from CTOS as valuable because it complements CCRIS's basic credit reference information. Though information provided by CTOS are compiled from public documents, financial institutions find the CTOS database as credible and systematic and the fee it charge for the service is also reasonable. For example, database from CTOS which contain legal related matters will alert bank of an applicant's legal issue which through a normal loan application cycle will appear anyway but will not be as fast. Therefore financial institutions are of the opinion to legalise CTOS services as this will improve CTOS credibility and image to the society.

The central bank, BNM has a neutral view towards CTOS. BNM regards CTOS as private credit information service provider. It has no intention of interfering with CTOS services as long as it does not negatively affect the credit reference information market. However, the fate of CTOS will be determined by the government by the end of 2009.

5.4 Suggestions and Recommendations

CTOS is a success story of a private credit reference service in Malaysia. Despite the negative public views over its operations, it has survived and has been complementing CCRIS credit check for more than 17 years. According to this study, CTOS and CCRIS should remain as the key credit checks in Malaysia.

CTOS collects basic information from public documents but is able to compile and supply these information to requestors in a convenient and timely manner, thus making it indispensable for the period. CTOS also is willing to learn and to listen. Lately CTOS has been under a serious attack by the public and politicians because the information that they provided have negatively affected the borrowers' ability to obtain financial facilities from financial institutions in Malaysia. This relates to its outdated database. CTOS however offers affected individuals to change the record by providing updated information to CTOS. Therefore CTOS still have some role in the credit checking of applicants until another legalised agency is willing to take over the role of compiling public financial information of individuals for general public scrutiny.

5.5 Banking Institutions and Development Financial Institutions Schemes

There are too many complaints among SMEs against taking too much time processing the applictions, too much time taken to disburse approved loans, and complicated loan procedures and low the ceiling of loan amount when they use the SME related financing schemes.

5.6 Suggestions and Recommendations

To address this issue, it may be useful to re-examine the simpler application procedures for SMEs. The underlying idea and belief of assisting the SMEs are to make it as easy as possible for them to obtain financing.

From interviews we found that officials engaged in lending for SMEs were unaware of the diverse content and eligibility of financial schemes for SMEs. To address this issue it would be good to consolidate all government financing schemes under one roof. With this facility, all parties could obtain standardised information on all available financial schemes. A good example of a one-stop centre is the SME Credit Bureau.

5.7 Credit Guarantee Corporation

According to our financial institution survey, the most frequent complaint against the Credit Guarantee Corporation is the stringent requirement for recovery after subrogation. Usually it takes more than 1 year for financial institutions to receive subrogated payment after their loans become non-performing (In Malaysia, the creditor can file the claim for a subrogated payment by CGC 9 months after the loan becomes non-performing- arrears in interest payments for 6 months or longer under ordinary rule, but in reality financial institutions often apply the 3 months in arrears rule). In other words, under the present circumstances it takes at least 1 year or longer to be able to file the claim. In addition, the payment process for the claim often takes some extended time because of various procedures involved in the financial institutions and the CGC. Even if they are pressed by the CGC to recover non-performing loans after subrogation, it would be extremely difficult to do so in many cases on practical grounds. For instance, if legal action is taken against an SME to recover arrears in repayments, it might close the SME's business for good because usually, the SME would not have the financial avenues to settle the arrears in default. Furthermore, court action takes a long time to settle. In many cases financial institutions requested the CGC to provide guarantee because they have concerns in recovering their full loans, in view of the value of the collateral and the credit standing of their borrowers in the future. In such circumstances, some expressed a view that putting responsibility for recovery squarely on financial institutions is not entirely reasonable.

In the same survey, financial institutions also complained about the long time taken (in processing) for approval and the high guarantee fee imposed by the CGC. According to interviews with financial institutions, after an application is submitted, it may actually take as much as 3 months or more before it is approved. This often resulted in their missing the timing for loan disbursement. Complaints about high guarantee fees may be attributable to (a) time and high costs of processing relative to the loan amount because loans backed up by CGC guarantees are usually on small loans; and b) the perception of the borrowers that they are paying relatively high fees, given the increasing cost consciousness among them and the declining loan interest rates. Many documents required was caused by the processing is burdensome, as expressed in the interview with the financial institutions.

