

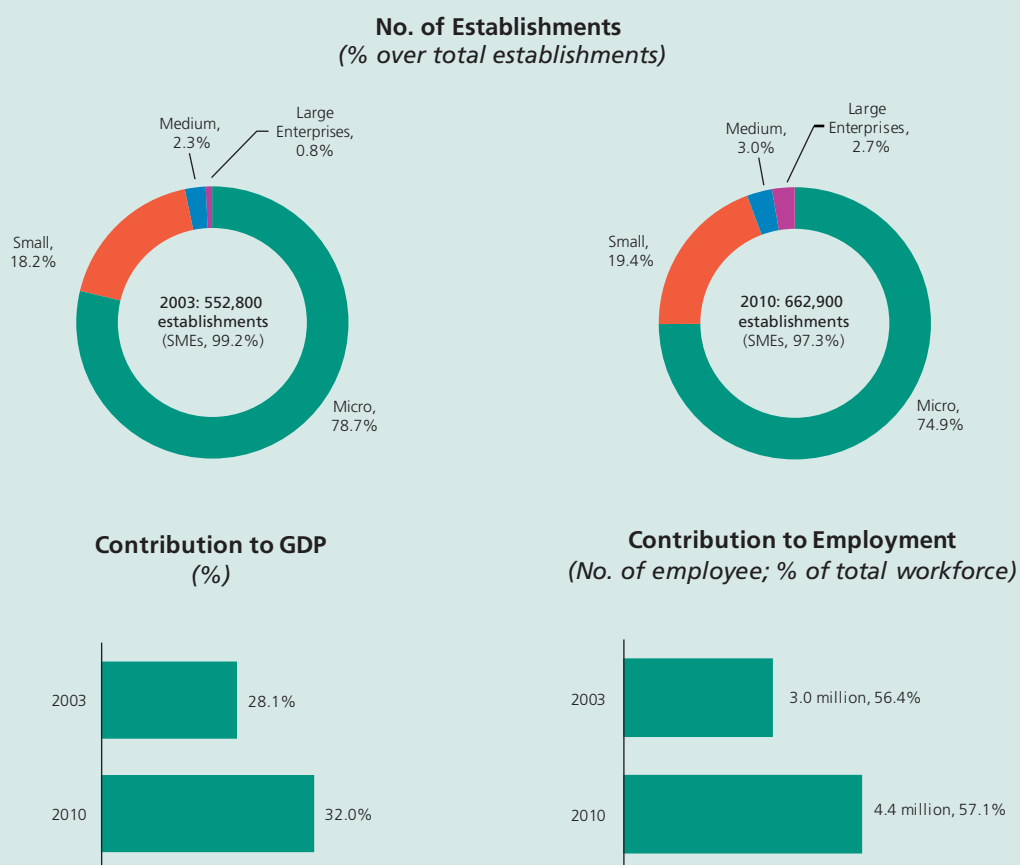
Developing the SME Financing Ecosystem

Introduction

SMEs are a critical component of the Malaysian economy, contributing a third of gross domestic product (GDP) and providing job opportunities to more than four million workers or 60% of total employment (Diagram 1). Based on the most recent census data compiled in 2011, the number of SMEs grew by 20% to over 662,000 compared with the last census of 2005. SMEs accounted for 97.3% (2005: 99.2%) of total business establishments. The development of the SME sector is crucial in ensuring balanced growth and shared prosperity as the country transitions into a high value-added, high-income economy. In particular, the sector contributes significantly to poverty alleviation due to the micro enterprises that make up more than three quarters of total SMEs. This sector is an important source of income and self-employment for low-income households, particularly in the sub-urban and rural areas.

