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FINANCING OF SMALL FIRMS IN MALAYSIA: COMPARISONS WITH  
INDONESIA AND SINGAPORE

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Thesis submitted for the fulfilment of the  
Degree of Master of Arts  
University of Durham  
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1992



- 8 SEP 1992



In the name of God (Allah), Most Gracious, Most Merciful

## ABSTRACT

Financing of small firms in Malaysia, Indonesia and Singapore is one of the main strategies of promoting them in achieving the country's national development priorities. In Malaysia and Indonesia, pronouncements in national development plans have led to the passage of specific laws and regulations favourable to small and medium enterprises (SMEs). Singapore however, stresses the need to create an overall economic climate conducive to enterprise, and believes that the market can provide many services for SMEs more effectively than the Government.

Policies and programmes established to redress the financial constraint are classified into those which improve the business environment or those which create or develop small firms directly.

Singapore appears to be successful in creating an overall conducive economic climate to enterprises. Regarding the objective of creating SMEs to be viable exporters of manufactured goods to world markets, there is yet an overall assessment to show its conclusive success. Malaysia and Indonesia had the additional problem of both poverty and lack of entrepreneurship concentrated in the indigenous people. Both these countries responded by various policies which appear complicated. In Malaysia, the incentives offered and the number of organisations involved indicate that the government is favourably disposed towards entrepreneurship and investments by SMEs. Some of the specific incentives have shown to be very effective; others slightly effective; a few have unintended effects. Institutional finance to facilitate the creation of entrepreneurs seems to be available but there seems to be an information gap, advice gap and education gap to meet the desired objective. Overall, financial institutions as a source of finance in Indonesia are still not readily accessible to the majority of small firms.

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**FINANCING OF SMALL FIRMS IN MALAYSIA: COMPARISONS WITH  
INDONESIA AND SINGAPORE**

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## ABBREVIATIONS

AFF	Armed Forces Fund
AJDF	Asean-Japan Development Fund
ASEAN	Association of South East Asean Nation
ASLS	Association Special Loan Scheme
ASN	Amanah Saham National (National Unit Trust Scheme)
ATM	Automated Teller Machines
BA	Bankers acceptances
BBMB	Bank Bumiputera Malaysia
BDS	Business Development Scheme
BEFIP	Banker's Export Finance Insurance Policy
BEST	Basic Education for Skills Training
BIPIK	Proyek Bimbingan & Pembangunan Industri Kecil (Project for Developing and Upgrading SSI)
BLR	Base Lending Rate
BPM	Bank Pertanian Malaysia (Agricultural Bank of Malaysia)
BPMB	Bank Pembangunan Malaysia (Development Bank of Malaysia)
COSEC	Core Skills for Effectiveness and Change Scheme
CGC	Credit Guarantee Corporation
DAS	Design Advisory Scheme
EDB	Economic Development Board
EDD	Entrepreneurial Development Division
EDP	Entrepreneurial Development Programme
EPF	Employees Provident Fund
ERF	Enterprise Rehabilitation Fund
ESIFS	Extended Small Industries Finance Scheme
EXIM	Export-Import Bank of Japan
GDP	Gross Domestic Product
GGS	General Guarantee Scheme
GNP	Gross National Product
IAF	Industrial Adjustment Fund
IBA	Industrial Building Allowance
IBMB	Industrial Bank of Malaysia
ICA	Industrial Coordination Act
ICFC	Industrial and Commercial Finance Corporation
IGMS	Interest Grant for Mechanisation Scheme
IMF	International Monetary Fund
INTEC	Initiatives in New Technology Scheme
ITA	Investment Tax Allowance
ITAF	Industrial Technical Assistance Fund
ITM	Institut Teknologi MARA (MARA Institute of Technology)
KIK	Kredit Industri Kecil (Small Investment Credit)
KMKP	Kredit Modal Kerja Pemesaran (Small working capital credit)
LFHPT	Loan Fund for Hawkers and Petty Traders
LGS	Loan Guarantee Scheme
LIS	Light Industries Loan Service
LIUP	Local Industry Upgrading Programme
MARA	Council of Trust for the Indigenous People
MARDI	Malaysian Agricultural Research and Development Institute
MAS	Monetary Authority of Singapore
MDAS	Market Development Assistance Scheme
MECIB	Malaysian Export Credit Insurance
MEDEC	Malaysian Entrepreneur Development Centre
MIDA	Malaysian Industrial Development Authority
MIDF	Malaysian Industrial Development Finance
MIEL	Malaysian Industrial Estates Limited

MNC	Multinational Corporation
NBFI	Non-bank Financial Institution
NCB	National Computer Board
NCD	Negotiable Certificate of Deposit
NDP	New Development Plan
NEF	New Entrepreneurs Fund
NEP	New Economic Policy
NERDA	National Entrepreneur Research Development Association
NIF	New Investment Fund
NPB	National Productivity Board
NPC	National Productivity Centre
NSB	National Savings Bank
OECD	Overseas Economic Cooperation Fund
OPP	Outline Perspective Plan
PDAS	Product Development Assistance Scheme
PERNAS	National Trading Corporation
PGS	Principal Guarantee Scheme
PNB	Permodalan Nasional (National Equity Corporation)
RA	Reinvestment Allowance
RDAS	Research and Development Assistance Scheme
RIDA	Rural Industries Development Authority
SBA	Small Business Administration
SDAS	Software Development Assistance Scheme
SDF	Skills Development Fund
SEDC	State Economic Development Corporation
SIFS	Small Industries Finance Scheme
SIRIM	Standards and Industrial Research Institute of Malaysia
SISIR	Singapore Institute of Standards and Industrial Research
SITAS	Small Industries Technical Assistance Scheme
SLS	Special Loan Scheme
SME	Small and Medium Enterprise
SMI	Small and Medium Industry
SOCISO	Social Security Organisation
SSE	Small Scale Enterprise
SSI	Small Scale Industry
STF	Staff Training Fund
SWIFT	Society for Worldwide Interbank Financial Telecommunications
TGS	Training Grant Scheme
TPF	Teachers Provident Fund
TRS	Trainee Release Scheme
UDA	Urban Development Authority
USM	Unlisted Security Market

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## CHAPTER ONE

### INTRODUCTION AND OVERVIEW

The thesis is concerned with financing of small firms in Malaysia, Indonesia and Singapore. The choice of the topic arises from several considerations. The recent interest in the potential role of small firms in solving economic, social and political problems. Secondly, financing of small firms is crucial to business start-ups, and their subsequent survival and growth. The reason for the selection of these three countries for the study is that not only these three countries are neighbours in ASEAN (Association of South East Asian Nations) but also they are in different stages of development and pursuing different development priorities.

### BACKGROUND OF THE STUDY

Although there has been a great deal of research directed at entrepreneurship (Low and MacMillan, 1988) and the management problems of small firms (Mohamed, 1988), most existing research is done in developed countries. In recent years there has been great interest on small firms in Malaysia, Indonesia and Singapore. Most of the studies are concerned with entrepreneurship development (Popenoe, 1970; Mohamed, 1988) and management of small business (Ch'ng, 1986; Ghosh et al., 1991). Relatively little is known, however, about the financing of small firms in developing countries such as Malaysia, Indonesia and Singapore. Also very little is known about the strategies, challenges and success of the governments and financial institutions of these three countries in meeting the financing needs of small firms within the context of their national development priorities.

## Finance gap

The concern to identify the sources and size of financial constraints on small scale enterprises and to design policies to lessen them has been an issue for debate since the 1930s. The identification of a gap in the availability of relatively small quantities of finance was first identified by the Macmillan committee in the Macmillan Report of 1931 in the United Kingdom (UK), and the gap has come to be known as the "Macmillan Gap".

*"it has been presented to us that great difficulty is experienced by the smaller and medium sized business in raising the capital which they from time to time require even when the security offered is perfectly sound. To provide adequate machinery for raising long-dated capital in amounts not sufficiently large for a public issue always presents difficulties"* (Report of the Committee on Finance and Industry, HMSO, Cmnd.3897).

The Macmillan Gap was the lack of provision of financial facilities for small and medium enterprises seeking external finance and was a shortage in the flow of long-term capital to small scale enterprises.

New firms which often seem small are seen as reservoirs of innovation, entrepreneurship and employment and so are seen as important for the growth and development of an economy. Any deficiencies in the supply of funds are therefore a cause of concern both to the firms' owners and the economy. Thus, the issue of the existence of a finance gap has caused much government involvement in financing small firms.

In the UK the identification of the Macmillan Gap resulted in the establishment of the Industrial and Commercial Finance Corporation (ICFC) in 1946. The corporation was set up by the Bank of England and the English and Scottish clearing banks and was intended to supplement the existing financial institutions to provide either loan or equity finance or a combination of both, for small organisations.

In the United States (US) the American Small Business Administration (SBA) was established by Act of Congress in 1953 to *"assist, counsel and champion the millions of American small businessmen which are the essence and backbone of this*

country's competitive free enterprise economy." The SBA provided funds both in the form of loans and loan guarantees and in the form of equity. The SBA also provides counselling services and training for small businesses' owners.

The issue of a finance gap came back when it was reported in the US Federal Reserve Board Report of 1958 that:

*"there was an unfilled margin, perhaps a rather thin one, between the volume of funds available to small concerns in general and to new firms in particular, and the volume that could be put to use without prohibitive risk"* (Federal Reserve System, Financing Small Business, Select Committee, United States Congress, 1958).

Kaplan and Banner (1958) and Garvin (1968) claimed to have evidence on the small scale enterprise (SSE) capital gap with respect to intermediate and long term loans. However, Stoll and Curley (1970) in their paper concluded that there is no small business equity gap.

In the UK, the Radcliffe Committee Report 1959 commented that the financial facilities for small firms lack some of the facilities open to large companies for obtaining capital:

*"There is, moreover, no recognised and readily accessible channel corresponding to the new issue market for large firms, through which the small industrialist can raise long-term funds"* (Report of the Committee on the Working of the Monetary System, London, HMSO, Cmnd.827).

Bates (1961) viewed that a financial problem for SSE exists and it is partly economic in that many firms are not credit-worthy by normal standards, and partly institutional in that the existing institutions are inadequate. However, the Bolton Committee Report (1971) concluded that there was no gap in terms of institutional provision but there was a gap in terms of information about sources of finance. The Bolton Committee Report (1971) stated:

*"no institutional deficiency in the finance market; that while there are some deficiencies on the basis on which small and large firms can raise money, these are mostly functions of inherent costs and scale differences ..... there is a need for an information and referral service intended to advise businessmen on the sources of advice available and*

*to offer guidance as to which is the most appropriate for a particular purpose" (Report of the Committee of Inquiry on Small Firms, HMSO, Cmnd. 4811).*

To remedy the disadvantage of the information gap, the Bolton Committee recommended the establishment of small firms' advisory bureaux. As a result the British government set up small firms information centres which provided a range of advice and counselling services.

Binks (1979) summarised the financing problems of small firms as:

*"the smaller the firm, the larger the proportionate increase in the capital base required to respond to an increase in demand, but the lower its ability to command loan and equity finance" (Lloyds Bank Review, October 1979).*

In 1979, an interim report was produced by the Wilson Committee, concerning the functions of financial institutions in UK. The Committee identified that a finance gap still existed in the arrangements for financing small firms, whatever the availability of finance to the rest of industry as a whole:

*"bankers believe that lending to small firms is more risky than lending to large and that loss ratios are therefore likely to be higher. Moreover, banks are notably reluctant in supporting innovative developments" (Interim Report of the Committee, HMSO, Cmnd.7503, March 1979).*

The Wilson Committee considered that institutional changes might counteract such a situation. Some of the institutional changes that were brought about included the introduction of the Unlisted Security Market (USM) at the end of 1980 to provide venture capital for small firms, and the establishment of a Loan Guarantee Scheme (LGS) which would help to remove the constraints imposed by security requirements that restrict bank lending to small firms.

The Wilson Committee also identified the alleged information gap and communication gap between small firms and financial institutions, saying that small firms may not know enough about the source and range of financial facilities and advice available to them. Even after small firms have identified an appropriate source of finance, they may lack the skills and experience to prepare a persuasive case.

Ray and Hutchinson (1986) claimed that a finance gap can exist in two ways:

*"firstly, a finance gap would exist if the marginal return on the investment available to small business exceeds their marginal cost of capital; due to discontinuities in the provision of finance, such funds were not available for otherwise profitable investment. Secondly, a gap would exist if the cost of money to small concerns, defined as the riskless rate of interest plus allowances for differentials in risk and loan administration costs, exceeded the cost of money to large concerns. Thus due to excessive cost, small enterprises would be unable to invest" (p.26).*

In the investigations of institutional short-termism, the Confederation of British Industry concluded that there is a communication and educational gap between management, owners of companies and those providing funds. This gap is attitudinal and educational rather than financial (CBI, 1987). Does the finance gap physically exist today or is it attitudinal and educational? It seems that the existence of such a gap and its interpretations has proved to be inconclusive. With what seems to be an apparent abundance of financiers in the market, empirical research findings show that obtaining external finance is one of the major problems of small and medium enterprises (SMEs).

In Malaysia, it is reported that banks suggested that there is abundance of capital to invest but there is inadequate demand for loans from small firms and also very few viable business propositions at the smaller end of the financing scale to invest in. On the other hand, findings of empirical research showed that one of the major problems of small firms is obtaining finance, claiming that costs are too high and packages are still inflexible to meet their needs.

With apparent abundance of financiers in the market, what can one deduce about the existence, magnitude and position of the finance gap at present? Perhaps it can be viewed that generally the finance gap may exist in either one or more of the following:

- (a) a shortage of long term finance
- (b) relatively high cost of finance
- (c) discontinuities in the provision of finance
- (d) inadequate capital base

Additionally, perhaps it can also be said that the existence and magnitude of a finance gap may take different forms, at different times, in different countries or within the same country, depending on the relative size of the firms, government involvement in the financing of small firms, the financial structure and system of the country, awareness by small-business managers/owners of the existing range and benefits of credit facilities, social contacts and success/failure of government policy.

The fact that the Malaysian Government continues to have thought it necessary to intervene with the development of the capital market by instituting government lending schemes, government grants, regional and national incentives and so on, suggests that all may not be well in the sector.

#### PURPOSE OF THE STUDY

The purpose of this study is two-fold:

Firstly, an attempt is made to understand the national development priorities of the three countries that has led to their support for the promotion of small firms. The role of government and non-governmental institutions in promoting small firms particularly in the provision of finance, either directly or indirectly, are discussed and analysed. From the analysis, it is hoped to answer whether there exists a finance gap or other related gaps relevant to financing of small firms in these three countries and to point out the issues arise from such gaps.

Secondly, to have an insight into the attempts of financial institutions in meeting the financing needs of small firms a case study on some of Malaysia's major government and non government financial institutions and their present strategies in meeting the needs of small firms financing is done.

#### SIGNIFICANCE OF THE STUDY

It is hoped that the study can answer some of the questions that economists and policy makers have concerning the finance gap and the issues that need to be dealt with

to overcome the problems of financing small firms in these three countries. Of equal concern, the study is intended to make some comparison on how the government of three neighbouring countries with three different strategies of development priorities, at three different stages of development and with different social structure background, support the promotion of small firms.

The questions hoped to be answered are:

- a) Why and how do governments of Malaysia, Indonesia and Singapore support the promotion of small firms?
- b) How far have these governments been successful and why?
- c) What is the extent of the non governmental financial institutions involved in the financing of small business?
- d) Is there a finance gap?
- e) What are the important issues relevant to the financing of small firms that need to be dealt with to overcome the growing problems of financing small firms?

#### DEFINITIONS OF SMALL FIRMS

One of the problems that is faced in the study of small firms is the problem of definition. Curran and Stanworth (1986) have already indicated "*this is no easy task*". John Bolton (1971) and his committee of enquiry on small firms in the UK systematically examined a number of ways of defining "*small*". Even within a country, different financial institutions provide different definitions of small firms. The advantages of having a single definition which covers all industries and possibly all countries are very great (Dewhurst and Burns, 1983).

Against this background on the problems of arriving at a single definition of small firms, the investigation of this thesis views that it is not possible to have a single definition which is applicable to all three countries and sectors. Recognising the above problems, the following definitions are adopted in Malaysia, Indonesia and Singapore.

**Malaysia:**

Although different institutions offers different definitions of small firms, there seems to be some broad agreement on the definition of small firms based on either total net assets or shareholders' funds.

The Central Bank of Malaysia or Bank Negara Malaysia defines small firms as those firms (including petty traders) with net assets of up to M\$500,000 for non corporations and with shareholders' fund up to \$500,000 for corporations. The Central Bank and Bank Pembangunan Malaysia classifies small loans as loans of less than M\$500,000 each.

**Indonesia:**

In Indonesia, small firms are classified according to the number of workers. A large firm in the manufacturing sector is one with 100 or more employees which means that those firms with 99 or less employees are small or medium scale firms. A medium scale firm is defined as one with 20 to 99 employees. Those firms with 5 to 19 employees are defined as small scale firms and those with 1 to 4 employees are defined as cottage industries (National Development Information Office, Indonesia, 1991).

**Singapore:**

There is no official legislative definition of small firms in Singapore. Apparently, a small firm is defined in many ways, following the classical view that definitions make good servants but bad masters.

Although the Economic Development Board (EDB) of Singapore, a government institution, has defined Small-Medium Enterprises as firms employing less than 50 workers and having fixed capital assets of less than S\$250,000 in 1963, the ceiling of fixed assets was raised to S\$1,000,000 in 1976 and S\$2,000,000 in 1979. The most recent definition of small firm offered by EDB was in the Small-Medium Enterprises (SMEs) Master Plan 1990 where SME is defined as a firm with at least 30 per cent local equity with no more than S\$8 million net fixed assets investment in the manufacturing sector, or one with less than 50 employees in commerce or services.

In addition, there are other definitions of small firms in Singapore. For example, Soon (1986) defines small firms as those with:

- i) less than 50 employees for commerce and service industries; and
- ii) less than 100 employees for manufacturing industry.

Chew (1988) defines small firms as those with 5 to 99 employees.

## OVERVIEW ON THE SOCIO ECONOMIC STRUCTURE OF MALAYSIA, INDONESIA AND SINGAPORE

### Malaysia:

Malaysia was formed in 1963 as a merger of the Federation of Malaya (Peninsula Malaysia), Sarawak, Sabah and Singapore. In 1965, Singapore left Malaysia and became an independent country. The land area of Malaysia is estimated to be 329,758 sq km. In 1990, the total population was estimated to be about 18.01 million of which 61.9 per cent would consist of Malays and other indigenous groups (referred to as Bumiputeras), 29.3 per cent Chinese, 8.1 per cent Indians and 0.06 per cent Others (Malaysia, 1991).

For the same year 1990, the total GDP was US\$42.5 billion after a growth rate of 10 per cent. GDP per capita was US\$2,388 (Financial Times, August 29, 1991). Contribution from the agricultural sector was about 20.1 per cent of GDP in 1985 and was about 18.9 per cent in 1990.

Poverty is still a problem in Malaysia with a recorded incidence of poverty at 17.1 per cent in 1990 (Malaysia, 1991). Poverty has been a problem in Malaysia with the incidence of poverty among the Malays and other indigenous people being disproportionately high. In 1970 the incidence of poverty in Malaysia was 49.3 per cent with 73 per cent of poor households being Malays (Aris, 1984). Not only a high proportion of the Malays (64.8 per cent of all Malays) were poor but illiteracy rate was also high among them. For example in 1957, less than a quarter of all Malays had more than primary education as against a third of the Chinese (Burki, 1990). In terms of occupation, historically, Malays were mainly involved in the agricultural sector and

owned only "*padi*" (rice) land and small holdings of rubber and coconut; the Chinese were mainly engaged in mining, small scale manufacturing, and wholesale and retailing, while the Indians were employed in the estates and technical services. The socio economic problems had generated political tensions and induced the Government to launch the New Economic Policy (NEP) in the early 1970s which aimed to eradicate poverty and the restructuring of society to eliminate the identification of race with economic function. Towards this goal, the Malaysian Government recognised the potential role small firms can play.

#### Indonesia:

Indonesia declared its independence from the Netherlands in 1945. The Republic of Indonesia comprises 13,677 islands with total land area of 1,926 million sq km and territorial water nearly four times the land size (National Development Information, Republic Indonesia 1991). The population in 1990 was approximately 180 million making it the world's fifth most populous nation after China, India, the Soviet Union and the United States. Indonesians are basically of Malay origin, classified into approximately 300 different ethnic groups. In addition to the indigenous people or the Pribumis, are the Chinese, Arab, Eurasian, Indians and Pakistanis. As race is a sensitive issue in Indonesia, the Government did not make an ethnic distinction. However, it was reported that the Chinese which made up only 4 per cent of Indonesia's population accounted two thirds of the private economic activity, owned most of Indonesia's largest conglomerates and almost all of the biggest private banks. Total GDP in 1990 was estimated to be US\$96.3 billion with estimated growth rate of 6.7 per cent. Its GDP per capita for the same year was estimated to be US\$527 (Financial Times March 22, 1991). Agricultural share in GDP in 1985 was 23.9 per cent (Mizoguchi, 1990).

Poverty (which may be the resultant of development process affecting the distribution of income earning assets across households or the rate of return on these assets) was also a problem in Indonesia with nearly 60 per cent of its population being

impoverished in 1970 as compared to 22 per cent in 1987 (Burki, 1990). Additionally most of the Indonesians lived in rural areas engaged in agricultural activities. Recognising the potential of small firms in generating employment and therefore income, the promotion of small firms in Indonesia was seen as a means for redistributing income to overcome poverty problem.

#### Singapore:

Singapore is a small multiracial island state with land area of only 626 sq km and having a population of 2.71 million mainly ethnic Chinese. Total GDP in 1990 was US\$34.6 billion after a growth rate of 8.3 per cent. Its GNP per capita was reported to be US\$12,765 in 1990 (Financial Times April 30, 1991). Agricultural share in GDP in 1985 was only 0.8 per cent (Mizoguchi, 1990).

Singapore became an independent state when it separated from Malaysia in 1965. With the separation, Singapore diversified its entrepot economy towards industrialisation for import substitution and later towards industrialisation for export. Foreign investments were encouraged to bring in the much needed capital and technology. Currently, there were more than 600 multinational manufacturing companies in Singapore (Soon, 1990). However, the multinationals were mainly involved in large enterprises and they provided much of Singapore's export drive while the local enterprises were mainly small or of medium size contributing only about 30 per cent of the country's annual export (Phuong and Jiuang, 1990). The Economic Survey of Singapore (1990) reported that small and medium enterprises in Singapore accounted for 77 per cent or 2,822 establishments in the manufacturing sector. Due to shortages of labour (full employment was realised and domestic labour shortages began to emerge in the early 1970s) small firms have to compete with other firms in the market for labour. To solve the labour shortage and also to produce products for exports, the promotion of small firms in Singapore is towards promoting high technology activities producing high value added products.

### Currencies And Exchange Rates:

Although the three countries, Malaysia, Indonesia and Singapore are members of ASEAN, they adopt different currencies. Malaysia's currency is the Ringgit, and Indonesia's currency being the Rupiah while Singapore uses the Singapore Dollar.

**Table 1.1: Currencies and Exchange Rates**

Country	Currency	Symbol	Per US\$ in 1990 (average)
Malaysia	Ringgit	M\$	M\$2.70
Indonesia	Rupiah	Rp	Rp1,843
Singapore	Dollar	S\$	S\$1.81

Source: Financial Times March 22, April 30, and August 29, 1991 issues.

### OUTLINE OF THE THESIS

Chapter 1 sets the scene to the following chapters. The chapter has outlined the area of study, the purpose and significance of the research. To overcome the definition problems, different definitions are adopted for different countries and where applicable they are defined according to sectors.

Chapter 2 examines the general distinction between the policies for improving the business environment and those which directly create or develop small firms to provide an understanding of the purpose of various policies and their potential effects on small firms.

To address the financing of small firms in Malaysia, Indonesia and Singapore will necessarily require an understanding of the financial system and structure of the three different countries and how are they affected by the government policies. This is dealt with in Chapter 3.

Chapter 4 relates the financing theory to understand the financing requirements of small firms. Reliance on external finance and the problems faced by small firms with respect to their choice of finance is discussed.

Chapter 5 examines closely the influences and effects of government policies and the activities of the non governmental institutions on the financing issues of small firms in Malaysia, Indonesia and Singapore against the background of each country's national development priorities.

To gain a further insight on how government and non government financial institutions and agencies attempt to meet the financing needs of small firms in Malaysia, a case study is done. The results of the case study is discussed in Chapter 6. The case study is based on in-depth interviews on senior officers of five major institutions which provide finance to small firms in Malaysia.

On the basis of the analysis and findings discussed in the preceding chapters, Chapter 7 seeks to generalise the wider implications of the findings in this study and offer some major recommendations.

## CHAPTER TWO

### POLICIES FOR SMALL AND MEDIUM ENTERPRISES

#### INTRODUCTION

Small and medium enterprises are found to be operating in all forms of political environment and guide-lines or policies are laid down for the development of specific programmes. These policies are aimed at, among others, controlling and standardizing the various assistance programmes. However, for most part, the existing policies and incentives favour large enterprises rather than small enterprises. Governments have claimed to remove the obvious existing inequalities but the notable absence of effective and efficient small enterprise membership organisations may account for the absence of relevant policies for small enterprises in many countries. They lack a political lobby. For many years, policies on small and medium enterprises have meant safeguarding the small and medium-sized enterprises against the economic power of large scale companies.

Policies can be explicit and are stated in formal documents or are inferred from statements justifying specific initiatives. In Malaysia and Indonesia, pronouncements in national development plans have led to the passage of specific laws and regulations favourable to small enterprises. Singapore, however, stresses the need to create an overall economic climate conducive to enterprise and efficiency through appropriate policies and believes that the market can provide many services for small enterprises more effectively than government (Neck, 1987).

#### CLASSIFICATION OF POLICY

Policies relevant to businesses can generally be classified into two classes, the first is those policies for improving the business environment and the second is those policies for direct government intervention in creating and developing small businesses.

## POLICIES FOR IMPROVING BUSINESS ENVIRONMENT

The business environment appears to be a major factor influencing the performance of business both large and small. Schmenner (1980) and Aldrich (1979) suggested that business environment involves the willingness of government to work with business and also the activities that government legitimizes. The United States of America, for example, has been said to have a more conducive business environment that makes enterprises more competitive than that of the European. Kotter (1978) pointed out the difference of task environment which he defines as:

*"all possible suppliers (of labour, information, money materials and so on), markets, competitors, regulators and associations that are relevant in the light of the organisation's current products and services".*

In addition, Kotter (1978) also suggested the meaning of the wider environment as:

*"residual environment which can be defined by such indicators as public attitudes, state of technological development, the economy, the occupational system, the political system, the demographic characteristics of people and organisations, the society's social structure, current price levels, loans and so on".*

A number of writers have noted that environmental contexts are changing at an increasing rate and towards increasing complexity. Adaptation of the organisation is therefore a function of the ability to learn and adapt to changes to environment (Terreberry, 1967).

Entrepreneurs are said to have a special tolerance of ambiguity in the environment but what seems a belief that success flows from personal efforts sets the demand for informations about the environment, particularly about the future. Responses to environmental change in markets, raw materials, and processes leads to changes in the organisation's strategy concerning lines of business in which to engage in (portfolio strategy) and, within each line of business, the specific market segment to be pursued (business strategy). Lacking information about environmental factors including the impact on the organisation and inability to allot or assign some

probabilities to events may create uncertainty. The degree of environmental uncertainty affects business performance. While uncertainty offers opportunities for profit (Kirzner, 1979), too much uncertainty may block or hinder performance. The degree of uncertainty faced by the entrepreneur not only depends on his knowledge of the productive process but also upon the degree of control being exercised. Brockhaus (1982) notes that perceived probability of failure may be altered if the individual:

*"acquires additional information about the competition, the amount of capitalization required, the managerial skills and technical knowledge required" (p.48).*

Therefore it can be assumed that Government policy may be able to help entrepreneurs when uncertainty is due to gaps in their knowledge or skills, or to information shortages due to limited resources or time to gather it.

Policy may influence technology and structure relations through its impact on the scale of operation and on the sophistication of the fit between the organisation and its environment. For example, scale may be influenced by the availability of cheap money for equipment and building. Policy may also make use of enough private money to permit a more sophisticated organisation to be created. From the psychological point of view, government policy may appear to indicate that government does care (Mokry, 1988).

The law and regulations which govern the conduct of businesses usually determine the condition of the business environment to be favourable or otherwise. Although these regulations are well intended and their benefits are assumed without question, their costs may be high. These government regulations may incur additional cost to businesses and ultimately the consumers may have to bear the cost of such regulations in the form of higher prices.

Not only government regulations add costs to businesses, government regulations have also been blamed for hindering competition. Many regulations appear to require the same compliance for small businesses as for large enterprises. However, the burden of regulations is naturally heavier for the small businesses as they lack the

broad financial bases and the larger volume of output of the large enterprises. Big enterprises are often well represented and have strong lobby groups. They may have effective membership organisations through which they can influence the regulations that concern their interest. On the contrary, Levitsky (1990), suggested that in practise some regulation worked against large industry, as small firms found it easier to avoid compliance. Nevertheless, in many cases, improvement to the business environment is needed to ensure that it is not hostile for small business and does not stifle SSEs. To achieve this, approaches that can be taken include those using policy tools such as regulation and deregulations, tax policy change, administrative reform in new ways and defining new roles for key actors, changing inspection procedures to be less burdensome, infrastructure improvements and setting up of special governing body to care for the interest of small firms. In short, probably it can be said that business environment is a "*business climate*" that government sets to show that the area is a good place to do business.

#### DIRECT INTERVENTION POLICIES

Direct intervention policy for the creation and development of small firms includes among others, the provision of incentives such as fiscal incentives through tax deductions and exemptions; financial incentives through subsidised interest rates; physical incentives through the provision of operating sites with infrastructure, water and electricity supply, provision of training and education, provision of finance, provision of information, provision of counselling and consultancy, and other support initiatives. However, the extent of these direct intervention policies are greatly determined by the political system of the country and also the general attitudes of policy makers towards small firms.

## A CASE OF MALAYSIA

Government involvement in small firms in Malaysia began mainly after the adoption of the two-pronged New Economic Policy (NEP) in 1971 incorporated with the First Outline Perspective Plan (OPP1) for the period 1971-1990. The first prong of the NEP is to reduce and eventually eradicate poverty by increasing income level and employment opportunity for all Malaysian irrespective of race. The second prong of the NEP is to restructure Malaysian society to correct the economic imbalance so as to eliminate the identification of race with economic function and geographical location (Malaysia, 1971:p.1).

*"The targets are that by 1990 the employment pattern will reflect at all levels the ethnic composition of the population and that Malaysians will own and control 70 per cent of the equity capital, with Bumiputera (Malays and other indigenous people) at least 30 per cent and foreign interests, 30 per cent. The NEP also seeks to create a viable Bumiputera Commercial and Industrial Community through its participation in modern commercial and industrial ventures"* (Malaysia, 1986).

The NEP was formulated following the racial conflict in May 1969. In a plural society like Malaysia, there are various diversities and differences - race, economic, political, social, religious, cultural and language. Each of which can be a source of conflict and instability. The economic imbalances appeared to be the basis for the feeling of deprivation and social injustice that generated the riot in 1969. Benefits of growth of the economy were not felt by all the people. The growth of GDP in the 1970s was 7.6 per cent per annum but poverty and uneven distribution of income remain serious across the major ethnic groups with the incidence of poverty among the Malays and other indigenous people being disproportionately high. The incidence of poverty in Peninsular Malaysia was 49.3 per cent in 1970 (Malaysia, 1986:p.8). Poverty incidence in the rural areas where the population is mostly Bumiputeras, was 58.7 per cent while the incidence of Urban poverty was 21.3 per cent in that same year (Malaysia, 1986:p.85). Real Bumiputera mean income as a proportion of the national average monthly household income was 65 per cent in 1970 or M\$172, increased to 78 per cent in 1984 or M\$384. The Chinese mean income remained above the national

average at M\$678 in 1984 while the Indians mean income at M\$494, was close to the national average (Malaysia, 1986:p.8). Aris (1984) indicated that:

*"The problem of the poor for the country as a whole is mainly a Malay one with 73 per cent of poor households being Malays 64.8 per cent of Malays were poor compared to 26 per cent Chinese and 39.2 per cent Indians .... the Malays formed 79.6 per cent of the poor in rural areas."*

The experience learned from the incident of May 1969 revealed that any development efforts that did not deal adequately with the problems of socio economic imbalances among ethnic groups would lead to growth without equity and result in a fragmented and less secure nation (Malaysia, 1986).

The problems of socio economic imbalances due to differentiated economic function was somehow said to be a consequence brought about by colonial rule. Mohamed (1988) and Fong (1990) suggested that as a result of the British colonial practices, the economic function in multiracial Malaysia (Malaya then) was differentiated by ethnicity. The activities in the agricultural sector, especially traditional agriculture, were preserved for the Malays. The Chinese were engaged in mining, small scale manufacturing as well as service activities like wholesale and retailing. The Indians were employed in the estates and plantations, and technical services.

The historical development structured the population of Malaysia into Malays mainly living in the rural areas, the Chinese in the urban areas and the Indians in the estates. The Europeans controlled the plantations, mines, banks and imports and export trades. After independence, the economy was in the hands of foreign agencies. Puthuchearry (1960) in his study concluded that:

*"The agency houses control about 75 per cent of the nearly two million acres under plantation ..... The control of commerce is in fact in the hands of the exporter - importer; and the import and export firms are very largely European ..... Malays generally own only padi-land and small holdings of rubber and coconut. Very few Malays are engaged in trade and probably none in mining and manufacturing."*

Other countries in South East Asia also experienced being ruled by colonial power. Indonesia, for example, was ruled by the colonial power and was free from Dutch

colonialism in mid 1940s. In history, it was the Dutch colonisers who established the Chinese as the merchant class pushing indigenous Indonesians into administrative positions (Schwarz, 1991).

After gaining independence, most South East Asian governments took initiatives to correct these imbalances and to encourage the formation of indigenous entrepreneurs. Popenoe's (1970) study revealed some of the initiatives.

*"Burma expelled most of the Europeans and Indians and put an end to most private enterprise. Thailand and Philippines banned aliens.....meaning primarily Chinese .....from many fields and showed government favouritism to indigenous entrepreneurs. Indonesia expropriated European properties and drove Chinese businessmen out of the rural areas. Malaysia has done the least to discriminate against the Chinese and European businesses, although it has established certain economic preferences for the Malays."*

So in short, it can be said that Malaysia is not the only country that tries to encourage the formation of indigenous entrepreneurs.

The first agency to help the indigenous enterprises in Malaysia was RIDA (Rural Industries Development Authority) formed in 1951 with the objective of improving rural life through productive welfare programmes; and later its objective was redefined to include the promotion of non agricultural activities in the rural areas to help Malay participation in commerce and industry. RIDA was reorganised in 1965 and renamed MARA (Council of Trust for the Indigenous People).

Industrialisation was the prime objective of the government when Malaysia regained independence in 1957 (Mohamed, 1988). To create a conducive environment for industrial growth, incentives were offered by the government but over the period 1957 to 1970, most of these incentives offered, were often biased towards large enterprises (Chee, 1986; Fong, 1990). The incentives offered under the 1958 Pioneer Promotional Act for manufacturing activities were granted mainly to capital intensive and large scale industries. The 1968 Investment Incentives Act provided incentives in accordance to size of capital investment.

To help ease the problem of capital shortage of the Bumiputera entrepreneurs, the government sponsored the establishment of a commercial bank, Bank Bumiputera Malaysia Berhad (BBMB) in 1966. However the bank was not guided to help the Bumiputera entrepreneurs but allowed to operate as a private enterprise resulting in the bulk of the loans given to the more credit-worthy non-Bumiputera entrepreneurs; the climax being the US\$1 billion loan failure to Chinese property speculators in Hong Kong (Mohamed, 1988).

The government also established a procurement policy to help Bumiputera entrepreneurs through which Bumiputera contractors were allocated firstly at five per cent and later increased to thirty per cent of the total government contracts. However, the problem of "*Ali Baba*" appeared where prominent Malay politician or high ranking officers nicknamed generally as "*Ali*" who through their influence managed to secure the government contracts, end up giving it to Chinese entrepreneurs, nicknamed generally as "*Baba*", to carry out the work for a percentage of the contract as commission. This arrangement undoubtedly satisfied both parties concerned, but it appeared to have defeated the aim for such preference given to Malay contractors.