5.8 CGC: Issues and Problems

Being a public credit guarantee institution, CGC has capitalized its monopolistic position in the SME financial market. In terms of capitalization and continuous funding, BNM and the financial institutions have always backed it. Without competition, it is able to completely control the credit guarantee market. This is unhealthy, particularly in terms of an effective check and balance.

The usual complaints from the participating banks is that the CGC is slow to process its guarantee covers and that the guarantee fees that it charges are, on the whole, too high. This is on top of the processing fees charged by the banks and CGC (in the case of the DAGS) and the interest payments.

CGC’s response to the above is that the guarantee fee it charges is not a burden, considering the fact that it is covering 80% of the risk as compared to the 20% risk carried by the banks. The guarantee fee is one of the sources of income for CGC. CGC states that this issue needs to be corrected and resolved immediately through a negotiated policy decision.

Many SMEs have voiced their grievances on the long bureaucratic time for CGC to arrive at its decisions for the guarantee covers. There have been cases where documents already submitted have either been misplaced or lost. On the issue of delays in processing the loans and guarantees, the CGC states that this is often due to the submission of incomplete documents and late submission of documents or information by the applicants.

From the CGC’s perspective, this asymmetrical information is mainly due to the inexperience and an inadequate understanding by the SMEs in preparing loan documentation process. The CGC also stress that the business proposal from SMEs must be viable and based on its internal 5Cs criteria - Credit, Character, Capacity, Collateral and Condition.

Additionally, to improve the information flow in the application process, CGC suggests that this could be done by expanding advisory and hand-holding services. One avenue would be leveraging on the services of the SME Credit Bureau, which serves as a one-stop centre of information on SMEs. But this would take some time since the SME Credit Bureau which is owned by CGC only started operations in 2008.

There have also been cases where the participating banks have approved the loans (non-DAGS) of some SMEs but were finally rejected by the CGC. No concrete reasons were given for the rejections.

The public image of the CGC and its employees is not that good. This could be due to its complacency as a monopolistic public guarantee provider. It has rarely communicated well with the public. To this criticism, CGC mentions that it has a well-packaged on-going corporate communication programme including road shows and media coverage, except television.

5.9 Possible Routes of Developing the CGC in Malaysia in Meeting SMEs' Financing Needs

It would be possible to have another credit guarantee provider to cater for the large number of SMEs which require financing. This could be a financially sound and stable private entity with a well-established credit bureau. The rationale for this is to generate competition so that the credit guarantee companies, both public and private, can provide better products and services. The goal is to strive for greater effectiveness and efficiency in the critical areas of operations, delivery systems and customer service levels.

If that is not possible, then another way is to eventually turn CGC into a fully independent private entity. A hint of this is already evident in CGC's transformation plan. However, this would have some major policy implications, particularly regarding ownership and control. The question is to what extent would BNM reduce its dominance in CGC, bearing in mind the political and social dimensions in the larger SME framework and the total financial sector in Malaysia. The intellectual challenge would be to strike a right balance between government intervention and free enterprise.

Being a partner and supporter of the SMEs and an important link between the SMEs and financial institutions, GCG's role and functions would definitely become more complex and multi-faceted. As it makes forays into new and exciting areas like securitization and equity financing and possibly other sophisticated financial instruments in the future in line with its aim to become financially sustainable, it must not lose sight on the increasing significance of micro-financing of SMEs. In the context of CGC, the range of loan size guaranteed between RM1,000 -100,000 could indicate the micro-financing. However, it is interesting to note that although the number of loans guaranteed in this bracket was the highest (2007), reported as 5,693 or 43.8% of the total, but in terms of value, it was the lowest, recording only RM282.2 million or 7.1% of the total facility. Since BNM has indicated a trend towards an expansion in micro-financing in the near future, the challenge for CGC is to improve and strengthen its micro-financing component and to find creative and innovative ways to smoothen the risk management aspect of micro-financing. One possible solution would be to establish a subsidiary which could focus on providing an array of less cumbersome guarantee schemes to really assist the SMEs that actually need micro- financing.