Diagram 1

SME's Contribution to the Economy



Source: Department of Statistics, Malaysia

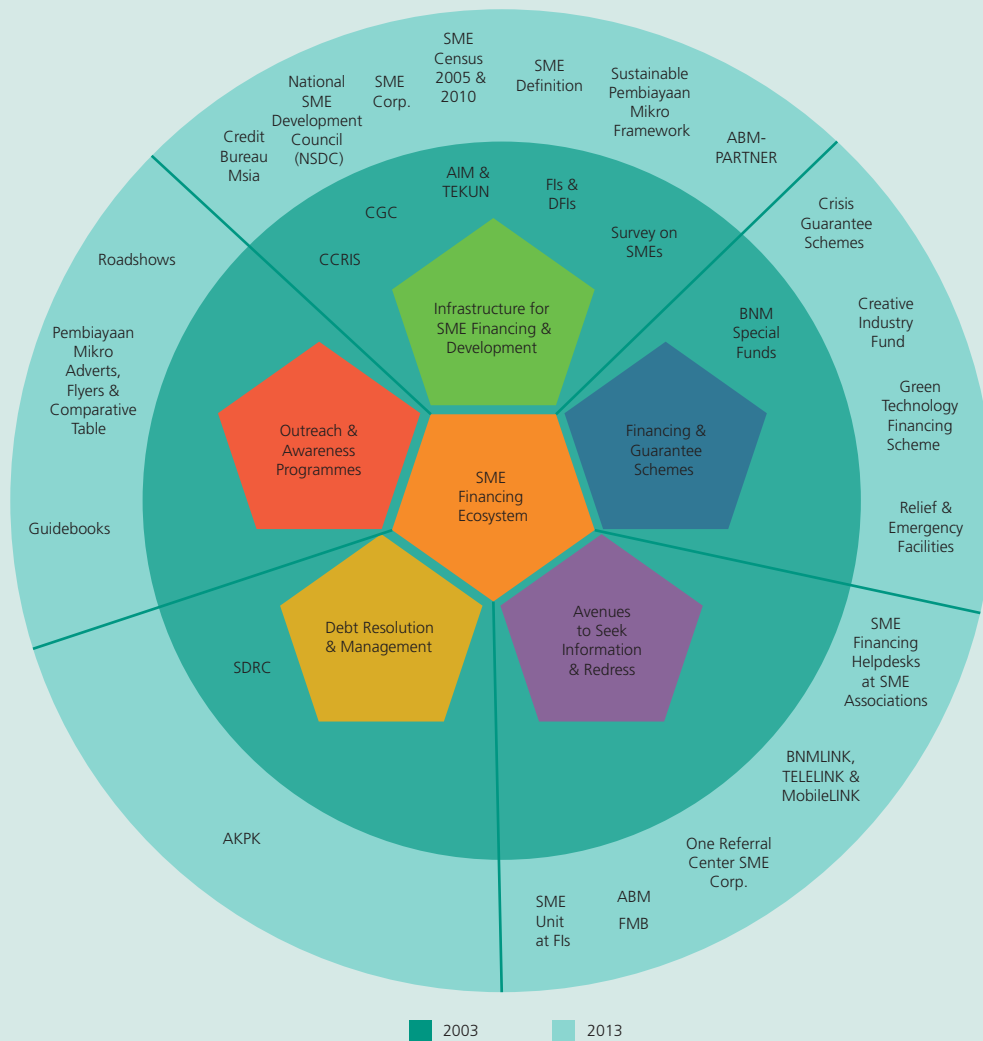
Recognising the importance of SMEs' contribution for sustainable growth, the Bank has collaborated with the relevant Ministries and agencies since 2001 to develop a holistic and coordinated framework for the development of this sector. This culminated in June 2004 with the establishment of the National SME Development Council (NSDC), chaired by the Prime Minister and comprising 16 Ministries and key agencies, as the highest policy-making body for SME development. The NSDC plays a pivotal role in driving policy, monitoring the implementation of development programmes and improving the quality

of and access to information to inform both policy and business decisions. An important focus of the NSDC has also been on promoting greater access to financing and advancing initiatives to build and strengthen the capacity of SMEs to grow and succeed.

The NSDC drove a number of key initiatives such as the establishment of a national SME data baseline through the Census for Establishments in 2003 and the adoption of a standardised definition which provided a clear focus for development programmes. The SME definition was recently revised to reflect changes in economic structure, business trends and inflation-adjusted indicators of size. This will ensure that policies and programmes are directed at the targeted segments. In line with the nation's economic transformation agenda, the NSDC continues to focus on creating an enabling environment for the SMEs to prosper as well as nurturing and developing their capacity to be commercially viable and competitive in the global market.

Diagram 2

Evolution of SME Financing Ecosystem



Source: Bank Negara Malaysia

The Bank was the Secretariat for the NSDC until 2008, when the role was assumed by the Small and Medium Industries Development Corporation (SMIDEC), which was later transformed in 2009 as SME Corporation Malaysia (SME Corp). SME Corp acts as the central coordinating agency for SME policies and programmes across relevant Ministries and agencies. It also serves as the point of reference for information and advisory services.