For corporate ownership, a policy was formulated at the early stage, to allocate a percentage of all new shares issued, at a discount, to Bumiputeras. The result seems to be unsatisfactory as these units of shares were sold off as soon as possible for a profit.

Under the restructuring strategy of the NEP, restructuring the equity ownership was to be a key element whereby by the end of 1990, Malaysians would own and control 70 per cent of the equity capital with Bumiputera share would be increased to at least 30 per cent and that of other Malaysians increased to 40 per cent. The NEP also seeks to create a viable Bumiputera Commercial and Industrial Community through its participation in modern commercial and industrial ventures. In the light of these objectives of the NEP and also its objective to eradicate poverty, the Malaysian government recognised the potential significance of SMEs.

Consequently, a number of institutions were established during the Second Malaysia Plan period to encourage the development of small industry. These institutions included the Credit Guarantee Corporation (CGC) and Malaysian Industrial Development Finance (MIDF) Industrial Consultants Limited. An advisory Council on Consultancy and Advisory Services for Small-Scale Industries was established in 1973 to ensure coordination of the services provided by the different agencies (Malaysia, 1973:p.144).

The significant role of small industries was confirmed in the Third Malaysia Plan 1976-1980 which stated that the government is to develop small industries "*as an integral part of Malaysia's industrial development*" (Malaysia, 1976:p.315). It was also mentioned in the plan that the Advisory Council on Consultancy and Advisory Services for Small-Scale Industries and Businesses would be strengthened to become the Coordinating Council for the Development of Small-Scale Industries. The main policy during this period was on training of small entrepreneurs. In the Mid-Term Review of the Third Malaysia Plan, it was noted that agencies such as the National productivity Centre (NPC), MARA, the Ministry of Culture, Youth and Sports, in association with other relevant agencies such as the Malaysian Entrepreneur Development Centre (MEDEC) in the Mara Institute of Technology (ITM) and National Entrepreneur Research Development Association (NERDA), conducted a number of entrepreneurial training and development programmes.

The important role of small industries "*in the development of entrepreneurship, creation of employment, mobilisation of individual savings for investment, broadening the industrial base of Bumiputra and providing inputs and supportive services for larger scale industries*" was emphasised in the Fourth Malaysia Plan 1981-1985 (Malaysia, 1981:p.247). The Plan reaffirmed the government policy of providing assistance to small industries, particularly Bumiputera small industries.

In the Mid-Term Review of the Fourth Malaysia Plan, it was noted that small enterprises mainly concentrate in three sectors - manufacturing, wholesale and retail

trade, and construction. About 74 per cent of the value added of small enterprises were in these sectors (Malaysia, 1984:p.27). The Review also noted that small enterprises were responsible for almost a third of all non-agricultural jobs and therefore, played an important part in the generation of employment and in the eradication of poverty and restructuring of society. The Review acknowledged that the existing tax incentives tended to favour large-scale enterprises because they were linked mainly to size of investment and employment, and that the industrial estates did not cater to the needs of small-scale industries.

The government policy towards small industries during the Fourth Malaysia Plan (1981-1985) period was stated as :

*"Priority is given to those small enterprises that complement the activities of the bigger enterprises. The choice of industries must also conform with the need to achieve the NEP objectives, particularly in Bumiputra encouraging participation, especially in metal-based industries such as welding and foundry.*

*Efforts to promote small enterprises will be reviewed as an integral part of the strategies to develop the manufacturing sector. Among the measures to be undertaken include improvements to the production capacities of small enterprises, and the provision of support services incorporating marketing, credit, consultancy and technology development. Other measures include efforts to provide access to market and income through sub-contracts and franchises. The move towards integration of small enterprises with medium and large scale industries will be undertaken in the context of overall industrial estate planning. This is to be implemented through the development of self contained mini industrial estates or through location of small-scale industries within the existing industrial estates to facilitate common sharing of industrial support facilities."*

In recognising the role and contribution of small-scale industries towards the development of a sound industrial structure for long term sustained growth and their potential to create vast interindustry linkages, the government, in its Fifth Malaysia Plan 1986-1990,:

*"will continue to undertake several measures to actively encourage small-scale industries to expand, upgrade and modernize their activities. In this regard, the Government, with the co-operation of the World Bank, has designed a special programme for the development of small scale industries which became operational since early 1985 and will continue until 1988. A number of government agencies identified for active participation in the programme includes Bank Pembangunan Malaysia Berhad (BPMB) the Development Bank of Malaysia, Forest Research Institute of Malaysia (FRIM), Malaysian Agricultural Research and Development Institute (MARDI), National Productivity Centre (NPC), Standards Industrial Research Institute*

*of Malaysia (SIRIM), and the Malaysian Industrial Development Finance (MIDF). The Small-scale Industries Division of the Ministry of Trade and Industry has been entrusted with the co-ordination of the activities of each of the agencies under the programme. The programme which involves a total financial assistance of about M\$234 million, will benefit small-scale entrepreneurs in various sectors except agriculture. Bumiputera entrepreneurs in particular will be given credit facilities and technical assistance through BPMB ..... Several measures will also be undertaken to assist small-scale industries in export promotion. Links with research agencies such as Standards and Industrial Research Institute of Malaysia (SIRIM) is to ensure the highest standard in product design and quality. Links with Malaysia Export Trade Centre (MEXPO) will ensure up to date information on potential external markets" (Malaysia, 1986:pp.357-358).*

The most recent development on the government's view towards small firms was that their importance to the economic development of Malaysia was further emphasised in The New Development Policy (Malaysia, 1991). The New Development Policy, or in short NDP, was formulated for the Second Outline Perspective Plan period 1991-2000; it aims at accelerating the process of eradicating poverty and restructuring society so as to correct the social and economic imbalances (Malaysia, 1991).

In the strategies and programme trusts of NDP:

*"The small and medium scale industries (SMIs) will be further promoted and upgraded, with the objective of making them an important and viable vehicle for industrial expansion and the creation of inter-industry linkages and support. The SMIs are expected to contribute significantly in terms of value added and labour absorption in the manufacturing sector to the level of 40 per cent and 50 per cent, respectively, within the decade from the current position of 20 per cent and 30 per cent" (Malaysia, 1991:p.133).*

Small businesses are also recognised as a training ground for the creation of a successful Bumiputera business community (Malaysia, 1991:p.18).

In summary the policy in Malaysia is seen as:

- (a) to provide a conducive environment for business
- (b) to increase the Malaysian share in equity ownership in the corporate sector particularly to increase the share of Bumiputera equity ownership
- (c) to increase Bumiputera participation in business ventures, and

(d) one of promoting SMEs in recognising the significant role of SMEs, particularly in achieving the goals of NEP and NDP and the contributions of SMEs in the country's general economic development towards growth with equity.

Having given a broad account of the government's policy in Malaysia, we will now examine specific aspects of Government's policy for improving the business environment and Government's direct intervention policy for the creation and development of SMEs.

### POLICY FOR BUSINESS ENVIRONMENT

Malaysian Government's policy in creating a favourable business environment includes among others, the setting up of law and regulations. Regulations are set usually to, among others, govern the conduct of enterprises and also for a smooth running of planned programmes. It seems to appear that usually, these law and regulations which govern the conduct of businesses can determine the condition of business environment to be favourable or otherwise.

The Industrial Coordination Act (ICA) which was introduced in 1975 and later amended in 1985 and 1986, is to ensure an orderly development and growth in the manufacturing sector. The Act requires people who are engaged in any manufacturing activity to obtain a licence in respect of the manufacturing activity. Only manufacturing enterprises with shareholders' funds of M\$2.5 million and above, or employing a full time work force of more than 75 workers, need to apply for manufacturing licences in order to commence or continue operation under the ICA (Malaysia, 1991). This limit for which companies have to obtain licences was raised from M\$250,000 to M\$1 million in terms of shareholders' funds in 1985 and was further increased to M\$2.5 million in 1986 (Bank Negara Malaysia, 1989).

The Malaysian government welcomes foreign investment in the manufacturing sector (Malaysia 1991). Recognising the role which direct foreign investment can play in terms of generating capital inflows, employment, technology transfer, and market

creation, the guide-lines for foreign equity participation in manufacturing sector were regulated. However, to ensure an increase in Malaysian participation in the manufacturing activities, the government has a policy to encourage projects to be undertaken on a joint venture basis.

In participation in manufacturing activities, foreign investors were permitted to hold whatever level of equity of up to 100 per cent on condition that the company exports 80 per cent or more of its production. Foreign investors who applied to invest in Malaysia up to end 1991 could be granted 100 per cent ownership and would not be required to restructure at any time thereafter if the company exported 50 per cent or more of its production or employed 350 full time Malaysian workers, and on condition that the products did not compete with products manufactured locally for domestic market. For other export oriented projects exporting 51 per cent to 79 per cent of their production, foreign equity ownership up to 51 per cent will be allowed, depending on factors such as level of technology, size of investment, location, value-added and utilisation of local raw materials and components. For projects exporting between 20 per cent to 50 per cent of their production, foreign equity ownership of between 30 per cent to 51 per cent will be allowed depending upon similar factors as mentioned above; and for projects exporting less than 20 per cent of their production, foreign ownership up to 30 per cent is allowed (Malaysia 1991).

Where foreign equity is less than 100 per cent, projects that have 70 per cent or more foreign equity, the balance of the equity will be reserved for Bumiputeras with the exception of projects initiated by non-Bumiputeras on a joint venture basis with foreigners, where the balance of the equity will be allocated to the non-Bumiputeras concerned. For projects that have less than 70 per cent foreign equity, 30 per cent of the equity will be reserved for Bumiputeras and the remaining equity for non-Bumiputeras except for projects that are initiated by Bumiputeras on a joint venture basis with foreigners, where the balance of the equity will be reserved for Bumiputeras. However if Bumiputeras are unable to take the entire balance of equity, allocation of

the balance to non Bumiputeras will be at the discretion of the Ministry of Trade and Industry (Malaysia, 1991).

To provide the necessary support and environment for the healthy growth of the economy, the private sector had been identified to provide the leading role and dynamism in the economy for the Fifth Malaysia Plan period from 1986-1990. The Government introduced a number of policy changes aimed at enabling the private sector to expand its activities. However, the public sector is expected to continue to play a supportive role in ensuring that the basic infrastructure and other amenities are sufficient to provide a conducive environment for enterprise to flourish. At present there are 140 industrial estates throughout the country which provide basic infrastructure such as roads, water, power and telecommunication facilities. Realising the industrial needs for competitively priced power and water supply, the government reviews these rates from time to time.

Regarding communication system in Malaysia, it has been described by the World Bank as being the "A" category that is comparable to developed countries (Malaysia 1991). At present, Malaysia has 16,000 miles of the finest roads in Asia and an efficient rail and air system. The international sea and air ports assure efficient handling and transport of cargo whether in liquid, bulk or containerized (Malaysia, 1991).

To ensure a favourable economic environment, the Government also set labour policy to promote cordial employer-employee relations, social justice, equity and conscience to bring about a generally contented and productive labour force which thereby ensure a favourable climate for investment. Labour laws were set to provide guidance on the rights and responsibilities of employers and employees as well as a legal framework for orderly conduct of industrial relations.

The Employment Act 1955 sets the regulations and condition of employment. Among the conditions regulated are the provision of paid holidays for employees and payment of maternity allowances for female employees on maternity leave for 60 days

at ordinary rate of pay subject to a minimum rate of M\$6.00 per day. The Employees Provident Fund Act, 1951 provides a compulsory contributory provident fund which is payable to employees in full on reaching the age of 55 years. All employers and employees are required to contribute to the Fund at the rates of 11 per cent and 9 per cent respectively of the employees' monthly wages. Expatriates employees, domestic servants and self employed are precluded from the compulsory contributions. However, they can opt to contribute to the Fund.

The Employees' Social Security Act, 1969 requires all industries with five or more employees whose wages do not exceed M\$1,000 a month, to insure their employees under the Employment Insurance scheme and the Invalidity Pension scheme, of the Social Security Organisation. Those employers who are not required to contribute under the Social Security Act, are required to insure with a locally registered insurance company in respect of any liability which they may incur under the Workmen's Compensation Act, 1952.

The Workmen's Compensation Act, 1952 covers all manual workers irrespective of their wages and non manual workers whose earnings do not exceed M\$500 a month. The Act requires compensation payable to employees or their dependents for injury or death suffered in the course of employment.

Beside the law and regulations, the monetary policy has a role in creating a favourable business environment. In Malaysia, its monetary policy was geared towards facilitating growth and to promote price stability (Ministry of Finance Malaysia, 1990). Deregulatory and reregulatory measures were taken to promote a greater market oriented system of interest rate determination, and to evolve an efficient and a more sophisticated financial system to meet the challenges of an industrialising economy and a more competitive international environment.

When credit demand expanded rapidly, monetary policy is required to maintain a balance between the need to ensure capital availability for productive investment at reasonable cost and the need to ensure that the liquidity available does not translate

itself into higher price pressures. As an anti inflationary measure to reduce excess liquidity in the economy from large inflows of investments and a strong export earnings, the Government increased the statutory reserve requirements of financial institutions from 4.5 per cent of their eligible liabilities in May 1989 to 5.5 per cent in October 1989 and it was further to 6.5 per cent in January 1990 (Ministry of Finance Malaysia, 1990).

A deregulationary measure taken by the Government was the freeing of the Base Lending Rate (BLR) from the administrative control of the Central Bank on February 1, 1991. Under the deregulated regime, individual banking institutions are free to fix their own base lending rate on the basis of free market forces (Bank Negara Malaysia, 1991).

To ensure an adequate flow of credit to priority sectors, new set of lending guide-lines and two new funds, the Special Fund for Tourism and the Abandoned Housing Projects Fund were established. Other monetary measures taken were the introduction of reforms to strengthen the financial system. These include allowing certain finance companies to issue negotiable certificates, the establishment of a credit rating agency and an international off-shore financial centre in banking and insurance.

To improve the business environment, the Government also introduced a new range of tax incentives, introduced export promotion schemes and provide special funds administered by the Central Bank. The above Government policy in addition to a stable political system in the country, the financial system and structure, the administration of law and regulations, the richness in natural resources, and the educated labour force, help creates the business environment that Malaysia has at the moment.

#### **DIRECT INTERVENTION POLICIES**

Direct intervention policy that the Government introduced for the creation and development of SMEs includes among others the provision of: fiscal incentives; physical incentives; training and education; finance; information; counselling and

consultancy, and other support initiatives. The implementation of NEP brought about the sprouting of numerous government agencies and development institutions to provide assistance in one form or another to SMEs. For the creation of Bumiputera Commercial and Industrial Community (BCIC), the Government not only support through the allocation of contracts, quotas and licences to Bumiputera businesses and joint ventures, Government agencies such as MARA, PERNAS (National Trading Corporations) and SEDCs (State Economic Development Corporations) were actively involved in setting up commercial enterprises to assist the Bumiputeras.

A total of 13 Ministries and more than 30 government and other agencies are involved (Appendix I) in one way or another with small and medium enterprises programmes in Malaysia (Chee, 1986). In view of the large number of organisations involved the Committee to Coordinate the Development of Small Industry headed by the Deputy Minister of Trade and Industry was established in October 1981 to take over the functions of the Coordinating Council for Development of Small-scale Industries which was under the charge of MIDA (Malaysian Industrial Development Authority).

#### PROVISION OF FISCAL INCENTIVES

The fiscal incentives are designed to grant relief from taxes in various forms through tax exemptions, tax deductions and the provision of tax allowances. The tax incentives system in Malaysia was improved by the decision to reduce corporate tax rate. With effect from the year of assessment 1989, the company tax rate was reduced from 40 per cent to 35 per cent. The existing development tax rate of 5 per cent will be abolished on a "*staggered*" basis and starting from the year of assessment 1990, the rate was reduced to 4 per cent. Companies which were given pioneer status incentive are exempted from these taxes. In the case of the other incentives, the benefits are in the form of allowances given.

The principal incentives for investments in manufacturing, agricultural and tourism sectors are contained in the Promotion of Investments Act 1986, and the Income Tax Act 1967. Basically investment tax incentives in Malaysia are in the form of:

- (a) Pioneer Status
- (b) Investment Tax Allowance
- (c) Abatement of Adjusted Income
- (d) Export Allowance
- (e) Double Deduction for Promotion of Exports.

**(a) Pioneer Status:**

The period of tax relief under this incentive is five years commencing from the production date as determined by the Minister of Trade and Industry. The tax relief period may be extended for a further five years period for a company that meets certain criteria (see Appendix II) as determined by the Minister of Trade and Industry. All companies which intend to participate in "*promoted activities*" or to produce "*promoted products*" (see Appendix III) are eligible to apply for the pioneer status incentives. A company granted pioneer status must request for a pioneer certificate, specifying among others, the date of production from which the tax relief will be granted for a period of five years, irrespective of the level of capital investments. In addition, small scale companies (with shareholders' fund of M\$500,000 and less) are also eligible for the Pioneer Status if one of the following conditions is fulfilled:

- (i) The company produces components or inputs for supply to the manufacturing companies with shareholders' funds of M\$2.5 million or more
- (ii) The company's products are substituting imports and where the local content of the materials used are 50 per cent or more in terms of value

(iii) The company exports 50 per cent or more of the total products produced. The exports may include sales to companies located in Free Trade Zones or Licensed Manufacturing Warehouses.

(iv) The project contributes to the socio economic development of the rural population.

**(b) Investment Tax Allowance (ITA):**

Companies producing "*promoted products*" or engaged in "*promoted activities*" are eligible to apply for the ITA. Allowance up to a maximum of 100 per cent may be granted to a company in respect of qualifying capital expenditure incurred within five years from the date of approval of the project.

The grant of either Pioneer Status or Investment Tax Allowance will be determined according to priorities as determined by the Minister of Trade and Industry.

**(c) Abatement of Adjusted Income:**

This incentive is to encourage the exports of locally manufactured products, the development of "*promoted industrial areas*", the promotion of small scale industries, the compliance with the Government's policy on equity participation and employment and the promotion of linkages between the large and small-scale enterprises.

**(i) Abatement of Adjusted Income for Exports:**

An Abatement of adjusted Income for export is granted to a resident manufacturing company exporting directly or through an agent, products which are manufactured in Malaysia. The adjusted income to be abated shall be at a rate which is equivalent to 50 per cent of export sales in relation to total sales; and 5 per cent of the value of "*indigenous Malaysian materials*" used in the product exported.

**(ii) Abatement of Adjusted Income for location:**

An abatement of 5 per cent of the adjusted income for a minimum of five years is granted to resident manufacturing companies located in "*promoted industrial areas*" as gazetted by the Minister of Trade and Industry.

**(iii) Abatement of Adjusted Income for Small-Scale Industries:**

An abatement of 5 per cent of the adjusted income is granted to resident small scale manufacturing companies for a period of five consecutive years starting from the year business commences.

**(iv) Abatement of Adjusted Income for Compliance with Government Policy:**

An abatement of 5 per cent of the adjusted income is granted to large manufacturing companies which purchase components from small scale manufacturing companies. The abatement will be 5 per cent of the adjusted income of the large company or 5 per cent of value of components purchased by the company, whichever is the lower.

To be eligible for the abatement, both the participating large and small scale companies must register with the "*Subcontracting Exchange*" in the Ministry of Trade and Industry. Dividends paid out of tax exempt income to shareholders under the abatement of adjusted income are also exempted from tax.

**(d) Export Allowance:**

An export allowance of 5 per cent of the f.o.b. value of export sales will be granted to exporters of agricultural produce and to trading companies exporting manufactured goods purchased from manufacturers in Malaysia.

**(e) Double Deduction of Expenses on Promotion of Export Overseas:**

Certain expenses incurred for the purpose of seeking opportunities for exports of Malaysian manufactured products and agricultural produce are eligible for double deduction. This incentive is available to all resident companies and in the case of pioneer companies, the deductions are accumulated and allowed against their post pioneer income.

The expenses that qualify include overseas advertising, supply of free samples abroad, export market research, preparations of tenders for the supply of goods overseas, public relations work related to exports, exhibits and/or participation in trade

fairs or industrial exhibitions approved by the Ministry of Trade and Industry, fares in respect of business travel overseas and the cost of maintaining sales office overseas for promotion of exports.

Local companies which participated in approved international trade fairs held locally would also be given double deduction on selective expenses incurred in order to assist domestic products, particularly from the small and medium scale companies to enter the international market.

**(f) Exemption from customs duty on direct raw materials/components:**

The level of exemption from customs duty granted on raw materials/components will depend on the market for the finished goods whether it is domestic market or for export. If the finished products are for export, imported direct raw materials are normally granted full exemption from import duty provided such direct raw materials/components are not manufactured locally, or where they are manufactured locally, are not of acceptable quality and price.

If the finished products are for the domestic market, an application for full exemption from a manufacturing company is eligible for consideration if it complies with equity condition as stipulated in the manufacturing licence in terms of equity participation, management and employment structure. In addition, the raw materials are not manufactured locally. Partial exemption may be considered for other cases. Application for this incentive should be submitted to MIDA in the prescribed forms.

**(g) Tariff protection:**

The Government provides tariff protection to deserving industries which are able to supply a major portion of the domestic market provided that the product is of acceptable quality and the price of the product is reasonable to customers. In granting the tariff protection, consideration would be given to the degree of utilisation of

domestic raw materials, and the value added to be achieved, and the level of technology of the industry.

In addition to the incentives mentioned above a number of other incentives are provided for the establishment, expansion, diversification and modernisation of projects. They include:

**(a) Reinvestment Allowance (RA):**

The RA is granted to a manufacturing company which incurs qualifying capital expenditure on plant, machinery and building for the purpose of approved expansion or reinvestment which includes modernisation and diversification, before 31 December 1995 (Bank Negara Malaysia, 1991). The existing rate is 50 per cent for capital expenditure incurred by small scale companies and 40 per cent for capital expenditure incurred by large companies, for expansion purposes.

Capital allowance on motor-cars used for business purposes was increased from M\$25,000 to M\$50,000 effective from the year of assessment of 1991.

**(b) Industrial Building Allowance (IBA):**

A company which has incurred expenditure on approved buildings that are used as warehouses and bulk storage installations for storing goods for export, used for approved industrial training and approved research is eligible for IBA which consist of an initial allowance of 10 per cent and annual allowance of 2 per cent.

**(c) Double deduction on expenses incurred on training:**

An incentive in the form of double tax deduction on expenses incurred on approved training is given to companies in the manufacturing, construction and tourism sectors. Automatic approval on deduction for expenses incurred is given if employees are trained at approved training institutions such as at the Standards and Industrial Research Institute of Malaysia (SIRIM), National Productivity Centre (NPC), Mara

Institute of Technology (ITM) and the Malaysian Agricultural Research and Development Institute (MARDI).

**(d) Incentives for Research and Development (R&D):**

To encourage R&D, the incentives provided included a five year tax exemption to approved research companies or institutions and to new technology based firms; and double deduction would be provided for cash contribution made to approved research institutions .

**(e) Double Deduction of Export Credit Insurance Premiums:**

To encourage exporters to penetrate into non traditional markets, premium payments in respect of export credit insured with a company approved by the Minister of Finance are eligible for double deduction with effect from the year of assessment 1986.

#### PROVISION OF FINANCE AND FINANCIAL INCENTIVES

Among the outstanding means and processes in the provision of assistance to upgrade and to promote SMEs were the provision of financial incentives and the provision of finance through grants; loan schemes sponsored by the Government and the World Bank, the ASEAN-Japan Development Fund; commercial bank loans to viable SMEs under guarantee of the Credit Guarantee Corporation (CGC); MARA loans to Bumiputera businessmen; and facilities offered by the Small and Medium Industries Unit of the Ministry of Trade and Industries and the Ministry of National and Rural Development.

**(a) Credit Guarantee Corporation (CGC):**

The Credit Guarantee Corporation (CGC) was incorporated in July 1972 with equity participation of the Central Bank and the commercial banks. Its main objective

was to provide guarantee cover to commercial bank loans for loans extended to small scale enterprises, which had been redefined as registered businesses with net assets of up to M\$500,000 each or for a limited company having shareholders' funds of not more than M\$500,000 each and a loan limit not exceeding M\$500,000 each (Bank Negara Malaysia, 1991).

The first scheme started in 1973 was known as the General Guarantee Scheme (GGS) and the next scheme known as the Special Loan Scheme (SLS) was introduced in 1981. At the end of 1985, outstanding loans guaranteed by the corporation totalled \$852 million compared with \$341 million at the end of 1980 (Malaysia, 1986:p.365). For the period 1986-1988, the commercial banks extended M\$269.7 million to small scale enterprises under the Special Loan Scheme of the CGC, of which M\$24.3 million or 9 per cent were extended to finance manufacturing activities (Malaysia, 1990:p.193).

The SLS and GGS were replaced by the Principal Guarantee Scheme (PGS) from April 1989. As at December 31, 1990, after more than a year of its implementation, a total of 7,279 applicants with loan limits of M\$391.8 million had been approved, with a total guarantee cover of M\$144.9 million (Bank Negara Malaysia, 1991).

The Special Loans Scheme for Hawkers and Petty Traders was set up with an allocation of M\$30 million from the New Investment Fund (NIF) in 1986. The scheme was to assist the growing number of unemployed to become self employed by engaging in petty trading activities. The allocation was subsequently increased by another M\$20 million in 1989. In 1990, the Government increased its loan allocation by M\$70 million to M\$120 million . Of the M\$70 million, M\$50 million was allocated to the Loan Fund for Hawkers and Petty Traders (LFHPT) which was introduced in April 1990. Beside hawkers and petty traders, those engaged in service businesses such as tailors, barbers, photo studios, motor repairs and tourist related activities are also eligible for loans to be guaranteed under LFHPT (Ministry of Finance Malaysia,

1990). The balance M\$20 million was allocated to the Association Special Loan Scheme (ASLS) which was introduced in July 1990 (Malaysia 1990).

Maximum loan available under LFHPT was raised from M\$5,000 to M\$10,000 and carried an interest rate of 4 per cent per annum (Ministry of Finance, 1990). As at December 31, 1990, total loans approved under LFHPT amounted to M\$6 million, of which M\$5.2 million (87 per cent) was extended to 1,479 Bumiputeras borrowers. The Government, in 1990, agreed to increase the M\$50 million fund to M\$100 million (Bank Negara Malaysia, 1991).

The objective of the ASLS was to enable the hawkers and petty traders associations to play a more direct and effective role in helping their members to secure loans and also to expose these associations to the workings of basic lending functions. Maximum loan under ASLS is M\$2,000 in the form of term loan for acquiring capital assets or working capital. Loans were repayable monthly but the repayment period would not exceed 24 months. It is interest free with only a nominal service charge with no requirement for security or guarantor. The CGC acted as the guarantor for the loans issued through eight participating banks. As at December 31, 1990, total loans approved under ASLS amounted to M\$4.2 million of which M\$4.1 million (97 per cent) was extended to 2,043 Bumiputera borrowers (Bank Negara Malaysia, 1991).

Currently the three main schemes administered by CGC are the PGS, the LFHPT and the ASLS. Although the GGS (1973), the SLS (1981) and the Hawkers and Petty Traders Loan Scheme (1986) had ceased to operate, the CGC continued to monitor those loans which were still subject to its guarantee.

Total loans guaranteed by CGC under all its schemes as at December 31, 1990 totalled 172,394 applications with approved loan limits of M\$3258.1 million compared to 162,609 applications with approved loan limits of M\$2933.6 million as at December 31, 1989 (Bank Negara Malaysia, 1991).

(b) Lending Guide-lines:

To ensure that certain priority sectors or special groups have ready access to bank credit at reasonable cost, a maximum lending rate of 10 per cent per annum was placed in October 1976 on loans to Bumiputeras and loans to small scale enterprises. The ceiling rate was reduced to 9 per cent in June 1977. However, in 1978, the ceiling lending rates for small loans under the SLS was fixed at 7.5 per cent per annum. To ensure that the priority sector would continue to have ready access to funds at reasonable cost, the Central Bank introduced a new set of lending Guide-lines with effect from April 1, 1990. These Guide-lines had been regulated to include only lending to the Bumiputera Community and for loans made under the Principal Guarantee Scheme (PGS) of the Credit Guarantee Corporation (CGC). Under the Guide-lines, commercial banks were required to extend a minimum of 20 per cent of their loans outstanding as at Dec. 31, 1988 (base) year to the Bumiputera community. On lending under the PGS of the CGC, the commercial bank were required to extend loans to small scale enterprises with guarantee cover by CGC of at least M\$200 million of which at least M\$100 million must be the guarantee cover of loans extended to Bumiputera borrowers. The compliance date for these new requirement was set for March 31, 1991. Lending Guide-lines to SSE were no longer considered necessary and hence removed.

In the case for new loans extended to SSEs which were under the PGS of the CGC, the rate of interest applicable for small loans was set at 1.5 per cent points above the average Base Lending Rate of the two lead banks. The ceiling interest rate applicable to this group of borrowers was 8.25 per cent per annum until September 9, 1990 and rose to 8.75 per cent after that date.

Finance companies were subject to only one lending guide-line that is, lending to Bumiputera community. Like the commercial banks, the finance companies were required to extend at least 20 per cent of their total loans outstanding as at 31

December 1988 (base year) to Bumiputera community. The date for compliance was 31 March 1991.

With effect from 1 February 1991, each commercial bank and finance company was free to declare its own base lending rate (BLR) on the basis of its own costs of funds. The maximum spread between the actual lending rate and the declared BLR was maintained at 4 percentage points. However, the Central Bank would continue to fix ceiling rates for loans to the priority sectors.

**(c) MARA Loans**

MARA, the Council of Trust for the Indigenous People, was set up in 1966. It is financed by the Federal Government in the form of grants as well as loans (Chee 1986). MARA's Entrepreneurial Development Division (EDD) provides loans, advisory as well as consultancy services to Bumiputera small and medium enterprises. The types of loans provided are:

(i) Ordinary loans which offer up to a maximum of M\$50,000

(ii) New Entrepreneurs Loans which offer a maximum of M\$150,000 for setting up manufacturing enterprises.

(iii) Special Loans which provides loans of M\$2,000 without collaterals or guarantor for petty traders and hawkers particularly to those starting up a business.

More than 90 per cent of MARA's loans were of M\$5,000 or less and about 4 per cent of MARA 's loans were those not exceeding M\$10,000 each. Nearly 60 per cent of MARA's loans were given without any security (Chee 1986).

**(d) Financing by Malaysia Industrial Development Finance (MIDF):**

MIDF was established in 1960 to provide medium and long term capital for manufacturing sector. It provides financing in the form of:

(i) medium and long term loans (for periods of 5 to 15 years) where MIDF normally provides as much as half of the total fixed capital requirements of a new venture or for the modernisation and expansion of an existing enterprise.

(ii) factory mortgage finance scheme where MIDF would assist in the purchase of factory buildings and land through a mortgage credit scheme. Up to 80 per cent of the cost may be granted under such loans and the repayment periods may extend over 3-5 years.

(iii) and machinery finance scheme to assist in the financing of machinery and equipment. This is a hire purchase arrangement where the borrower would be required to provide at least 25 per cent of the cost of the plant or machinery, and MIDF would advance the balance and arrange for the borrower to repay over a period of not more than 4 years.

**(e) The World Bank Special Loan Scheme:**

The World Bank Special Loan Scheme of M\$210 million sponsored by the Government and the World Bank was launched in 1985 to provide financial assistance to small scale enterprises. This scheme is being administered by MIDF and BPMB (Development Bank of Malaysia). Up to 1988 a total of 1,022 loan applications were approved amounting to M\$202.4 million or 96.3 per cent of the total allocation, benefiting 85.2 per cent of the 1200 targeted entrepreneurs. The scheme which was originally made eligible to Bumiputera entrepreneurs only was extended to non Bumiputeras beginning from October 1986. Total loan approved at end of July 1990 amounted to M\$178 million. Total loan outstanding by end of July 1990 under the scheme amounted to M\$41 million (Ministry of Finance Malaysia, 1990).

**(f) Rural Industries Programme:**

Financing facilities provided by the Ministry of Trade and Industries under its Rural Industries programme were in the form of grants. For individual entrepreneurs, a

grant of not more than M\$10,000; for group projects run by 3-14 people, a grant of not more than M\$50,000 for the value of machines plus M\$20,000 for the value of workshop; and for cooperatives of 15 or more people, a grant of not more than M\$100,000 for the value of machines and M\$20,000 for the value of workshop would be provided.

**(g) Financing programmes of Bank Pembangunan Malaysia (BPMB) or the Development Bank of Malaysia:**

In 1981, BPMB initiated 2 financing programmes to strengthen and expand its assistance to Bumiputera entrepreneurs. They were:

- (i) Entrepreneurial Development Programme (EDP) to develop new entrepreneurs particularly in the small and medium sector. Under this programme, potential entrepreneurs would be identified and would provide the necessary inputs assistance to encourage them to become owner/manager of their own enterprise. The financing facility under this scheme included project financing, equity financing, working capital loans and the rental of facility units.
- (ii) Leasing and Hire Scheme where the programme was divided into two categories namely the Financial Lease and Operational Lease. Machinery with the operators and technical assistance would be provided at special rates.

Based on the Bank's classification of small and medium borrowers as "*loans of less than M\$1.5 million each*", this sector accounted for almost 93 per cent (or 3,418 borrowers) as at May 1990. Of these, small loans that is loans of less than M\$500,000 each accounted for 82 per cent while 11 per cent are for medium borrowers. In terms of value, SME as a group accounted for about 42 per cent or M\$708 million compared to the bigger corporate borrowers (Abdullah, 1990). Interest charged to small and medium projects are as low as 5 per cent.

**(h) New Investment Fund (NIF):**

As part of the Government's effort to increase domestic productive capacity and to promote exports, a New Investment Fund (NIF) was introduced in September 1985 to finance new fixed investment in the manufacturing, agriculture and tourism sectors at moderate rates of interest not exceeding 1.25 per cent above the prevailing base lending rate of commercial banks. Under this scheme, the Central Bank would channel Government deposits, of which the current amount is M\$1 billion, to the commercial banks at the NIF funding rate for on-lending for new eligible investment projects. The minimum amount of financing is M\$250,000 per project, up to 75 per cent of the investment expenditure, excluding land, for a period of up to five years. However working capital requirements (except for special cases for export industries) and loan to finance the acquisition of shares, land or existing assets will not be funded.

**(i) ASEAN-Japan Development Fund:**

The Asean-Japan Development Fund (AJDF) with M\$890 million provided by the Overseas Economic Cooperation Fund (OECF) and the Export-Import Bank of Japan (EXIM) was launched by the Government in 1989. The fund was channelled to four financial institutions (namely, BPMB, IBMB, BPM and MIDF) to provide financial assistance to small and medium businesses by providing loans at concessionary interest rates.

The maximum loan size under the scheme will be M\$20 million per project subject to the lending policies of the financial institutions. Interest rate charged would be 6.5 per cent per annum for the OECF portion while the average interest rate charged for the EXIM portion would be 7.8 per cent. As at July 1990, a total of M\$602 million of the allocation has been approved for 565 projects. Of this amount, M\$403 million came from OECF and M\$199 million came from EXIM Bank (Ministry of Finance, 1990).

**(j) New Entrepreneurs Fund:**

The M\$250 million New Entrepreneurs Fund (NEF) was launched by the Central Bank in December 1989 to provide Bumiputera entrepreneurs with funds for new ventures, especially in the field of manufacturing, agriculture, tourism and export-oriented industries. The maximum loan per eligible applicant was M\$500,000 and the maximum interest rate charged was fixed at 5 per cent per annum. The maximum loan period was set for five years.

From August 1990, the NEF was also made available to existing Bumiputera entrepreneurs who had been in business for less than five years, but wanted to expand existing capacity.

**(k) Industrial Technical Assistance Fund:**

The Industrial Technical Assistance Fund (ITAF) was set up by the Government in early 1990 with an initial allocation of \$50 million to provide grants for eligible Small and Medium scale industries which participate in any of the following schemes: Feasibility Study scheme, Product Development and Design scheme, Quality and Productivity Improvement scheme and Market Development scheme.

All small and medium industries in the manufacturing sector that fulfil the following conditions are eligible to apply: incorporated under the Companies Act 1965; have shareholders' fund not exceeding M\$2.5 million; and has at least 70 per cent of the equity held by Malaysian citizen.