Currently, the policies pertaining to the CGC's functions and roles are well in place. But in the larger SME framework in Malaysia, the CGC is also classified as a

Development Financial Institution (DFI). There is no clarity about CGC's functions and responsibilities as a DFI. Can a public credit guarantee company at the same time be a DFI? Do they have the same roles, functions and responsibilities? Logically, it means complexity and haziness. If the CGC is mandated to be a DFI, then it should publicly explain and clarify this issue, to avoid confusion.

5.10 Other Alternative System and Scheme of Financing for the SMEs to Meet the Current and Future Need

Various approaches have been taken to promote the development of SMEs in Malaysia. As of 2007 the government has move towards higher value-added economic activities for SMEs, namely towards K-SMEs. The Multimedia Development Corporation and Biotech Corporation under the Ministry of Science, Technology and Innovation has been made responsible for nurturing and monitoring the performance of K-SMEs. It was decided that comprehensive policies and incentives, that include fiscal incentives, access to capital and financing, facilitating quicker intellectual property and patent registration, as well as priority access to government procurement for innovative Malaysian SMEs would be implemented to further this agenda. Technology funds are also made available to enable K-SMEs to improve their research capabilities.

While planning towards enhancing SMEs government consideration were also focused on the changing economic environment. In light of the current economic slowdown Bank Negara has introduced a RM2 billion SME Assistance Guarantee Scheme (SAGS) to assist SMEs against the rising cost of running business. All SMEs with shareholders funds below RM3 million; SMEs that are not affiliates and subsidiaries of GLCs and PLCs; SMEs owned by Malaysians (at least 51% shareholding) residing in Malaysia, and SMEs adversely impacted by the current economic slowdown are eligible to apply.

Eligible SMEs can obtain financing of up to RM500,000 per SME under this Scheme for tenures of up to 5 years. The Credit Guarantee Corporation Berhad (CGC) will provide an 80% guarantee cover for financing approved under this Scheme. The guarantee cover will be provided free of charge and the cost of the guarantee will be fully borne by Bank Negara Malaysia. Financing obtained under this Scheme is for new financing only and must be used for business purposes, such as working capital, project financing and capital expenditure. However, participating financial institutions will determine the lending or financing rate to be charged and applications are subject to the normal credit approval process of the participating financial institutions.

Besides introducing assistance guarantee schemes, the NSDC has also agreed to set-up a Special Committee to recommend appropriate measures to reduce the impact of rising costs and oil prices on SMEs. Measures to be considered include tax incentives to encourage SMEs to upgrade their machineries and equipment, as well as for technology adoption, implementation of development programmes to enhance capabilities of SMEs and reduce their operational costs, and, to enhance awareness and understanding on existing SME development programmes and financial assistance schemes.

Below are other financing approaches that have been promoted and are being planned to enhance SMEs development.

Micro Businesses in Malaysia

The government of Malaysia has given serious attention to the enhancement and viability of SMEs contribution to the economy. The initiatives implemented in 2007 have yielded positive results. More than 286,000 SMEs were assisted through the implementation of 189 key development programmes, involving a total expenditure of RM4.9 billion. This also included a total of 135,000 SMEs, women entrepreneurs and students who benefited from entrepreneurship and technical training, while more than 4,750 SMEs were provided with business premises and factories.

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In the same period a total of RM63.2 billion financing was approved to more than 132,000 SME accounts by banking institutions and development financial institutions. This exceeded the initial 2007 target of RM51 billion financing approvals to 110,000 SME accounts. At end-March 2008, SME financing outstanding provided by the financial institutions amounted to RM132.4 billion, accounting for 44.3% of total outstanding business financing. The quality of SME financing has also improved, with SME gross non-performing loan ratio declining to 9.1% from 11.1% in the last year.

On a sectoral basis, financing to SMEs has become more diversified. Significant growth was seen in financing outstanding to the primary agriculture sector (14.6%), while a large percentage of financing (46.8%) was channelled to SMEs in the services sectors.

