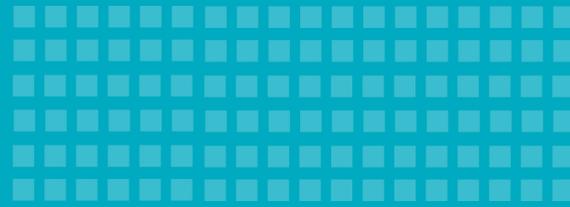


## :: SMEs Access to Financing



A well-developed financial infrastructure that is able to meet the diverse financing needs of SMEs is essential to support the competitiveness and continuous growth of SMEs.

The challenge has been for greater understanding by the financial services industry of the unique and diverse financing needs of SMEs across all sectors, and to ensure that adequate institutional arrangements and appropriate financial policies are put in place to address these needs. This has to be complemented with efforts to strengthen SMEs' capability, including in the area of business and financial management. Of importance is for SMEs to maintain rigorous business and financial records and submit complete information.

## Sources of Financing

The results of the Census of Establishment and Enterprise 2005 (Census) showed that most SMEs used their own internally generated funds and funds sourced from friends and family members to finance their operations. Only 16% of SME respondents indicated a reliance on financing from financial institutions (that is, banking and development financial institutions). In contrast, 50% of large companies indicated that financial institutions were their main source of funding.

### Sources of Financing

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

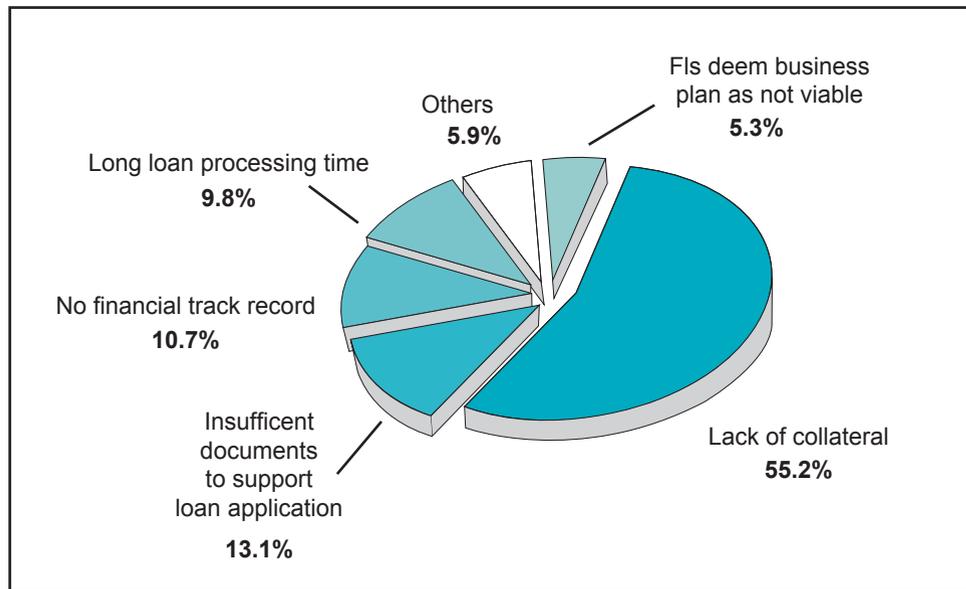
Source: Census of Establishment and Enterprise 2005, Department of Statistics Malaysia

A closer look at the sources of financing of SMEs by size, revealed a similar trend. Financial institutions were the main source of financing for medium-sized enterprises. However, micro and small enterprises depended mainly on their own internally generated funds. Indeed, only 10% of micro enterprises indicated that they relied on financial institutions for financing.

## Constraints Faced by SMEs in Obtaining Financing

Of the total 523,132 establishments that responded to the Census, only 54,011 establishments provided responses on difficulties faced in obtaining financing from banking institutions.

### Constraints Faced by SMEs



Source: Census of Establishment and Enterprise 2005, Department of Statistics Malaysia

The Census highlights lack of collateral as the main obstacle faced by SMEs when seeking financing from banking institutions. 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.