**(l) Special Fund for Tourism:**

A M\$120 million Special Fund for Tourism was set up by the Central Bank on March 1990 to finance tourism related projects. All small and medium companies including non resident controlled companies were eligible as long as the fixed investment was situated in Malaysia and the cost of each project did not exceed M\$3 million. Under special circumstances projects costing up to M\$5 million would be

considered. The minimum loan is M\$250,000 per project (excluding cost of land and working capital), while the maximum is up to 75 per cent of the project cost. The Central Bank would channel funds at 5 per cent per annum to commercial and merchant banks participating in this scheme but the maximum lending rate chargeable under this fund was 7.75 per cent per annum for a maximum time period of five years.

**(m) Abandoned Housing Projects Fund:**

This fund was set up in June 1990 to assist deserving housing developers to complete viable housing schemes abandoned during the recession period. The fund had an initial allocation of M\$300 million which was subsequently increased by another M\$300 million in February 1991. The rate of interest charged was 2 per cent per annum.

**(n) Enterprise Rehabilitation Fund:**

To help Bumiputera entrepreneurs who faced financial difficulties following recession, the Enterprise Rehabilitation Fund was established in early 1988 with an allocation of M\$500 million. It is a revolving fund managed by MIDF on behalf of the Central Bank was formed to provide financial assistance to those ailing but viable enterprises under dedicated management and having a good prospect for recovery. Only members of the Malay Chamber of Commerce are eligible to apply. However, to qualify for the loan, the applicant needs to have a viable plan for rehabilitation.

As at end of July 1990, total loans valued at M\$450.7 million for 649 loan applicants were approved but only M\$309.3 million were disbursed. The balance of the amount approved would be disbursed when the pre disbursement conditions were met (Ministry of Finance, 1990).

**(o) Export Credit Refinancing Scheme:**

To promote the growth of exports of manufactured goods and to promote backward linkages in industrial development, the Central bank has implemented an

Export Credit Refinancing Scheme which provides Malaysian exporters with credit at preferential rates of interest. The credit is extended by commercial banks, and the current interest rate for exporters under this facility is 5 per cent per annum. The period for refinancing both preshipment and postshipment is a maximum of three months. However, for the export of certain primary products, the refinancing period is 180 days for postshipment and 120 days for preshipment. The minimum amount for refinancing (value of each substitution bill) is M\$20,000 expressed to the nearest thousand ringgit (M\$). The maximum amount of refinancing for each firm is M\$5 million but a higher limit may be given on case by case basis upon application to Bank Negara, the Central Bank.

**(p) Joint Venture Trust**

In April 1990, IBMB has set up a Joint Venture Trust with Walden Group, a United States based company to provide venture capital for new ventures. Agreements for fund subscription and fund management had been signed but real investment has yet to be carried out (Ministry of Finance, 1990).

**(q) Export Credit Insurance and Guarantee Schemes:**

Malaysian Export Credit Insurance Berhad (MECIB) provides a variety of insurance and guarantee schemes to facilitate access to export financing especially for the small and medium manufacturers and input suppliers. The MECIB's Banker's Export Finance Insurance Policy (BEFIP) would compensate a bank on account of non payment of short term credits extended to direct or indirect exporters.

## **THE PROVISION OF PHYSICAL INCENTIVES**

During the period 1981-1985, 2,100 units of business premises which comprises of shopping and office complexes, arcades, bazaars and stalls, for small traders were constructed by the SEDCs, MARA and the Urban Development Authority (UDA).

SEDCs were active in the construction of business premises in the rural areas while UDA concentrated its activities in the urban areas (Malaysia, 1986:p.365).

Up to 1988, UDA had provided 678 units of business spaces for Bumiputera traders in selected major towns (Malaysia, 1989). BPMB, in its Nursery Factory Scheme, provides suitable industrial premises in the form of clusters of factory units complete with infrastructure facilities and machinery for rent (Abdullah, 1990).

### THE PROVISION OF TRAINING

The government recognised the need to develop and upgrade the entrepreneurial skills to ensure the growth of small enterprises. Training activities in various aspects related to business finance and management were offered at the Malaysian Entrepreneurial Development Centre, facilitated by ITM; NPC; and BPMB. MARA also provides consultancy services on product identification, preparation, and financing (Malaysia, 1989).

For skills in management, financial and marketing at degree and diploma levels, programmes at Universiti Pertanian Malaysia or the Universiti of Agriculture of Malaysia were restructured since 1985 to provide greater emphasis on agribusiness, commercial and financial management and marketing skills among graduates. It would provide graduates with opportunities for career development in agricultural production, aquaculture and also in processing, marketing of agricultural products.

MARA Vocational Institutes and other Industrial Training Institutes introduced new courses in electronics and foundry and pattern making. Business and management courses were also introduced into secondary vocational school curriculum while other training agencies which had incorporated such courses, the teaching of such skills were improved.

To give Bumiputera entrepreneurs the international exposure, a Special Overseas Training Scheme were introduced in the 1980s.

Recognising the problem of unemployed graduates (91 per cent were Bumiputeras) who were mainly with engineering, sciences and social sciences degrees, a package scheme was introduced which included entrepreneurial training and attachments to public and private sector agencies (Malaysia, 1989). Total number of unemployed graduates registered were 4560 in August 1990 compared to 6900 in August 1989 a decrease of 34 per cent (Ministry of Finance Malaysia, 1990).

#### OTHER SUPPORTING INCENTIVES

(a) A Sub-contract Exchange was introduced and implemented in 1986 to provide linkages between the SMI and the large heavy industries in the manufacturing sectors. The subsectors identified for the Sub-contract Exchange were the automotive components, electrical and electronics, light engineering, rubber, and plastics industries.

(b) BPM, through its subsidiary Besta Distributors, provide marketing assistance locally and overseas. Besta Distributors which acts as a supplier of manufactured food products for agencies would subcontract to BPM's small and medium scale clients.

(c) Assistance in marketing of rural industries were given by agencies like the Malaysian Handicraft Development Corporation, Batik Malaysia, Village Industry Development and Marketing Company, Karyaneka and KEMAS.

(d) The implementation of the privatisation policy gave opportunities for Bumiputera to new areas of economic activity or increase further their participation in the commercial and industrial sectors. To ensure a wider participation, the Government required the National Equity Corporation (PNB), be given the option of taking at least 30 per cent and 51 per cent shares in all future privatised projects which was initiated by the private sector and the Government respectively (Malaysia, 1989).

## OTHER INCENTIVES

(a) To reduce the tax burden on primary commodities sectors, export duties on rubber, pepper and selective minerals were abolished and at the same time import duties on rubber and pepper were abolished to promote the processing and manufacturing of agricultural based products.

(b) BPM has published guidebooks which identify specific manufacturing projects that can be undertaken on small and medium scale. The publication provides information on aspects of production, marketing and finance. To date, BPM has published 54 such guidebooks (Abdullah, 1990).

## A CASE OF INDONESIA

Concern over the small scale industries in Indonesia came about openly in the early 1970s. Prior to that small scale industries were only referred to indirectly (Rahardjo and Ali, 1986). Suhartono (1988) reported that in Indonesia the treatment of small industries and other industries are distinct in one essential aspect that, the small industries are under the guidance of a special Directorate General for Small Industry whereas other industries are subject to policies implemented by the respective directorates general for basic and multifarious industries. Policies are said to have been implemented in support of the development of small industries but there is no specific policy directed towards medium scale industries as these are subject to more general sectoral policies.

It is only since the First Five Year Development Plan (PELITA 1) period from 1969/70-1973/74, under President Suharto's New Order government that the government of Indonesia has given a high priority to small industries in particular and small enterprises in general. Financial provision has been made available to facilitate the development of small enterprises and during the Third Five Year Development Plan period from 1979/80-1983/84, the Directorate of Small Industry was created in the Ministry of Industry.

The growing attention to small industries is said to be the Government's response to criticism on earlier strategy that stressed economic development and industrialisation at the expense of equitable income. Therefore, the development of the small industry sector was considered as a means for redistributing income (Rahardjo and Ali, 1986).

To facilitate small indigenous enterprises, that had insufficient collateral for bank loans a concession credit programme was introduced in December 1973 providing small investment credit (KIK) and small working capital credit (KMKP) at subsidised rates. To upgrade bank lending procedures and training of loan officers, Bank Indonesia launched the Small Enterprise Development Project in 1977.

It also said that in 1980 the ceilings for both KIK and KMKP loans were increased from Rp 5 million to Rp 15 million but the average loan size in 1986 was in the range of Rp 3.6-4.2 million for KIK and Rp 0.9-1.5 million for KMKP.. Outstanding credits through KIK and KMKP at the end of financial year 1986/87 was Rp 1,189 billion but Bank credits to economic sectors at the end of financial year 1986/87 amounted to Rp 27,852 billion, out of which Rp 9,508 billion went to the manufacturing sector.

The share of small industry in KIK and KMKP loans in 1986 was only 9.4 per cent and not more than 5 per cent of the total bank credits to the manufacturing sector (Suhartono 1988). While KIK and KMKP programmes had been suggested to be the most important sources of subsidized credit to small industries, the above figure implies that there may still be constraints in small industries getting loans or that the programmes have not reach a portion of the targeted establishments.

To reach those who do not qualify for KIK and KMKP the government established Kredit Mini (small credit) in 1978, Kredit Midi (medium credit) in 1981 and Kredit Usaha Pedesaan (KUPEDAS) in 1984.

Since 1979, the regional government of Jakarta has provided a special credit called Kredit Lebaran for small entrepreneurs. The objective is to ease provision for

basic materials used for the festive market season. The festive season includes the "*Eid*" celebration ending the fasting month of Ramadan, the Chinese New Year and Christmas. The conditions for receiving this credit was reported to be easier whereby the applicant need only a recommendation from a co-operative or relevant government body. However, repayment was reported to be a problem with repayment arrears and defaults by nearly half of all borrowers (Rahardjo and Ali, 1986).

At province and regency levels, there are also some departments that give credits at low interest rate to small scale establishments in their respective regions, such as the Department of Social Affairs, the Department of Industry, and the National Family Planning Coordinating Board gives credit in the form of money especially to participants of Keluarga Berencana Lestari (Lestari Family Planning). Badan Kredit Kecamatan (BKK or Subdistrict Credit Body) was formed in 1981 to help in providing loans up to a maximum of Rp 100,000 at a rate of 1.6 per cent per month, to artisans and traders.

In the provision of guidance to alleviate production and marketing constraints faced by small industries the most significant step taken by the government is said to be the creation of an umbrella organisation, Proyek Bimbingan dan Pengembangan Industri Kecil (BIPIK, a project for developing and upgrading small scale industries) in 1974-75. The activities of BIPIK include among others establishing Pusat Pengembangan Industri Kecil (Centres for Developing Small Scale Industries) in several cities like Yogyakarta, Surabaya and Jakarta, establishing centres for technical aids to help technical industrial problem in introduction of machines and new equipment, organising training and education for entrepreneurs on marketing and management, giving aids in the form of machines and equipment, and the promotion of craftwork.

There is also the Lingkungan Industri Kecil (LIK) programme for developing industrial estates for small scale industries. Essentially LIK is a grouping of small scale industries, where facilities such as marketing, training, education and developing small

scale industries are provided. From this programme, it is hoped that the entrepreneurs will form cooperatives. Unfortunately this programme has been reported to be a failure and thus has been discontinued since middle of 1984.

In 1980-81, activities for small industries under the Directorate General of small scale industries are categorised into four main programmes which were to be executed simultaneously and in an integrated way. The four programmes are: creating a favourable environment for establishments/industries, aid and services, support, and finally, technical upgrading all of which were to be executed simultaneously and in an integrated way.

In these programmes, three essential activities to be carried out were identified as protection; rationalizing regulations and procedures; and the improvement of cooperation between small and medium operations, the "*bapak angkat*" (foster parent relationship). In the concept of *bapak angkat*, larger firms "*adopt*" small firms, providing assistance which may take the form of business management, supply of inputs, financing, technology transfer, and subcontracting arrangement (Rahardjo and Ali, 1986).

A special program has been developed to create greater linkages with state enterprises so that small industries through vendor development, subcontracting or procurement programmes can produce certain commodities for these enterprises; to assist in production and promotion of certain products; and to enable small industries to obtain higher earnings from exports through production and marketing assistance. To ensure effective implementation of the linkage programme, especially for products requiring higher quality and precision, assistance is needed in obtaining the right materials and equipment as well as training and increasing the technical capabilities of small industries. Programmes in technical assistance, skills training as well as consulting services have been undertaken in cooperation with state and private institutes, universities and consultants, and are also provided by the Ministry of

Manpower through its training centres. For standard quality materials, efforts have been made through linkage programmes and in cooperations with government agencies.

To strengthen the marketing ability, procurement of materials, access to credit and the undertaking of related activities, the enterprises formed cooperatives in "*sentra*". These cooperatives were to receive guidance from the Ministry of Industry, Cooperatives and Manpower.

While several credit programmes which were designed to help the Pribumi or indigenous businessmen helped many small businesses, much of the money was said to be misused (Schwarz, 1991). It was also mentioned that for further protection of indigenous businessmen, the government required all foreign investors to form joint ventures with Pribumis and state banks to offer Pribumis special credit. In addition to that, several Presidential Instructions reserved certain categories of government procurement contracts for small, usually indigenous businessmen. In January 1990 Bank Indonesia the central Bank, instructed all banks to channel 20 per cent of their loan portfolios to small businesses.

Besides other incentives in the promotion of small industries, UPAKARTI, a special presidential award is given annually since 1985, to those who have helped foster the development of small industries (Suhartono, 1988).

#### A CASE OF SINGAPORE

The economic system in Singapore is one governed by market forces and indicative planning (Ch'ng, 1985). On gaining self government in 1959, the government of Singapore aimed to diversify its entrepot economy towards import substitution industrialisation through labour intensive programmes. The Economic Development Board (EDB) was established in 1961 to centralise the supervision and implementation of the industrialisation program.

With Singapore's separation from Malaysia in 1965, the government's development strategy shifted to export manufacturing and internationalization of its

economy (Chia, 1983; Lim and Pang, 1982). The import substitution industrialisation strategy was abandoned as the city-state has a very small domestic market. With this change in strategy, Singapore launched a deliberate policy to encourage foreign investment into the resource scarce economy. Tax holidays and other investment incentives were offered generously to manufacturing companies to operate and set up off shore plants in Singapore. Several manufacturing industries including local SMEs that engage in activities such as producing footwear, garments, textiles and T.V. assembly, continued to benefit from tariff protections. However they were encouraged to develop export markets.

The early phase of economic development is said to be a matter of survival and the multinationals (MNCs) brought much needed capital, modern technology and managerial skills as well as massive employment opportunity for the workforce and access to world market through their world wide distribution network (Soon, 1986).

The strategy of labour intensive manufacturing with increasing emphasis on export orientation continued through the period 1966 - 73. Full employment was realised and domestic labour shortages began to emerge during this period. As Singapore could no longer compete with other developing countries which were able to offer much lower labour cost, economic development strategy was shifted away from labour intensive to capital intensive industries. In 1979, a major policy intervention by the government launched the second industrial revolution to restructure the economy into one manufacturing high value products, high technology and capital intensive activities. The restructuring policy involves the continuing attempt to be a viable exporter of manufactured goods to world markets and to compete with the most efficient and best exporter globally through the phasing out of low value, labour intensive manufacturing activities; and upgrading of technology and skills to export more high value manufactured goods. Singapore is said to be pushing hard to broaden its industrial base with the rapid establishment of diverse high value priority industries (Ch'ng, 1985).

To promote industrial development, fiscal and financial assistance would be provided by the government.

## FISCAL INCENTIVES

A variety of fiscal incentives or inducements are provided by the government to encourage the establishment of new enterprises or expansion of existing ventures.

### (a) Corporate tax incentive

Remissions of corporate income tax was first introduced in 1959 under the Pioneer Industries Ordinance with "*pioneer status*" new firms in "essential" industries serving domestic market or export market could enjoy 40 per cent corporate tax relief for five years. The Industrial Expansion Ordinance also introduced that year, gave tax relief to existing firms expanding capacity of approved products. In 1967, the incentive provisions in these two ordinance were consolidated and amended under the Economic Expansion Incentive Act.

A new industrial strategy came into being in August 1975 with the introduction of an amendment to the Economic Expansion Incentives Act. The incentives were revised as follows:

- (i) the period of pioneer status was extended from 5 to 10 years in response to the larger gestation period of technology and skill intensive industries.
- (ii) the minimum requirement of S\$1 million of capital was abolished in order to nurture local supporting industries which are modern and small in size but are involved in sophisticated technology and skill intensive development.

In 1979, the objective was to restructure the economy into one based on high value added. Other investment allowance incentives were introduced as an alternative to existing pioneer and export tax concessions, and various tax benefits were provided to motivate manufacturers to conduct research and development.

**(b) Tariffs and Quotas**

Given Singapore's successful outward looking development strategy with the necessary reliance on unrestricted overseas markets for its manufactures, there are hardly any protective tariffs and quotas of much significance at present.

**(c) Investment Allowance Benefits**

The investment allowance incentive provides the following benefits:

- (i) It is an investment tax credit against taxable income. A tax deduction ranges from 10 to 15 per cent of new fixed investment in plant, machinery, factory buildings which has to be implemented within a qualifying period up to 5 years.
- (ii) There is no time limit for the use of the tax credit.
- (iii) The investment allowance is granted in addition to the normal capital allowance. A firm can simultaneously claim 3 years accelerated depreciation to offset against its taxable income.

**(d) Trade Development Board's "Export Expansion Scheme"**

The Trade Development Board was created in January 1983, as a response to an increasingly protectionist environment in other countries and rapid changes in the pattern of world trade.

Double tax deduction is granted to manufacturing companies incorporated in Singapore participating in the following schemes:

- (i) approved overseas trade fairs and trade missions
- (ii) marketing campaign in foreign countries through market surveys, advertising and other promotional activities
- (iii) production of high quality promotional publications effective for overseas publicity of Singapore products
- (iv) establishing trade offices overseas.

## FINANCIAL ASSISTANCE SCHEMES

The government's medium of financial assistance is primarily the EDB which also administers certain SME financing schemes in conjunction with selected financial institutions. The financial assistance schemes available are:

### (a) Small Industries Finance Scheme (SIFS)

The SIFS was launched in November 1976 to replace the Light Industries Loan Services (LIS) set up in 1963. SIFS provides finance for deserving manufacturing firms or firms providing supporting services related to manufacturing with fixed productive assets not exceed S\$3 million. The SIFS is also aimed at encouraging the further development and technical upgrading of small local industries which serve a vital role in providing the base of supportive services for large companies. To date, the SIFS is being promoted by a number of participating financial institutions such as DBS Bank, Overseas Chinese Banking Corporation, Hong Leong Finance, Chartered Bank, Tat Lee Bank, United Overseas Bank, Overseas Union Bank, United Overseas Finance, Forward Overseas Credit, DBS Finance, Shing Loong Finance and International Bank of Singapore.

Loans applied for under the scheme must be for one or more of the following purposes (EDB, 1984, p. 43):

- (i) establishment of new viable businesses
- (ii) expansion of existing manufacturing capacity
- (iii) modernisation of plant and machines
- (iv) diversification of plant and machines
- (v) augmenting working capital resources
- (vi) factoring

In addition, DBS Finance and Shing Loong Finance offer factoring services up to 90 per cent of invoice value.

**(b) Extended Small Industries Finance Scheme (ESIFS)**

The scheme is basically an extension of SIFS and is aimed at providing financial assistance to industries with fixed productive asset exceeding S\$3 million but less than S\$8 million. Interest rate is at 10 per cent per annum and has a cumulative loan limit of S\$3 million.

**(c) Interest Grant for Mechanisation Scheme (IGMS)**

IGMS is one of the three schemes operated by the Skills Development Fund (SDF) established by EDB in October 1979 to provide financial assistance to employers for the training of skills relevant to Singapore's economic restructuring effort. The two other schemes offered by SDF are Training Grant Scheme (TGS) and the Initiatives in New Technology Scheme (INTEC).

**(d) Small Industries Technical Assistance Scheme (SITAS)**

SITAS, introduced in October 1982, is designed to provide incremental technical expertise to local industries with less than S\$8 million in fixed assets. More specifically, SITAS provides free services in matching a firm's technical needs with the suitable consultant. In cases when firms are unable to identify the problems and requirements themselves, SITAS too fills in such a gap. In addition SITAS is prepared to fund up to 90 per cent of the consultancy cost incurred in engaging the expert.

The programmes currently eligible for SITAS grants, both to individual companies as well as to groups of companies in similar industries are: quick surveys, in depth studies, group study experts and short term specialists. The scope of SITAS grants ranges from simple advice to helping improve the general standard of activities common to a particular industry, for example the standard of food packaging.

**(e) Trainee Release Scheme (TRS)**

Local companies are given some priority in the allocation of trainees from EDB training centres which conduct two-year in-centre apprenticeship courses. For the SMBs the release fee of S\$3,000 per trainee is being waived.

**(f) Product Development Assistance Scheme (PDAS)**

PDAS was established in 1978 to develop local applied research and product development capability and to build up indigenous technology. As such only local companies meeting conditions related to the stated above objectives are eligible. The scheme provides a dollar to dollar grant, that is, the government and the company will bear equally the direct cost of the project. The maximum grant per project is S\$200,000 which will be disbursed in two stages, subject to satisfactory progress of the project.

**(g) Trainee Grant Scheme (TGS)**

Set up in late 1979, the TGS seeks to encourage employers to embark on training programmes to upgrade the skills of their employees. The grant subsidised up to 90 per cent of the allowable costs incurred for the training programme. Eight areas for training identified for priority development are technical skills, computer related skills, management/supervisory skills, craft skills professional education/specialized skills training, product design, R&D skills, company wide productivity improvement programmes and Basic Education for Skills Training (BEST) programmes.

**(h) Initiatives in New Technology Scheme (INTECS)**

INTECS, introduced in 1984, by SDF, provides financial assistance for start ups in industries of cutting-edge technologies, which have been identified to include the following priority areas: automation and robotics, micro electronics, information

technology, biotechnology, optical and laser technology, engineering science and material science.

INTECS has the aim of developing a pool of highly trained professionals and scientists who will form the nucleus and catalyst for building up knowledge and competence in new technologies in Singapore. As such, only Singapore citizens or permanent residents of Singapore in the Singapore-registered companies are eligible.

**(i) Monetary Authority of Singapore (MAS) Rediscounting Scheme**

MAS is established with the main objective of making Singapore's manufactured exports more competitive by lowering the cost of credit to exporters. The Rediscounting Scheme consists of two major categories of financing:

- (i) Pre-export financing is for those applicants with a firm order; funds can be obtained to finance production of goods for export.
- (ii) Export financing is for the exporter who receives immediate payment from MAS when goods are shipped.

**OTHER SUPPORTING ASSISTANCE**

In the activity to turn out innovators and people who are responsive to changing environment and management practices, a course on "*Small Business Management*" is offered to final year students at the University of Singapore. Part of the requirement of the course is a student counselling project whereby a student will be attached to a local enterprise for a period of up to three months. On completion of the project, the students should have identified the strength and weakness of the firm and offered recommendations and solutions to the weakness and also plan for the future of the firm.

## CHAPTER THREE

### FINANCIAL SYSTEM AND STRUCTURE

#### INTRODUCTION

A financial system basically serves to assist in the allocation of resources in an economy from the surplus units (individuals and enterprises with excess income over expenditure) to the deficit units (individuals and investors who have the capacity to spend more than their income and resources). In order that the scarce resources would be used to their optimum for the development of a country, an efficient recycling mechanism is essential. To link the process of borrowing and lending, financial intermediaries play an important role in pooling the resources of lenders and reducing the risk to them of defaults by borrowers; at the same time supplying funds to borrowers in amounts and requirements that meet their financing needs. In other words, the financial intermediaries take a role of mobilizer and allocator of the country's scarce pool of savings. As the financial system reaches maturity, there would eventually be a complex of financial intermediaries offering a variety of financial instruments as savings media for the surplus units as well as a wide range of credit and investment facilities to meet the financing requirements of the deficit units. Not only would the financial intermediaries transact their own instruments directly with economic units in an economy, but they would also transact their instruments among themselves in the financial market. The market may be broadly classified as the money and foreign exchange market and the capital market. The money and foreign exchange market usually transact in short term liquid financial assets which normally mature within one year, whereas the capital market usually deals in long term financial assets of maturity exceeding one year (Bank Negara Malaysia, 1989). Through the process of economic growth and economic development, Malaysia also experienced the process of

monetisation and growth of financial intermediaries and intermediation in the development of its financial system.

#### THE FINANCIAL SYSTEM IN MALAYSIA

Developments in the financial system are closely related to economic growth and development in a market oriented economy (Yan, 1984). The financial system in Malaysia had undergone significant transformation in line with the expanding and industrialising economy. It had transformed from playing the role of mainly financing trade to one that has begun to mobilise and channel resources more effectively and is responsive to basic needs and national priorities.

In the early years the financial system was mainly dominated by the branches of a few foreign banks which were mainly British, specialising in trade financing serving the big British and European companies in Malaysia. Financing at the time was mainly for the exploitation of mineral resources and cultivation of rubber for export, for imports of food and manufactured goods, and domestic commercial and trading activities. There were very few local banks, of which most were generally family owned or formed by individual investors within the same clan. By the beginning of 1959, there were 8 locally incorporated banks with 12 branches in few major towns. Their share of total deposits was less than 10 per cent in 1959, so also their share of total assets. In contrast, the growth of plantation, agriculture and mining in the country, had induced the expansion of foreign banks throughout the country and by the end of 1959, there were 18 foreign banks with 99 branches (Bank Negara Malaysia, 1989).

Access to bank credits by SMEs in the rural areas as well as for non export activities were presumably poor because of the export oriented nature of banking business and the concentration of the banking network in the urban areas. Since the majority of the Bumiputeras lived in the non urban areas, banking would generally be

"foreign" to them. Even for the Bumiputeras in the urban areas, access to bank credit was confined to the privileged few.

When the Central Bank of Malaysia was established in 1959, measures were taken to develop the Malaysian banking system. Policies were designed to strengthen and develop the existing financial institutions and to introduce new intermediaries and markets. Following this, the 1960s saw the development of domestic commercial banks and the widespread branching of banking services particularly to the rural areas. New financial institutions and markets including discount houses, agricultural bank, money and stock markets were established and financing companies were also promoted. The country's first development bank, The Malaysian Industrial Development Finance Limited (MIDF) was established in 1960 with equity participation of the Federal Government, the Commonwealth Development Corporation, the commercial banks and the insurance companies. The Stock Exchange of Malaysia and Singapore was established in 1962 under the guidance of Central Bank. The Central Bank also promoted the development of Treasury bills and other Government securities.

In the 1970s, more financial institutions including merchant banks (many with equity participation of foreign financial institutions) and development finance institutions were established to meet the financing needs of an increasing industrialising economy. By the end of 1970, the number of domestic banks had doubled to 16 with 177 branches across all states and by the end of 1975, the domestic banks had equalled the foreign banks in terms of numbers, assets, total deposits and total loans. By end of the 1970s foreign banks no longer dominated the financial sector but continued to play an important role in the development and modernisation of the Malaysian economy and banking industry. Being a small open market economy, Malaysia relies heavily on international trade as well as foreign capital and technology; and foreign banks with their extensive international linkages, particularly with Malaysia's trading partners, would facilitate quick and reliable settlement of international trade finance. Foreign banks would also act as a media for transfer of financial innovation and new banking

technology. Additionally, foreign banks with their bankers who had first hand knowledge of the country, would also act as a channel for foreign investment.

In the 1980s the financial system was strengthened further when the Central Bank imposed rules to ensure professionalism, accountability and integrity in the conduct of banking. Financial reforms, deregulations, reregulations and innovations were introduced to enhance competition, provide depth to the money market and further develop the capital market. To avoid banks being dominated by a single shareholder or a group of individuals, a regulation on maximum shareholdings in licensed financial institution was introduced in 1986 whereby the maximum shareholdings allowed for individual was 10 per cent and for non individuals was 20 per cent. Not only was there a change in the shareholding structure of these banking institutions, their institutional structure also became more complex, involving a wide range of financial activities which include leasing and factoring, stockbroking, management of unit trusts, venture capital and insurance. With the establishment of off-shore banks in Labuan in October 1990, some of these institutions would have expanded their activities into off-shore private banking, international portfolio management and advisory services.

The keener competition in the banking industry and increased sophistication of consumers had generally led to the proliferation of the host of new financial instruments and new delivery systems. Additionally, the advance in computer technology had transformed the range of services available to the public and also the character of banking towards "*convenience banking*". Technological advancement had contributed to the reduction of costs of producing and delivering financial services, and information. Additionally, the establishment of automated teller machines (ATMs) had permitted cardholders the flexibility in withdrawals, transfers and the deposit of funds, including the payment of selected bills. By joining the Society for Worldwide Interbank Financial Telecommunications (SWIFT) which provides a computer-controlled system for transmitting messages throughout the world, the Malaysian banking system had the

opportunity to have direct links with world financial markets. In the domestic money market, the implementation of a completely computerised on line electronic Interbank Funds Transfer System, had speeded up the daily interbank funds transfer and settlement. Secondary market transactions for Malaysian Government papers and bonds could also be speeded up with the introduction of a Scripless Trading System in January 1990.

At the end of 1990 the number of bank and finance company branches totalled 1,540 serving an average 11,566 persons per branch. Its per capita M2 rose from US\$1,091 in 1982 to US\$1,600 in 1989 and its total bank deposits per capita rose from US\$958 in 1982 to US\$1,600 in 1989. The financial assets/GNP ratio was 2.9 in 1990 when the total assets of the financial system of Malaysia rose by M\$48.5 billion or 17.8 per cent to M\$320.4 billion during the year ending December 1990. Total loans and advances extended by the financial institutions to private sector increased by 22.1 per cent during the year to M\$128.1 billion at the end of 1990 (Bank Negara Malaysia, 1991).

To ensure that the banking system remains "*solid*" while it becomes increasingly competitive and sophisticated, the Base Lending Rate (BLR) was freed from the administrative control of the Central Bank. Under this deregulated regime, with effect from February 1, 1991, individual banking institutions were free to fix their own BLR on the basis of free market forces. It would therefore be partly based on their cost of funds and administrative overheads. However, to prevent banking institutions from charging excessive interest rates, the existing guide-lines on maximum margin over BLR, where the lending rate for loans cannot exceed the declared BLR by more than 4 per cent, would remain in force. On lending to priority sectors, the Central Bank would still continue to determine the ceiling interest rates.

In summary, the financial system and structure in Malaysia had developed from the domination of a few foreign banks specialising in external trade and trade in commercial bills to a Malaysian financial system that is able to mobilise and channel

funds more effectively and is responsive to the needs of national priorities in line with industrialising economic development.

The Malaysian financial system is composed of the banking system and the system of non-bank financial intermediaries.

## BANKING SYSTEM

The banking system in Malaysia was the main financial intermediary with total assets amounting to M\$223.5 billion or 69.8 per cent of the total assets of the financial system at end of 1990. Total deposits mobilised (excluding Repos) by the banking sector amounted to M\$111 billion at year end 1990. The loan portfolio of the banking system increased by 23 per cent to M\$116 billion at year end 1990 (Bank Negara Malaysia, 1991). Within the loan category, term loans accounted for the bulk of total outstanding loans (60 per cent) compared to 22 per cent for overdrafts. This indicated that banking institutions had place more emphasis on term lending and also perhaps there was awareness among customers of its advantage over traditional overdraft arrangement for business investment and development.

The banking system comprises the monetary institutions whose principal liabilities are generally accepted as money. In Malaysia they comprise the Central Bank which is the sole currency issuing authority, and the commercial banks which are the only institutions allowed to operate current accounts. Additionally, the banking system includes several non-bank financial institutions which are closely linked to the monetary institutions and whose liabilities are generally accepted as near money. These institutions which are supervised by the Central Bank are the finance companies, the merchant banks and discount houses. In addition, the banking system also includes the money and foreign exchange brokers, and the Credit Guarantee Corporation which was established by the monetary institutions to provide guarantee cover for commercial banks on their loans to small scale enterprises.

## THE CENTRAL BANK

The Central Bank of Malaysia (Central Bank of Malaya until the formation of Malaysia in September 1963) was established in January 1959 under the Central Bank of Malaya Ordinance 1958. It is wholly owned by the Federal Government of Malaysia and has the legal power to regulate and supervise the financial system in the country.

The principal objectives of the Central Bank are to issue currency, to keep international reserves and safeguarding the value of the Ringgit, to act as a banker and financial adviser to the Government, to be responsible for monetary policy, and to act as a banker to the banks. However, it was not until June 1967 that it became a full fledged Central Bank. Up to June 1967, the currency issuing powers were still held by the Currency Board which was the Board of Commissioners of Currency, Malaya and British Borneo that continued to issue its currency in the Federation of Malaya, Sabah, Sarawak, Singapore and Brunei under the Malaya-British Borneo Currency Agreement of 1960. After Malaysia was formed, comprising the Federation of Malaya, Singapore, British North Borneo (now Sabah) and Sarawak in 1963, the Malaysian Government lodged a notice to the Currency Board of its intention to have the Central Bank as the sole currency issuing authority. However, when Singapore separated from the Federation and became an independent nation in 1965 it resumed as a participating Government in the Currency Board. By then there were three parties to the Currency agreement, namely Malaysia, Singapore and Brunei. The currency Board continued to issue currencies in the three countries until June 1967, after which, the Central Bank replaced the Board of Commissioners of Currency, Malaya and British Borneo, as the sole currency issuing authority in Malaysia. The new Malaysian currency, the Ringgit was issued on June 12, 1967 but the old Malayan dollar continued to be legal tender during the transition period to change to new currencies in the three countries until end of 1968. The Central Bank which had a branch in Singapore continued its function and responsibilities in Singapore after 1965 with the consent of the Singapore Government till 1967.

As a keeper of international reserves and safeguarding the value of the Ringgit, holdings of the country's official external reserves are centralised at the Central Bank. As at the end of September 1988, international reserves at the Central Bank amounted to M\$15,888 million representing an external backing of 189.8 per cent for the currency issue (Bank Negara Malaysia, 1989). The external value of the Ringgit is determined in terms of a basket of the currencies of those countries which are significant trading partners of Malaysia.

On the role of fiscal agent of the Government, the Central Bank acts on the public loan programme (internal and external loans) and managing the public debt. Additionally, it administers the Exchange Control Act, 1953 on behalf of the Government, and is the official depository in Malaysia for the International Monetary Fund, the International Bank for Reconstruction and Development, the International Finance Corporation, the International Development Association and the Asian Development Bank.

The Central Bank is responsible for regulating the country's supply of money and credit to promote monetary stability and a sound financial structure. The ability to influence the availability and cost of money contributes towards achieving the nation's overall economic objectives. Monetary policy instruments used by the Central Bank include the statutory reserve requirements, minimum liquidity requirements, regulation of discounting and open market operations, interest rates regulation, credit control and guide-lines on lending. To ensure effective implementation of these guide-lines, penalties are imposed for failure in compliance.

Some of these guide-lines were made more specific such as the guide-lines introduced in February 1975 that required the commercial banks and finance companies to extend a minimum of 50 per cent of their increase in net credit during 1975 to the Bumiputera community and the manufacturing industry. These guide-lines were revised and made even more specific in 1976 when commercial banks were required to direct a minimum of 20 per cent of their increase in loans to Bumiputeras; in addition, a

minimum of 10 per cent of the net increase in loans must be for agricultural food production, 25 per cent to the manufacturing sector and 10 per cent for individual housing loans. Finance companies were required to extend a minimum of 20 per cent of their new loans to the Bumiputera community, 25 per cent for individual housing loans and 30 per cent for agriculture, manufacturing, building and construction, and real estates development.