An important element in this holistic development framework is an inclusive financing ecosystem. This includes establishing effective institutional arrangements for financing and development through the establishment of specific schemes and providing avenues for information, advice and redress as well as debt resolution and management, and outreach programmes.

Building the Foundations of an SME Financing Ecosystem

The initial stages of building a financing ecosystem involved developing key infrastructure and institutional arrangements that expanded access to financing while promoting a sound credit culture. Initiatives by the Bank included the SME Client Charter guidelines which lifted the standards of efficiency and effectiveness in providing financial services to the enterprises. These standards have been raised further under the ABMPARTNER initiatives in recent years which have streamlined application processes and turnaround times across the financial industry. The Central Credit Reference Information System (CCRIS) has also played a critical part in improving the ability of banking institutions to undertake credit assessments and monitor the performance of borrowers. This is complemented by the Credit Bureau Malaysia which enabled the development of credit history which would in turn, enhance the prospects for SMEs to obtain financing.

In 2006, *Skim Pembiayaan Mikro* was introduced under the National Sustainable Microfinance Framework. This scheme enables fast, easy and convenient access to business financing without collateral from participating financial institutions (PFIs), thereby overcoming problems arising from the lack of credit history and collateral which often prevented SMEs from qualifying and obtaining financing facilities. A common branding platform has enabled the scheme to achieve scale and enhance its outreach to micro enterprises across the country. Under this scheme, PFIs manage their credit risk exposures by placing greater emphasis on assessments of business viability and cash flow patterns of borrowers. In addition, amount of financing extended will be increased over time as borrowers build good repayment track records. PFIs are also given access to funding at a lower cost from the Bank's Micro Enterprise Fund. The sustainability of the scheme is further supported by guarantees from CGC covering groups of borrowers with similar risk profiles and the ability of PFIs to set financing rates that reflect the risks assumed. Experienced PFIs also have developed customised products meeting the needs of small borrowers. For example, certain financing products are packaged with training in financial management and advisory services that are provided by the PFIs or in collaboration with other agencies such as SME Corp. Such value-added services will help micro enterprises better manage their businesses and in turn contribute to the sustainability of the scheme.

The *Skim Pembiayaan Mikro* complements other Government-sponsored microfinance programmes such as Amanah Ikhtiar Malaysia (AIM) and Yayasan Tabung Ekonomi Kumpulan Usaha Niaga Nasional (TEKUN). Since its inception, a total of RM2.4 billion of financing was approved under the scheme, which is supported by over 2,400 access points nationwide. As at end-2013, the total number of accounts under the scheme stood at 68,000 with total financing outstanding of RM857 million.

Guarantee schemes also played an important role that enable viable SMEs but without adequate collateral or track records to obtain financing. In this respect, the CGC was established in 1972 to pioneer the provision of guarantee schemes and has since developed a wide range of products and services to meet the needs of SMEs through widely distributed branches nationwide. To date, CGC has assisted more than 417,100 SMEs to obtain financing worth RM50.3 billion. More recently, the adoption of risk-based pricing model and the offering of portfolio guarantees have enabled CGC to further expand its reach to a larger number of viable SMEs. The corporation has also rewarded

borrowers with excellent repayment track records with rebates as an added incentive. CGC has maintained a healthy financial position in performing its mandate, enabling it to repay RM2.2 billion in loans that were provided by the Bank, including a RM300 million loan of which RM150 million was repaid and the balance was converted into equity. This also demonstrates that, with the appropriate structure and proper governance processes established, policy initiatives with a social mandate could be implemented in a financially sustainable manner.

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Development financial institutions (DFIs) play an important role in supporting priority sectors. Such institutions include the Small Medium Enterprise Development Bank Malaysia Berhad (SME Bank) which serves SMEs across all sectors, Bank Simpanan Nasional which focuses on the provision of microfinancing to micro enterprises, and Bank Pertanian Malaysia Berhad (Agrobank) which serves entrepreneurs in the agricultural sector. Since the responsibility for regulation and supervision of these institutions was vested in the Bank under the Development Financial Institutions Act 2002, broad measures were taken to significantly strengthen the institutional capacity and capability of these institutions to better serve their respective mandates in a sustainable manner. A customised prudential framework was implemented to promote sound corporate governance, risk management and financial prudence. As at end-2013, the total financing outstanding by DFIs amounted to RM13.3 billion, extended to 101,865 financing accounts. The DFIs' financial position has also improved substantially. Between 2005 and 2013, the gross impaired financing ratio had improved from 10.4% to 5.6% and the capital position remained strong at 20.9% as at end-2013 (end-2008: 22.4%).