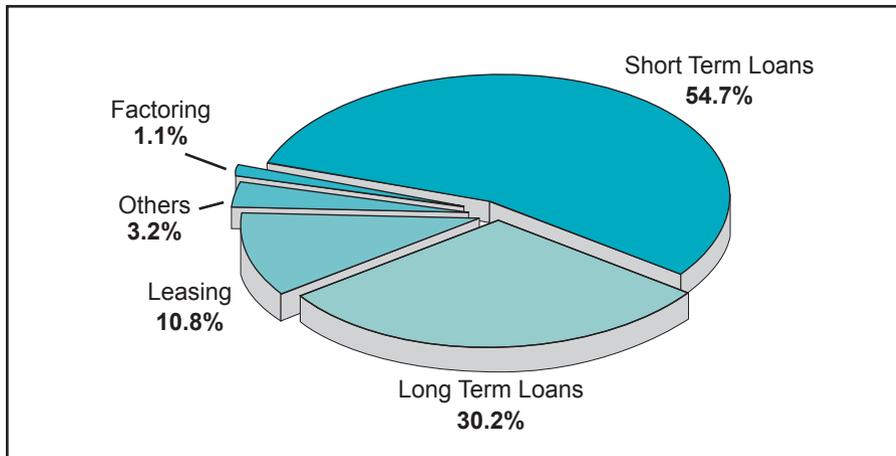
The findings are not unique to Malaysia. A survey of European SMEs<sup>1</sup> revealed that lack of collateral mostly affects micro and small enterprises, while poor business performance and insufficient information are the main reasons for medium enterprises failing to obtain financing from banking institutions.

<sup>1</sup> 2003 Observatory of European SMEs by European Commission, SMEs and Access to Finance

## Types of Facilities and Purpose of Financing

A total of 139,845 SMEs provided responses in the Census on types of credit facilities utilised.

**Types of Credit Facilities Utilised by SMEs**

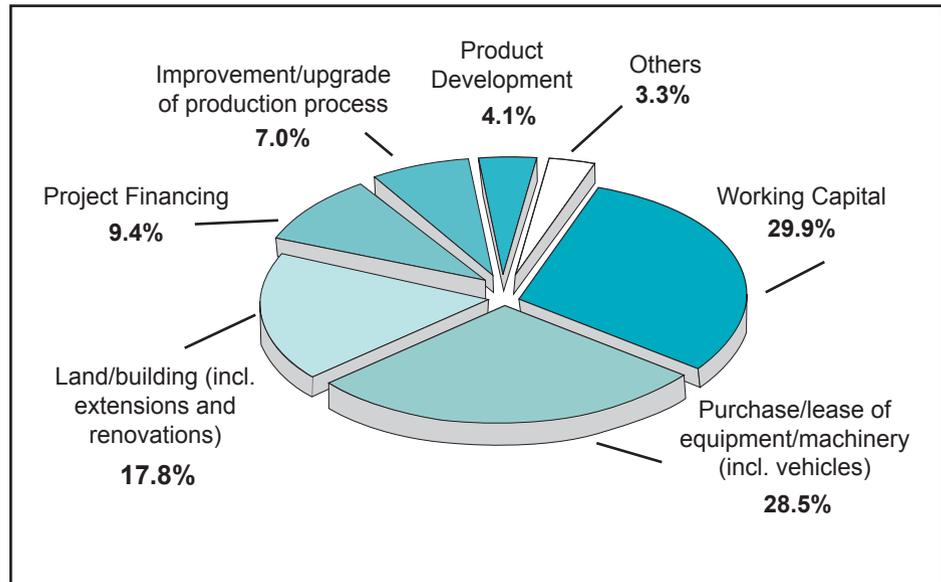


Source: Census of Establishment and Enterprise 2005, Department of Statistics Malaysia

The main types of credit facilities utilised by SMEs are short-term and long-term loans, as well as leasing. 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.

## Purpose of Financing by SMEs



Source: Census of Establishment and Enterprise 2005, Department of Statistics Malaysia

Based on a sample size of 423,400 SMEs, 30% indicated that the main purpose of financing is for working capital requirements, followed by the requirements to purchase/lease of equipment/machinery.

The Census results indicate that working capital requirements are greater the smaller the size of the establishment. Working capital is 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.

## Financing to SMEs

SMEs can seek financing from various types of financial institutions, including banking institutions, development financial institutions (DFIs), leasing and factoring companies, as well as venture capital companies, which provide equity financing. In addition, SMEs can also make use of various specific-purpose special funds set up by the Government to help SMEs.