To ensure distribution of credits for national priority uses, a new set of guide-lines based on the stock of loans outstanding was introduced in August 1979. Under the new guide-lines, ratios in relation to loans outstanding at a particular base period was prescribed. The August 1979 guide-lines required commercial banks to extend a minimum proportion of loan outstanding as at June 30 1979, to Bumiputera community, SSEs, agricultural food production, manufacturing and individuals for housing. Similarly, finance companies were required to extend a minimum proportion of loan outstanding as at June 30 1979 to Bumiputeras, SSEs, individuals for housing, agriculture, manufacturing, and building and construction. The August 1979 guide-lines were reviewed and replaced in March 1981. Subsequently, these guide-lines were reviewed annually every March to ensure the priority sectors have ready access to credit at reasonable costs and also to allow adjustments of these guide-lines in accordance with developments in the economy. To ensure that the priority sectors would continue to have ready access to funds at reasonable cost, the Central Bank introduced a new set of lending guide-lines with effect, from April 1, 1990. The priority sectors covered included the Bumiputera community and the Principal Guarantee Scheme (PGS) of the CGC. Under these guide-lines, commercial banks and finance companies were required to extend a minimum of 20 per cent of their loans outstanding to the Bumiputera community. On lending under the PGS of the CGC, the commercial banks were required to extend loans to SSEs with guarantee cover by CGC of at least M\$200 million, of which at least M\$100 million must be the guarantee cover

of loans extended to Bumiputeras. The compliance date for these requirements was set for March 31, 1991.

### COMMERCIAL BANKS

In Malaysia the commercial banks dominate the financial structure in terms of head offices and number of branches and outlets. The commercial banks increased steadily from 26 (of which 18 were foreign incorporated banks) with 99 branches in 1959 to 38 (of which 16 were foreign incorporated banks and 22 domestics) and 998 bank branches (of which 852 represented branches of domestic commercial banks) in 1990. Additionally, the Central Bank had already approved the establishment of another 141 new branch offices. The increase in commercial banks and banking offices makes the country better served with banking facilities. As at the end of 1990, the population per banking office was 18,277 (Bank Negara Malaysia, 1991).

In terms of assets, the commercial banks (including Bank Islam) formed the largest group with total assets of M\$130.6 billion (the foreign banks accounted for M\$31.3 billion or 24 per cent of the total assets of all commercial banks) or 40.8 per cent of the total assets of the banking system. In terms of the share of total assets, the commercial banks accounted for 58.4 per cent at the end of 1990 (Bank Negara Malaysia, 1991).

Total deposits mobilised by the commercial banks rose rapidly by M\$7.6 billion or 10.1 per cent to M\$82.4 billion at the year end 1990. Growth in the extension of credit had become most significant in Malaysia. Commercial banks provided about 60 per cent of the total new credits during 1990, the same as in the previous year. Loan growth was 20.3 per cent increasing by M\$13.6 billion to M\$80.8 billion at end of 1990 (foreign banks' share of loans was 25 per cent or M\$18.6 billion; and deposits was 26 per cent or M\$19.2 billion). During the year, overdrafts and term loans increased by M\$3.6 billion and M\$5.5 billion respectively. The new loans were extended mainly to the manufacturing sector (M\$4.7 billion or 34.4 per cent of total

new loans extended in 1990) reflecting the commercial banks major role in the country's thrust towards industrialisation. Increases in new credit to other sectors included finance and insurance (M\$1.7 billion), and general commerce (M\$1.1 billion). Although agriculture no longer played a predominant role in the economy, loans to the agriculture sector continued to increase by M\$616 million during the year.

Bank loans to the manufacturing sector had expanded rapidly since the late 1960s and early 1970s both in value and scope. This expansion was initially for the financing of production for import substitution and at a later stage for industrial production. Financing of foreign trade had decline in relative importance over the years. In 1955, financing of foreign trade was as high as 40 to 50 per cent of the total bank credit but by the end of 1988 bank credit for general commerce accounted for only 17 per cent of the total (Bank Negara Malaysia 1989). Foreign banks' market share of trade financing was well over a third in 1990 (Bank Negara Malaysia, 1991).

Regarding financing SSEs, the Government seems to succeed in using the lending guide-lines imposed on commercial banks towards financing SSEs. On complying with the 1989 guide-lines as at compliance date of March 31, 1990, the commercial banks had approved loans of M\$1.5 billion to SSEs, which was well above the minimum requirement of M\$600 million. Of the amount approved for SSEs, M\$208.8 million was extended to Bumiputeras. Guide-lines for financing SSEs were no more applicable after March 1990. However, commercial banks continue to be guided on lending to the Bumiputera community. Total non performing loans of the commercial banks as a proportion of total loans was reported to have declined to 20.4 per cent from 24.7 per cent mainly due to the expansion of total loans (Bank Negara Malaysia, 1991).

Banking services available to the public were improved with advances in banking technology. Presently, banks had computerised their operations and made the calculation of interest on savings deposits on a daily basis. The establishment of automated teller machines since 1981 had permitted cardholders the flexibility in

withdrawals, transfers and the deposit of funds, including the payment of selected bills. Cheque settlement was improved when the National Automated Cheque Clearing System (SPAN) was launched by the Central Bank in January 1987.

In addition to computer technology investment, quality of services and assets of the banking industry depend ultimately upon quality of management. Hence, staff training and development were also emphasised. To instil greater sense of discipline, responsibility and ethics into the bank staff and to avoid getting staff from other financial institutions, a Staff Training Fund (STF), funded by contributions from financial institutions was established in 1985 for the purpose of training programmes to upgrade professional skills and to inculcate a high sense of moral responsibility in the industry. In 1987, the Central Bank issued guide-lines on staff training whereby commercial banks were required to spend each year at least 1.5 per cent of the total gross salaries of the preceding year on staff training and education. Institutions which failed to comply the regulation would be required to pay a levy to the STF.

Performances of bank services and competition in the banking industry are also influenced by the interest rates charged on loans and deposits. A response to the deregulation would likely be an increase of interest rates. If interest rates charged on loans are to increase, SSEs which no longer are considered as a priority from April 1990 might face some financing problems. Even if interest rates are not raised, as long as SSEs are being considered as riskier than large enterprises, SSEs may face financing problem because crowding out might occur.

#### **CREDIT GUARANTEE CORPORATION (CGC)**

The CGC in Malaysia was established in 1973 to provide guarantee cover to commercial banks for loans extended to SSEs, which had been redefined as registered businesses with net assets of up to M\$500,000 each or in the case of limited companies, shareholders' funds of not more than M\$500,000 each. The three main schemes administered by CGC are the Principal Guarantee Scheme (PGS), the Loan Fund for

Hawkers and Petty Traders (LFHPT), and the Association Special Loan Scheme (ASLS). Total loans guaranteed by CGC, under all its schemes as at December 31, 1990 totalled 172,394 applications with approved loan limits of M\$3,258.1 million compared with 162,609 applications with approved loan limits of M\$2,933.6 million as at December 31, 1989.

### ISLAMIC BANKING

Bank Islam Malaysia or the Islamic Bank of Malaysia was established in March 1983 under the Islamic Banking Act, 1983 to meet the banking and credit needs of the Muslim population in Malaysia according to the rules of Syariah which prohibits interest. The Syariah instead provides non-interest based concepts such as the Mudharabah (financing project on a profit sharing basis but the lender has to share the loss in case of a failure); Musyarakah (partnership); Murabahah (sale and purchase agreement); Wadiah (asset deposit agreement); Al-Bai Bithaman Ajil (deferred sale), Al-Ijarah (leasing finance); Al-Takjiri (acquisition of leased asset by the lessee); Al-Wakalah (agency); Bai'al-Dayn (debt trading) and Shahadah al-Dayn (promissory notes). Returns on investments would be in the form of dividends rather than interest. With 28 branches in operation, its total assets increased by 4.6 per cent to M\$1,385 million at year end 1990; and deposits mobilised rose by 0.5 per cent to M\$1,151 million, while financing extended rose by 14.1 per cent to M\$865 million at year end 1990. Financing under the principle of Al-Ijarah and Bai-Bithaman Ajil had increased by M\$79 million (416 per cent) and M\$44 million (8 per cent) respectively. Financing under Al-Murabahah had declined by M\$20 million (15 per cent) and financing under Al-Mudharabah remained unchanged at M\$0.4 million. Out of the total loan extended, 33 percent was granted to manufacturing sector, 21 per cent to individuals for housing and 12 per cent for real estate development (Bank Negara Malaysia, 1991).

## (b) FINANCE COMPANIES

In 1969, the Finance companies were brought under the jurisdiction of Central Bank under the Finance Companies Act 1969 (Bank Negara Malaysia, 1989). They are the second largest group of deposit taking financial institutions in Malaysia.

Finance companies came into being since early 1960s. They were established as limited companies engaged in money lending activities like the larger licensed moneylenders by providing loans for the purchase of consumer durables. But unlike the moneylenders, finance companies can mobilise savings and idle funds from the public in the form of deposits. Since finance companies are not allowed to accept demand deposits, they concentrated in mobilising funds through fixed deposits and savings deposits. Rates charged on loans are often higher than commercial banks which may be due to higher cost of funds. Additionally finance companies offered higher interest rates on deposits in order to attract more savings. Some companies tend to rely on their shareholders' funds for lending operations.

Finance companies expanded in mid 1960s particularly with entry of commercial banks establishing their wholly owned finance company subsidiaries. To control and supervise the activities of all finance companies, the Central Bank is empowered to regulate and supervise the activities of all finance companies which accept deposits from the public in the interest of depositors. The Finance Companies Act 1969 distinguishes between those finance companies which are licensed under the Act and those which are not. Under the Finance Companies Act 1969, licensed companies were authorised to accept deposits (or loans) from more than 10 persons and to engage in the lending or investing of these funds. The unlicensed finance companies were no longer allowed to use the term finance companies in their company names in any language. To be eligible for a license under the Act, the company must be a public company incorporated in Malaysia, with paid up capital not less than M\$1 million.

At the end of 1990, there were 45 finance companies in the country. Their total assets expanded by 35 per cent in 1990 reaching M\$39.5 billion at end of year 1990,

equivalent to about 30.5 per cent of the total size of commercial banks assets. Total deposits mobilised (excluding Repos) rose by M\$8.2 billion. Total loans extended increased by 35.9 per cent in 1990 mainly in the form of hire-purchase finance, which rose by 71.6 per cent (M\$5.4 billion) to M\$13.1 billion to account for 47.6 per cent of total outstanding finance company credit at the end of 1990. Leasing finance provided by the finance companies also increased (by 29 per cent). Small loans of less than M\$100,000 each extended by the finance companies accounted for 83.6 per cent of the industry's total new loans.

On compliance with the Lending Guide-lines, as at the compliance date of March 31 1990, loans granted to Bumiputeras accounted for 49.7 per cent of total loans outstanding as at December 31, 1987, well in excess of the minimum 20 per cent. As at the end of 1990, loans granted to Bumiputera individuals and Bumiputera controlled enterprises amounted to M\$9 billion, an increase of 43.1 per cent from M\$6.3 billion at end of 1989. The number of Bumiputera loan accounts rose by 60.1 per cent to 715,842 at end of 1990, of which 99.1 per cent of the outstanding loan accounts was for loans not exceeding M\$100,000 each. Outstanding loans to SSEs as at the same date (M\$3.2 billion) represented 23.8 per cent of the total loans outstanding as at December 31, 1987 or 14.9 per cent of outstanding loans as at March 31, 1990. Total non performing loans of the finance companies increased moderately from M\$5.7 billion at end of 1989 to M\$5.9 billion at the end of 1990. However, with the expansion of total loans in 1990, the non performing loans as a proportion of total loans declined from 28.75 per cent in 1989 to 21.7 per cent in 1990.

**(c) MERCHANT BANKS:**

Merchant banks complement and supplement the activities of financial institutions by operating in "wholesale" banking and as corporate advisers and financiers. They specialise in financial services which cannot be adequately covered by

commercial banks such as the fee-based activities of underwriting of securities, portfolio management and other financial services geared to the corporate sector.

In Malaysia there were 12 merchant banks and 5 branches operating at the end of 1990. Total resources of the merchant banks in Malaysia increased by 24.6 per cent to reach M\$11.1 billion at the end of 1990. More than three quarters (80.1 per cent) of the new resources were generated from borrowing from domestic financial institutions. The incremental resources were used to finance mainly in merchant banks' investments in marketable securities and lendings to domestic financial institutions. Total loans extended by the merchant banks increased by M\$729 million or 13.2 per cent to reach M\$6,254 million at the end of 1990. The larger part of the merchant banks' new credit was extended to the financing, insurance and business services sector. The balance was extended to real estate and property development, manufacturing and agriculture. Term loans with maturity period of 1 year or less accounted for 54.7 per cent of total loans, while term loans of more than a year accounted for 36.5 per cent of total loans.

#### **(d) DISCOUNT HOUSES**

The seven discount houses operating in Malaysia specialised in short term money market operations investing in treasury bills, Government securities, BAs, NCDs and Bonds.

#### **THE NON-BANK FINANCIAL INTERMEDIARIES**

The non-bank financial intermediaries which are supervised by various Government departments and agencies, are broadly classified into five institutions namely the development finance institutions, the savings institutions, the provident and pension funds, the insurance companies, and a group of other financial intermediaries comprising the building societies, the unit trusts and several special investment agencies.

## SAVINGS BANKS

The savings banks in Malaysia started as post office savings banks. As postal savings banks, their operation for private savings were lethargic and prompted the government to amalgamate and absorb them into a national savings institution. The National Savings Bank (NSB) was therefore established in 1974. In 1990, the bank had a total of 313 regional, mini and sub-branches, 539 permanent and 232 mobile post offices with banking facilities. Total resources of the bank rose by M\$307 million or 10.5 per cent to M\$3,236 million at end of 1990. Loans extended during the year 1990 increased by M\$166 million or 30.6 per cent to M\$708 (M\$315 million or 139 per cent in 1989). Bumiputera individuals received the largest share of the loans through the ASN loan scheme (the National Unit Trust Scheme) to purchase trust units which would have a market value depending on the market value of the portfolio of investments held by the scheme.

Lending activities of saving banks were specified or subjected to some limitation since most of these banks were operated by Government. In compliance with the statutory requirement, the saving banks in Malaysia invested the bulk of its new resources in Federal Government securities.

## PROVIDENT, PENSION AND INSURANCE FUNDS

Provident, pension and insurance funds are a group of financial schemes designed to provide members and their dependents with a measure of social security in the form of retirement, medical, death or disability benefits.

In practise, all employers including the Government are required to adopt some form of social security scheme to protect the welfare of their employees. In Malaysia, the provident, pension and insurance funds consisted of the Employees Provident Fund (EPF), the Social Security Organisation (SOCSO), the Armed Forces Fund (AFF), the Teachers Provident Fund (TPF) and the seven largest separately constituted private pension funds, and life insurance funds provided the largest source of long-term

financing for the public sector. To widen the investment portfolio of the EPF, the Employees Provident Fund Act, 1991 which was passed by Parliament in March 1991 would enable the EPF to widen its investments into immovable properties, promissory notes and bills of exchange. In addition, the Fund could also invest in joint venture or participate in privatisation programmes with prior approval of the Minister of Finance. For the contributions towards EPF, employers contributed 11 per cent and employee contributed 9 per cent of employee's monthly gross wage.

### **INSURANCE COMPANIES**

The financial intermediary role of insurance companies are not as obvious as that of banks and other non-bank financial institutions because they are more associated with minimisation of and compensation for risks. Insurance companies accept funds in the form of premiums from those they insure and stand ready to pay off on the risks they insure. They also invest the funds they received, thus acting as a lender. Their liabilities were mainly in the form of insurance premium. Loans would also be extended to corporate and policy holders. Insurance companies in Malaysia were mainly private companies. As at the end of 1990, there were 58 registered insurers which comprised of 3 life companies, 39 general companies, 15 composite companies and one reinsurance company. In addition, there was Takaful Malaysia, the only Islamic insurance registered.

#### **(d) MALAYSIA EXPORT CREDIT INSURANCE (MECIB)**

MECIB was incorporated in 1977 to provide insurance coverage to Malaysian exporters against the risk of non payment of foreign buyers. In 1989 it launched a Bond Indemnity Support Facility to provide guarantees to commercial banks to encourage the issuance of bonds to support overseas projects. In March 1990, a new export credit insurance/guarantee scheme known as Bankers' Export Finance, was launched to

protect commercial banks and other financial institutions against default or non payment of advances taken by exporters or their suppliers.

#### INDUSTRIAL FINANCE INSTITUTIONS

The industrial finance institutions comprise Sabah Development Bank, Malaysian Industrial Development Finance (MIDF) and its subsidiary, Malaysian Industrial Estates Ltd. (MIEL), Development Bank of Malaysia (BPMB), Industrial Bank of Malaysia (IBM) and Borneo Development Corporation. These institutions mainly cater for enterprises in the industrial sector. Total resources of these institutions expanded by 8.3 per cent to M\$3,459 million at the end of 1990, arising mainly from larger borrowings and paid up capital. Total borrowings were mainly from both domestic and international sources which increased by 31.9 per cent to M\$1,538 million at end of 1990 with the larger funding provided by the Central Bank and the ASEAN-Japan Development Fund (AJDF). The share of total borrowings to total resources at end of 1990 was 44.5 per cent. The Federal and State Governments, the Central Bank and Government agencies were the main providers of credits to the industrial finance institutions, accounted for 64.8 per cent or M\$997 million of their total borrowings at the end of 1990. Shareholders' funds constituted 21.1 per cent of total resources. Total credit extended by the industrial finance institutions increased by 17.6 per cent to M\$2,073 million at end of 1990. The share of outstanding credit to total assets were 60 per cent at the end of 1990 compared to 55.2 per cent at the end of 1989. These industrial finance institutions expanded their trade financing by providing letter of credit facilities. They also diversified into venture capital operations and had programmes to assist SMEs engaged in manufacturing, particularly in the technical aspects of operations such as quality assurance and control, machinery utilisation, design and production process.

## AGRICULTURAL CREDIT INSTITUTIONS

Agricultural credit was mainly extended by three major groups of institutions. They were the banking system, Government development agencies and rural credit institutions. The banking system comprised of the commercial banks, finance companies and merchant banks. Government development agencies included the Federal Development Authority, and Sabah Development Bank while the rural credit institutions included Bank Pertanian Malaysia (BPM), Bank Rakyat, Farmers' organisations, cooperatives, agro based cooperative societies and the rural credit cooperatives in Sabah and Sarawak. The rural credit institutions were the main depositories of the savings of the rural populations and hence they had their main liabilities in the form of savings and fixed deposits. The bulk of their funds were lent out to agricultural and other rural activities. Total loans granted to the agricultural sector by the Agricultural credit institutions in Malaysia, at the end of 1990 were M\$9,738 million an increase of M\$690 million or 7.7 per cent from the previous year.

## URBAN CREDIT COOPERATIVE SOCIETIES

The Urban Credit Cooperative Societies provided consumer credit and served as a channel for investment by their members. Total resources were mainly from share subscriptions and deposits.

## PILGRIMS MANAGEMENT AND FUND BOARD

The Pilgrims Management and Fund Board was formed to mobilise the savings of Muslims and also to assist Muslims in their performing the pilgrimage. Resources were mainly from deposits which contributed 85 per cent of total resources in 1990. Total resources at end of 1990 were M\$1,234 million. Investments of the Fund were mainly in corporate securities (M\$588 million invested at the end of 1990).

## UNIT TRUSTS, GILT-EDGED UNIT TRUST AND PROPERTY TRUST

Unit Trusts serve as a medium through which small individual investors can acquire a share in a diversified portfolio of corporate securities, government securities and real property.

## SPECIAL INVESTMENT INSTITUTIONS

Komplek Kewangan Malaysia Berhad (KKMB), the Bumiputera Investment Foundation and its subsidiary, the National Equity Corporation (PNB) are institutions closely related to the unit trusts, established to promote the ownership of share capital by the indigenous population in Malaysia.

## OTHERS

Other types of financial institutions that contribute to greater diversification of the financial structures but were seldom mentioned were the pawnshops. They did not have savings facilities but were involved in lending which still meet the emergency loans needed by the public and are now being supervised by the Government.

## PAWNSHOPS

Pawnshops involve in lending money that is known as pawnbroking where loans are pledged on any item that can be of value. In pawnbroking, the pawn broker will appraise the value of the pawn (items can be anything from a watch, radio, and even cloth. But valuables like jewellery and gold or silver ornaments are commonly pawned) and the borrower simply sells the item to the pawnbroker on the condition that he (the borrower) buys back the item within a specified time for the same amount plus interest. If the borrower does not buy back the item, the broker may sell or keep it for himself.

Pawnbroking is an attractive way of moneylending because of the low risk and low transaction costs involved. Appraisal time taken by the pawnbroker to appraise the value of the pawn usually takes a few minutes, therefore loan transaction in

pawnbroking occurs within a short period of time. Additionally, loan administration is simple and straightforward with no lengthy procedures and no lengthy forms to be filled. Moreover, the seller of the item or borrower who pledges the item, may use the funds for purpose of consumption, productive investment or capital formation.

It was reported in the national Malaysian rural credit survey of 1986 that pawnbroking was the most important source of informal lending in Malaysia's rice producing areas (Bouman, 1989).

### THE FINANCIAL SYSTEM IN INDONESIA

The financial system in Indonesia is basically composed of the banking system and the formal non-bank financial institutions (NBFIs). At the end of 1977, total assets of the financial system totalled R\$7,852,897 million compared to R\$1,659,819 in 1973. As at the end of 1979, there were 799 state owned bank offices, 102 private owned bank offices, 22 foreign bank branches and 186 domestic non foreign exchange banks totalling 1,109 of bank offices in all. The population per bank office ratio was 135,220 in December 1979 (Nasution, 1983). However Yan (1984) reported that in Indonesia, a vast and underdeveloped economy, banking offices were found to be concentrated in the major towns. Frings (1988) supported the view by reporting that state and private national banking business was concentrated on the island of Java where Jakarta, the capital city, and the more affluent 100 million of the country's population are. Jakarta, was even reported to be overbanked. However, Yan (1984) further reported that each banking office was serving an average of 148,700 persons in 1982. Its per capita M2 was only US\$121 and per capita deposit was US\$89, the lowest in the region of ASEAN countries. Its total financial assets/GNP ratio was 0.55 for the same year. In 1989, Indonesia's lower M2/GNP ratio of 0.31 also indicated a slow rate of penetration of the commercial banking system in the country (Bank Negara Malaysia, 1991).

## THE BANKING SYSTEM

The Banking system is the most important segment of the Indonesian financial system. In the period between 1973 and 1977, the banking system contributed about 96 to 98 per cent of the financial system total assets. Its banking offices are also more widespread than the offices of NBFIs. At the end of March 1978 there were 134 banking head offices with 1141 branches (Nasution, 1983) in the country.

In the early days of Indonesia, the banking system was primarily for financing Dutch private enterprises in the colony. Under the "*Guided*" economy of President Sukarno, the Dutch banks and some other foreign banks were nationalised, while other foreign banks were closed down. The Dutch bank Javasche Bank, was nationalised and became Bank of Indonesia by statute in 1953 and it had the power to issue currency but it was also involved with commercial banking. The nationalisation of branch offices of foreign banks in Indonesia and excessive control of foreign exchange, had disconnected the link between domestic banks and the overseas money market. In its anti Western stance, Western aid was rejected, and Indonesia withdrew from the International Monetary Fund (IMF), World Bank, United Nations, and other international organisations. In 1960s, Indonesia experienced constant inflation (due to budget deficit because of high Government expenditure and subsidies), widespread price control and political instability (to liberate West Irian from Dutch in 1959-1962, the rebellion in the outer islands in 1959-1960, and the confrontation against Malaysia in 1963-1965). The people at that time distrusted the banking system because there were several deposit freezes, bank failures and monetary purges. People even went back to barter trading and reversed the monetisation of the economy (Nasution, 1983). In May 1965, the central bank, three state commercial banks, one state savings bank, and state pawnshops were consolidated into one single institution called Bank Negara Indonesia (Indonesian State Bank), composed of five units. However, under the New Order regime of President Suharto who came to power in September 1965, a series of new banking laws was introduced by Bank Indonesia to reorganise the banking institutions.

The single Bank Negara Indonesia was reorganised into separate banks namely the central bank, one development bank, one savings bank, and five state owned commercial banks with defined functions for each. The commercial bank department of Bank Indonesia was transferred to other state commercial banks. Since then, Bank Indonesia has taken the role of Central Bank as the country's sole issuer of currency, a banker's bank and bank to the Government, a controller of foreign exchange, regulator of financial institutions except insurance companies.

The banking system in Indonesia was allowed to extend medium and long term loans as well as capital participation in non bank business ventures. Direct credits were extended to non financial institutions to finance the implementation of Government programmes. Additionally, commercial banks were also encouraged to finance credit for small agriculture, small businesses, handicraft industries and other traditional enterprises.

Contacts with the West were re-established and Indonesia rejoined the IMF, World Bank, and other international organisations. To overcome constraints in capital and technical skills, foreign investors were invited. Foreign banks were allowed to open their branches and sub branches but only in Jakarta and a joint venture bank was allowed to operate in Surabaya, as protection for state owned and national private banks outside Jakarta.

Resumption of diplomatic and economic ties with Malaysia and Singapore allowed the resumption of regional trade and reopened avenues to international markets and also finance.

With political and economic stability, people's confidence in money and banking was gradually restored.

## THE CENTRAL BANK

Bank Indonesia became the central bank by statute on July 1, 1953. However, it was not until 1968 under the "*New Order*" regime that it began to function as a pure

central bank (Nasution, 1983). As the central bank, Bank Indonesia is the sole issuer of the Rupiah, the Indonesian currency. Other roles and responsibilities of the central bank are to hold the official international reserves of the country, supervise and regulate all financial institutions (with exception of insurance companies) and NBFIs. Bank Indonesia is also responsible for the preparation and implementation of the monetary policy under the direction of the Economic Stabilization Council, a governmental advisory body chaired by the Coordinating Minister for the Economy, Finance, Industry and Development Supervision, and consisting of the Minister of Finance, the Minister of Trade and the State Minister of National Development Planning. Under the direction of the Government the bank also regulates the money supply, credit policy and interest rates through its portfolio-cum-selective credit policy (Nasution, 1983). Bank credit was allocated directly through selective credit control by setting interest rates for short term loans higher than those of the longer term loans. Priorities of credit uses were by economic sector, economic activities and recipients determined by directives from the authorities. Rediscounting facilities at the Central Bank were restricted to state banks and only occasionally available for domestic private banks on a limited basis. The purpose of the rediscounting facilities was mainly to subsidize state banks where in many instances their average interest rates on savings and time deposits were higher than their average lending rate. Due to the selective credit policy, there were different levels of interest rates at the state banks. At private banks, NBFIs, and at the interbank money market, there were also different levels of unregulated interest rates.

Scarce availability of credit and high interest rates for non priority sectors and non favoured borrowers such as multinationals and Chinese-owned businesses, had encouraged capital inflows to meet their demand of credit. The red tape and time consuming administrative procedures in applying for credit from state banks was also a contributing factor for prime business establishments to have borrowed from abroad.

Reserve requirements were also imposed on commercial banks. The definitions of reserves and current liabilities were changing from time to time with changes in its monetary policy. However, different ownership of banks (state, foreigners, private nationals) was subjected to different definition of reserve base which therefore imposed different effective reserve requirement even though the reserve ratio was made uniform for all banks. But as each group of banks served a different class of customers, interbank funds movement were said to be minimal during periods of tight money (Nasution, 1983).

The Central Bank also acts as an adviser and a banker to the Government. Activities of the Bank are supervised by a commissioner appointed by the President, and the Bank is required to submit annual and supplemental budgets to the Government for approval. The governor of the Bank and his managing directors are appointed by the President for a term of five years.

#### COMMERCIAL BANKS

Commercial banking in Indonesia is the main source of financing for firms in Indonesia as the capital market was reported to be undeveloped (Frings, 1988).

In October 1968, savings and time deposits were introduced and savings schemes were introduced in 1969. Until May 1969, the Central Bank had to subsidise the interest cost of savings schemes to commercial banks because the interest rates paid on savings and time deposits exceeded the average interest rates earned on their loans. When the Government started its five years development programme starting from 1969, the subsidy on interest at state banks was abolished. In 1969, state banks started to offer government guarantee and tax free high interest rates on time and savings deposits. Tax facilities was also made available to savings schemes deposits at non state banks. In 1973, special concession credit programmes to promote the development of the indigenous SSEs were introduced. They included the Kredit Industri Kecil (KIK) or Small Investment Credit and Kredit Modal Kerja Pemasaran (KMKP) or Small

Permanent Working Capital Credit offered to all sectors in the economy. In Indonesia, the commercial banks formed the largest institutions which contributed 47.9 per cent of its total financial assets. As at 31 December 1979, there were 5 state owned commercial banks, 83 private national banks and 10 branches of foreign banks (Nasution, 1983).

#### DEVELOPMENT BANKS

Development banks raise funds from time and savings deposits and the issuance of medium and long term financial papers. In 1978, there were 28 development banks of which one is Government owned, one privately owned, and 26 owned by provincial governments (Nasution, 1983). The responsibilities and functions of the state development bank were to assist the Government in financing its development projects. Since 1966 the state development bank became a commercial bank.

Provincial development banks were established by provincial governments to finance development projects in their jurisdiction. Besides acting as provincial cashiers they also handles demand deposits like commercial banks.

#### SAVINGS BANKS

Savings banks in Indonesia are non deposit money banks. Their sources of funds are mainly from saving and the uses of funds are mainly in trading of financial paper. In March 1978, there were one state savings bank and six small private savings banks.

#### NON BANK FINANCIAL INSTITUTIONS

Non bank financial institutions that were in operation in Indonesia were the rural banks, pawnshops, insurance companies, the Development Finance Corporation and the Investment Finance Corporation. The main source of funds for the NBFIs were the International Development Association and the World Bank.

## RURAL BANKS

In Indonesia, rural banks were classified according to their clients that they served namely, employees, village, paddy and petty traders. At the end of March 1978, there were 5928 branches of rural banks which were under the supervision of Bank Rakyat Indonesia with guidance of the Central Bank. The three types of rural banks were the village banks which were mainly concerned with extending small loans to farmers; the Paddy Banks which extends rice loans to members in the village; and the Petty Traders' Bank which extends loans to petty traders.

## PAWNSHOPS AND INSURANCE COMPANIES

State pawn service came under the supervision of the Directorate General of Domestic Monetary Affairs, Ministry of Finance while the insurance companies came under the supervision of the Directorate of Financial Institution, the Directorate General of Domestic and Monetary Affairs, Ministry of Finance. At the end of March 1978 there were one head office with 441 branches for the pawnshops; and 53 insurance companies head offices with 259 branches.

## FINANCE COMPANIES

The Development Finance Corporation concentrates its activities on medium and long term financing and equity participation while the Investment Finance Corporation's main activities were to act as intermediaries and underwriters of financial papers and to finance medium and long term investments. At the end of March 1978 there were 2 development finance corporation head office with 2 branches. As at the same date, there were 10 Investment Finance Corporation head offices with 10 branches. Nine out of the twelve finance corporations were joint ventures between public and private enterprises. State commercial banks or the Central bank were the majority participating shareholders in the NBFIs and through NBFIs, the state banks

and the Central bank extend short term credits and invest in sectors and activities that the banks themselves could not reach.

The finance companies in Indonesia, were limited to issuing promissory notes and other papers in their fund gathering activity. They contributed 2 per cent of its financial system's total assets (Tison, 1986 p:28).

#### THE FINANCIAL SYSTEM IN SINGAPORE

Singapore which was reported to have led in terms of economic performance was also reported to be the most financially developed among the ASEAN countries. Yan (1984) found that Singapore had a broad network of banking offices, each serving an average of only 7,300 persons in 1982. The development was also reflected in a high per capita M2 (M2 being private sector liquidity) of US\$4,314 and per capita deposits of US\$4,519. Its financial assets/GNP of 2.74 in the same year indicated its monetisation and financial deepening where financial assets had increased at a much more rapid rate than its non-financial wealth.

Singapore was also reported to be a major international financial centre (Bank Negara Malaysia, 1991). With foreign exchange averaging some US\$80 billion a day, Singapore was considered the fourth most important foreign exchange centre in the world after New York, Tokyo and London (Balakrishnan, 1991).

At the end of March 1991, there were 137 commercial banks and 71 investment banks operating in Singapore with almost all the world's leading financial institutions represented except the Bank of Credit and Commerce International which failed to get an operating license despite having applied several times. Reports have shown that there has not been a single bank failure in Singapore since it gained independence in 1965.

## BANKING SYSTEM

The banking system comprises the monetary institutions whose principal liabilities are generally accepted as money .

## THE CENTRAL BANK

Monetary Authority of Singapore (MAS) was reported to be the most powerful, politically independent central bank in ASEAN (Balakrishnan, 1991). Except for issuing of currency, the MAS is responsible for overseeing virtually all other financial matters in Singapore, including monitoring commercial and investment banks, the stock and future exchanges, and the insurance industry.

Singapore has few controls on how much money that can be taken in or out of the country for off-shore transactions. However, Singapore does not allow the local currency to be internationalised, to be borrowed for projects or acquisitions elsewhere. This has made Singapore the only financial centre of any stature whose currency cannot be freely traded (Balakrishnan, 1991).

The value of the Singapore dollar is measured against a basket of the country's main trading partners' currencies.

## COMMERCIAL BANKS

The commercial banks dominate the financial structures of Singapore in terms of assets, deposits mobilised and credit extended. Singapore had (excluding the off shore banks) 51 commercial banks with 250 branches as at the end of 1984 (Tison, 1986). The leading role of commercial banks could be explained partly by the fact that they are the first institutions to emerge in the organised sector of the financial structure. Their early establishment enabled them to reap the benefits associated with the pioneer in the financial service industry without competition from other organised intermediaries. An oligopoly granted them for accepting demand deposits and dealing in international trade financing and foreign exchange, which principally distinguishes

the commercial banks from other financial institutions. At the end of March 1991, there were 239 local bank branches which also owns securities houses, finance, insurance and property companies (Balakrishnan, 1991).

#### FINANCE COMPANIES

In Singapore, the finance companies raised funds by regular deposits (savings and fixed deposits and certificates of deposits) in addition to issuing their own papers. In Singapore, the finance companies accounted for 5 per cent of its financial system's total assets (Tison, 1986 p:28).

#### MERCHANT BANKS

Singapore has the largest number of merchant banks in ASEAN and they are all multinationals.

#### SAVINGS BANKS

Singapore still had post office savings banks in 1984. However, in 1984, a legislature amendment to the charter of the Post Office Savings Bank of Singapore authorised it to accept chequing accounts. The Post Office Savings Bank of Singapore participated actively in the money market as supplier of funds and had set up joint ventures with other financial institutions. The bulk of savings bank funds went to the government and other public enterprises either in the form of direct loans or purchases of Government Securities.

#### PROVIDENT AND PENSION FUNDS

These institutions have a captive market since all employees with a few exception have to contribute regularly to their funds. In view of this, provident and pension funds could gather a sizeable amount of funds, the investment of which could have a substantial impact in the financial market. The regular contributions of members

and the more predictable nature of cash outflows, would make the pool of funds gathered ideal for long term investment. In Singapore, both employer and employee contributed equal shares.

#### OTHERS

Pawnshops are also found in Singapore. In 1990, it was reported that pawnshops in Singapore lent as high as S\$700 million (or \$260 for every Singaporean) compared to S\$513 in 1985 (Veloo, 1991). Loan period from pawnbrokers may be up to six months though extension may be granted with continual payment of interest. It was reported that generally people who cannot get a bank loan or qualify for credit cards to pay their bills go into debt at the pawnshops and these borrowers were no longer only those of the lower income bracket. Direction of loan is not available but presumably they are for consumption purposes. Moreover, the problem was referred by the Prime Minister as the "*middle class squeeze*" due to people whose earnings do not qualify for welfare, but desire some finer things in life that they could not afford. In Singapore failure to redeem the pawned items were reported to be less than 10 per cent.

## CHAPTER FOUR

### FINANCE THEORY, INSTITUTIONS AND SMALL FIRMS

#### INTRODUCTION

Business is about making profits and profits will be determined by the way in which resources of the business in terms of capital, physical resources, people and other elements were being organised. In organising the firm, the business owner/manager faces many problems; and securing funds for the business venture seems to be a major problem throughout the life of the firm. From the stage of business idea to that of profit returns, finance is needed for the initial capital, working capital, and buffer capital to sustain business at existing level and also to stay in business during bad times and emergencies. Harper (1984) suggested that most small business people believed that shortage of capital was their major if not their only problem. The more readily finance could be obtained, the more easily it seemed that other difficulties and constraints could be overcome. Not only the firm's growth from entrepreneurial activity would be constrained by lack of finance, but under-capitalisation could cause the firm to fail.