Looking closer into the SME profiles, micro enterprises has been seen to excel over medium and small enterprises. In view of this the government and Bank Negara Malaysia implemented several measures to ensure adequate access to financing for this segment of businesses. Especially with the current challenging economic situation, the government is taking the initiative to educate small traders and micro-businesses about the government's micro-financing scheme and assist them in their applications through the micro-financing.

As of October 2007, Bank Negara Malaysia has announced the launch of a RM200 million Micro Enterprise Fund to increase access to micro financing for micro enterprises with viable businesses. The fund is being channeled to micro-enterprises through the existing Pembiayaan Mikro scheme. Nine financial institutions are participating in this micro financing scheme.

Under the *Pembiayaan Mikro* scheme, micro enterprises with viable businesses can obtain micro financing up to RM50,000 for working capital or for capital expenditure. Micro financing under this scheme requires no collateral, minimal documentation and provides for quick approval and disbursement. *Pembiayaan Mikro* is offered at more than 2,600 branches and affiliates/agents of the participating financial institutions that display the National Microfinance Logo.

An Alternative SME Financing Solution - Islamic Banking Approach

The Islamic Banking worldwide has been introducing Islamic banking practices as a way to create a permanent solution to individuals and small businesses which require financing. The approach is however different from the conventional financial institution's approach. In Islamic banking practice there is no separation between financial institutions and other business institutions. Hence the term Islamic Bank is actually a misnomer. In actuality, an Islamic bank is a conglomerate that involves many types of businesses and holding many types of trading assets such as properties, motor vehicles, plants and machineries. At the same time the conglomerate also offers some financial services to accommodate the trading activities with their clients and suppliers.

Two types of financing that Islamic banks could offer, these are for debts and equity financing. Though debt financing such as instalment sales and deferred payment schemes are allowed in Islamic banking but generally Muslims prefer to use equity financing in their funding mechanism. The purest form of equity financing will be in the form of venture capital and common shares subscriptions in the businesses. However the concept of temporary investment using the concept of Declining Balanced Investment (Musyarakah Mutanakisah) is gaining popularity in the Islamic banking practices. In its basic form, the financial institutions will finance a particular project of business as an equity investor. It however allow the entrepreneur's partners to buy back the equity held by the financial institutions at any time during a particular time period. The entrepreneur's projected return on the business will be used as the basis of gauging the return on the equity investment. The return will still be measured in terms of a percentage of the total equity in the business. This approach can create a true partnership arrangement between the entrepreneurs and the financial institutions in running a business.

In the context of SMEs' financing, at the outset one would see the Declining Balance Investment arrangement for the financial institutions will only increase its risk profile in financing the SMEs. However this will only depend on the circumstances and the surrounding system.

The whole system now shifts the attention towards the profitability and viability of the projects financed. The decision in financing a business or project will be viability-centric. This will be more efficient in promoting productivity increase in a the economy. It will be seen to be fairer to the entrepreneurs who can structure a viable venture or business opportunity rather than 'clean' entrepreneurs - who are clean financially and has good collateral to offer but not necessary the most viable projects.