**All main providers of funds have registered significant increases in financing provided to SMEs.**

Recent trends have shown a marked improvement in terms of financing provided to SMEs. All main **providers of funds have registered** significant increases in the financing provided to SMEs. The banking system loans to SMEs accounted for 42.6% of total business loans outstanding at end-2005, compared with 30.1% at end-1999. There are 81 Government special funds with total allocation of RM12.7 billion available for SMEs at end-2005.

### (a) Banking Institutions

With the development of the domestic bond market, the banking institutions have given greater focus on loans to SMEs, while the large corporations have shifted to the capital markets to meet their financing requirements.

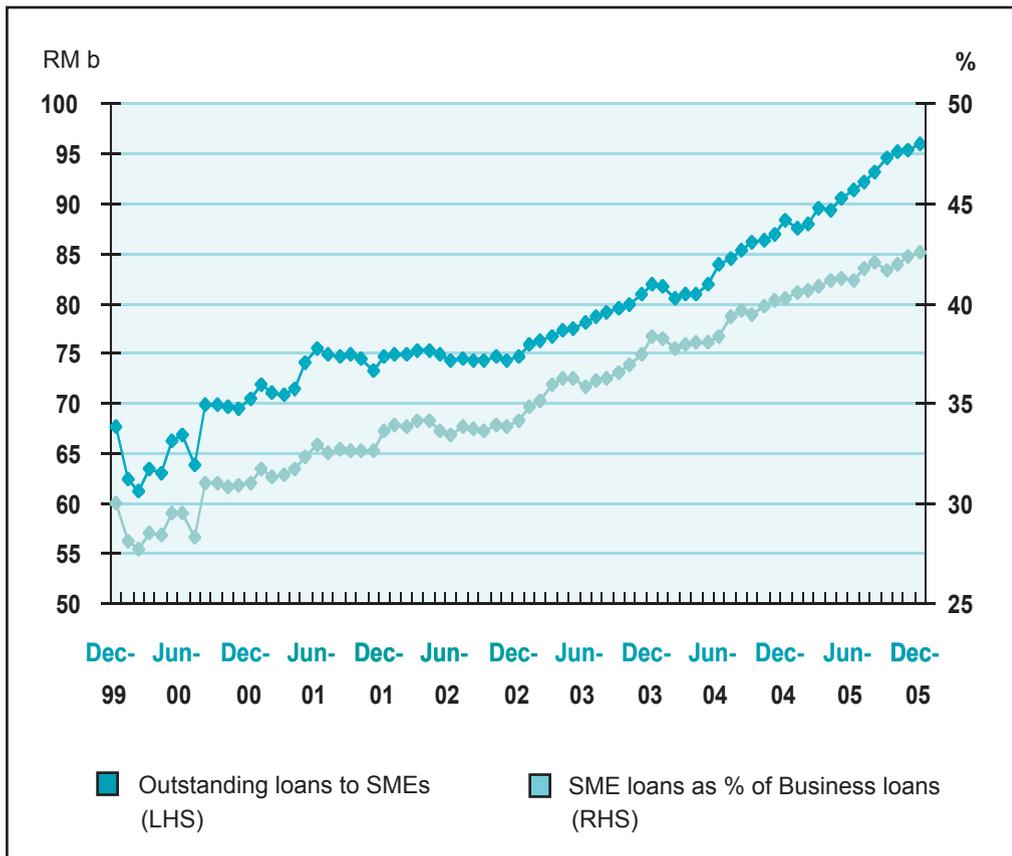
To give SMEs better access to financing from the banking institutions, Bank Negara Malaysia had initiated efforts towards improving the banking institutions' facilities, outreach and services to SMEs. Now, all commercial banks have:

- Established a dedicated unit to deal with SME customers  
The role and function of the unit covers a broad spectrum of SME issues ranging from identifying and structuring appropriate financial requirements to providing cash management services and other ancillary services such as financial management and insurance protection.
- Set up Bumiputera Development Unit  
The unit is entrusted with the mandate to address the financing needs and development of Bumiputera entrepreneurs.
- Established a Complaints Unit  
The unit aims to provide a proper channel for customers, including SMEs, to raise complaints and serve as the focal point in the banks for managing complaints.
- A Client Charter  
Banking institutions are required to display a client charter on processing of loans to SMEs, which should disclose at least the following:
  - Relevant documents and information to be submitted to the banking institutions;
  - Eligibility criteria for obtaining loans;
  - Duration taken to process a loan application; and
  - Requirement to inform reasons of rejection to applicants.