Whenever finance is needed for the firm, the owner/manager of the firm seeking finance, needs to identify the types of finance that he needs and the different sources of finance available because the suitability of different sources of finance appears to vary according to the needs of the firm. For example, it would appear to be inappropriate to borrow on overdraft to finance the purchase of building. The amount, the type and the timing of finance needed and the reliance on credit in general may vary by type of enterprise.

#### FINANCIAL CHARACTERISTICS OF SMALL ENTERPRISE

The traditional view of the financial life cycle of the firm based on Evans' Hypothesis is that the life cycle of the firm has an influence on the pattern of financing

(Ray and Hutchinson, 1986). According to Weston and Brigham (1978) the hypothesis suggests that there are three stages of growth in a business firm which might be referred to as (i) the early stage (ii) the maturity stage (iii) the levelling stage.

Table 4.1: The Traditional View Of The Financial Life Cycle Of The Firm

Stage	Source of finance	Potential problem	Managerial Characteristics
Inception	Owner's resource	Under capitalisation	Personal
Growth I	As above plus: retained profits, trade credits, bank loans and overdrafts, hire purchase, leasing.	Overtrading, liquidity crisis	
Growth II	As above plus: Longer term finance from financial institutions	Finance Gap?	Competent Management
Growth III	As above plus: New Issue Market	Loss of Control	Competent Management
Maturity	All sources Available	Maintaining ROI	
Decline	Withdrawal finance, Firm taken over, liquidation	Falling ROI	Insufficient management foresight

Source: Weston and Brigham (1978); Ray and Hutchinson (1983)

In developing the traditional view of the financial life cycle of the firm, Weston and Brigham (1978) suggested six stages for enterprise development. They are the inception stage, growth I, growth II, growth III, maturity stage and decline. Each stage of the Weston and Brigham model is characterised by financial and managerial profile. The elaboration of the traditional view of financing of the small growing firms states that small firms start by relying upon the owner's resources and the start up stage is often accompanied by under capitalisation. The initial period of growth is characterised by over trading where the sales of the firm expand more quickly than its financial resources. Since owner's personal resources are usually already committed to the business, and since there is no easily available market for raising new equity, it means raising longer term loans from financial institutions and seeking venture capital ( Ray and Hutchinson, 1986).

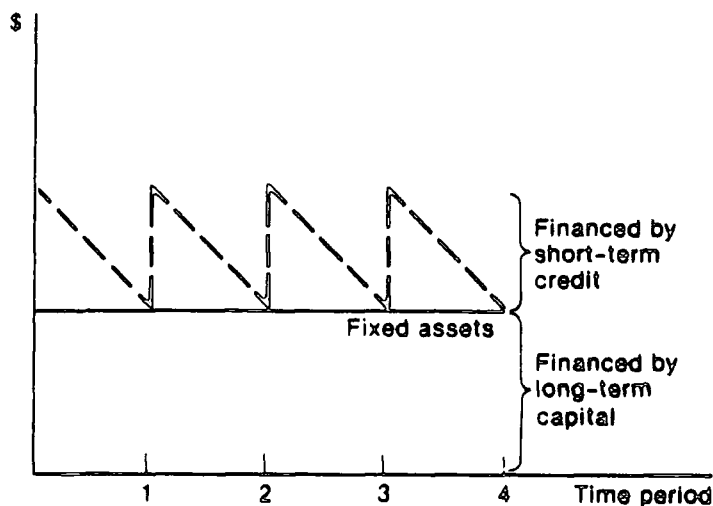
Hisrich (1989) categorised the stages of business development funding into (i) Early stage Financing (ii) Expansion or Development Financing and (iii) Acquisition and Leverage Buyout Financing. At the early stage of financing, two types of financing are said to occur. They are seed capital and start up. Seed capital is the relatively small amount of funds needed to prove concepts and finance feasibility studies; while start up finance is needed to develop and test initial products or services to determine if commercial sales are feasible. Funds at this early stage are mentioned as usually difficult to obtain from external finance.

The expansion or development financing is known to consist of the second stage where funds are used as working capital to support initial growth; the third stage where the company is at break even or a positive profit level and uses funds for major sales expansion; and the fourth stage where funds are used as bridge financing in the period when the company prepares to go public. For the final type of financing, Acquisitions or Leveraged buyout Financing, funds are used to buy out present owners or to enable a publicly held firm to become a private company.

## MATCHING OF MATURITIES

It is commonly known in the finance literature that financing strategy should be based on the matching of assets and liabilities. This implies that short term assets should be financed only by short term funds. By using the shortest possible maturity, this means minimising risk and possibly minimising capital costs if we assume that the short term interest rate is less than the long term rate.

Table 4.2: Financing Working Capital: A simple model

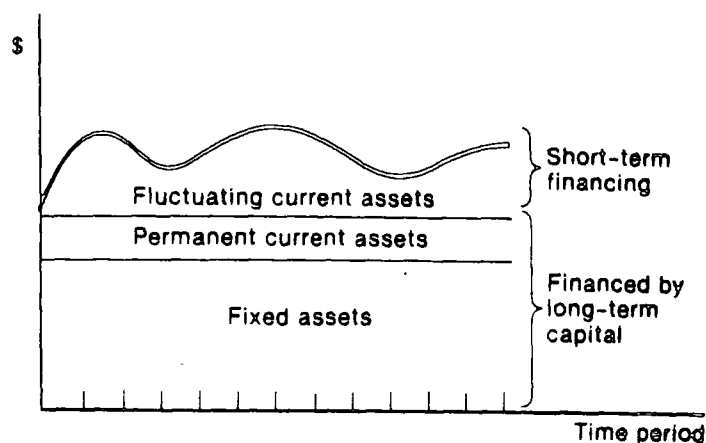


Source: Levy and Sarnat (1988, p. 471)

In the simple model it illustrates that resources acquired at the beginning of the production period are used up during the period and resources fully reacquired at the beginning of the next period. However, in the uncertainty of the real world, firms have reserves of cash, inventories and account receivables which in a sense are considered as the fixed portion of the firm's current assets. Hence, the matching strategy is to employ long term funds to finance fixed assets plus the fixed portion of current assets, and the short term funds to finance only those current assets that fluctuate over the firm's operating cycle. The component of current assets which is financed by long term funds

is defined as the net working capital (the excess of current assets over current liabilities).

Table 4.3: Financing Working Capital Under Uncertainty



Source: Levy and Sarnat (1988, p.472)

Table 4.4: The Working Capital

Current assets	Current liabilities
Net working capital	Long-term debt and equity
Fixed assets	

Source: Levy and Sarnat (1988, p.472)

Some writers regard the firm's financing needs as the firm's cumulative capital requirement which is defined as the cost of both current and fixed assets and should be financed mainly by long term sources. This viewpoint suggests that the long term finance is the determinant of short term finance. The implication is that if the

raised long term finance exactly meets the cumulative capital requirement, the firm faces no financial constraints; if the raised funds are less than the cumulative capital requirement, the firm has to borrow on a short term basis to bridge the gap; and if the raised long term finance exceeds the firm's cumulative capital requirement the firm has the opportunity to invest the excess raised funds. However, why should the firm raise funds in excess of its needs? If the firm invest the excess funds on other activities, it would imply that the returns on this particular activity of the excess funds must be greater than or at least equal to the cost of the long term finance. Even if the raised long term finance meets the cumulative capital requirements, some of the funds may not be put to use as yet, as not all assets are bought at the same time. These unused funds, as a form of short term assets may need interest payments which may be long term based. Additionally, when the raised long term finance falls short for the firm's cumulative capital requirement, and the difference financed by short term financing (which obviously has shorter maturity period), this may result in using the short term financing to finance long term assets.

Some writers view that there are strong similarities between a long term financing and a lengthy finance relationship of a sequence of short term financing. This view is based on the notion that a long standing lender-borrower relationship will enable short term loans to be extended even in bad period and makes the maturity period of such loans indefinitely long. This means that short term loans are often granted with mutual expectation of the borrower and the lender that the loan will be renewed. Even when the unexpected happens, the lender is not expected to reject the renewal of the short term loan.

However, the borrower's application for short term loans should be based on his financing needs according to investment plans and lenders should advance loans only after assessing the borrower's application and other factors. Perhaps, the lender may wish to put the funds to other use in investments which may bring higher returns or less risk. Therefore, loan renewals should not be expected to be often granted.

The matching of maturities is not an easy task especially for newly established enterprises because their financial needs have to be predicted which requires an assessment of their future investment plans (both short term and long term), with consideration of the currency of the debt portfolio (if assets and/or liabilities are held overseas), and the interest rate (fixed or floating).

Future investment plans depend on the future expected market share, the availability of finance and the cost of financing. To the established enterprises, the matching of maturities of assets and debt maturities depends to a large extent on their experience in the business world.

However, the matching concept should be the basis for determining the financing needs of the firm to avoid the consequences of unmatched maturities. Financing decisions should be based on facts for a sound planning policy.

#### SOURCES OF FINANCE

In every society, lending and borrowing does take place. The amount, the type and the timing of this financing and the extent of the reliance on credit in general may vary enormously by place, and by type of enterprise. Peterson and Shulman (1987) had showed that the capital structure of growing firms depends on age, size of the level of economic development of the country. There are also decisions to be made that influence the amount of funding required by directly affecting the risk accepted by the entrepreneur. Entrepreneurs with different attitudes to risk aversion could have different financial requirement for the same project. However, for a given level of risk aversion, the amount of finance required for a given project will be determined by the costs established in the market confronted.

The influences of religion and beliefs, on work, saving, risk-taking and other elements of entrepreneurial behaviour may vary widely and can be most important. Religious prohibitions on loan interest (as in Islam) may or may not discourage participation in schemes with such charges. The charges may sometimes be reclassified as

administration fees or profit sharing to the satisfaction of the borrowers or lenders. Interest sometimes is concealed also by requirements that a loan issued in one commodity be repaid in another.

The efficiency and risk aversion of external equity investors also affects the volume of funds available to entrepreneurs. The more unsuccessful external investors are at assessing risk, entrepreneurial visions, the entrepreneurial team, the more inaccessible external equity becomes. Providers of debt finance can constrain the firm's activity if they overdiscount the value of the firm's assets. Imperfections may also be present in the finance market.

There are broadly two types of financing available, namely internal financing and external financing.

#### INTERNAL FINANCING

Internally generated financing can come from several sources from the firm itself such as retained profits, sales of assets, reduction in working capital, credit from suppliers and account receivables (Hisrich, 1989). While self financing (generated from accumulated wealth and savings of the entrepreneur, personal loans and/or sales of personal properties and assets) is believed to be the most important source of start up capital (Choy, 1990), it is the traditional view of financing of the firm that additional funds are needed to be raised to sustain growth. While funding problems as well as costs of funds are said to be different at each stage of development of the firm, the start up stage is particularly often costly and difficult to obtain through external finance. Thus, the start up years may usually involve retaining all profits and reinvesting them back into the firm to finance growth.

Sometimes the needed funds can be generated internally by selling off little-used assets of the firm. However, wherever possible, in a start up stage, assets should be on a rental basis and not ownership basis as long as the terms are favourable.

Reducing short term assets inventory, cash and other working capital items may also contribute to the funds needed through internal financing.

Internal financing can also be generated through credit from suppliers. By delaying the payment of bills, needed short term funds which would otherwise be used for the payment would be available to be put to other uses. However, care must be taken to ensure good relations with suppliers for continuous supply.

Another source of internal financing is collecting bills more quickly, allowing short aging period in account receivables. However, the firm's owner/manager has to be careful in implementing the practise to maintain good customer relation.

## **EXTERNAL FINANCING**

Owner/managers of firms may at some stage of the business venture, find it essential to seek additional funds through external financing. There are two forms of external financing, namely debt financing and equity finance. When considering the alternative sources of external financing that are available, evaluation is needed in terms of among others, the period of fund available, the costs involved in terms of interest rates and also in terms of the amount of company control lost.

## **EQUITY FINANCING**

Equity financing typically does not require collaterals as security but offers the investor some form of ownership of the firm. It is essentially a permanent risk of financing as it is not repayable and the investor has no assurance that he/she will receive payment for the use of his/her money. On the other hand, the whole profits of the firm, after its creditors and tax have been paid and any debt has been serviced, belongs to the equity holders. Since returns on the investment depend entirely on the outcome of the project, it is the investor's interests to conduct careful appraisal and monitoring of the project. Equity finance therefore inevitably incurs information gathering costs. Equity cost is determined by the price an investor will be prepared to



pay for a given share in the project, which varies from case to case in accordance with the distribution of expected returns of the project in question. Since monitoring costs contain a high fixed element which does not depend on size of the project, they may contribute in some way to the investors' apparent biasness against SMEs resulting to lack of SMEs' accessibility to equity finance.

Equity finance may be required when the firm needs permanent capital for expansion and development, for technological innovation, and for refinancing of borrowings.

Main sources of equity finance are investment trust companies, venture capital and other specialist investment institutions, pension funds, insurance companies and government agencies. Additional equity can be obtained from new external source or can be provided by present owner(s) of the firm.

However, even when equity finance is available on terms comparable to those pertaining to large firms, some proprietors of small firms might not wish to take it on the grounds that the dilution of ownership and control from accepting outside equity reduces the attractions of running a small business.

These arguments suggest that small firms are likely to be less dependent on external equity funds than large firms and also that external equity is likely to be a relatively minor source of funds for very small firms in particular. Oakey (1984) found that external equity capital was very little used by UK firms and that venture capital was a more important source of funds for firms in his US sample. However he suggested that the venture capital market is relatively well developed in that particular part of US where high technology firms are likely to be particularly attractive to potential equity stake holders.

In Malaysia, the response for venture capital financing comes a little late considering that the Government had just set up a Joint Venture Trust in April 1990 but investment had not been carried out yet (Bank Negara Malaysia, 1991). In Singapore, a venture capital fund was set up by the Economic Development Board (EDB) to assist

local companies to acquire new technology or to diversify into new technology companies and also to support local entrepreneurship and innovation under its umbrella scheme which started in February 1987. When the project is successful, the local investors were given the opportunity to buy out the EDB's shares within a specified time period at a fair market price. Local companies in Singapore may also use the scheme to set up local venture capital funds jointly with EDB to undertake venture investments in Singapore or overseas.

### DEBT FINANCING

Debt financing is a financing method involving an interest bearing loan. Repayment for debt is normally due according to an agreed schedule or after an agreed period of time while interest is payable regularly. Lending may be secured by fixed charges upon certain specified assets, or by a floating charge upon the whole of the assets of the firm, or both; or it may be unsecured. Banks' request for security or collateral is a step to limit the downside risk of adverse selection and moral hazard. While the adverse selection problem arises from hidden knowledge, moral hazard arises from hidden action. Adverse selection problem arises if borrowers know more than the banks about the riskiness of project returns, and if banks are unable to identify the specific riskiness of each particular project, they may find their risky lending unprofitable. Moral hazard arises when once a bank had made a loan to finance the particular project, the borrower is able to take actions that make the project riskier and may mean that the risky loans make losses. The willingness to offer collateral has the added attraction to the bank that it provides a positive signal about the borrower's own belief in the viability of the project. However, viable projects which are not supported with sufficient security to insure the bank against the downside risk may continue facing the problem of getting finance. Additionally, due to imperfections in banks' internal decision making processes such as the irrational bias and risk attitudes of credit

managers, some potentially profitable projects may not being funded by financial institutions.

Some forms of lending have built-in security. In leasing finance for example, the title of assets being financed remains with the lender. Small firm owners may be able to offer as security their personal assets such as their house; or external guarantees may be available from family, friends or contacts. For firms borrowing under the Government's loan guarantee scheme complete security is provided on the percentage of such borrowing. Lenders are said to assume less risk when compared to equity investors because their claims have preference over the equity holders if a firm fails; and secured lenders have preference over the unsecured.

The many forms of debt finance include among others, overdrafts, leasing, hire purchase, factoring, term loans and mortgages. These types of debt are usually described as short, medium or long term depending on the length of time before repayment is due.

### SHORT TERM FINANCE

The term used to cover the repayment period may not be the same period of years, but short term finance usually refers to loans borrowed under three years (Bank of England, 1983). Short term finance is most suitable for financing transactions that are self-liquidating over a short period of time and to cover the working capital needed in the day-to-day running of business such as financing the fluctuations in saleable goods; increase in debtors; financing seasonal peaks and investment in short-lived assets. Investment in vehicles may also need short term finance.

The traditional view of the financing of the firm suggested that small growing enterprise had great reliance on short term finance due to lack of access to capital market (Ray and Hutchinson, 1986).

Main sources of short term finance are trade credits; accruals in taxes and other short term payments such as wages; bank credit in the form of short term loans and

overdrafts; bills of exchange; some hire purchase; discounting debtors; factoring debtors; customers' advance and some government incentive schemes.

**(a) Bank credit**

Banks are keen to lend money to businesses but are certainly not keen to have businesses default on their loan (Choy, 1990). Therefore, Bank credits are normally granted to firms that can show an evidence of their capability to repay. Short term financing available through bank credits are in the form of overdrafts and short term loans.

**(i) Overdrafts**

A bank overdraft is a widely used type of short term finance. It is particularly used to provide short term working capital for production cycle; finance seasonal requirements; and bridging loans for the purchase of assets with repayment coming from the realisation of another asset.

The system of overdraft is simple where arrangements can be negotiated and be set up fairly quickly. It is also flexible in the way that amounts can be drawn or repaid within the agreed limit at any time entirely at the option of the borrower and without prior notice. Not only is overdraft a cheaper form of borrowing where interest is payable only on the amount outstanding each day; it is also generally renewable subject to the creditworthiness of the borrower and may be some other factors. The disadvantage of overdraft is that it is subject to periodic renewal and in general is inappropriate and risky for long term requirements of the firm.

**(ii) Short term loan**

A short term loan is usually made for a specific purpose rather than for general working capital. It has a more formalised term of repayment than overdraft. The interest rate may be fixed or set at variable interest.

**(b) Trade credit**

Short term working capital can be added by making use of trade credits that suppliers extend. However, to depend on finance through trade credit may be risky and expensive if cash discount is taken into considerations.

**(c) Bill Finance**

It is as a post dated cheque that can be sold for cash at a discount. It enables the seller of goods to obtain cash as soon as possible after goods are despatched while allowing the buyer to delay payments until the goods reach them. Bills of finance are usually used for imports and exports, and also to provide working capital.

**(d) Factoring**

Factoring is an arrangement where the factoring company purchases all the trade debts due to business as they arise and relieves the businessmen of debt collection; thus providing cash for the day to day needs of business. The cost of the services of the factor is a service fee which is normally expressed as a percentage of debts purchased.

In Singapore for example, factoring is being offered at a rate of nine per cent per annum on a reducing balance by the Small Industry Finance Scheme (SIFS) through its Development Bank Finance programme. In addition, the firm had to pay an administrative fee which ranges from 0.25 per cent to 1.5 per cent of the gross invoice value factored.

**(e) Invoice discount**

Invoice discount is a means of generating cash by selling to a factoring company at a discount on a selection of invoices or the entire sales account. The cost of service is expressed as a percentage discount charged on finance used.

**(f) Hire purchase and other instalment credit**

Short term finance through hire purchase agreement enables the firm to acquire the ownership of the goods after making an initial downpayment, and paying regular fixed amount over an agreed period which covers interest and the balance of capital cost. Interest charged is usually at a fixed rate for short term contracts, on the amount or value initially advanced. Security is provided by the goods being purchased as they remain the property of the finance company until final repayment is made, when the ownership passes to the firm.

Credit sales may be offered instead of hire purchase and ownership is obtained at the outset. The borrower must however continue to pay the agreed payments. The security here is the borrower's promise to pay. The advantage of instalment credit is the flexibility on repayment terms which can be arranged to suit the firm's cash flow pattern, the absence of legal fees and the widespread availability of the facilities.

The Malaysian Industrial Development Finance (MIDF) provides hire purchase arrangements for SMEs under its machinery finance scheme. Borrowers are required to provide at least 25 per cent of the price of plant or machinery and MIDF advances the balance and arranges for the borrower to repay over a period of not more than four years (Chee, 1986).

**(g) Government Incentive Schemes**

Government incentives may be in the form of tax incentives through tax exemptions, tax deductions and tax allowances; special loans; and grants provided under special schemes. For example, tax incentive in the form of pioneer status exempted firms from paying tax for a specified period of years while tax deductions relieved firms with a certain percentage of tax, and tax allowance benefited firms in the benefits received. Tax incentives would usually be granted to firms engaged in specified activities or promoted activities.

Short term finance through special loans schemes may include loans at concessionary interest rates and/or require no collaterals or guarantees. For example in Malaysia, under the Association Special Loan Scheme (ASLS) a maximum loan of up to M\$2,000 is made available at free interest rate, repayable monthly over a repayment period of 24 months, and requires no security nor guarantor (Bank Negara Malaysia, 1991). MARA also provides loans of M\$2,000 each without collaterals or guarantee, for petty traders and hawkers especially those willing to start a business. Loans not exceeding M\$3,000 under the Credit Guarantee Scheme (CGC) also require no collaterals and the maximum interest charged was set at 8.5 per cent per annum which was below the market rate of 12 per cent in 1986 (Chee, 1986). Collaterals were also not required for loans under the Hawkers and Petty Traders Scheme of the CGC where loans up to a maximum of M\$10,000 each at a concessionary interest rate of 4 per cent were made available for SMEs (Latiff, 1990).

#### **MEDIUM TERM BORROWING**

Medium term finance is the term usually used to cover a period of three to ten years of borrowing (Bank of England, 1983). Typically medium term finance is raised by borrowing from the banks although other financial institutions also provide such finance. It may be secured or unsecured, and at either a fixed or variable rate of interest. Borrowings with variable rates may be advantageous over borrowing at a high fixed rate if there is a possibility that the market rate will fall. On the contrary, variable rate borrowings can be disadvantageous at times of rising market interest rates. Term loans may be more expensive than overdrafts but with term loans the repayment date and schedule is certain and clear that the firm owner/manager can make necessary future plans without unnecessary uncertainties.

Medium term finance is usually used for financing plant and machinery of the firm; general working capital; and overdraft funding. Main sources of medium term

finance are bank credits, other financial institutions' credits, public sector agencies, leasing companies, venture capital and other specialist investment institutions.

**(a) Term loans**

Medium term loans are provided by banks often as a part of a package of financial facilities. Repayment pattern may be set to suit the earning capacity of the asset being acquired or to match the overall cash flow of the firm. Thus, repayment may be immediate or after a short grace period, or after a long grace period, or it may be deferred until the end of the loan period. Interest rates are generally higher than short term loans.

**(b) Leasing**

A leasing arrangement is essentially a contract whereby the leasing organisation retains ownership of the leased equipment, while the firm has possession and use upon payment of agreed rentals over a specified period.

**(c) Instalment credit**

Instalment credits may also be available for the medium term as for the short term though agreements are usually not more than five years.

**(d) Government agencies**

In Malaysia, loans from the Industrial Adjustment Fund (IAF) through the Industrial Bank of Malaysia, the Development Bank of Malaysia (BPMB), and through MIDF are provided mainly for the purchase of new machinery, plant and equipment. Under IAF, the maximum lending rate was set at 7.75 per cent per annum and the repayment period must not exceed eight years. MIDF assists in the purchase of factory building and land through its Factory Mortgage Credit Scheme. Up to 80 per cent of the cost may be granted under such loans and the repayment period extends over three

to five years. Additionally MIDF also provides loans normally referred to as project loans for the financing of fixed assets such as factories, land, building, machinery and equipment. Through the Malaysian Industrial Estates Limited (MIEL), a subsidiary of MIDF, factory mortgage loans to assist in the purchase of factories are available and may be repaid by equal monthly instalments of principal and interest at prevailing rate over a period of 10 years or less.

The Development Bank of Malaysia (BPMB) provides term loans to develop new entrepreneurs particularly in small scale sectors at special rates of interest from as low as five per cent. Additionally, under its Leasing and Plant Hire scheme, machinery together with operators and technical assistance are provided at special rates.

#### LONG TERM FINANCE

Long term finance usually refers to borrowings of more than ten years (Bank of England, 1983). Long term finance is usually needed for financing of buildings, permanent working capital and corporate acquisition. Sources of long term finance can be provided by the owners of the firm, banks, venture capital and specialist investment institutions, insurance companies, finance corporations, trust and private loans.

##### (a) Term loans

These are conventional loans for periods exceeding ten years. Rates of interest may be fixed or variable. Borrowers usually have to provide comprehensive information of past performance and future prospect in the application for the loan. Additionally, the loan normally requires a security tied to existing fixed assets of the firm. At times, an independent valuation of assets securing the loan is required by the lender but cost of valuation and investigation has to be paid by the borrower.

**(b) Mortgage loan**

These are loans where specific assets in land and buildings are used as security. Interest rates are usually fixed but more flexible arrangements are increasingly being used.

**(c) Sales and Leaseback**

Sales and leaseback normally operate for property and large items of capital equipment. A company sells a specific major asset to a buyer and then leases it back on a rental. The advantage of this arrangement is that the firm's gearing (debt to equity ratio) is lower than with a conventional loan.

**(d) Government Agencies**

In Malaysia, Government agencies like BPMB also provide fixed asset loan and lease financing on a long term basis. MIEL offers long term credit on sale of modern factories that they construct in industrial estates. Long term secured loans to help small entrepreneurs to plan, equip and operate the factory are also available from MIDF.

**EXPORT FINANCE**

Other finance that a firm may need is export finance to develop export market and to finance export trade. Sources for export finance included banks, finance houses, factoring companies, foreign banks and government incentive schemes.

**FINANCING FROM THE INFORMAL SECTOR**

The informal sector seems to have a role in providing finance to entrepreneurs despite the expanding role of formal financial intermediaries. Contributing factors for the choice of raising finance from the informal sector include the simple and straightforward loan administration and procedures that do not require lengthy and bureaucratic paperwork, convenient opening hours, easy access and speedy loan

transaction service, experienced appraisers and no restrictions on the use of loan. Most common sources of financing from the informal sector are family members and friends (Choy, 1990). Connections and loose friendships may also lead to other sources of finance outside family members and close circle of friends. Other sources of financing from the informal sectors are the moneylenders and the rotating credit and savings associations.

**(a) Moneylenders**

Where moneylenders exist they may lend for production, distribution and consumption, or only for consumption. In Malaysia, the Chettiars were known for their specialising in moneylending. However, there are other people who lend money but do not seem to specialize in moneylending as a sole occupation. Frequently they are landlords, shopkeepers, produce buyers or dealers. Interest rates charged by moneylenders often appear usurious to their borrowers but they may be partly justified by high rates of inflation, high risk of lending, high cost of supervision on borrowers and the opportunity cost of capital. Furthermore moneylenders often lack the social networks of kinship, friendship or other informal associations by which pressure can be exerted on borrowers to ensure loan repayments.

**(i) Pawnbrokers**

Pawnbroking is a form of moneylending where the borrower sells an item to the pawnbroker on condition that he buys back the item within a specified time for the same amount plus interest.

**(b) Rotating credit and savings associations**

These locally organised groups occur in many regions of developing countries though not in every society (Ardener, 1964). They are known as Tontines (in French) or Huays, and are commonly found among Chinese and other Asian communities

(Choy, 1990). In Indonesia, it is called Arisan which literally means mutual help. In Malaysia and Singapore it is known as Kootu which in Tamil means cooperative endeavour (Shanmugam, 1991).

The groups are based on the simple principle that in periodic meetings, all members contribute except one who takes home the total amount, and that each member has a turn as a recipient. The contributions may be fixed or variable, and so may the order of rotation. Interest may or may not be paid. However, where there is no fixed order of rotation for recipient, at each periodic meeting eligible members who are interested to get access to the fund have to make a bid with a premium that a member is willing to pay to the group (as an interest) for using the fund first. The member who makes the highest bid at the meeting will usually have access to the fund. Eligibility to bid for use of the fund would depend on the number of shares the member has. Unless the member has more than one share, he is allowed to use the funds only once after which he is no more eligible to bid. The last person who uses the fund obviously does not need to pay any premium and obviously has benefited most from the premiums paid by other members. With the last member getting the funds, the tontine is terminated.

Some governments discourage these associations, because their assets are difficult for the government to tax and control. There are even cases where a member (the one who does the collection of the contributions from members) had absconded with the pool of funds. In Malaysia, rotating credit and savings associations are prohibited by the Kootu Funds Prohibition Act 1971. Despite that, Kootu activities are still going on. Perhaps the multiple useful functions for borrowers brought about by the activities had contributed to the survival of these associations. Not only does the rotating credit and saving association provide credit (for borrowers early in the cycle) but also savings (for those later in the cycle); they provide a form of insurance (order of disbursement may be altered in emergencies); and they serve as social gatherings.

Among the advantages that these associations can offer over formal credit organisations are that they are conveniently located, accessible to the illiterate, and not

as intimidating as institutional offices. Also their funds are hard to embezzle. Where rotating credit associations exist, members commonly belong to several simultaneously; the associations thus serve to circulate funds through a capital short population in useful sums. Additionally, because they spring from local initiative, they can generate greater incentive and loyalty than other kind of lenders.

Little is known about the durability of rotating savings and credit associations, nor is it yet clear whether they can serve as useful links between formal financial institutions and small entrepreneurs. In some regions, there may even be no readily apparent sources of credit at all. Yet credit may occur inconspicuously in the form of inter-familial exchanges, tributes to and redistributions by local authorities, brides' wealth and dowry, share contracting, and other practices often not recognised as credit. Nevertheless, a firm's financial needs are frequently met by employing a combination of both debt and equity finance.

## CHAPTER FIVE

### ANALYSIS AND DISCUSSION ON FINANCING OF SMEs IN MALAYSIA, INDONESIA AND SINGAPORE

#### INTRODUCTION

This chapter will attempt to analyse and discuss the financing of SMEs in Malaysia, Indonesia and Singapore. In the analysis, firstly, the national development policy of each country will be looked into to identify each government's priority objective in promoting SMEs. Secondly, the business environment issues and Government policy to improve the business environment will be analysed to show those external environment factors that may affect the finance of SMEs. Thirdly, Government direct intervention policy through its financing programmes and activities will be analysed to identify the achievement of each country in filling up the financing gaps of SMEs.

The analysis and discussion hope to answer the following questions:

- (a) Has the financial constraint on SMEs shifted such that institutional source of funds is no longer a major constraint?
- (b) Is there an over emphasis on the adequate provision of finance?
- (c) To identify if there are any other significant gaps contributing to the problems in SMEs finance?
- (d) Should the Government develop and/or adopt a new set of programmes for financing of SMEs in these countries?

Generally, any Government involvement in the promotion of SMEs was in due recognition of the significant role of SMEs in their contributions towards economic development. However, economic development varies from country to country, so does the potential of SMEs. In view of this, it is therefore believed that the promotion of SMEs in each country would be influenced by its development priorities spelt in their

development policies. In promoting SMEs, Government establishes policy and programmes to improve the business environment for SMEs and also provides facilities and incentives to redress the constraints faced by SMEs; and finance is known to be one of the major if not the only constraint.

To compare and discuss the financing of SMEs in Malaysia, Indonesia and Singapore, we first need to look into the national development policies of each country.

#### **THE NATIONAL DEVELOPMENT POLICY OF MALAYSIA, INDONESIA AND SINGAPORE**

As mentioned in an earlier chapter, Malaysia's national development policy goes back to the New Economic Policy (NEP) which was introduced during the period from 1971 to 1990 to eradicate poverty and to restructure the society so as to eliminate the identification of race with economic function. The restructuring of society involves the attempt to increase indigenous Bumiputera entrepreneurs and to encourage Bumiputera active participation in business ventures in all categories of enterprises and at all levels of operations. Building on the thrust of the NEP in eradicating poverty and restructuring society, the New Development Policy (NDP) which was formulated to cover the period from 1991 to 1995, emphasised growth with equity. In Malaysia, the promotion of SMEs was in due recognition of their role particularly in achieving the goals of NEP and NDP because dynamic SMEs can be a major contributor to the country's economic development and also can offer a source of income to large number of people.

In Singapore (where there is dominance of multinational firms) however, its national development policy is to restructure the economy into one manufacturing high value products, high technology and capital intensive activities. The restructuring involves the attempt to be a viable exporter of manufactured goods to world markets through the phasing out of low value, labour intensive manufacturing activities and upgrading of technology and skills to export more high value manufactured goods. So,

the promotion of SMEs in Singapore would involve promoting high technology, capital intensive activities , and the manufacturing of high value products.

In Indonesia, the promotion of SMEs was a response to criticism of earlier strategy that stressed economic development and industrialisation at the expense of equitable income. Therefore, it can be considered that the promotion of SMEs was a means for redistributing income in view that SMEs can be generators of employment and can offer sources of income to a large number of people. The redistribution of income policy involves the attempt to promote the indigenous Pribumi enterprises and the weak economic groups.

From the above, it is evident that different countries have different national development policies which set different development and objective priorities. Therefore, the analysis and discussion on financing of SMEs of Malaysia, Indonesia and Singapore has to be against the background of their national development policies. For Malaysia and Indonesia, they seem to have a common social objective of promoting the indigenous SMEs. While Malaysia's promotion of indigenous SMEs was towards achieving the objective of eradicating poverty, and restructuring of society to eliminate the identification of race with economic function and geographical location, Indonesia's promotion of indigenous SMEs was mainly to achieve the objective of redistributing income. For Singapore, it appears that it has a policy of promoting SMEs into one manufacturing high value products, high technology and capital intensive activities in the attempt to be a viable exporter of manufactured goods to world markets.

#### **BUSINESS ENVIRONMENTAL ISSUES**

A conducive business environment which positively influence the performance of SMEs is more likely able to stimulate the growth and performance of SMEs. Business environmental factors included government regulations, suppliers of resources (labour, money, materials, informations etc), markets, competitors, current price

levels, the economy, the political system, the society's social structure, the financial system and structure, and the state of technological development. However, as environmental factors are changing, the ability of SMEs to learn and to adapt to the changes in the environment would naturally affect their performance because information regarding the environment may improve business decision making and their performance. Lack of information however, would create uncertainty which increases the business risks. Changes in economic condition such as changes in interest rates, inflation, material resources may not only cause important changes to product mix but may also cause major changes to the cost of business operations which subsequently may change the working capital requirement. Many SMEs cannot cope with high levels of inflation for extended periods because in a keen competitive market they have very little control over the prices they can charge, and they usually cannot quickly establish cost control. Rising interest rates which normally reflect the scarcity of funds, tend to affect small firms more severely than large firms because small firms tend to rely heavily on financial institutions for capital requirements for expansion. The rising interest rates would tend to boost the operation costs. In addition, as debt comprises a large proportion of the SME's capitalisation, the firm's net worth would tend to be reduced.

Other changes that may affect cost of business operations include changes in government administration and regulations regarding tax policy, product safety, product quality, consumer protection, transportation; market changes such as changes in population, sales and potential sales size, competing products, entry of new firms; and changes in service and production technology. Large organisations' managers often have better access to formal information gathering systems (Johnson and Kuehn, 1987). For example, large organisations generally have qualified accountants, auditors, and marketing experts to advise the management in the effects of the changes in the environmental factors above. Small business owner/managers, which seem to require a broad and continuing search for information about the external environment due to their

inability to specialize, may have to devote a higher proportion of their time and energy in search of this information. However, they generally narrow the focus of their information search on their marketing channels and rely primarily on information from suppliers, distributors and customers views towards uncovering opportunities in the market place. Changes to tax law for example, are generally confusing and lack clarity and may take a long time to obtain, to interpret and to understand in their implications for SMEs. Franklin and Goodwin (1983) in their study suggested that small business owners considered most important those sources that were convenient and required minimal aggressive effort to employ. It appears that since their access to specialist tax consultants to advise them on tax planning strategy were rather limited, SMEs would therefore be less likely to take advantage of any changing tax law. To improve business environment for SMEs, the Government in its activity included among others, reregulations or rather simplifying rules and regulations; deregulations; administrative reforms and defining roles of key factors; improving the accessibility of SMEs to suppliers of resources (such as access to loans, marketing channels, raw materials, technology and training) and the setting up of a special governing body to care for the interests of SMEs.

Having discussed the environmental issues affecting the finance of SMEs, we now look into accessibility to the capital market or rather accessibility in raising capital, an external factor affecting SMEs finance.