The Bank has also set up special funds to ensure the availability of funds at reasonable costs. These include the Fund for Food (3F), Bumiputera Entrepreneur Project Fund-i (BEPF-i), Fund for Small and Medium Industries 2 (FSMI2), New Entrepreneurs Fund 2 (NEF2) and the Micro Enterprise Fund (MEF) which provide financing support for SMEs in specific sectors including new growth areas. With an initial allocation of RM11.4 billion, more than 58,000 SMEs have received financing from these funds. On a revolving basis, the total financing extended to date totalled RM24 billion as repayments of financing were used to finance new loans. In 2009, the Bank introduced BEPF-i managed by CGC to provide contract or project financing for Bumiputera entrepreneurs with an initial allocation of RM300 million. As at end-2013, a total of RM418 million financing was approved, benefitting more than 700 Bumiputera entrepreneurs. The asset quality remained stable attributed to the strengthened credit assessment process using cash flow analysis coupled with intensified recovery process undertaken.

Measures were also instituted to assist SMEs in managing challenges arising from economic and financial crises and natural disasters. During the Global Financial Crisis of 2008-2009, more than 10,500 SMEs received assistance through various channels including the Working Capital Guarantee Scheme (WCGS), the Industry Restructuring Loan Guarantee Scheme, and the SME Assistance and SME Modernisation Facilities. To enhance the safety net and emergency relief facilities due to natural catastrophes, a RM10 million SME Emergency Fund was established by SME Corp. Financial institutions have also stepped forward to provide other forms of financial relief, including temporary moratoriums for financing repayments, as demonstrated during the floods of December 2013. Similar support was provided under the Special Relief Guarantee Facility to 4,640 affected SMEs during earlier floods in 2007.

The Expanding Frontier for SME Financing

Building on the strong foundation laid by earlier measures to ensure access to financing, the policy focus has shifted towards facilitating financing for new growth areas and enhancing capacity and growth potential through advisory services and financial education.

The Bank, together with the financial sector, Government agencies and other stakeholders collaborated to spur investments and financing for new growth areas such as green financing and other innovative and strategic sectors. The Bank facilitated various avenues to bring businesses and financiers together to create a better understanding on the dynamics of financing required in these new areas. This included the Green Technology Financing Forum and seminars that were held in collaboration with the Institute of Bankers Malaysia (Institut Bank-Bank Malaysia, IBBM) to promote dialogue and increase awareness of transformative solutions for green technology financing. Support for financing facilities in new growth areas currently include GTFS established in 2010 with a fund of RM3.5 billion to facilitate financing in the energy, building, water and waste management, and transportation sectors. In addition, a RM200 million Creative Industry Fund was launched to spur commercial activity in the creative industry and a RM2 billion SME Financing Scheme-Islamic was established to cater for the various innovative sectors.

With increasing complexity in the financing ecosystem, the availability of avenues for SMEs to obtain information and redress has become more important. These avenues are widely available through the financial institutions, the Association of Banks in Malaysia (ABM) and SME Corp. This is further complemented by the Financial Mediation Bureau (FMB) as an additional avenue for borrowers to resolve disputes with financial institutions, and the Credit Counselling and Debt Management Agency (AKPK) which provides counselling and debt management services to individuals and sole proprietors. The Small Debt Resolution Scheme (SDRS) was established by the Bank in 2003 as a platform to assist SMEs in resolving debt and to avert defaults. Since its establishment, the scheme has helped 875 SMEs and restructured more than RM925 million of impaired loans.