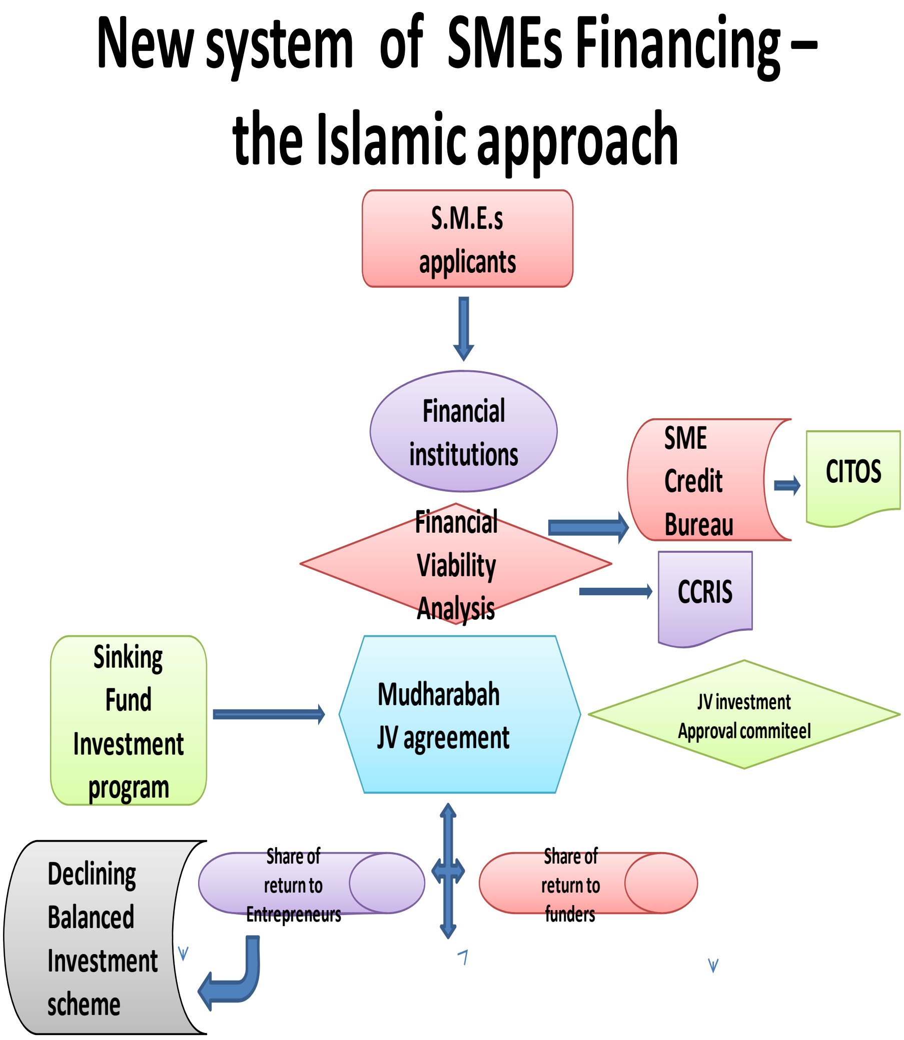
Another principle in joint venture investment applied in the Islamic Banking practice is the 'Mudharabah' (entrepreneurial profit sharing basis). Under this scheme two parties - one as capital provider (shahibul mal) and the other as the entrepreneur (mudharib) will work jointly to run a business. They will agree on the basis of profit sharing based on the different forms of contribution into the business. The financial institutions provide the capital and the entrepreneurs provide the experts and effort. The profit sharing basis varies according the agreement between the two parties – ranging between 10:90 to 30:70 between the entrepreneurs and the capital providers.

Hence as long as the project runs as expected, according to the financial projection, both the financiers and the entrepreneurs will benefit from the joint venture business and the entrepreneurs will have the opportunity to buy back equity investment in the project held of the financiers. This will provide the mechanism for the financiers to recover their investment over an agreed period, failing which the financiers can opt to sell the investment to another to recover the investment.

But then one may ask how does the financier mitigate the risk of project or business failure. A scheme of Sinking Fund investment could be initiated – that is agreed by both parties by which the financier will contribute a funding for double the volume necessary to fund the business or project. The other half of the fund will be invested in a safe lucrative investment that will generate a respectable annual return. The return on the investment will be re-invested and accumulated for several years until the whole investment value and return becomes more than doubled to take care of the initial total capital investment into the project and the investment program.

If arrangement could be made with a central bank, for example, to make the amount invested in the sinking fund investment above to form part of the legally required reserves to the central bank, then the financing banks will not feel the strain in the financing arrangement and at the same time mitigate their risk profile in the financing activities, Figure 5.1.

Figure 5.1: Illustrative Version of the SMEs Islamic Financing Scheme



An Islamic Micro Business Financing

Like SMEs, we could create a special financing scheme for the micro businesses in Malaysia using a special system and mechanism applying the Islamic banking practices. Unlike the SME financing that are more commercial in nature, the micro business financing will need to be regarded as a social banking mechanism. In Islam, there is a concept of 'Benevolent Loans' (Qardhul Hassan) which enable people in need to borrow at benevolent terms. At benevolent terms means that the borrower will not have to pay for any charges including financing charges for the loans. The objective is to relieve the borrowers from the hardships in life so they could up-lift their living condition financially. This does not prevent them from donating some extra money when they return their borrowing to the financial institutions as gifts to show gratitude if their business prosper subsequently.