### **ACCESSIBILITY TO CAPITAL MARKET**

Accessibility to capital market or the sources of capital would obviously be a major factor affecting the finance of SMEs because some form of capital is needed to start a business. Accessibility to capital appears to have a significant impact on the success of SMEs. The composition of the initial capital (ie. debt versus equity) may also have an effect on business success. While undercapitalization was often generally reported to be a major cause of small business failure, too much debt may lead to

liquidity problems especially during the early years when there are high start up expenses and low revenue. Inability to repay short-term borrowing at maturity is a potential problem because when this happened the firm may refinance the original amount or the original amount plus accumulated interest. Businesses that continue to refinance the original amount plus accumulated interest would eventually experience liquidity problems especially when the lending institutions must finally be repaid.

Shortage of funds for investment purposes and for maintaining adequate working capital for operational needs are often suggested as the main financial problem faced by SMEs (Ch'ng, Tan and Lim, 1986). Factors contributing to the shortage of funds included the high operating costs from added fees, charges and taxes that were imposed by the government through its regulations; secondly, their borrowing capacity was constrained due to having limited assets, or insufficient track records to show their credit-worthiness, even if they had adequate collateral. As such, SMEs were regarded by banks and financial institutions as higher risk borrowers and involving higher administrative costs (from higher information and higher transaction costs incurred in project appraisal and monitoring). As a result, SMEs were either charged with high interest rates or their loan application turned down. However, when banks raise interest rates in an attempt to compensate for the risk of default, some potential borrowers are discouraged more than others. The change in risk composition of the bank's lending portfolio may have an adverse effect on banks returns which exceeds the beneficial effect from higher interest. Therefore, profit maximising banks may prefer to set interest rates at a level where demand exceeds the supply, thus creating credit rationing. Additionally, because dealings with SMEs require relatively small loans, commercial banks had preferred dealing with larger businesses . Finally, SMEs were not able to use public stock issues for source of capital because regulations of public stock offering made the option impractical for SMEs as they cannot spread cost of the issue over a large number of shares to be marketed nationally. In addition, funds from pension and trust funds were not made accessible to SMEs. Therefore, SMEs were

facing a restricted set of financial markets and option to raise funds for their capital needs. However, not only the external factors but also internal controllable factors can affect the finance of SMEs.

#### INTERNAL FACTORS AFFECTING THE FINANCE OF SMEs

Beside the external factors, several internal controllable factors such as management incompetence, management inexperience and poor decision making ability regarding purchasing, production and products, improving sales and attracting customers, may affect the financial position of SMEs. Scarborough (1988), revealed that over 90 per cent of all business failures in any given year resulted from incompetence and lack of experience. In Malaysia, there was evidence that due to lack of capital and business management skills, Bumiputera entrepreneurs have had limited success in business activities. Osman (1989) found that entrepreneurs were too involved with daily problems such as handling unmotivated, less disciplined, unskilled and low productive workers so that entrepreneurs had less time for production, product quality, inventory and financial control. However, Chee (1986) suggested that lack of entrepreneurial and managerial skills were mainly due to relatively low level of formal education and limited training. Shahadan, Berma, Zin and Mahbar (1990) found that despite having low levels of education, many SMEs entrepreneurs had some basic managerial skills and concluded that previous business experience rather than formal education provided the most significant training to acquire entrepreneurial and managerial skills. Not only are these skills required to cope with establishing a new enterprise but these skills may also be required to cope with the problems of its day to day running. For example the skills may help in deciding the financial structure of the firm, arrangement in the types of finance from sources available and optimisation of the firm's finance. Dependence on debt capital or loan from banks may mean losing profits to interest payments. Undercapitalisation from lack of cash flow, may make it impossible to take advantage of discounts on special terms with suppliers and therefore

affect profitability directly. Additionally, poor financial control such as lack of inventory control, lax customer credit, and overestimating in fixed assets can also contribute to the financial problems. For example, lack of control on credit sales to customers would affect the financial health of SMEs because additional capital for investment may be required during the lag between the sale of an item and the actual collection of the proceeds. Furthermore, credit collecting could be an extremely difficult task requiring a great deal of skill and persistence in order not to lose customers or end up with uncollected accounts. Participation in Government procurement which may secure market for production and/or services of SMEs may also affect finance if payments were not settled on time for deliveries of the Government orders for these goods and/or services. Federal Government had been reported to be one of the slowest paying customers a small business could have (Chilton, 1984).

SME finance would also be affected when the owner/manager had invested excessive amount of capital on fixed assets such as land, building, and equipment so that there would be insufficient liquid funds to finance expansion if the need arose. To obtain further borrowing could be difficult as they may be considered by the banks to be already over-borrowed.

Lack of inventory control with both insufficient inventory or excessive inventory would also affect business finance. While insufficient inventory levels may result in shortages and stockouts causing customer disillusionment, too much inventory or too much of the wrong inventory would cause excessive amount of working capital tied up in an accumulation of needless inventory, not to mention the cost of storage. Additionally, improper pricing of inventory such as underpricing of goods or services may result in lower revenue and lower profits.

SME owner/managers were often found not up to date with financial records and statements. For example, Shahadan, Berma, Zin and Mahbar (1990) found that many small firms do not differentiate between their business and personal finances.

Some did not even bother to keep any records while some would only keep special records for legal requirement and tax purposes. Perhaps, a reason for not keeping records of financial statements was to evade tax. However, if records were kept, these statements when analysed and interpreted properly could be a reliable indicator of potential financial problems. For example, declining sales, slipping profits, rising debt and deteriorating working capital could be symptoms that require immediate attention.

In summary, it can be said that financial problems of SMEs are due to a combination of internal financial factors (which the owner/manager deals with in the day to day management and has some degree of control), external or environmental factors (factors which are usually beyond direct control of management such as inflation, taxes and government regulations) and the external capital market (Franklin and Goodwin, 1983). The Government therefore in their activities of promoting SMEs tries to redress these financial constraints through its policy in improving the business environment, and also through its direct intervention policy which includes provision of guidance, advice and training, and the provision of financial facilities and incentives.

Government intervention in the financial market may be justified by the possibility that market imperfections may have prevented apparently viable SMEs from raising finance. The possibility that SMEs activities may bring about greater public benefits (such as employment creation, entrepreneurship development, geographical dispersion of economic growth, etc.) than their private returns, provided the motive for some form of subsidy. The choice in the ways to provide SME finance may vary from country to country. For instance, the Government may establish an independent government agency or arrange a ministerial division or section of the Government to finance SMEs. However, in Malaysia, Indonesia and Singapore, financing SMEs was by ministerial division of the Government.

## A CASE OF MALAYSIA

Malaysia is made up of Peninsula Malaysia, Sabah and Sarawak, covering a total land area about 329,293 square kilometres. It is a plural society with an estimated population of 17.8 million in 1990, comprising about 56 per cent Malays and other indigenous people (together, they are referred to as Bumiputeras), 33 per cent Chinese, 10 per cent Indians and 1 per cent others (Financial Times, August 29, 1991). GDP growth rate was 10 per cent for 1990 compared to 8.8 per cent in 1989 and 8.9 per cent in 1988; GDP per capita was US\$2,388 in 1990; growth of consumer price showed 3.1 per cent for 1990 compared to 2.8 per cent in 1989 which indicated that inflationary pressure was low. Its current account of the Balance of Payments showed a deficit of 4.3 per cent of GNP in 1990 compared to a deficit of 0.4 per cent in 1989. During 1990, there was strong growth in merchandise imports (30 per cent) and imports of investment goods (42.9 per cent). The nation's external debt was reported to decline by M\$791 million to M\$41.4 billion at end of 1990. The reduction of external debt during the year was said to be negated to some extent by an exchange loss of M\$2.1 billion which arose from the weakening of the Malaysian Ringgit against Japanese Yen and major European currencies. However the overall external debt service ratio had improved to 7.2 per cent in 1990 compared to 9.6 per cent the year before.

Malaysia's financial system and structure appears pretty developed, with a complex of financial intermediaries offering a variety of financial instruments as savings media as well as a wide range of credit and investment facilities to meet the financing requirements. At the end of 1990, there were 38 commercial banks, 45 finance companies, 12 merchant banks with their branches totalling 1,540 serving an average 11,566 persons per branch. Its per capita M2 was US\$1,600 and its deposits per capita was US\$1,600 in 1989. Its financial assets/GNP was 2.9 in 1990 which indicated that financial assets had increased at a much more rapid rate than its non financial wealth (Bank Negara Malaysia, 1991). With computer technology, financial

information and services are speeded up contributing to a more conducive environment for business.

Political stability, price stability, good infrastructure and communication system contributed to a conducive environment for business. Law and regulations, administrative procedures and policy adjustments also influence the economic environment for business. Some environmental issues however, tend to be biased against SMEs and affect their finance, for example, regulations relating to zoning, health, safety, pollution, product quality and social benefits contribution. Zoning regulations had imposed the heaviest burden on small industry (Chee, 1986). Chee (1986) also reported that due to inadequate capital and limited market location, a number of small firms would tend to start up in a residential area which is violating the law and they would be fined or forced to close down. It was alleged that some would even engage in business illegally without a business licence. To neutralise the effect of zoning regulations so as to make the business environment more conducive to SMEs, the Government had provided industrial sites to relocate small and medium industries. These sites were provided with common infrastructure facilities and services to promote research and development activities, improve productivity and increase competition. Examples are a furniture complex in Olak Lempit in Selangor state, and land provided for pipeline projects in the state of Perak, Negri Sembilan, Sabah and Sarawak. Business premises were also allocated for SMEs activities in both rural and urban areas: for example, the business premises in the form of shopping complexes, shop lots, and bazaars set up by Government agencies like MARA, the State Economic Development Corporations (SEDCs), Urban Development Authority (UDA) and the National Corporation (PERNAS).

A study revealed that many small manufacturing firms did not have a licence to operate business in residential dwellings to avoid government taxes (Chee, 1986). Therefore, it appears that tax was a determining factor to operate illegally in residential areas. However it was not revealed as to what aspect of tax was a problem to those

small manufacturing firms. Perhaps the complexity of the tax system faced by many SMEs was a contributing factor or perhaps tax itself was a burden as it means less profit.

Special rates on electricity and water supply were provided for industrial activities, but this seemed to benefit those plants which generally have larger industrial activities and were therefore more likely to enjoy the cost advantage.

The social legislation in relation to contributions to the Employees Provident Fund, Employment Insurance Scheme and Invalidity Pension Scheme have raised directly the costs of employing labour in all sizes of establishment but, they inevitably weighed more on the small enterprises than the larger enterprises.

Government administrative requirements and environmental contexts are increasingly changing and getting more complex so that information gathering regarding these changes would mean extra cost for SMEs (Chee, 1986). For example tax related incentives, double deductions for tax purposes and tax allowances provided by the government are too complex for the ordinary small and medium entrepreneurs to digest and understand. Although SMEs are now eligible to apply for the pioneer status incentive which provides five years tax relief, it is granted for the manufacture of gazetted products and meeting certain conditions and criteria laid down by the Ministry of Trade and Industry. Investment tax allowance is also provided on condition that the firm produces promoted products or engages in promoted activities. Information gathering on these promoted activities and promoted products may be too time consuming and costly for SMEs in relation to its returns. The administrative procedures and red tape involved may also contribute to the problem. For example in order to claim the abatement of adjustment income, and double deductions on selected expenses on promotion for exports, firms need to register with the Ministry of Trade and Industry and to get their approval. Double deductions on training expenses are granted only to approved training institutions which in many cases are situated in major towns and far from the locality of SMEs.

The incentives for Research and Development give five years tax exemption to approved research companies, but the field of research or development is not specified. However, it may not be wrong to say that larger companies are more likely eligible for this incentive. In addition, larger firms are also more likely to benefit on capital allowance provided on motor-cars.

Unlike large enterprises who have specialised personnel in their payroll, to advise on the related matter, SMEs need to get external expertise to interpret and to be able to get the benefits from tax policy but that means added cost. Perhaps if Government could give location incentive to accounting firms to set up branches throughout the country to provide professional services to clients, it would indirectly help SMEs who would then be able to utilize these professional services such as auditing, accounting and taxation services and at relatively much less cost.

Due to limited resources, knowledge and skills, SMEs would face a higher degree of uncertainty which may block or hinder their performances. The Government, in their activities to redress these constraints had also included the provision of financing facilities.

### **FINANCING SMEs**

In Malaysia, as already mentioned in an earlier chapter, a total of 13 Ministries and more than 30 government and other agencies were involved in one way or another with SMEs policy and programmes. The Ministries involved in financing SMEs were mainly the Ministry of Finance, the Ministry of Trade and Industries, the Ministry of National and Rural Development and the Ministry of Youth, Sports and Culture. Agencies under these ministries that were involved in providing financial and credit facilities to SMEs were the Credit Guarantee Corporation (CGC), the Malaysian Industrial Development Finance (MIDF) and its subsidiary, the Malaysian Industrial Estates Private Limited (MIEL), the Development Bank of Malaysia (BPMB), the Industrial Bank of Malaysia, Council of Trust for Indigenous People (MARA), the

Agricultural Bank of Malaysia, Bank Rakyat, National Corporation (PERNAS) and State Economic Development Corporations (SEDCs). Additionally, commercial banks and finance companies were required to provide finance and credit facilities to SMEs through the lending guide-lines set by the Central Bank, the latest to be complied by March 31, 1990. After that date guide-lines regarding finance and credit facilities to SMEs no longer applied. A new guide-line however, which came effective from April 1, 1990, required commercial banks and finance companies to extend to the Bumiputera community a minimum of 20 per cent of their loans outstanding as at 31 December 1988 (base year), to be complied by 31 March 1991. In addition, with effect from February 1, 1991, commercial banks and finance companies were free to set their Base Lending Rate (BLR) which was previously set under the administrative control of the Central Bank. Their BLR would be based on their cost of funds. However, ceiling rates for loans to priority sectors (which includes the Bumiputera community) and loans under the CGC would continue to be fixed by the Central Bank. Special funds were made available to SMEs. They were among others, the New Investment Fund, ASEAN-Japan Development Fund, New Entrepreneurs Fund, Industrial Technical Assistance Fund, Special Fund for Tourism, Abandoned Housing Projects Fund, and Enterprise Rehabilitation Fund. Funds were also made available for special schemes such as The World Bank Special Loan Scheme, Special Loan Scheme for Hawkers and Petty Traders, Export Credit Refinancing Scheme, Export Credit Insurance and Guarantee Scheme and the Rural Industries Programmes. The enlarged spectrum of intermediaries used to provide assistance shown in the range of financial and credit facilities provided under the different ministries and by different organisations through the different funds and schemes, and Government's direct intervention through lending guide-lines for SMEs in Malaysia seems to indicate the importance placed by the authorities in enlarging the spectrum of end users of this assistance towards creating entrepreneurship and widening investment.

Initially, commercial banks were encouraged through moral suasion to increase their lending to priority groups which included Bumiputera community, Small Scale Enterprises and prospective house buyers. However, when the result were not satisfactory, specific guide-lines on direction of bank lending were introduced in October 1976 and were reviewed annually ever since to meet the needs of the economy.

#### COMMERCIAL BANK LOANS TO SMALL SCALE ENTERPRISES (SSEs)

The guide-lines on direction of bank lending were issued to stimulate private sector investment support for economic growth and also to ensure that priority sectors had ready access to credits at reasonable costs. The guide-lines had a provision which covers enterprises that fit within the definition of small scale but there were no specific guide-lines of bank lending for medium scale enterprises. The definition of SSEs was found to vary from time to time. Perhaps the change of definition was necessary to keep up with the changing needs of the economy, but then the information gathering regarding these changes involved time for SSEs and therefore involved costs, either the direct cost in gathering information or the benefit lost in not being able to take the full advantage in time with the changes. However credits extended by commercial banks to SSEs was initially defined as loans of M\$150,000 or less, granted to enterprises with fixed investments not exceeding M\$300,000 each. With the guide-lines, the loans granted to SSEs increased from M\$311 million at the end of 1970 to M\$1872 million at the end of 1978. In 1979, the definition of SSE was expanded to include loans of M\$250,000 or less granted to enterprises with fixed investments not exceeding M\$500,000 each. The definition was revised in March 1981 as loans of M\$250,000 or less, granted to registered businesses (including petty traders who had licence to trade and borrowers engaged in agriculture) with net assets of up to M\$250,000 or in the case of corporation, had shareholders' funds of up to M\$250,000. In support to the country's industrialisation drive, SSE was redefined in 1981 to include registered businesses with net assets of up to M\$500,000 and for limited companies which had

shareholders' funds of up to M\$500,000 and a loan limit not exceeding M\$500,000. Total credits extended to SSE during the period between 1970 and 1978 ranged from 14.5 per cent to 19.2 per cent of total bank loan outstanding during the period. In 1979, a specific lending guide-line to SSE was introduced whereby commercial banks were required to extend at least 20 per cent of their loans outstanding at end of June 1979 to SSEs, to be complied by end of 1980. In 1981, following the redefinition of SSE, new guide-lines were introduced, requiring at least 12 per cent of total bank loans outstanding as at December 1980 to be extended to SSEs. Additionally, commercial banks were also required to extend 5 per cent of their total loan outstanding as at December 31, 1980 under the Special Loan Scheme (SLS) of the Credit Guarantee Corporation (CGC). These guide-lines which were reviewed annually required (after the fourth revision of the definition of SSE in March 1988) commercial banks to extend at least M\$300 million of new loans to SSEs, of which at least M\$150 million must be extended to Bumiputeras. These loans included loans under the SLS of the CGC and must be complied by March 31, 1989. In the first nine months of 1988, total loans approved for SSEs amounted to M\$537 million, of which M\$74 million were approved for loans under SLS (Bank Negara Malaysia, 1989).

Lending guide-lines to priority sectors announced in March 1989 required not only commercial banks but also finance companies to provide loans to SSEs to be complied by March 31, 1990. On the compliance date as at March 31, 1990, commercial banks had approved M\$1.5 billion which was above the minimum requirement of M\$600 million (Bank Negara Malaysia, 1991).

Table 5.1: Outstanding Loans To SSEs Against Total Outstanding Loans (in M\$ million)

Year	Loans to SSEs	Total loans	Percentage
1980	3330.7	18798.6	17.7
1981	2890.0	22711.3	12.7
1982	3216.2	26167.6	12.3
1983	3468.7	32624.1	10.6
1984	3673.5	38374.8	9.6
1985	3473.5	42675.4	8.1
1986	3232.0	45290.0	7.1
1987	2983.6	44922.0	6.6
1988	3819.5	48738.0	7.8
1989	3712.4	58999.0	6.6

Source: Haron (1990)

The above figures shows that during the period between 1980 and 1984, there is a general increase on amount of loans to SSEs. For the period of 1985 to 1987, the amount of loans to SSEs is shown to decline, perhaps due to the slow down in the economy during that period. However, the amount of loan had increased tremendously from M\$2983.6 million in 1987 to M\$3819.5 million in 1988 during a period of economic improvement. Overall, it can be said that there is an increase in the amount of loans granted to SSEs. However, the percentage of outstanding loans granted to SSEs to total loans is shown to have a declining trend from 17.7 per cent in 1980 to 6.6 per cent in 1989. Perhaps this is due to the greater increase in the total amount of outstanding loan when compared to the increase in loans to SSEs. It may indicate that commercial banks are more committed in granting loans to larger enterprises and it may also indicate that perhaps there is less demand for small loans.

However the general increase in the amount of loans granted to SSEs seems to indicate that commercial banks as a source of institutional funds for SMEs is no more a major constraint. It appears to show that commercial banks had managed to fill the financing gap for SSEs following the lending guide-lines set by Bank Negara. Whether commercial banks could continue to provide these services to SMEs on their own accord without the requirements of lending guide-lines is yet to be seen. Considering the amount of loan given out to SSEs was much more than the required amount stated

by the lending guide-lines, and the experience that the banks had in dealing with small loans and small borrowers, perhaps banks had discovered the potential of good business dealings with SSEs. It therefore seems to show that institutional source of fund is generally no longer a major constraint to SSEs in Malaysia. However, certain groups of SSEs such as the Bumiputeras seems to continue facing the constraints. For example on the proportion of loan to SSEs that was extended to Bumiputera SSEs only M\$208.8 million out of the M\$1.5 billion (Bank Negara Malaysia, 1991). This indicated that although there was a policy preference for promoting Bumiputera SSEs, the Bumiputeras could enjoy only a small proportion of the total value of loan offered to SSEs. Although the number of Bumiputera loan accounts was reported to have increased by 48.1 per cent to 493,765 at the end of 1990, 96.1 per cent of the outstanding loan account was for loans not exceeding M\$100,000 each (Bank Negara Malaysia, 1991). The large number of end users indicated that the loan had benefited a large number of Bumiputeras. However, considering that small enterprises were defined as those with net assets of up to M\$500,000 perhaps the loan of not more than M\$100,000 each could be considered only as a small portion that could be used to start a small Bumiputera enterprise. In terms of value, the credit extended to these small Bumiputera borrowers accounted for 26.3 per cent (M\$5.7 billion) of the total loan outstanding to Bumiputera community (M\$21.6 billion excluding trade bills at end of 1990 or about 7.05 per cent of total outstanding loan at the same date). Loans of more than M\$1 million each were extended to 2,369 borrowers (compared to only 14 in the early 1970s) with a total value of M\$12.2 billion or 56.3 per cent of total credit outstanding to Bumiputera community in 1990. There was a growing participation of Bumiputeras in larger scale projects but a gap between the large number of Bumiputera borrowers (96.1 per cent) who were granted small loans of not more than M\$100,000 and the few Bumiputera borrowers (0.48 per cent) who were granted loans of more than M\$1 million. Was there a gap of funds for those borrowers who wished to take loans in the range between M\$100,000 and M\$1 million or a gap of borrowers to take

up loans in the stated range of loans made accessible to them? Lack of Bumiputera borrowers in the M\$10,000 to M\$1 million loan range could be due to an information gap where Bumiputera SMEs, many of whom were newcomers to the enterprise world, may lack information on the different types of loans offered by different financial institutions including the commercial banks. Additionally perhaps, Bumiputera SMEs did not have sufficient knowledge, advice or know how regarding the process of presenting a case for loan application due to inexperience in the trade.

Regarding the distribution of loans by commercial banks, during the first half of 1970s, loans extended to SSEs were generally well distributed among the domestic and foreign-incorporated banks. However, since 1977, domestic commercial banks had extended more share of loans to SSEs. As at September 1988, domestic banks accounted for 78.2 per cent of the total commercial bank credits to SSEs (Bank Negara Malaysia, 1989).

In terms of direction of loans to SSEs, a greater portion of the loan was channelled to wholesale and retail trade, and hotels and restaurants which increased from M\$93 million (or 27 per cent of total bank loan to small borrowers) at the end of 1970 to M\$1,751 million (or 47.1 per cent) at end of September 1988. The second largest portion went to manufacturing sector which accounted for about 13.3 per cent of total loans to SSEs in 1988. 12 per cent of total SSE loan were channelled to small contractors and 6.5 per cent of the total credit to SSE went to the agriculture sector during the same period.

#### LOANS UNDER CREDIT GUARANTEE CORPORATION (CGC)

The lending guide-lines also required commercial banks to extend loans under guarantee cover by the Credit Guarantee Corporation (CGC). Under the Principal Guarantee Scheme (PGS) of the CGC, commercial banks were required to extend loans with CGC guarantee cover of at least M\$200 million, of which M\$100 million must be guarantee cover for loans extended to Bumiputera community. The compliance date

was however, extended to March 31, 1991. As at December 31, 1990, M\$391.8 million of loan had been approved with guarantee cover of M\$144.9 million which was still below the required amount (Bank Negara Malaysia, 1991).

Table 5.2: Bank Lending Under The CGC Scheme - General Guarantee Scheme (GGS), Special Loan Scheme (SLS) and Principal Guarantee Scheme (PGS)

Year (M\$million)	Total value	Total Number
1973	11.8	2,292 (GGS)
1980	124.3	6,103 (GGS)
1981	524.0	18,309 (GGS and SLS)
1982	519.3	16,958 (GGS and SLS)
1983	298.3	10,563 (GGS and SLS)
1985	142.6	5,372 (GGS and SLS)
1986	250.48	11,290 (GGS and SLS)
1988	50.5	2,470 (GGS and SLS)
1990	391.8	7,279 (PGS)

SLS started in 1981

PGS replaced GGS and SLS in 1989

Source: Phang (1989); Bank Negara Malaysia Annual Report (1990)

The guaranteed loans extended by commercial banks over the period of 1980 to 1990 fluctuated in the amount and number of loans. Banks were reluctant to utilise the guarantee facilities, in spite of the Central Bank's directives, and incentives provided to participate in the scheme. (Participating banks were granted a tax concession in respect of the amount loaned under this scheme and borrowers were eligible for double deduction for tax purposes). Perhaps the reluctance was due to the lower profit margin as compared to the returns from ordinary loans. The CGC only covers 60 per cent of the amount of loans and advances in default not recoverable by commercial banks. In other words, the commercial banks were responsible for the 40 per cent default which may be considered a fairly high proportion of bearing risk especially for loans made without any security (the guide-lines stated that loans may be made without security); and the banks had to pay a guarantee fee of 0.5 per cent per annum on credit outstanding. In addition the commercial banks were required to take all possible legal

actions (costs to be borne by the banks concerned) to recover the loans before claims can be submitted to the CGC. Although it was stated in the claim procedures that CGC had a right to reject claims which had low quality appraisal and poor follow up by the individual bank, the procedures and arrangement before claims can be brought forward to CGC could be a deterrent for commercial banks to push all their risky loans towards the claim against CGC because guarantee cover for loans was given automatically by the corporation when approved by commercial banks. However, there was evidence that some banks were rather reluctant to use the guarantee facilities and comply to the guide-lines regarding loans under CGC. Latif (1990) reported that at end of 1976 only 10 out of the 36 banks were fully taking part in the scheme and by the end of 1987 only 1.2 per cent of total loans granted by banks were made through CGC. Some banks were reported as preferring to face being fined rather than complying to the guide-lines regarding loans under CGC. There were also cases where participating banks' claims were not made in cases of default. Levitsky and Prasad (1987) reported that the handling of claims had been very poor. Up to December 31, 1981, a total of 1,342 claims valued M\$4.39 million had been lodged with the CGC but only 132 claims for M\$277,787 had been paid out while, 760 claims valued M\$2.17 million had been rejected. Up to end of 1985, a total of 1,935 claims had been processed but only 429 claims for M\$1.27 million were paid out, 1,186 claims were rejected and 320 claims were withdrawn by the banks. This seems to be a deterring factor contributing to the performance of commercial banks in this programme. At the request of the Malaysian Government, a World Bank consultant who reviewed the scheme in 1982, found that the scheme was grossly underfunded in view of the volume of guarantees given. Latif (1990) found that the lack of enthusiasm of the bankers for CGC activities were due to the following:

- (a) Credit risk was neither reduced nor really transferred from the bankers since commercial banks were the majority shareholders of CGC.

- (b) The CGC provided cover for 60 per cent of defaulted loans while the remaining 40 per cent had to be borne by the individual bank.
- (c) Legal charges in the claim process for a bad loan had to be borne by the lending bank.
- (d) Time taken for recovery of claims was "*fairly long*".
- (e) More paperwork involved for CGC loan as compared to those for normal loan and unit cost in handling per CGC loan was higher than normal loan.

Additionally, credit officers and banks tend to be risk averse since performance is generally judged by the number of problem or bad loans they were responsible for. Since SME loans were regarded as high risks, in addition to the above reasons banks had preferred to keep their CGC loans to the barest stipulated minimum.

Currently there are three schemes administered by the Credit Guarantee Corporation (CGC) namely PGS, the Loan Fund for Hawkers and Petty Traders (LFHPT) and the Association Special Loan Scheme (ASLS). However, the corporation still continued to monitor those loans under schemes that had ceased to operate but were still subject to its guarantee.

As at December 31, 1990, within six months of its implementation, total loan approved under ASLS (funded from M\$20 million provided by the Central Bank) amounted to M\$4.2 million of which M\$4.1 million (97 per cent) was granted to 2,043 Bumiputera borrowers. Perhaps this indicated that the majority of Bumiputera trade association members have very small businesses because to be eligible for the ASLS scheme, total business assets should not be more than M\$10,000 and total existing loan should not exceed M\$2,000. Through the provision of this scheme it appears that the financial constraint on these very small business persons could be reduced.

The LFHPT scheme which was implemented in March 1990, had approved loans amounting to M\$6 million of which M\$5.2 million (87 per cent) was granted to 1,479 Bumiputera borrowers. The maximum loan granted under the LFHPT was

M\$10,000 each. The initial fund of M\$50 million for LFHPT scheme was increased to M\$100 million set aside from the New Investment Fund provided by Central Bank.

Total loan guaranteed by CGC under all its schemes as at December 31, 1990 totalled 172,394 applications with approved loan limits of M\$3258.1 million compared to 2,292 applications with loan approved which amounted to M\$11.8 million at end of 1973 (Bank Negara Malaysia 1991). From the above it was found that although the number of applicants has increased over the years since its implementation, it appeared that SMEs may still have constraints in securing external finance through CGC.

#### LOANS FROM FINANCE COMPANIES

The lending guide-lines announced in March 1989 required finance companies to comply with the guide-lines on lending to Bumiputera community and SSEs by March 31, 1990. As at compliance date, the finance companies had approved loans to SSEs amounting to M\$3.2 billion which represented 23.5 per cent of total loan outstanding as at December, 1987 (base year) against a minimum requirement of 15 per cent. It showed that loans from the finance companies were no more a major constraint to SMEs. The lending guide-lines could have influenced the extent of loans to SMEs. Having the experience in small lending perhaps, would improve the handling of small loans from the stage of appraising small loans proposals to the supervision of repayments of the loan, hence reducing the uncertainty or risk facing finance companies which would therefore be more encouraged to grant loans to SME. There were no data available regarding amount of loan granted to Bumiputera SSEs. Regarding compliance with lending to Bumiputera community, the finance companies had granted M\$6.8 billion or 49.7 per cent of total loan outstanding as at December 1987, well in excess of the minimum requirement of 20 per cent. Probably this aggregate amount would appear satisfactory but the proportion of 49.7 per cent of loans included all loans for housing, consumption credit and also for other purposes in the Bumiputera community. Increases in loans for consumption purposes would surely not contribute to the creation

of a Bumiputera commercial and industrial community in the country's development plan. Data regarding loans that were extended to Bumiputera SMEs were again not available.

Beside loan from banks and finance companies, special schemes and special funds were also set up by the government to help ease the financial constraints of SMEs. Among them were the Enterprise Rehabilitation Fund (ERF), New Investment Fund (NIF), New Entrepreneurs Fund (NEF), and ASEAN-Japan Development Fund (AJDF).

#### **THE ENTERPRISE REHABILITATION FUND (ERF)**

The M\$500 million Enterprise Rehabilitation Fund, managed by MIDF on behalf of the Central Bank, was to provide financial assistance to ailing (financial problems due to the last recession) but viable enterprises with good recovery prospect. Only members of the Malay Chamber of Commerce are eligible to apply. However, not many SME entrepreneurs are members of the Malay Chamber of Commerce. Therefore, the larger enterprises are more likely to be able to apply and more likely to benefit from this fund. As at the end of 1990, a total of 1,485 application had been received, of which 692 applications for projects amounting M\$479.9 million had been approved (Malaysia, 1991). It shows that nearly half (47 per cent) of the total number of applicants were successful in getting loan from this scheme. Perhaps, these were the applicants considered to have a viable plan for rehabilitation which was a criterion to qualify for the loan.

#### **THE NEW INVESTMENT FUND (NIF)**

The NIF was launched in 1985 with an initial allocation of M\$1,000 million by the Government to stimulate new investments in selected sectors such as manufacturing, agriculture, tourism and mining which was part of the Government effort to promote growth and shift new lending away from low priority sectors of property and real

estates (Malaysia, 1991). The fund was later expanded by M\$200 million to support Government's effort to promote private sector cash cropping on a commercial basis. The fund was further expanded by an additional M\$500 million bringing the total to M\$1,700 million. At the end of 1990, 422 loans amounting M\$1,428 million was approved. Of the total amount, M\$1,024 million was for manufacturing sector, M\$277 million for the agriculture sector, M\$80 million for tourism sector and M\$47 million for the cash crop scheme. It was reported that the NIF would no longer be extended as the economy was well on recovery and there was ample liquidity in the banking system.

#### THE NEW ENTREPRENEURS FUND (NEF)

The M\$250 million NEF was launched by the Central Bank in December, 1989 to provide funds at reasonable costs to encourage new Bumiputera entrepreneurs to engage in new ventures especially manufacturing, agriculture, tourism and export oriented industries. As at the end of 1990, 280 applications were received of which 153 applications for M\$21.7 million had been approved (Malaysia, 1991). It shows that more than 50 per cent of applications were successful in getting loans from this scheme.

#### THE ASEAN-JAPANESE DEVELOPMENT FUND

The AJDF loan scheme with M\$890 million provided by the Overseas Economic Cooperation Fund (OECF) and the Export-Import Bank of Japan (EXIM) was launched by the Government in 1989. The fund was to provide loans to SMEs at an interest rate of 6.5 per cent per annum from the OECF portion while loans from the EXIM portion will be charged at an average of 7.85 per cent per annum. As at July 1990, M\$602 million had been approved of which, M\$403 million was from the OECF and the balance of M\$199 million was from EXIM.

### ABANDONED HOUSING PROJECTS FUND

As the rehabilitation of abandoned housing projects was the focus of ERF, a separate scheme, the Abandoned Housing Projects Fund with M\$600 million allocation was set up in June 1990 (Malaysia, 1991). The scheme was to help housing developers to revive abandoned housing projects. Most housing developers are large enterprises which therefore had more opportunity to benefit from this scheme. At the end of 1990, a total of 33 applications for M\$137 million had been approved.

### DEVELOPMENT FINANCE INSTITUTIONS

The development finance institutions which comprise the Malaysian Development Finance (MIDF), the Borneo Development Cooperation, the Sabah Development Bank, Bank Pembangunan Malaysia (the Development Bank of Malaysia), Bank Industri Malaysia (the Industrial Bank of Malaysia) and Bank Pertanian Malaysia (the Agricultural Bank of Malaysia) complemented the role of the banking system in terms of providing medium and long term capital financing as well as supplying a range of financial services not normally provided by commercial banks and finance companies.

The Development Bank of Malaysia was reported to be a major player among the multitude of organisations in the promotion of SMEs (Abdullah, 1990). Although it was not exclusively set up to cater for SMEs, it had a great role in project financing to assist and develop such enterprise. The Development Bank of Malaysia classified small and medium loans as those of less than M\$1.5 million each. Abdullah (1990) reported that in May 1990, almost 93 per cent or 3,418 borrowers of the Bank portfolio of clients were in this group. Loans of M\$500,000 each were considered small and comprised 82 per cent of borrowers, while the remaining 11 per cent were classified as medium borrowers. In terms of value, SME loans accounted for 42 per cent or M\$708 million. The loan extended by the bank to small and medium projects were charged interest rate as low as 5 per cent.

The Development Bank of Malaysia was involved in extending the M\$150 million credit line from the World Bank and the Malaysian Government through the Small-scale Enterprise Programme. SME loans totalling M\$189.6 million were granted to assist about 900 entrepreneurs under this scheme at end of December 1989 when the programme expired.

#### CREDIT PROGRAMMES FROM MARA (Council of Trust for Indigenous People)

MARA, which is financed by the Federal Government in the form of loans and grants, was established in 1966. It had a role in promoting the development of Bumiputeras in training, education, commerce and industry. To ensure greater success in business venture, MARA provided various assistance, guidance and support programmes. Financial assistance to SMEs were provided in the form of three types of loans (Chee, 1986). Firstly, the ordinary loans which have a maximum of M\$50,000 each. Secondly, the New Entrepreneurs Loans provided M\$150,000 each for setting up manufacturing enterprises and thirdly the Special loans which provided smaller loans of M\$2,000 each (without collaterals or guarantors) for petty traders and hawkers. The maximum loan ceilings offered by MARA were later increased (Malaysia, 1991). Loans of M\$250,000 to M\$1 million are now being provided. Chee (1986) also reported that between 1966 and 1982, MARA had granted 60,257 loans which amounted to M\$388.2 million and 90 per cent of MARA loans were said to be below M\$5,000 while nearly 60 per cent of MARA loans were given out without any security. The high proportion of loans granted without collateral seems to show that SMEs loan applications process by MARA was quite flexible. However, the large number of small loans given out and the high proportion of loans without collaterals were reported to be a contributing factor to the supervising of loans problem and loan recovery faced by MARA.