Diagram 3

Key SME Financing Indicators

	2003 ¹	2006 ²	2013 ²
SME financing outstanding in RM mil (No. of accounts)	81,995 (406,086)	117,631 (615,634)	212,900 (676,144)
<i>Pembiayaan Mikro</i> outstanding in RM mil (No. of accounts)	-	84 (10,181)	857 (68,360)
Financing to green technology sector under GTFS in RM mil (No. of accounts)	-	-	1,580 (120)
% to total business financing	38.4	44.5	42.1
Average size of SME financing (RM)	202,000	191,000	315,000
Impaired loan ratio (%)	14.5	10.4	3.8

¹ Refers to banking institutions only

² Refers to banking institutions and DFIs

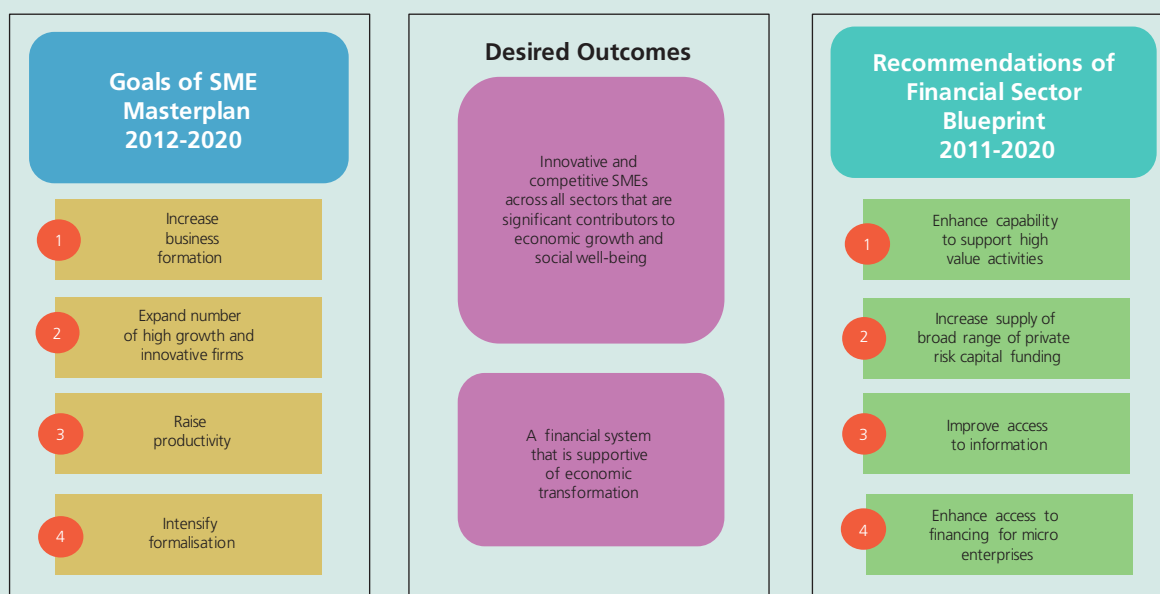
Source: Bank Negara Malaysia

Outreach programmes have been intensified to continuously educate SMEs especially micro enterprises on the availability of financing sources, assistance, and qualifying requirements. Chambers of businesses and associations have continued to run SME Financing Help Desks nationwide following training programmes initiated by the Bank for staff and members of the associations since 2011. The Bank also continues to disseminate educational materials and actively participate in outreach events organised by Ministries and agencies in collaboration with associations and other strategic partners.

The comprehensive and collaborative approach in developing the financing ecosystem has delivered significant outcomes. Total financing has doubled over the last decade, while the quality of financing has improved markedly from an impaired loans ratio of 14.5% in 2003 to 3.8% in 2013. Responsible financing practices by the financial institutions, and clients that are more informed and responsible in obtaining and utilising financing facilities, have also contributed to improved risk profiles of borrowers. These developments have seen Malaysia ranked 1st for six consecutive years by the World Bank in its 'Doing Business' reports since 2009 for 'Getting Credit'. Malaysia is also ranked 5th by the World Economic Forum for 'Ease of Access to Loans'.

Diagram 4

Holistic SME Development Framework



Source: Bank Negara Malaysia and SME Corporation Malaysia

Moving forward, continuous support for the development of the sector remains imperative for Malaysia's economic transformation. The SME Masterplan 2012-2020 (SMEMP) emphasises its importance as a strategic sector for achieving a high-income and high value-added economy while maintaining balanced and inclusive growth. With action plans directed at the focus areas of technology and innovation, marketing, human capital and entrepreneurship, infrastructure, the legal and regulatory environment, and access to financing, the sectors' contribution to GDP is projected to increase to 41% in 2020. This is complemented by recommendations under the Financial Sector Blueprint 2011-2020 (the Blueprint) which aims to further develop and expand the financing ecosystem. With the successful implementation of the SMEMP and the Blueprint, the SMEs will continue to be a key driver of sustainable growth of the Malaysian economy.