Initiatives undertaken led to substantial increases in lending to the SMEs with outstanding SME loans expanding at an annual growth rate of 6.5% since 2001, to reach RM96 billion or 42.6% of business loans outstanding at end-2005. Improving asset quality for SMEs amidst a conducive business and economic environment further supported the strong growth in lending to SMEs. Financing approved to the SMEs between 2002 and 2005 averaged at RM31.2 billion annually, whilst disbursements to SMEs averaged at RM86.9 billion annually.

In 2005, the banking system approved RM35.8 billion of loans to more than 85,000 SME accounts, an increase of 13.3% from 2004 (2004: RM31.6 billion; 92,000 SME accounts). Loan disbursements grew by 10.2% to RM110.7 billion (2004: RM100.4 billion), while loans outstanding to SMEs expanded by 8.7% to RM96 billion as at end-2005 (end-2004: RM88.3 billion).

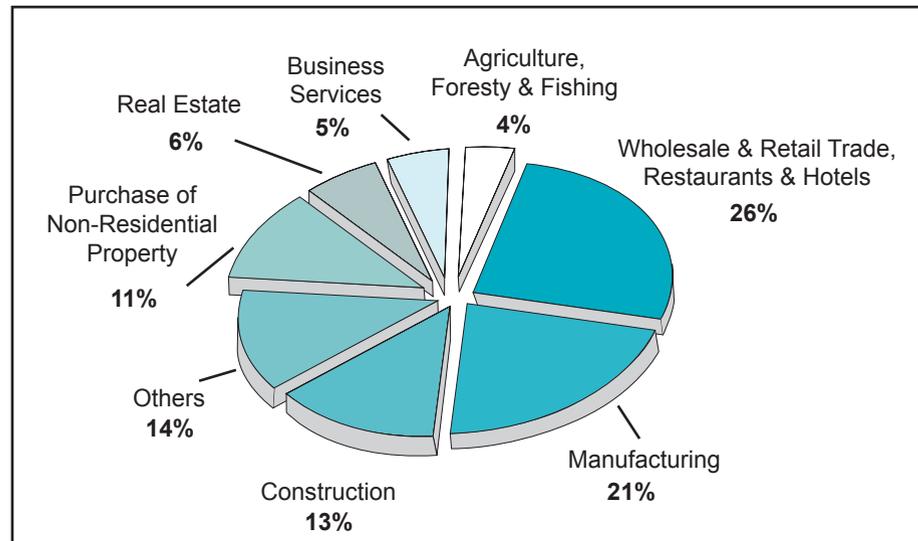
### Lending to SMEs on Upward Trend



Source : Bank Negara Malaysia

On a sectoral basis, lending to SMEs was diversified, with almost two-thirds being channelled to distributive trade, manufacturing and construction sectors.

### Loans to SMEs in all Sectors in 2005



Source : Bank Negara Malaysia

#### (b) Development Financial Institutions

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.

The DFIs that provide SME financing in Malaysia include the SME Bank, EXIM Bank, MIDF, Bank Pertanian Malaysia and Bank Pembangunan Malaysia Berhad for high-technology and ICT companies.

In 2005, the DFIs approved RM2.3 billion of loans to 5,225 SME accounts (2004: RM2.4 billion to 5,397 SME accounts), and disbursed RM1.5 billion (2004: RM1.2 billion). The loans outstanding of DFIs to SMEs increased by 3.3% to RM3.1 billion as at end-2005 (end-2004: RM3 billion).

The Credit Guarantee Corporation Malaysia Berhad (CGC) continued its role as Malaysia's primary provider of guarantees to enable SMEs with insufficient collateral to attain financing from banking institutions. As at end-2005, outstanding guarantee cover by CGC totalled RM6.9 billion, with outstanding guaranteed loans amounting to RM8.6 billion.

### **(c) Leasing and Factoring Companies**

Another source of financing for SMEs is 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.

In 2005, RM819 million of financing was extended by leasing and factoring companies to businesses in services, manufacturing and general commerce sectors (2004: RM996 million).

### **(d) Venture Capital Companies**

For newly established businesses, especially in the information and communications technology (ICT) sector, financing could also be obtained from venture capital companies. Venture capitalists usually take a stake in a business in exchange for providing capital.

The total available funds for venture capital investments increased by 14.3% to RM2.6 billion as at end-2005 (end-2004: RM2.3 billion). The funds were invested in 380 companies as compared with 332 companies as at end-2004.