## RURAL SMALL SCALE INDUSTRIES PROGRAMME

The rural industries programme was aimed to increase the villagers income. Previously, the objective was to be achieved through productive work during the spare time but now it was to be implemented mainly by projects that could be a main source of income and have potential for expansion and diversification. Financing under this programme is in the form of grants which vary according to the management of the enterprise. For individual entrepreneurs, a grant of not more than M\$10,000 for the value of machines will be provided. For a group project run by 3-14 persons, a grant of not more than M\$50,000 for the value of machines plus M\$20,000 for the value of the workshop. For cooperatives of 15 or more entrepreneurs, a grant of not more than M\$100,000 for the value of machines and M\$20,000 the value of workshop would be provided. Activities under the rural industries programmes included handicraft (consisting of weaving, woodcraft and furniture, batik, leathercraft, metalcraft, mudcraft and songket), and food processing.

Siwar, Jaafar, and Zin (1990) in their study on rural small industries programmes found that although there were sufficient funds channelled through commercial banks, finance companies and specialised financial institutions like MIDF, MARA, the Agricultural Bank and the Development Bank to finance urban SMEs there was insufficient funds being channelled to rural areas. Siwar, Jaafar and Zin also found that only 24.5 per cent of their respondents' source of initial capital was from Government and private finance institutions while 60.3 per cent of the respondents obtained their initial capital from private savings, sales of private property and contributions from family members and/or friends. Those who had obtained credits from government and private financial institutions had problems in repayment. Gosling (1983) found that in the rural areas Government backed sources of credit had been less successful in displacing local moneylenders' credit or Chinese dealer credit because even though government credit charges were lower, most of the credit programmes were less flexible and less efficient than the moneylender credit or Chinese dealer

credit. The moneylenders and credit dealers tend to be more flexible and provided more personal service than formal institutions. Government funded rural credit was also reported to be channelled mainly through cooperatives which had a wide range of limitations, often required a guarantor and usually had fixed schedules of repayment. Dishonest or inefficient management of cooperatives were also reported and rural farmers in Malaysia were said to find it easier to deal with the one person credit dealer who provided them with goods, services, information, crop marketing and credit without all the restrictions imposed by cooperatives and banks. Government had attempted to utilise these credit dealers where private traders were permitted to operate one third of the Government-sponsored local credit centres, set up to channel credits from banks to farmers, but it seems that the dealers were not interested in working through Government programmes. The credit terms (where loans were for production only), formal and systematic collection of interest and principal and aggressive insistence on repayment were seen as damaging to the smooth dealer operations. The traditional ways of collecting overdue accounts through shortweighting, overcharging for inputs and goods were seen to be more subtle and the subterfuge was claimed to be preferred by both borrowers and lenders.

In summary, the promotion of SMEs in Malaysia is influenced by its priority objective of its development policy in eradicating poverty and restructuring the society. The restructuring of society involves creating a viable Bumiputera commercial and industrial community. Since finance is generally believed to be one of the major problems facing SMEs particularly Bumiputera SMEs, it justifies the need for Government to provide financial facilities for SMEs. The range of financial facilities provided and the number of organisations involved implies that the Government was highly favourable towards supporting entrepreneurship and promoting investment by SMEs. Whether the provision of facilities and the involved organisations had really facilitated the creation of more successful entrepreneurs and investment, is a complex problem because it would involve comparison of the effect on entrepreneurs before and

after the provision of these facilities, and also a comparison with those entrepreneurs that missed out or do not benefit from any of these facilities. Additionally it is difficult to say whether the facilities provided for SMEs and the involved organisations had influenced the restructuring of society, eradication of poverty and improvement of income distribution. However, it was reported in the Sixth Malaysia Plan that the growing participation of Bumiputera in modern economic activities had improved the income distribution. In terms of inter ethnic income differences, the ratio of mean income for Bumiputera compared with that of Chinese in Peninsula Malaysia improved from 56.7 per cent in 1985 to 58.8 per cent in 1990. At the same time, the ratio of the mean income of Indians to Chinese also improved from 72.8 per cent to 75.9 per cent. Additionally, there was a narrowing of income differentials between rural and urban households where the ratio of rural household income to that of urban household had increased from 53.5 per cent in 1985 to 58.3 per cent in 1990. The achievement in poverty eradication showed an overall decline of poverty from 20.7 per cent in 1985 to 17.1 per cent in 1990 (Malaysia, 1991).

On the objective of restructuring of society, the rapid expansion of investment activities had generated many new jobs in the manufacturing, agriculture and commercial sectors where Bumiputera had gained as much as 60 per cent of the new jobs. However, in terms of occupational categories, the majority of Bumiputera workforce was still in the lower-pay categories (Malaysia, 1991).

In the objective of restructuring of the corporate sector, the share of Bumiputera including trust agencies accounted for 20.3 per cent (Bumiputera individuals as direct investors only accounted for 8.2 per cent if trust agencies and related institutions were excluded) of the total paid up equity capital in the corporate sector in 1990 while non Bumiputeras held a total of 46.2 per cent, the foreigners held 25.1 per cent and nominee interest held 8.4 per cent (Malaysia, 1991). Despite various forms of assistance given by the Government, Bumiputera still lacked the corporate control.

In the objective of creating the Bumiputera commercial and industrial community, it was reported in the Sixth Malaysia Plan 1991 that the overall impact remained limited. Sallih and Yong (1988) reported that the Government objective in creating 30 per cent of viable Bumiputera commercial and industrial community was a definite failure.

Although finance was agreed to be a major problem facing SMEs this problem appears to be closely related to management, marketing and opportunity identification. It was reported in the Sixth Malaysia Plan 1991 that a major factor contributing to the low performance of Bumiputera in the commercial and industrial sector was the small and narrow base of business enterprise, inadequate experience and lack of management capabilities. The lack of success of Bumiputera were also reported to be partly due to their inability to take full advantage of the opportunity given to them. It therefore appears that Bumiputera SMEs need training and development in management, marketing and opportunity identification because the above skills may be acquired through training in the related field. It can therefore be concluded that currently, there is a training and advice gap.

The Government and the list of involved organisations claimed to have provided financial facilities and support services for SMEs. However, it appears that little is done to communicate regarding what is available and offered by the Government to meet the needs of SMEs. Provision of facilities without reaching the target market at the right time and provision of facilities without meeting the needs of SMEs would seem meaningless. Information on the facilities and support services provided, must be linked to SMEs through effective communication network. Partly, it would appear that there is an information gap due to this communication gap.

Overall, the facilities provided and the organisations involved seem to indicate that institutional funds were no longer a major constraint for some SMEs while others seem to still have the problem of securing a loan from finance institution. More funds

seem to be allocated for specific sectors rather than providing for all SMEs without bias irrespective of any specific sector. However, there seem to be a need for Government support beyond the financial facilities to include other support programmes like training, marketing etc.

Perhaps the continued provision of all these facilities would mean greater reliance on Government support and therefore entrepreneurs to be created would not be entrepreneurs in the true meaning any more because entrepreneurs are suppose to be self reliant, innovative, risk takers and motivated. Perhaps the training, advice, and information can be given (though it may take time) to gain skills, knowledge and experience but without the inner motivation in the person himself, entrepreneurs cannot be created. However it can be argued that all financial support and facilities will not necessarily create entrepreneurship but financial and other support can facilitate the creation of enterprises and entrepreneurship.

#### FINANCING SMEs IN INDONESIA

Indonesia comprises 13,667 islands, covering a distance of about 3,500 miles from west to east and covering a total area of 1,919,443 sq km. Its population of 182.6 million in 1990 (from over 300 different ethnic groupings) is the fifth largest in the world (Financial Times, March 22, 1991). Indonesia had a vast and underdeveloped economy. Its infrastructure and communication system was not efficient and there was power shortage as the state electricity monopoly was only able to provide electricity to 54 per cent of urban households and 13 per cent of rural households (Schwarz 1991). Banking offices are concentrated in major towns, and each bank office was serving an average of 148,700 persons in 1982. Its per capita deposit was only US\$89 and per capita M2 was only US\$121 indicating a lag in its financial development (Yan 1984). Additionally, Rahardjo and Ali (1986) found that financial institutions were not much utilised by SMEs in Indonesia because most SMEs were

mainly located in small towns, while financial institutions were situated in large towns usually a distant away.

In Indonesia, the promotion of SMEs was under the Directorate of Small Industry created in the Ministry of Industry. The Government's involvement in financing SMEs included direct control over bank credit ceilings and interest rates and subsidising credit rates such as those provided for its small investment credits (KIK) and small working capital credits (KMKP) programmes introduced in 1974. However the interest rates control was later removed in 1983. To provide greater access to bank loans, Credit Guarantee schemes were also established. Askrindo, a publicly financed credit insurance corporation set up in 1971, provides a guarantee coverage of 75 per cent against defaults on business loans to both large and small. At the end of 1983, it was claimed that Askrindo's over generous terms had contributed to a high arrears and default rate in KIK/KMKP programmes. As a result, claims on KIK/KMKP losses rose from Rp6.0 billion in 1981 to Rp 13.2 billion in 1982. As of 1983, loans under KIK/KMKP were limited to loan amounting to the equivalent of US\$15,000 (Levitsky and Prasad, 1987).

In the early 1980s, small, usually Pribumi businessmen, were also given contracts through Government procurement. Around the same period, the concept of adoption in the Bapak Angkat or foster parent relationship programme, was introduced to link large companies with small businesses. Through the link, it was thought by the Ministry of Industry then, that SMEs would have better access to credit using the link with foster parent as collateral for loans. Beside that, large companies were encouraged to provide finance to SMEs beside other assistances such as production and management. Suhartono (1988) reported that during the period of 1974-1986, there were constraints in expanding the KIK and KMKP programmes. Although it had been found that the ceiling for both KIK and KMKP loans were increased from Rp 5 million to Rp 15 million, the average size of KIK and KMKP loans did not rise. For example, the average loan size in 1986 was below the ceiling in the range of Rp 3.6-4.2 million

for KIK and Rp 0.9-1.5 million for KMKP. While the number of cumulative loan approvals for small industries had increased from less than 5,000 in 1974 to more than 225,000 in 1986, the number of industries receiving loans was relatively small compared to the estimated 1.7 million small industry establishments. It indicated that a major proportion of SMEs were still not able to benefit from the financial facilities provided by the Government. Financial assistance to SMEs through cooperatives was introduced during the third 5 years Development Plan (1979/80-1983/84).

The importance of cooperatives as a source of institutional credits as compared to commercial banks need further discussion. As a source of long term loans, cooperatives contributed 40 per cent compared to 18.8 per cent from commercial banks while the rest of the loans were raised from the informal sector such as private individuals and moneylenders. Reasons for the banks' low performance in extending loans to SMEs were reported by Rahardjo and Ali (1986) to be due to difficulties experienced by SMEs when requesting bank credits. Among the difficulties faced were not having a certificate of fixed assets; no business licence; interest rate was high; period of credit was too short before debt had to be paid off; lack of knowledge in the procedure of requesting credits; and high cost incurred for administration to comply with the conditions. Perhaps, the lack of knowledge on the part of potential borrowers about the availability of credit and the procedures for requesting credits were either due to lack of information or due to the distance from the bank office. The mobile and village bank branches were only opened on certain days for certain office hours and were not contributing much to giving information and educating the people. In addition, apparently, bank employees were unfamiliar with the local rural problems. To ensure bank personnel familiarity with local factors, perhaps recruiting bank employees at local level may help; also the cost of information would be much reduced. Although, interest rates charged by banks were low, the procedure for obtaining credit required too much paper work. In addition banks required collateral that was difficult for many to meet. These are a few of the reasons which had led SMEs to prefer borrowing from

cooperatives (interest rate at 2-3 per cent per month) and moneylenders which charged interest rate at 3-30 per cent per month (Rahardjo and Ali, 1986).

The usurious interest rates charged by moneylenders not only cause hardship to the borrowers but also prevent the flow of funds for long term development purposes because profits in money lending were so large that there would be little incentive to invest in development projects in which returns cannot be equally high. It is for this reason that perhaps, the Government should consider a law limiting interest rates charged by private pawnbrokers and moneylenders, but, this law is known to be very difficult to enforce. In Indonesia, there were government pawnshops whose pawn services were under the supervision of the Ministry of Finance. These government pawnshops had a partial monopoly on loans whereby private money lenders by law, were not allowed to grant loans of less than a minimum amount against the security of pawns in areas served by the government pawnshops.

Other agencies involved in financing SMEs in Indonesia at the province and regency levels included the Department of Social Affairs, the Department of Industry, and the National Family Planning Coordinating Board and the Subdistrict Credit Body.

Savings may be an essential part in investment activities because, investment may be seen as a form of savings for productive purposes. However some people could not afford to save while others could not save because of compulsive spending and lack of savings habit. Regarding savings, Rahardjo and Ali (1986) found that 53.2 per cent of SME owners/managers had no savings. Of those who had savings, 43.1 per cent of them had savings in the form of non money such as rice fields, jewellery, other land and houses, indicating the lack of liquid funds for production. However, Conroy and Drake (1990) reported that Indonesia's real saving and investment aggregate was increasing approaching 30 per cent and over 30 per cent of GNP respectively in 1989.

Bank credits to private sector increased by 37 per cent in 1987, by 77 per cent in 1988 and by 79 per cent in 1989 which probably was a response to the removal of credit ceilings in 1983 over bank lending. The dominant state banks were however

reported to be slow in their lending policies and procedures adjustment. The deregulation had created opportunities and strengthened commitment to the private sector. The Chinese, which made up only 4 per cent of Indonesia's population and accounted for two thirds of the private economic activity, owned most of Indonesia's largest conglomerates and almost all of the biggest private banks. As a result, they appear to have greater access to capital and managed to seize the opportunity from deregulations. Effective from March 1990, the Government in its attempt to curb inflation, adopted a tight money policy through phasing out the liquid credits system or the subsidised refinancing facilities, and the issue of Bank Indonesia certificates. The subsidised refinancing facilities were reduced beginning March 1990 because of the growth in bank lending and base money in 1989. Another reason contributing to the phasing out of liquid credits was the allocation abuse found in the system (Conroy and Drake, 1990). Perhaps with Indonesia's open exchange regime it would not be easy to control inflation. Inflation reached 9.5 per cent in 1990 compared to 6 per cent in 1989 (Ministry of Finance Malaysia, 1990). Some banks became chronic net borrowers on the interbank market when they expanded their loan assets much faster than they could raise deposits to support loan growth. The inadequate professional accounting standards and training was partly to be blamed as Indonesia had only 390 Certified Public Accountants in the whole of the private sector in 1988 (Conroy and Drake, 1990).

The tight capital and liquidity positions in times of high interest rates would appear to be detrimental to SMEs whereas large public companies could easily borrow from cheap funds from state banks or resort to off-shore borrowing at lower interest rates and raise capital in the stock market. Many large private companies own private banks to cater for their financial needs. To ensure that SMEs had access to bank loans, every national bank was required to allocate within a year a minimum of 20 per cent of its loan portfolio to small businesses effective from January 1990. It has been suggested that this requirement had put tremendous lending pressure on some banks which had no staff who had expertise and experience in small credit assessment (Conroy and Drake,

1990). In the activity to reduce income disparity, through the policy package of March 1990, the corporate sector was required to make shares available to cooperatives (many SMEs in Indonesia form cooperatives through its "sentra" development programmes). By early 1991, 105 companies had complied with the requirement but shares issued only represented 1 per cent of the capital of participating companies from the call for 10 - 40 per cent of capital to be distributed. Neither the Chinese nor the Pribumis seem to be able to see the effectiveness of the scheme. Government officials were also reported to feel uncomfortable with the requirement, which may harden attitudes rather than foster partnership (Schwarz, 1991).

Lately, since February 1991, the concept of foster parent was reemphasised in the attempt to narrow the income disparities that were increasing. In the attempt to link SMEs with the country's large business companies, the Ministry of Industry had identified 10,000 companies that were to become foster parents to SMEs, with the ministry acting as the match maker. However, up to May 1991, only 200 large firms were reported to have responded to the programme. State owned firms would also be made foster parent to SMEs in areas where there were few large private companies. In this campaign, large companies were urged to take smaller Pribumi enterprises as suppliers, agents, distributors, subcontractors and retailers. In doing so, the financial position of SMEs could be strengthened. The Pribumis were also expected to be given the opportunity to integrate into the top management of large Chinese owned firms (Scharwrz, 1991). The programme was reported to have obstacles because while the ministry thought that smaller firms would be cost competitive alternatives as suppliers, distributors etc., the larger companies had doubts and some had claimed that capable Pribumis were very few. Perhaps with intensive education and training for Pribumi SME owner/managers, the integration process can speed up and be in better form.

As race is a sensitive issue in Indonesia, the Government did not make an ethnic distinction but rather described its efforts as support for the weak economic groups.

In May 1990, a policy package known as Pakmei was introduced. In the new policy package, specific deregulations and reductions of tariff levels were introduced. The deregulated measures included the lifting of export controls over 4 main agricultural commodities and the lifting of import controls of foreign retail drugs. However, 80 per cent of agriculture exports in Indonesia were handled under arrangements which limited access to new players (Conroy and Drake, 1990). Thus it gave the implication that the potential of new entrants into the activity to take advantage of the opportunity was rather tight for a nation where 70 per cent of the population still live in rural areas and where the agricultural sector contributed about one fifth of GDP.

Previous deregulations (such as the removal of credit ceilings) had aggravated the income imbalance. The resurgence of the private sector had meant a relative decline in the economic role of the state, traditionally viewed as the protector of small and medium scale enterprises, Pribumi enterprises, against big businesses. Without Government intervention, such as the provision of financing facilities and financing incentives for SMEs in the short term, income disparities would more likely increase than decrease. Perhaps deregulations would increase competition and enhance true entrepreneurship but when there is distortion in the capital market where large private companies have monopoly control of part of the financial system (since many private companies had their own private banks) and there is monopoly of the marketing system, income disparities would more likely remain high for a long while.

In summary, Government policies in promoting SMEs for employment creation particularly to achieve the equity objective seems to be limited mainly to the provision of credits through its banking system. In spite of that, SMEs in rural and province areas appear to prefer to continue to borrow from moneylenders than borrow from the banks, which implies that rural banks have not been successful in reducing or eliminating financial constraints of SMEs through the credit facilities provided by the banking system. Perhaps, related policies such as education policy on vocational training, and

fiscal policy incentives in the form of tax exemption, tax deductions and tax allowances not only to SMEs but also to larger companies that help SMEs, may help to foster the linkage aimed for. Additionally, to encourage formal financial institutions as a source of finance for SMEs, perhaps loans through group lending may help to reduce transaction costs both for the formal institutional lenders and borrowers. Through group lending, the total amount of loan would be large enough to reduce transaction costs. Administrative costs for group lending could also be reduced if the group of borrowers were responsible for supervision of each loan repayment such that members of the group could not get further loans if repayment is not fulfilled by present borrowers in the group.

#### **FINANCING SMEs in SINGAPORE**

Singapore, a newly industrialising country, is a small island covering only about 626 square kilometres with an estimate population of about 2.71 million in 1990. For the same year 1990, its economic development indicators like GDP showed its growth rate was 8.3 per cent; GNP per capita was US\$12,765 third highest in Asia after Japan and Brunei; unemployment rate was estimated to be 2.5 per cent of labour force; growth of consumer prices was 3.4 per cent per cent and there was a surplus in the current account of the Balance of Payments (Financial Times, April 30, 1991). The external debt was estimated to be US\$0.1 billion in 1990 (Ministry of Finance Malaysia, 1990).

Its financial system and structure were reported to be matured, highly developed and sophisticated making it a major international financial centre (Bank Negara Malaysia, 1991). Singapore had a broad network of banking offices. In 1982 each banking office was serving an average of 7,000 persons and its per capita M2 was US\$4,314 while its per capita deposit was US\$4,519. Its financial asset/GNP was 2.74 indicating the financial assets had increased at a much more rapid rate than its non financial wealth (Yan, 1984).

Its efficient communication system, minimal price distortion, educated labour force and stable political system had contributed to Singapore's economic environment for business.

It seems that due to the small land size, lack of natural resources, small labour force and the reluctance to employ large numbers of foreign workers, Singapore had embarked on a policy of promoting high technology enterprises producing high value added products.

Its 1979 corrective wage policy which recommended a 20 per cent wage increase for three consecutive years meant higher cost of employing labour. In Singapore where 94 per cent of its establishments were local enterprises (which referred to companies with more than 30 per cent local equity), this wage policy had forced firms not to rely excessively on labour, consistent with the objective of encouraging high value added and technologically sophisticated firms in Singapore.

Various tax incentives and various financial assistance schemes had been formulated and implemented by the Government to promote higher value added and new technologically based activities, operational upgrading and innovation. However, Singapore government did not intervene in commercial banks' credit policy as it had believed that the market can provide services to SMEs more effectively than the Government. Perhaps, the non intervention or free market policy may work well for a developed economy like Singapore. It is a major international financial centre which is not only attractive to foreign investors, but also within easy reach for its own sophisticated domestic investors who are able to make a choice in investing using the range of instruments offered by the network of financial intermediaries in its financial system. Its financial services industry even grew at a rate of 22 per cent in 1990. Perhaps the accessibility to the financial institutions had an influence contributing to the growth.

In Singapore, generally, the official support for SMEs was provided by five main organisations namely the Economic Development Board (EDB), the Skills

Development Fund, the Singapore Institute of Standard and Industrial Research, the National Productivity Board, and the Trade Development Board (Chew, 1988). These organisations help in the implementation of the fiscal incentives and financial facilities provided by the Government to help local SMEs in all aspect of SME development needs.

The main tax incentive used by SMEs were investment allowance, pioneer status and double deduction.

**Table 5.3a: Tax Incentives Awarded to SMEs (Number of Approvals)**

Scheme	1976-80	1981-85	1986	1987	1988	Total
Total	N/A	381	528	851	1225	2,985
LIAS	N/A	N/A	88	477	555	1,120
PSC	N/A	N/A	10	2	4	16
DTD	N/A	381	430	372	666	1,849

**Table 5.3b: Tax Incentives Awarded to SMEs (Amount Approved in S\$ million)**

Scheme	1976-80	1981-85	1986	1987	1988	Total
Total		4.97	13.76	33.63	51.2	103.56
LIAS	N/A	N/A	4.9	24.1	38.0	67.0
DTD	N/A	4.97	8.86	9.53	13.2	36.56

Source: Economic Development Board, National Computer Board, National Productivity Board, Singapore Science Council, Trade Development Board

For investment allowance, companies were allowed to deduct 30-70 per cent of costs incurred in projects that required investment in capital assets for operational upgrading or to generate higher value added activities against taxable income, based on merits of the project. In 1988, the S\$38.0 million for 555 applications were approved compared to only S\$4.9 million for 88 applications approved in 1986. This shows that a large number of SMEs appeared to have enjoyed this special benefit which implies that a large number of SMEs had upgraded or generated higher value added activities.

Under Pioneer status, companies could enjoy corporate tax relief of five to ten years. Not only companies engaged in new activities but also existing companies engaged in substantially higher technology content than the prevailing industry

standards were eligible to apply. The number of SMEs granted the pioneer status was 10 in 1986; only 2 were granted in 1987 and only 4 SMEs were granted the pioneer status in 1988. The fall in the number of firms being granted the pioneer status may indicate that new high technology SMEs born in those years were not many. Additionally, for firms to undertake a higher technologically oriented activity, they have to be aware of the ever changing state of technology to realise that their techniques require upgrading.

Double tax deductions were awarded to companies engaged in marketing activities to promote the export of Singapore made goods or in research and development activities.

Companies could also apply for the Overseas Investment Incentive, a scheme encouraging local enterprises to go international, and the Venture Capital Incentive, a scheme which promote investments in venture capital funds.

The number of approvals given for Double Tax Deductions in 1988 were 666 with the amount approved being M\$13.2 million compared to 381 amounting S\$4.97 million during the period from 1981-1985. This again shows the ever increasing number of SMEs that were able to enjoy the benefits.

## **LOANS**

Financing in the form of soft loans for equipment and machinery, industrial buildings, working capital and export factoring were provided under the Small Industry Finance Scheme (SIFS). It was operated by 32 participating banks and financial institutions on a joint risk-sharing basis. SIFS loans were extended to SMEs in manufacturing, construction, commerce and service sectors. Additionally, a Special Interest Rate Programme had been introduced to promote investments leading to substantial upgrading. It is a soft loan scheme which comes with an interest grant and a packaged deal ranging from advice on buying, installation, implementation, and software programming to provision of management expertise. The effective interest rate

was 3.5-4.0 per cent per annum, much lower than the market rate which was about 9-10 per cent per annum in 1986.

Export factoring under the SIFS was to improve the competitiveness of small local exporters. A cash advance up to 90 per cent of the invoice value would be provided on postshipment goods. A discount fee of 6 per cent per annum would be charged, much lower than the current market rate of 9.5-10 per cent in 1985.

**Table 5.4: Total Number And Amount Of SIFS Loans Approved For SMEs**

Scheme	1976-80	1981-85	1986	1987	1988	Total
Number	382	1,341	929	1434	1355	5,441
Amount (S\$ Mill)	81.2	420.7	250.1	289.2	254.1	1,295.3

Source: Economic Development Board, National Computer Board, National Productivity Board, Singapore Science Council, Trade Development Board

SIFS loans extended to SMEs had increased from S\$81.2 million in the period of 1976-80, and reached S\$254.1 million in 1986, bringing the total amount approved since the inception of the scheme to S\$1,295.3 million. Total number of loans approved had increased from 382 during the period of 1976-1980 to 1,355 in 1988 bringing the total number of loans approvals since its inception to 5,441. This shows the SIFS growth had been remarkable and the scheme had benefited a large number of firms.

The main emphasis of SIFS was on the provision of development financing to encourage SMEs to upgrade their operations and enhance their capacity while the private financial institutions were encouraged to play a greater role in operational financing for SMEs. To expand the role of private financial institutions, they were encouraged to provide financial advisory services and setting up a review system. A special training course on appraising SME loan proposals for credit officers was also being developed.

The large number of participating banks and financial institutions in the scheme indicated that they are willing to take a greater role in extending loans to SMEs.

## GRANTS

Grants provided by the Government of Singapore to relieve part of costs incurred by SMEs cover major aspects of development activities of SMEs. This is shown in the grants provided in the wide range of schemes established by the Government such as the Small Industry Technical Assistance Scheme (SITAS), Business Development Scheme (BDS), Product Development Assistance Scheme (PDAS), Software Development Assistance Scheme (SDAS), Research and Development Assistance Scheme (RDAS), Market Development Assistance Scheme (MDAS), Initiative in New Technologies Scheme (INTECH), and the Skills Development Fund (SDF).

**Table 5.5a: Total Number Of Grants Approved For SMEs**

Scheme	1976-80	1981-85	1986	1987	1988	Total
Total		11,681	5,476	6,183	8,304	31,648
SITAS	N/A	82	318	490	288	1,178
BDS	N/A	N/A	58	53	15	126
PDAS	4	42	11	9	14	80
MDAS	N/A	48	243	233	228	752
RDAS	N/A	2	1	1	0	4
SDAS	N/A	1	0	4	4	9
SDF	N/A	11,506	4,845	5,393	7,755	29,499

**Table 5.5b: Total Amount Of Grants Approved For SMEs (in S\$ million)**

Scheme	1976-80	1981-85	1986	1987	1988	Total
Total	0.25	21.15	16.38	15.34	17.17	71.99
SITAS	N/A	0.7	1.8	2.7	2.8	8.0
BDS	N/A	N/A	0.1	0.1	0.2	0.4
PDAS	0.25	3.2	0.7	0.8	1.8	6.75
MDAS	N/A	0.36	1.7	1.48	2.11	5.65
RDAS	N/A	0.87	0.37	0.50	0	1.74
SDAS	N/A	0.12	0	0.35	0.34	0.81
SDF	N/A	15.90	13.41	9.41	9.92	48.64

Source: Economic Development Board, National Computer Board, National Productivity Board, Singapore Science Council, Trade Development Board

**(a) Small Industry Technical Assistance Scheme (SITAS):**

SITAS was designed to provide technical expertise to local industries. SITAS grants were provided to relieve part of the costs incurred by SMEs in their activity to improve productivity or build up technological competitiveness or managerial capabilities. SMEs were allowed to engage the services of private consultants, government agencies or tertiary institutions to undertake the projects. SITAS would fund up to 90 per cent of the consulting cost incurred in engaging the expert.

To speed up the process of application, EDB had established Approved-in-Principle arrangements with the National Computer Board (NCB), the National Productivity Board (NPB) and Singapore Institute of Standards and Industrial Research (SISIR) where the NCB's Small Enterprise Computerisation Programme and Small Enterprise Computerised Accounting Programme, NPB's diagnostic and consulting services, and SISIR's technical consulting and incubator programmes were funded by SITAS.

Also funded under SITAS were EDB's Local Industry Upgrading Programme (LIUP) and Design Advisory Scheme (DAS), and the Manufacturers' Association's European Article Numbering Programme (EAN). Under LIUP, MNCs would be given a grant of up to 90 per cent of training costs if they train local supplier firms in areas such as management, quality control, production process, technology and equipment. Under this programme, local firms would benefit from easy access to the latest technological development. However the success of this programme seems to depend on the willingness of MNCs to provide the training. Perhaps a full grant on the cost of training would be a better incentive, though MNCs would undeniably benefit by getting higher quality products from better trained and more knowledgeable local suppliers.

Total loans extended to SMEs under SIFS amounted to S\$254.1 million over 1,355 applications approved in 1988 compared to S\$81.2 million over 382 approvals in the period 1976-80. The total amount of loan extended since it started to 1988

amounted to S\$1,295.3 over 5,441 approvals. This appears that the loan scheme under SIFS had benefited many SMEs.

**(b) Business Development Scheme (BDS)**

Local SMEs participating in business development missions to seek opportunities for marketing arrangements, technological tie-ups or partnerships with foreign firms could apply for grants under BDS. In 1988, only 15 firms received grants, amounting to S\$0.2 million compared to 58 firms with grants which amounted to S\$0.1 million in 1986. It is interesting to note that although the number of approvals had reduced dramatically the amount of grants approved had doubled. Perhaps the current high technology involved and information gathering on the ever changing and complex technology, had contributed to the increase in cost of business development missions.

**(c) Product Development Assistance Scheme (PDAS)**

PDAS was established to develop local applied research and product development capability, and to build up indigenous technology. Under the scheme, grants of up to 50 per cent of direct development costs (which may include manpower costs, consulting fees, overseas travelling expenses, and charges for patent searches, and the costs of market feasibility and technical feasibility) incurred in product or process development were provided. In 1988, 14 applications were approved granting S\$1.8 million.

**(d) Software Development Assistance Scheme (SDAS)**

SDAS is similar to PDAS and designed to encourage local information technology companies to develop innovative and high quality computer software. Up to 1988, a total of 9 grants amounting S\$0.81 million had been approved.

**(e) Research and Development Assistance Scheme (RDAS)**

Companies engaging in longer term research and development projects were eligible to apply for grants under RDAS administered by the Singapore Science Council. Up to 1988, only 4 approvals for S\$1.74 million in grants had been approved.

**(f) Market Development Assistance Scheme (MDAS)**

MDAS is administered by the Trade Development Board (TDB). Grants of up to 50 per cent of eligible costs were provided to assist local companies to develop export markets. In addition, the Design Venture Programme introduced by TDB provided grants of up to 75 per cent subject to a maximum of S\$100,000 to encourage companies to undertake product design and packaging.

The number of approvals for the grants under MDAS was 288 in 1988 amounting S\$2.11 million compared to 48 approvals for S\$0.4 million in the period 1981-85. The tremendous increase in the number of approvals for grants in the scheme shows the increase in the number of projects to develop the export market. However the number of projects approved for grants may not indicate the number of SMEs that had benefited from this scheme because a firm could be involved in more than one promotion activity. Nevertheless, the great increase had shown that SMEs are increasingly exposed to international markets which may indicate that SMEs had managed to produce high quality products that are of international standard.

**(g) Initiative in New Technologies Scheme (INTEC)**

This scheme had an objective in the development of a pool of highly trained professionals and scientists who will form the catalyst for building up knowledge and competence in new technologies in Singapore. INTEC grants were given to encourage companies to invest in the development of their manpower resources in areas of new technologies, industrial research and development, design and development of new products, processes or services. Only Singapore registered companies were eligible and

the person to be developed to work in the new technologies must be a Singapore citizen or permanent resident.

**(h) Skills Development Fund (SDF)**

The SDF was established in 1979 to provide financial assistance to employers for the training of their workers. There are many schemes under SDF which included the Core Skills for Effectiveness and Change scheme (COSEC), the Approved in Principle Scheme, Introducing Training Opportunities Scheme, and Training Needs Analysis Grant Scheme.

Under SDF, assistance is provided for firms to recruit experts and train supervisors to help workers gain a set of five core skills namely, communication, personal effectiveness, problem solving, work economics, and computer literacy. The COSEC scheme was aimed at training workers earning less than S\$800 a month. Under COSEC scheme, SDF provided nine-tenths of the development cost and trainer's salary, and half of the trainees' absentee payroll.

The above financial assistance through tax incentives, loans and grants given to SMEs amounted to S\$3322.47 million over 10,884 number of approvals in 1988 compared to only S\$81.45 million over 386 number of approvals in the period between 1976 and 1980. This seems to show that generally a large number of SMEs had benefited from the financial assistance provided by the Government. It also shows that the Government is very much concerned in promoting SMEs to be involved in higher technology, capital intensive activities producing high value products. Whether it was the financial assistance and incentives provided by the Government or the changing economy that had caused the reported SMEs growing awareness to mechanize their operations and upgrade to high technology, capital intensive activities and the manufacture of high value products is a complex problem.

## CHAPTER SIX

### CASE STUDIES

#### INTRODUCTION

The chapter will present case studies on five institutions in Malaysia which provide finance to SMEs. Firstly, the study is to investigate the financing facilities provided for SMEs by these institutions. Secondly, the study is to identify the financing problems of SMEs as perceived by these providers of finance.

The five institutions chosen were Bank Pertanian Malaysia (the Agricultural Bank of Malaysia), a development finance institution and a rural credit institution; Bank Pembangunan Malaysia (Development Bank of Malaysia), a development and an industrial finance institution; Bank Rakyat, a cooperative finance institution; MARA, a council trust of the Indigenous people of Malaysia; and the Ministry of Youth, Sports and Culture.

Resources for the development institutions in Malaysia arise not only from shareholders' fund but also from borrowing from domestic and international sources. However, the Federal and State Governments, the Central Bank and Government agencies remain as the main providers of credit to the development institutions. Deposits were also a source of funding for the Agricultural Bank and Bank Rakyat. Resources of Bank Pertanian amounted to M\$1396 million at end of 1990 and resources of Bank Rakyat amounted to M\$1771 million at end of 1990 (Bank Negara Malaysia, 1991).

#### RATIONALE FOR THE CASE STUDY

There are numerous studies done to investigate the financing problems of SMEs as perceived by the demand side of finance which is from the owner/manager of SMEs. For example, Yaacob (1981), Hashim (1983), Mohamed (1988) had made

investigations on this aspect of financing. However, there is little research done in Malaysia on the financing problems of SMEs as perceived by providers of finance particularly from government related agencies. It is for this reason that this study was initiated.

The choice of the above institutions in the case study was based on three major reasons. Firstly, these institutions represented different types of financing institutions. For example, Bank Pertanian Malaysia were to represent the institution that served the agricultural sector; Bank Pembangunan Malaysia were to represent the institution involved in enterprise development; Bank Rakyat were to represent the cooperative sector; the Ministry of Youth, Sports and Culture were to represent the Ministry involved with Youth development; and MARA were to represent the institution involved in Bumiputera development.

Secondly, not only do these chosen institutions substitute for the private banking system in terms of providing medium and long term capital financing, they also supply a range of complementary financial services not normally provided by commercial banks and finance companies. Among the services provided by these institutions were concessionaire lending under the set margin funds to priority sectors identified by the Government and also financing high risk projects which other financial institutions were reluctant to finance. Thirdly, all these institutions had a common characteristic where the major source of fund was from the Government and had the objective of financing SMEs.

### **OBJECTIVE OF STUDY**

The case study will investigate the role played by these institutions in filling up the financing gaps of SMEs and the facilities provided towards their objective of helping SMEs. The study will also identify the problems of SMEs as perceived by these chosen providers of finance. The following questions are hoped to be answered.