The issue is how do we generate the 'free fund' to finance the micro businesses also at 'free of charge'? The challenge is to accumulate the excess fund belonging to individuals and corporate citizens in an economy. We could create a social bank – call it a Benevolent Bank. The bank will invite anyone to lend their money to the bank. This is simply by depositing their money with the Benevolent account which works exactly like the 'Current Account' of the normal conventional bank. Depositors put their money into the account without expecting any return except for the good deed that they can expect huge rewards in the day-after (in the next world). At the same time they can always withdraw their saving at any time they like using their cheques or ATM cards.

However, history has shown that only about 30% of bank deposits will ever be circulated by the owners. The rest will rest 'solid' in the accounts. Hence it is this balance of 'solid' amount that will be used to help finance the Micro Businesses under a benevolent basis. The social bank may have to invest 10 – 15 % of the fund themselves to generate sufficient return to pay for their operating overheads. As a social bank, it will not strive for any profit other than the objective to improve the well being of the citizen.

What we have here is a double 'benevolent' scheme being practiced – one at the fund accumulation's stage relying on all individuals and corporate citizen in the society, the other is at the social bank's stage where the bank provides financing facilities at benevolent terms. This will be a perfect system of complementarily between the 'have and have-not' in a society.

How could the bank protect themselves from the possible bad debts? The same sinking fund program could be created at the bank's level where, the bank will only lend 50% of their lending capacity (i.e. 50% of the 60% of funds available). The other 50% will be invested in the attractive safe investments in the economy. This could be done through the national guaranteed investment scheme – such as the National Equity Investment Institution in Malaysia.

In actual fact, the social bank would grow in the long term when they are able to collect back the financing that they provide to the Micro-businesses community and at the same time made money from their investment in the national investment program.

A mechanism must be created to closely monitor each of the micro-businesses that the bank's finance not only to make sure that they recover their investment (financing) but also to make sure that the micro businesses are run well and would grow to become substantial SMEs in the near future.

What then is the role of Credit Information and the credit bureau in this new Islamic Banking environment?
The credit reference and credit bureau services will act as the second expert opinion in the financing decision mechanism but their information will not become the main

decision basis. The SME Credit Bureau could shift their attention to rate project viability and profitability rather than credit risk. This will make their services more meaningful and create a new levelled at playing field in the SMEs and Micro businesses financing arena.

What about the role of Credit Guarantee Corporation in the new Islamic Banking scenario portrayed above?
Credit Guarantee Corporation works on the third party confidence system, whereby the CGC act as the third party to verify and certify the financial institutions decision on financing a particular applicant. It acts to add credibility of the financing decision by the bank. In essence, it is no different from the credit bureau's services in rating the applicant's credit risk. In the case of default, CGC will have to bear all the consequent losses. Since CGC is owned by all the commercial banks in Malaysia, the consequential losses with the commercial banks in Malaysia in a risk-sharing agreement.

Under the new scheme, CGC could change their role from guaranteeing financing by commercial banks just based on their credit evaluation, one which creates the Sinking Fund Investment scheme and program for the commercial and social banks. That means, for every loan or a group of loans disbursed to SMEs and Micro businesses, CGC will create a sinking fund investment scheme to totally protect the possible default of the financing. The banks could be the one providing the funding for the sinking fund investment. CGC would become the sinking fund managers to protect the financial institution from the possible default.

A more refined scheme would be to convert CGC to become an Investment bank that will specialise in managing sinking fund investment. CGC could through the scheme of the sinking fund Investment that they create, offer some form of guarantee to the financial institutions for the financing that they provide at a fee. The main objective is to protect the volume of financing that the financial institutions had disbursed out. What matter in the end is where there is loans default or bad debts occurring, the financial institutions become well protected and at the same time CGC will have something to rely or to back them ultimately. However, ultimately, all these suggestions and recommendations would involve regulatory reforms and changes. Above all, the policy implications would also be big and deep.

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