### **(e) BNM SME Special Funds**

Bank Negara Malaysia has a number of special funds aimed at enhancing access to finance at reasonable costs for SMEs.

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Currently, the Bank has five special funds with lending rates ranging from 3.75% to 6.00%. The funds are channeled through participating institutions comprising banking institutions, DFIs, and ERF Sdn. Bhd. They are:

- Fund for Small and Medium Industries 2 (fund size: RM6.75 billion);
- New Entrepreneurs Fund 2 (fund size: RM2.85 billion);
- Fund for Food (fund size: RM1.3 billion);
- Rehabilitation Fund for Small Businesses (fund size: RM200 million); and
- Bumiputera Entrepreneurs Project Fund (fund size: RM300 million).

As at end-2005, RM11.22 billion has been approved to 24,503 SME accounts under these five funds.

#### **(f) Government Funds for SMEs**

In addition to financing from the commercial sector, the Government also provides funds for SMEs. Government funds for SMEs are mainly for nurturing and developmental purposes.

As at end-December 2005, there were 81 Government funds/financing schemes for SMEs with a total allocation of RM12.7 billion. Of the 81 funds and schemes, 49 were in the form of soft loans, while the remaining were in the form of grants (20), equity financing (5) and venture capital funds (7). These funds and schemes have various objectives that could be summarised as follows:

- To encourage SMEs to be more innovative in using and adapting to the existing and new technologies and processes;
- To improve product quality;
- To assist SMEs to conduct market and technology feasibility studies, prepare business planning and formulate domestic and export market strategies;
- To stimulate the development of Bumiputera SMEs; and
- To assist youth including graduates to undertake business venture.

The funds and schemes are administered by 22 Ministries and agencies and have reached 893,687 SMEs with an outstanding balance of RM5.2 billion as at end-2005.

## Performance of Government Funds/Schemes as at end-December 2005

No.	Type of Assistance	No. of Schemes	Allocation (RM billion)	Applications Approved		Disbursed	Outstanding
				No.	(RM' billion)		
1	Loans*	49	8.5	855,193	58.0	55.7	4.7
2	Grants	20	2.1	37,670	2.0	1.7	-
3	Equity	5	0.6	704	0.7	0.5	0.4
4	Venture Capital	7	1.5	120	0.4	0.3	0.1
	<b>Total</b>	<b>81</b>	<b>12.7</b>	<b>893,687</b>	<b>61.1</b>	<b>58.2</b>	<b>5.2</b>

Source: Bank Negara Malaysia

\* Including schemes for micro enterprises - micro credit schemes (by Bank Simpanan Nasional & Bank Pertanian Malaysia), Yayasan Tekun Nasional and Amanah Ikhtiar Malaysia.

## Major Initiatives on Enhancing Access to Financing

The policy on enhancing access to financing by SMEs during 2004 - 2005 focused on strengthening the existing infrastructure to ensure a more effective channelling of funds to SMEs, provision of financial advisory support and enhancing awareness on financial products and assistance programmes available to SMEs.

A major initiative was also introduced to assist in debt restructuring of financially distressed SMEs with viable business.

## **(a) Institutional Developments**

- **Establishment of the SME Bank**

The SME Bank commenced operations on 3 October 2005 as a result of an integration and rationalisation exercise between Bank Pembangunan dan Infrastruktur Malaysia Berhad and Bank Industri & Teknologi Malaysia Berhad.

The SME Bank's aim is to support the development of the SME sector. To carry out this task, it will complement the banking institutions through the provision of financial and business support services to the SMEs.

Its services include equity financing, the funding of working capital, term loans, industrial hire purchase, leasing, factoring, contract financing as well as bank guarantees. In addition, the SME Bank will also provide business and consultancy support services, such as advisory services and preparation of business plans.

- **Transformation of Credit Guarantee Corporation Malaysia Berhad**

One of the initiatives to strengthen the infrastructure of SME financing is the transformation of CGC involving the enhancement of its role and expansion in the range of products and services offered by CGC.

In enhancing SMEs' access to financing, CGC will take a holistic approach, by providing wider range of credit enhancement products, advisory services on financial and business development, and credit information services, including business credit rating. These services are aimed at facilitating greater lending to SMEs while promoting sound financial management practice by SMEs.

The composition of the Board of CGC has been broadened to include members with direct experience in business and finance, while efforts are being taken to strengthen the resources of CGC.

### • The Small Debt Resolution Scheme

The Small Debt Resolution Scheme (SDRS) was established on 1 November 2003 to facilitate the restructuring of SMEs with viable businesses but burdened with non-performing loans (NPLs).

Under the mechanism, a Small Debt Resolution Committee undertakes independent assessments on the viability of the businesses, and loan restructuring and financing requirements of the SMEs.

As at end-2005, 394 applications with NPLs of RM278 million were received under the scheme. Of these, 286 applications (73%), involving NPLs of RM183 million, have

been approved for restructuring and RM16 million new financing was approved under the Rehabilitation Fund for Small Businesses.

A total of 83 cases, with total NPLs of RM83 million, were rejected due to non-viability, while 25 cases involving NPLs of RM12 million were being evaluated.

The performance of the scheme has shown that the restructuring of NPLs is more important than the provision of new financing in ensuring the viability and sustainability of financially distressed SMEs.

### • Financial Advisory Services

Bank Negara Malaysia provides financial advisory services to SMEs in the following areas:

- Information on various sources of financing;
- Assistance in facilitation of loan application process; and
- Advice on financial requirements and problems of SMEs.

In 2005, the number of enquiries and assistance sought by SMEs increased to 4,019 cases (2004: 1,399 cases) reflecting heightened awareness among SMEs as well as a result of the establishment of Laman Informasi, Nasihat dan Khidmat (LINK), in Bank Negara Malaysia, Kuala Lumpur.

Of these, 81% were enquiries on special funds provided by the Government and advice on loan matters, and 19% were complaints against financial institutions, mainly for cases of loan rejection and poor response on SMEs' loan applications.

## (b) Development of New Financial Products for SMEs

### • Securitisation of SME Loans

Securitisation of SME loans of the banking institutions will be introduced. Through securitisation, banking institutions will have greater flexibility in managing their SME loan portfolio and further enhance their financial capacity to provide lending to SMEs. In addition, securitisation would also enable SMEs to indirectly tap the capital market for financing, thus broadening the sources of funding for them.

### • New Trade Finance Products for SMEs

Two new trade finance products for SMEs were introduced in January 2006, namely the Multi Currency Trade Finance (MCTF) and Indirect Exporter Financing Scheme (IEFS), under both conventional and Islamic financing. These products are aimed at encouraging SMEs to export their goods and services, particularly to the non-traditional markets such as members of the Organisation of Islamic Countries.

The MCTF provides financing to Malaysia direct exporters in Ringgit and major foreign currencies in the form of pre and post shipment financing.

The IEFS provides Ringgit financing to indirect exporters without recourse, whereby the participating banks will discount their trade invoices arising from the supply of goods and services to direct exporters.

These products will benefit the SMEs by lowering financing costs, without collateral requirements. Under the arrangements, the SMEs can obtain financing from the participating banks, with the credit risks being shared between the bank and Export-Import Bank of Malaysia Berhad.

### • Venture Capital for Agriculture Sector

To support the Government's objective of realising the potential of the agriculture sector as the third engine of growth, BNM is establishing two venture capital funds of RM150 million each for the agriculture sector in 2006.

The objective of the funds is to create and develop an integrated agricultural business through the provision of venture capital

financing, as well as technical and business support, with spill over effects that will benefit and enhance the entire value chain of the agriculture sector.

The targeted areas for investments are integrated farming and fisheries, as well as biotechnology-related ventures.

## Moving Forward

Despite various measures and high amount of loans and financing extended to SMEs, the findings of the Census show that accessibility of loans remains an issue faced by SMEs.

To ensure greater access to financing for SMEs, strategies would focus on:

- Establishing and strengthening institutional arrangements that are conducive for the whole spectrum of SMEs. These would include the coordination of initiatives administered through various Agencies and Ministries, under the guidance of the National SME Development Council;
- Fostering a conducive environment to promote greater lending by the financial institutions to SMEs; and
- Increasing the level of awareness on various financing options and initiatives available to SMEs.

While the banking system will continue to be the main provider of funds to the SMEs, the Government and its agencies will continue to make available financing assistance in the form of special funds and financing packages to targeted groups.

Nevertheless, recognising that financing alone is not sufficient, the initiatives on financing will be complemented and supported by capacity building programmes to evolve strong and well-managed SMEs that would improve their prospects for better access to financing.