- (a) Is financing SMEs a priority objective of the organisation?
- (b) What are the major problems of SMEs as perceived by these providers of finance?
- (c) Does the structure of the organisation facilitate services in helping SMEs?

#### METHODS OF STUDY

Questionnaires and in depth interviews were the methods used in this study. Questionnaires were sent out to senior officers of the institutions chosen. To get extended informations from the Questionnaires, in depth interviews were also carried out. Beside the in depth and structured interviews and the administration of Questionnaires there was certain information which required further clarification and the respondents were later interviewed through telephone.

#### ANALYSIS

Although all the five institutions claimed to provide finance to SMEs and had a stated objective of helping SMEs, it appears that financing the SMEs was not a common priority objective to all these institutions. It seems only natural that the Agriculture Bank's top priority objective was to promote agricultural development and the main objective of the Ministry of Youth, Sports and Culture was stated as "*to provide all forms of guidance to youth to be economically progressive, socially cohesive and nationally dedicated*". The other main objectives included were the coordinating and supervising of credits from public funds. However, the Development Bank of Malaysia and MARA had specifically suggested that the objective of financing SMEs was one of their priority objectives.

Bank Rakyat on the other hand had listed making profit as one of its main objectives. Interestingly, it was the only organisation that stated profit making as one of its priority objective. Perhaps, being a cooperative organisation it had an obligation to pay dividends to its shareholders which therefore had a rational objective of maximising profit.

### OBJECTIVE IN HELPING SMEs

On the objective of helping SMEs, the Agricultural Bank stated that its objectives beside providing easy access to credit was to supplement other institutions in the development of SMEs. All the other institutions seems to be directly involved with the objective of promoting the development and growth of SMEs and to increase the participation of Bumiputera entrepreneurs, in line with the Government's Policy.

### PREFERENCES

Regarding preference in serving the SMEs, Table 6.1 reveals that all except Bank Rakyat had preference on sector, group and race. On sector preference, the Agricultural Bank had preference on the Agricultural/Agro based sector, the Development Bank had preference on the manufacturing sector, the Ministry of Youth, Sports and Culture had least preference on construction and retailing with no consideration given to trading, and MARA had preference on the commercial and industrial sector.

On Group preference, the Agricultural Bank had preference on the rural group, the Ministry of Youth, Sports and Culture had preference on youth club members between the ages of 18 and 35, while the Development Bank had no group preference. On race or ethnic preference, only MARA and the Development Bank had stated their preference on the Bumiputeras.

Table 6.1: Sector, Group And Ethnic Preferences Of Institutions Financing Small Firms

Institutions	Sector Preference	Group Preference	Race/ethnic Preference
Agricultural Bank	Yes	Yes	No
Development Bank	Yes	No	Yes
Bank Rakyat	No	No	No
Ministry of Youth and Sports	Yes	Yes	No
MARA	Yes	Yes	Yes

Therefore, it appears that a Bumiputera SME owner/manager aged between 18 and 35, a member of a youth club, engaging in manufacturing agricultural based products would be more likely to get financial help from these institutions. Consequently, what would be the chance of those non Bumiputera SMEs owner/manager aged beyond 35 and engaging in non manufacturing activity, getting financial help from these institutions? Perhaps, this may suggest that there is some form of sectoral financing gap. Beside having the five "Cs" which lending decisions were normally based on, character, capacity, capital, collateral and conditions, would contacts or connection of owner/manager with the "right" people have any effect to financing? Somehow, there always seems to be a gap in financing. In providing finance, these institutions help to narrow down the financing gap.

#### INFORMATION MEDIA

Regarding methods of informing SMEs regarding loans and schemes that were available, all institutions had used their branch networks and most organisation had made use of the mass media for promotion and advertisement. In addition, the Development Bank used business brochures, business advertisement in selected magazines and seminars as its media for spreading information. The number of SMEs owner/manager that had ready access to these business magazines and newsletters was

not known. Perhaps not many of the potential clients had ready access to these media of information because these magazines and newsletters were usually available to clients on request only. The list of participants in a seminar with reference to the International Conference on Small and Medium Scale Enterprises held in Langkawi, Malaysia in 1990, suggested that only a handful of SMEs owner/manager had participated in seminars or had access to seminar papers. Moreover, it would appear that the number may not be large as attending seminars may mean costs to the SMEs especially on time while being away from business.

It is interesting to note that the cooperative Bank had specified existing clients as its common channel to prospective borrowers. MARA had stated that politicians' speeches and campaigns were also its means of informing SMEs on its schemes and loans that were available. This gave the impression that MARA may be directly politically influenced. If so, what standing has the non politically involved SMEs owner/manager, or a known supporter of the political oppositions in getting MARA's help?

#### ORGANISATION STRUCTURE

Only MARA and the Ministry of Youth, Sports and Culture had stated that they had a SME division in their organisation for the processing of loan applications, and supervision of loan usage and repayment service. Additionally, the SME division is said to have its own key and auxiliary staff who were specially trained through formal courses, on the job training and also through experience.

Although the Agricultural Bank reported that it did not have a SME division in its organisation, it however, claimed to have a core of well trained staff to attend to SMEs. The Agricultural Bank did not even have a special section in its credit department for SMEs, with reason given that the proportion of SME portfolio to total loan was small.

The Development Bank, however, stated that all the departments in its organisation were expected to discharge the function of providing assistance to SMEs. Its credit department had a section that handled SME loans but there were no special or specific people assigned to the section.

Bank Rakyat admitted that it did not have even a special section in the credit department that handled SME loans. The reason given was that the distribution of job function in the credit department of the Cooperative Bank was defined by the purpose of the credit such as bridging loan, hire purchase, leasing, etc. and not by amount of loan. Helping the SMEs was said to be a part function of the credit department of the Bank and *"loan appraisal for SMEs are treated much similar to any other credit appraisal"*.

From the above, perhaps it is not wrong to deduce that most of the staff of these organisation were to assume that SMEs are mini big enterprises.

#### DECISIONS ABOUT LOAN

Bank Rakyat and the Ministry of Youth, Sports and Culture reported that they allowed their senior local staff to take decisions about loan. The maximum limit of loan allowed to be decided on was M\$5,000. at department level in the Ministry of Youth, Sports and Culture. In Bank Rakyat, a department head was allowed to decide on loans amounting to a maximum value of M\$50,000; the executive director was allowed to decide on loans amounting to a maximum value of M\$250,000; and for all loans that exceeded M\$250,000 the decision was by a management committee or a board.

All loans given out by the Development Bank were said to be decided by committees set up for such purposes. These committees were reported to meet every week. There are three main committees:

- (a) management credit committee to decide on loans of M\$30,000 to M\$99,000.
- (b) credit committee to decide on loans of M\$100,000 to M\$1,000,000.
- (c) loan and investment committee to decide on a loan of more than M\$1 million.

All MARA loans were reported to be decided by committees. (a) The State Loan Committee chaired by the state MARA Director, may decide on loans amounting to M\$50,000 each; (b) the Loan Committee chaired by the Loan Division Director, may decide on loans of up to M\$250,000; and (c) the High Committee chaired by the Director General may decide on loans of up to M\$1 million.

#### BRANCH NETWORK

Perhaps the number of branches that an institution has may indicate the extent of network coverage offered to SMEs. The Development Bank reported having 12 branches; the Ministry of Youth, Sports and Culture said that it had branches in every state therefore totalling 14 state branches in all; Bank Rakyat had 34 branches; the Agricultural Bank had 60 branches and MARA claimed to have branches in every states and districts totalling 84 branches in all. At state branches, MARA and the Ministry of Youth, Sports and Culture claimed to have a special section for SMEs with specially trained staff to attend to SMEs clients.

#### PERCEIVED PROBLEMS OF SMEs

All five providers of finance had perceived management related problems faced by SMEs such as, lack of managerial skill, lack of management experience, lack of alternative solutions when faced with difficulties, lack of exposure to innovative technique of production, low level of technologies adopted, and lack of marketing strategy. Lack of self confidence was also perceived as a problem faced by SMEs by two of these providers of finance.

Four out of the five providers of finance perceived that SMEs in Malaysia were faced with finance related problems such as undercapitalisation, shortage of working capital, do not have credible/positive track record and highly geared. The problem of having difficulty in gaining access to financing from financial institutions due to inadequate securities or collaterals for taking up loans was also highlighted. Problems

in the lack of working space within affordable rent and the lack of strategic places for SMEs were perceived by two of these providers of finance.

In ranking the severity of these problems (5 for most severe) they are presented in Table 6.2:

**Table 6.2: Ranking Of The Severity Of Problem**

Problems	Agric. Bank	Develop. Bank	Bank Rakyat	Ministry of Youth	MARA
Finance	5	5	5	3	3
Management	3	4	4	4	5
Marketing	4	2	3	1	4
Production	2	3	2	2	2
Staff	1	1	1	1	1
Others	Yes	-	-	Yes	Yes

**Key:**

Agric. Bank = Agricultural Bank

Develop. Bank = Development Bank

Most Severe = 5

Least Severe = 1

Table 6.2 suggests that financial problems may be considered to be the most severe problem followed by management, marketing and production. Other problems listed included getting strategic premises for the operation of SMEs and the lack of working space within the affordable rate. Highly politicised interference was also listed as a problem by an institution which resulted in bad loans or non performing loans of SME.

## SUGGESTIONS TO OVERCOME FINANCIAL PROBLEM

Among the suggestions given were:

- a) Government to create special funds for providing cheap, soft loans to SMEs.
- b) Easy access to soft loans towards proven SMEs.
- c) Financial intermediaries that provide soft loans to SMEs to have longer repayment periods.
- d) Government to devise special incentives such as giving a total waiver of interest payment to successful SMEs within a stipulated time.
- e) SMEs to limit their borrowing to working capital requirements only.
- f) SMEs to have a proper and good cash flow management
- g) SMEs to expand their venture gradually.
- h) Some form of Government's participation and interference in the overall marketing channels.
- i) Some form of entrepreneurs development programmes.
- j) Joint venture programmes with Government or private agencies.
- k) cooperative programmes.

## DIFFERENCES REGARDING PROBLEMS ACROSS ETHNIC GROUP

All the providers of finance with the exception of the representative from the Ministry of Youth, Sports and Culture agreed that there are differences regarding problems faced by SMEs across ethnic groups particularly between the Bumiputeras and the Chinese. The differences stated were mainly related to management problem, the limited experience and limited exposure of Bumiputera entrepreneurs in comparison with other races particularly the Chinese. Bumiputeras were generally rated as newcomers in business and it is interesting to note that most Bumiputeras were said to be wanting "*quick*" success and tended to be heavy spenders whereas most Chinese were reported to look to long term success and tended to be cautious savers.

Other problems stated were the marketing problems of Bumiputera entrepreneurs having limited market and having problems of penetrating or creating new market whereas the Chinese were said to have a very well established marketing network and were supportive of one another. Unlike the Bumiputeras, the Chinese were also said to have strong business supportive groups, associations and Chamber of Commerce.

The Agricultural Bank further noted the differences of problems across the region of the country where certain businesses were linked to the state of origin. For example, batik industry and silvercraft industry were linked to the East Coast States of Peninsular Malaysia.

Perhaps through entrepreneur management training and education, the desired entrepreneurial culture could be created and development in entrepreneurial activity could be achieved.

#### HANDLING SMEs LOANS

MARA is the only organisation that claimed to handle only SMEs and said it had special people who had been trained in various fields and had staff that perceive problems of SMEs to be different from those problems faced by large enterprises.

The Ministry of Youth, Sports and Culture also claimed to have special people who were specially trained to handle SME loans but the staff are said to perceive that problems faced by SMEs are no different from those faced by large businesses. If that is the case, it would appear that perhaps its organisation would not need specially trained staff to attend to SMEs or it may be a question of their training emphasis.

On the other hand, even though the Agricultural Bank and the Development Bank did not have special staff to attend to SME loans, the staff were said to perceive that problems faced by SMEs were different from those problems faced by large businesses.

Among the common problems faced by SMEs were said to be the lack of capital; inability of SMEs to furnish adequate securities or collaterals for loans; lack of credible/positive track record; and difficulty in gaining access to financing from financial institutions.

#### CRITERIA IN ASSESSING SME LOANS

MARA reported it processed loans only for SMEs. Among other providers of finance, only the Agricultural Bank reported to process SME loans differently from large business loans. The differences reported were that for SMEs, simple applications forms were used, security could be exempted for potentially profitable SMEs with proven good track records, and the processing of the loans were accelerated.

For other institutions, it is reported that the process of assessing SME loans were no different from the process of assessing large businesses loans. The criteria that were normally used in assessing loans were:

- (a) project viability and profitability where the proposed business would have a positive net present value
- (b) The loan could be repaid without affecting the business
- (c) Committed management, which could be shown by the capital commitment already made by the owner
- (d) On past loans for similar business project, the SMEs did not have dismal records

Only Bank Rakyat specified security as a criteria for assessing loans. The Ministry of Youth, Sports and Culture however, reported that a good guarantor would be adequate as a collateral for the provision of loans.

## HELP OFFERED TO LOAN APPLICANTS

Advisory services were said to be rendered by loan officers in the respective institutions. With reference to Table 6.3, regarding help in filling up the application forms, the Ministry of Youth, Sports and Culture (MYSC) and MARA reported to give help in completing the application forms. Bank Rakyat only gave assistance where necessary and the Development Bank would give assistance only when approached to assist in doing so. The Agricultural Bank reported that officially loan applicants were not helped in completing their application forms.

On the preparation of cash flow projections, only MYSC and MARA claimed to provide such assistance. MYSC claimed it also helped in the writing of the initial proposal project paper for certain cases. Bank Rakyat however, would give advice on important aspects of the inflows and outflows for the preparation of cash flow projection for its clients.

**Table 6.3 Some Of The Services Offered To Applicants**

Services	Agric. Bank	Develop. Bank	Bank Rakyat	Ministry of Youth	MARA
Filling Up Application Forms	No***	Yes*	Yes**	Yes	Yes
Cash Flow Projections	No***	No	Advise	Yes	Yes

Key:

No\*\*\* = Officially No

Yes\* = Only When Approached

Yes\*\* = Assistance Offered

The above may suggest that help and assistance were not readily offered to SMEs loanees but rather the loanees have to reach out for help and request for assistance. Perhaps it needed to be officially included as a duty or working ethic to offer all the necessary assistance and help to clients particularly to SMEs who are most likely to be inexperienced in loan application.

Table 6.4a: Proportion Of Number Of Loans Offered

Purpose Of Loan	Agric. Bank	Develop. Bank	Bank Rakyat	Ministry of Youth	MARA
Working Capital	40%	25%	85%	-	50%
Start-up Capital	30%	50%	5%	100%	20%
Expansion	30%	25%	10%	-	30%
Total	100%	100%	100%	100%	100%

Table 6.4b: Average Amount Of Loan Applied (in M\$'000)

Purpose Of Loan	Agric. Bank	Develop. Bank	Bank Rakyat	Ministry of Youth	MARA
Working Capital	10-15	*	30-300	-	50
Start-up Capital	20-25	*	30-50	30	150
Expansion	30-50	*	100-1000	-	100

Key:

\* means Not specified due to "absence of proper data"

Table 6.4c: Proportion Of Loans To Bumiputeras

Agric. Bank	Develop. Bank	Bank Rakyat	Ministry of Youth	MARA
Total	80%	80%	70%-80%	Majority 100%

Regarding the number of loans that were extended to Bumiputeras, only Development Bank specified that it had provided approximately 250 loans to SMEs in a year. Other institutions gave the percentage proportion.

## REPAYMENT PERIOD AND INTEREST CHARGED

The repayment period and interest rates charged on loans from the Agricultural Bank are shown in Table 6.5 below:

Table 6.5: Types And Purposes Of Agricultural Bank Loan

Purpose Of Loan	Types Of Loan	Repayment Period	Interest Per Annum
Working Capital	Soft	Less than 5 years	4%
	Commercial	Less than 5 years	10%
Start-up Capital	AJDF	10 years	6.5%
	Commercial	10 years	10%
Expansion	AJDF	10 years	6.5%
	Commercial	10 years	10%

Key:  
AJDF = Asean Japanese Development Fund

Development Bank loans were said to have the repayment period and the interest charged vary according to types of loans given out. The average repayment period was 5 years and the average interest charged was 7.5% per annum.

In the Bank Negara Report 1990, it was reported that the lending rates of the Development Bank ranged from 5.5% to 10.5% per annum but in 1989, its lending rate policy was changed to a two tier structure whereby the rates of loan not exceeding M\$250,000 were to be charged between 3 to 12 per cent per annum; while for larger amount of loan, the interest rate chargeable would range from 4.25 to 12 per cent per annum.

All Bank Rakyat loans repayment period for SMEs were reported to be between 3 years to 5 years and the interest charged varied from 9 per cent to 11 per cent per annum.

The Ministry of Youth, Sports and Culture only gave out loans for start-up capital. The repayment period were said to be between 6 months to 6 years and there was no interest charged. However, a service charge of 2 per cent was applied to these loans.

All MARA loans repayment period were reported to be between 3 years to 7 years and the interest charged for each loan was 7 per cent per annum.

Different institutions had different rates and had different repayment periods. For example, the interest rate for a start up capital loan could be as low as only 2 per cent in one institution and could be as high as 11 per cent in another institution. Even under the same institution, for the same type of loan, different interest rate and different repayment period could be offered depending on which scheme the loan came under. For example that had been shown by the Agricultural Bank where loans for start up capital under AJDF would be charged at an interest rate of 6.5 per cent per annum, much lower than the interest charged on its commercial loan of 10 per cent per annum. This implied that SMEs loanees who had information regarding all loans available to them would likely to be in a better position to seek the financing that best meets their needs and advantage. Perhaps the special schemes for SME financing should be available in all financial institutions to give SMEs better accessibility to such financing or perhaps the special schemes should be offered by one institution that can reach out to most SMEs. This way perhaps information gathering regarding what loan is available would be less difficult for SMEs and perhaps SMEs would get better opportunity in seeking for the loan which matches their needs best.

## SENSITIVITY TO THE EFFECT OF INTEREST RATES

When asked whether SMEs are sensitive to the effect of interest rates, the answer given as in Table 6.6.

**Table 6.6: SMEs' Sensitivity To Interest Rate As Perceived By The Institution**

Institutions	Yes/No
Agricultural Bank	No
Development Bank	Yes
Bank Rakyat	Yes
Ministry of Youth/Sports	No
MARA	Yes

## FOLLOW UP SERVICES

All providers of finance claimed to have follow up services on their loanees.

**Table 6.7: Follow Up Services - Time And Frequency**

	Agric. Bank	Develop. Bank	Bank Rakyat	Ministry of Youth	MARA
WHEN?	Pre-Comm & After Each	After Disb.	During & After Disb.	After Disb.	Pre & Post Disb.
HOW OFTEN?	Varies on project and operator	At least once	Monthly or quarter- ly where applicable	Monthly	Month- ly

Key:

Pre-Comm = Pre-Commission

Disb. = Disbursement

The providers of finance perceived that the follow up services were generally useful to SMEs. However, beside perceiving that the follow up services were useful for some SMEs, the Agricultural Bank also perceived that the follow up services might not

be useful to some SMEs as the follow up visits were considered to be interfering in the affairs of SMEs businesses.

**Table 6.8a: Proportion Of Borrowers Having Difficulty In Servicing Their Loan**

Purpose Of Loan	Agric. Bank	Develop. Bank	Bank Rakyat	Ministry of Youth	MARA
Working Capital	25%	30%	5%	-	30%
Start-up Capital	10%	30%	15%	25%	60%
Expansion	5%	30%	5%	-	30%

**Table 6.8b: Proportion Of Value Of Loan Never Repaid**

Purpose Of Loan	Agric. Bank	Develop. Bank	Bank Rakyat	Ministry of Youth	MARA
Working Capital	30%	30%	5%	-	10%
Start-up Capital	5%	30%	15%	20%	40%
Expansion	5%	30%	5%	-	10%

Comparatively, loans for start up capital seem to have greater difficulty in getting repaid and also seem to have greater failure in repayment. This may support the incidence of high failure rates among SMEs. Perhaps if loan repayment period is longer and if repayment is to start only after SMEs had made profits, it would ease the financial constraint affecting the survival and growth of SMEs. Additionally, perhaps if SMEs have access to joint-venture programmes the financial management of the venture could be better managed for its survival and growth.

In summary, it can be said that although it appears that these providers of finance have the objective of financing SMEs, their organisation structure and staff did not appear to be ready in full gear for its mission. Some institutions had no special

section in the organisation, in the branches and even in the credit department to attend to SMEs. Additionally, some institutions had no special/specific people or specially trained staff to attend to SMEs. Additionally, even though some staff may perceive problems faced by SMEs are different from those of large enterprises, they seem to treat the SMEs as mini large enterprises.

## CHAPTER SEVEN

### CONCLUSIONS

The promotion of SMEs in Malaysia, Indonesia and Singapore is in due recognition of their potential role in achieving each country's development objectives. In view of this, Malaysia's promotion of SMEs is one of the major strategies to reduce and eventually eradicate poverty, and to restructure society so as to eliminate the identification of race with economic activity. The restructuring of society involves the creation of a Bumiputera commercial and industrial community by increasing the number of Bumiputera entrepreneurs and also by encouraging Bumiputera active participation in business venture. Indonesia aims to narrow down income disparities. A large number of viable SMEs is seen to lead to a better distribution of income than a small number of the larger enterprises. Singapore's development objective is to restructure its economy into one manufacturing high value products, using high technology and capital intensive activities in the attempt to be a viable exporter of manufactured goods to world markets. The restructuring involves the phasing out of low value, labour intensive manufacturing activities and the upgrading of technology and skills. As most of the local enterprises in Singapore are of small and medium size, the promotion of SMEs seems to be only natural.

Since finance is known to be a major if not the only constraint faced by SMEs, the promotion of SMEs involves the government of each country establishing policies and programmes to ease the constraint. In Malaysia and Indonesia, national development plans have led to the passage of specific laws and regulations favourable to SMEs. Singapore however, stresses the need to create an overall economic climate conducive to enterprise, and believes that the market can provide many services for SMEs more effectively than the Government. The financial constraint faced by SMEs could be due to external factors such as distorted incentives, rationing of resources, and

excessive government regulation, a weak support system and economic uncertainty all of which are beyond the control of the owner/managers; or it could be due to internal factors which are controllable by the management of SMEs. These internal factors are mainly due to lack of management skills in credit management.

Policies for the financing of small firms are classified into those which improve the business environment or those which create or develop small firms directly. Singapore after much trial and error decided to pursue a policy that creates a supportive economic climate and appears to be successful in enhancing competition and growth. Singapore has a good support systems for enterprise development ranging from infrastructure to the financial system. Being a major international financial centre and having a broad network of banking offices in addition to its efficient communication system had contributed to the efficiency in its mobilisation and allocation of financial resources. Price distortion in Singapore is minimal and the government does not intervene in commercial banks' credit policy. To improve small firms' accessibility to capital, the financing of small firms in Singapore mainly takes the form of grants. Singapore has more competition and growth of enterprise than Malaysia and Indonesia. However there is little evidence to suggest SMEs success in achieving the nation's development objective. Whether it was the incentive programmes for SMEs or the general economic development that had caused the upgrading of technology, capital intensive activities and manufacturing high value products for exports, is difficult to deduce. To analyse the success of the programme, one needs to know the number of capital intensive and export oriented small firms created as a result of the incentive programmes. However, the numbers of firms granted incentives indicate an increasing trend and that a large number of firms have participated in the programmes. Since incentives for SMEs in Singapore are mainly in the form of grants, the financial constraints faced by them would be different from those faced by SMEs in Malaysia in the sense that with grants firms in Singapore would not have to face the problem of loan repayments. In Malaysia, incentives for small firms are mainly in the form of

loans which even with concessionary interest rates need to be repaid. In addition, although the number of small firms granted the incentives had increased tremendously over the years, it is difficult to determine whether these incentives really lead to high technology and capital intensive activities and exports; or whether the capital intensive activities involved in producing high value products for export are due to economic development itself. There is little evidence to suggest the success of the incentives in achieving Singapore's development objective.

Malaysia and Indonesia had the additional complication that, for historical reasons, both poverty and lack of entrepreneurship were concentrated in the indigenous people. These two countries responded to this by policies which appear complicating and which were long and incomprehensible except to civil servants. Even then, the civil servants involved on the subject tend to lose track because the list at any one time was so long and complex. In addition, when policies appeared not to work, they were frequently changed. If the complications of the package were the cause of the ineffectiveness of the programme, the frequent changes made this worse. Some changes which at the time seemed necessary to achieve a more effective and direct impact brought about some unnecessary and unintended consequences such as the Ali Baba effect. Nevertheless, the range of financial facilities and incentives provided and the number of organisations involved in administering them implies that the Government was highly favourable towards encouraging entrepreneurship and investment by SMEs particularly those of the Bumiputeras. Whether the incentives and organisations have really caused more entrepreneurship and investment is a difficult question to assess because the research would have to compare the effects on entrepreneurship and investment with and without the incentives. However, some of the specific incentives such as the guide-lines on the direction of loans to SSEs are shown to be very effective; others slightly effective; only a few had unintended effects such as the Ali Baba.

Government regulations often indicate whether the business environment is conducive or restricting small firms. A financial burden could arise from government

regulations on licensing, tax, and contributions towards funds for employees' welfare. Often tax policy is complicated. Though government may provide some tax incentives, these may be too complicated for small firm owner/managers to understand; the list of incentives made available is often long and may not even be accessible to small firms. As such, small firms may not know how to take advantage of the incentives. To get advice on matters regarding tax, small firms need to consult tax consultants which can be very expensive. Regulations that affect profits, business viability and the ability to service loans are burdensome to firms particularly small firms.

Indonesia's financial system and structure is not fully developed to provide an efficient mobilisation and allocation of financial resources. Many of the large private banks are owned by the Chinese (which totalled only about four per cent of the nation's population) who also owned most of Indonesia's largest conglomerates and accounted for two thirds of the private economic activity in the country. The deregulation of the financial system has not helped to improve small firms' accessibility to institutional finance because many small firms in Indonesia could not raise sufficient collateral. In addition, most financial institutions are located in urban areas which are not within easy reach of small firms, thus contributing to high transaction costs. Additionally, the process of loan application was also reported to be complex and bureaucratic. These problems have contributed to small firms preferring to seek external finance from the informal sector. The significant role of the informal sector especially the moneylenders in providing finance to small firms in Indonesia indicates that institutional finance is still a major constraint faced by small firms in that country.

Malaysia's financial system and structure is mature with a wide range of intermediaries and instruments to meet the financial needs of investors. Its banking offices are widely spread around the country, even to the rural areas where most small firms and Bumiputeras are found. Even though banking institutions including the bank branches have an objective to help small firms, some of the banking organisations' structure is not fully ready to handle small firm financing. All banking institutions

under study claimed that their staff are trained to attend to SMEs. However, there are no specific people assigned to attend to SMEs. Some organisations do not even have a section in their organisation specially for SMEs. Loan appraisal for SMEs were treated much similar to any other credit appraisal. This indicates that the banking staff are treating small firms only as mini large firms. Banking staff were also found to render their help only when it was requested. In normal circumstances, no help is given in filling up forms. Advice is rarely given to help in the preparation of cash flow projections. This suggest that there is an advice gap where help and assistance were not readily offered to SMEs. Regarding methods of informing SMEs regarding loans and schemes that were available, there seems to be a lack of coverage. This indicates the presence of an information gap. However, on the whole, Malaysia has shown a considerable degree of success in improving the accessibility of small firms to capital through the lending guide-lines (which were intended to improve small firms and Bumiputera accessibility to institutional finance) made mandatory to commercial banks and finance companies. Although commercial banks and finance companies were required to provide a minimum percentage of loan outstanding to small firms and the Bumiputera community, interest rates on commercial loans to these groups were at market rates.

To further improve the access of small scale enterprises (SSEs) to bank loans, a credit guarantee scheme was introduced to provide a guarantee cover to commercial bank loans extended to SSEs. Under the lending guide-lines, commercial banks were also required to provide a certain percentage of loans under the credit guarantee scheme to SSEs. However commercial banks do not seem to be very enthusiastic in participating in this scheme as claims made were often turned down.

Other loans with concessionary rates were provided by the Government through specific schemes or programmes administered by government and non government agencies. Some banks were selected to participate and to administer these loans. From this study, it was found that one of the complexities of the present setting is that a

number of institutions are offering different interest rates for loans to SMEs. For example, the interest rate for a start up capital loan could be as low as only 2 per cent in one institution, and could be as high as 11 per cent in another institution. Additionally, for the same type of loan, an institution could be charging different rates depending on which scheme the loan came under. For example, the Agricultural Bank of Malaysia had shown that loans for start up capital under the AJDF would be charged at an interest rate of 6.5 per cent per annum, much lower than the interest rate charged on its commercial loan of 10 per cent per annum. This implied that small firm owner/managers who had information regarding all loans available to them under the different schemes would likely to be in a better position to seek the financing that best meet their needs and advantage. However, accessibility of SMEs to this information is found to be limited.

On the whole total loan given out by commercial banks to SSEs have increased beyond the required minimum amount. The Government has found guide-lines on loan direction to SSEs are no longer necessary after March 31, 1991. Perhaps the experience in lending to SSEs has reduced the perceived risk. However, lending guide-lines on the direction of loans to Bumiputera community still applies. This could indicate that the activity of providing loans to Bumiputeras is still perceived to be a very risky affair. As long as such loans are perceived to be high risk, their availability is likely to be low. There are organisations that are involved in programmes that promote only Bumiputera activities to achieve the objective of creating the viable commercial and industrial community. MARA is an example of such organisations. However, results seems to show that many MARA loans were of small amounts, many were provided without collaterals and there were high loan failure rates. The defaults could arise from poor appraisal of loan applications and lack of monitoring by the officers involved; or they could be due to borrowers' lack of management skills. Management skills are related to training and experience. This therefore implies that staffs involved in administering

SSEs finance, and also Bumiputera firms' owner/manager who seek finance need more training to improve performance.

In the government's effort to further improve the accessibility to institutional credit and to improve on the monitoring of small loans to small firms, it had introduced a credit programme through groups or associations. In this programme, the association or group is responsible for the collection of loan repayments from borrowers. The effectiveness of this programme is not yet known as it is still at the early stage of implementation.

Entrepreneurship development is a long process and the creation of Bumiputera commercial and industrial community and the increase in the number of Bumiputera entrepreneurs cannot be made overnight. It needs internal drive and motivation for development towards self employment in small firms as a long term career. Providing finance is only one of the elements that help to facilitate the creation of small firms. It is however, not a sufficient element for entrepreneurship. Any government effort to create more small firms has to stress not only financing but also the development of motivation and career towards self employment in small firms as a long term process. There are many factors that influence the desirability of being self employed and working in small firms.

## RECOMMENDATIONS

Recommendations are put forward based on the findings on this study.

(a) Under the present arrangement, there seems to be no single ministry or organisation that can claim to be totally responsible for all the development programmes for SMEs. To improve the coordination of programmes, to simplify the process of information gathering regarding all programmes and incentives that are available and to supervise the implementation of programmes so as to improve the effective results, one ministry or one organisation could be made fully responsible for all programmes in the promotion of SMEs. This will not only simplify the planning of

all programmes regarding SMEs but also the implementation and review of all these programmes. SMEs will have less problems in seeking information and advice regarding all the current incentives that are available to them as they would only need to go to this one organisation. Time and cost in gathering any information related to SMEs would likely be reduced.

(b) External finance is an important source of finance for small firms. As such, not only financial institutions or their branches or even their mobile banks should be within easy reach of small firms, the banking officers involved in the administering of loans should be able to understand the difference in problems faced by small and large firms. Application of bank loan procedures should be simple. For small loan appraisals bank officers need further special training and refresher courses to better understand the different current problems and constraints faced by small firms. In addition, these bank officers should be a source of advice regarding credit management of small firms. Monitoring of loans could be improved as bankers, when giving advice, would also be able to assess the performance and financial standing of the particular firm.

(c) Role models of successful entrepreneurs in society can influence potential entrepreneurs to venture into self employment and at the same time inspire those already in business to do better. As a motivation drive, successful and innovative small firms should be given national recognition.

The mass media can stimulate potential entrepreneurs by providing a perception of desirability towards self employment as a long term career, and the positive role the entrepreneurs play in society.

The education system can play a role in influencing students' career to self employment in small firms, through career guidance and offering subjects in entrepreneurship and small firms management.

(d) In the effort to facilitate the creation of entrepreneurship, financial incentives and facilities are necessary but not sufficient. Financial incentives should be part of an incentive package which includes training in management skills especially in

credit management, production and marketing; and the training is done on the job to identify and solve real problems. However, entrepreneurs appear to require different types of training programmes at different stages of their enterprise development.

At a pre-start stage, individuals who that believe they have the potential to become entrepreneurs need information regarding self employment as a career option. Skills and attitudes regarding entrepreneurship should be developed at this stage. Promotional institutions need to identify potential entrepreneurs to provide them with the entrepreneurship education and training programmes.

At start-up stage, entrepreneurs would have made a total commitment to becoming self employed and beginning preparing business plans of their proposed enterprises. At this stage, information regarding credit sources and on technology options should be made available as these information can be extremely valuable. Promotional institutions need to provide training programmes on managerial and technical skills beside financial assistance.

At the maintenance stage, the entrepreneurs need information on markets, competitive growth strategies and a knowledge of the enterprise's strength and weakness. Upgrading of skills is needed at this stage. Promotional institutions need to identify small firms training needs and to provide them short courses. Support services such as financial advice, management assistance should be included.

At growth and maturity stage, entrepreneurs would seek new markets. Incentives for sub-contracting and export promotion could help to expand their enterprises.

(e) There should be provision of a good support system including venture capital, technological and marketing supports for small enterprises to encourage competitiveness.

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## APPENDIX I

AGENCIES INVOLVED IN SMALL BUSINESS DEVELOPMENT IN  
MALAYSIA AND THEIR FUNCTIONS

	Function												
	Strategies and Policies	Incentives	Basic Infrastructure	Marketing	Financial and Credit facilities	Data base and Information	Consultancy & Advisory Services	Training and Apprenticeship	Business Premises	Subsidies	Identification of New Projects and Research	Enforcement and Control	Evaluation
Prime Minister's Department 1. Economic Planning Unit 2. Implementation Coordination Unit Ministry of Trade and Industry 1. Small Industry Division 2. Malaysian Industrial Development Authority (MIDA) 3. National Productivity Centre 4. The Standards and Industrial Research Institute of Malaysia 5. Technology Centre, Kuala Lumpur Ministry of Finance 1. Bank Negara 2. Department of Inland Revenue 3. Credit Guarantee Corporation Ministry of Public Enterprises 1. State Economic Development Corporation 2. Urban Development Authority 3. Development Bank of Malaysia 4. Persekutuan 5. Food Industry Malaysia Authority 6. Malaysian Industrial Development Finance Ministry of National and Rural Development 1. Division of Small Industry 2. MARA 3. Cooperative Department 4. Handicraft Corporation of Malaysia 5. Karyanaka 6. Bumiputera Entrepreneurial Institute Ministry of Land and Regional Development 1. Federal Land Development Authority 2. Rubber Industry Smallholders Development Authority 3. Regional Development Authority 4. Federal Land Consolidation Rehabilitation Authority Ministry of Education Ministry of Labour Ministry of Youth, Culture and Sports Ministry of Science and Environment Ministry of Public Works and Utilities - Bumiputera Participation Unit Ministry of Federal Territory Ministry of Agriculture 1. Malaysian Agricultural Research and Development Authority 2. Federal Agricultural Marketing Authority Commercial Banks Medium and Small Enterprise Association of Malaysia Small Business Development Centre, Agricultural University of Malaysia	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓

(Source: Chee, 1986 p. 144)

APPENDIX II

# Criteria for Awarding Investment Tax Allowance (ITA)

## Manufacturing Sector

Criteria	Details	%ITA	Minimum %ITA
(a) Export	50% < 80% 80% - 100%	15% 30%	30%
(b) Value Added* (c) Local Content*	Minimum 25% Minimum 50%	20% 20%	20% 20%
(c) Employment	Employ at least 100 full time paid Malaysian workers	25%	25%
(d) Location	Location in promoted industrial areas as gazetted under section 32(4) of the Promotion of Investments Act, 1986	5%	5%
			100%

\* Definition of

Value added: Defined as gross sales less raw material costs.

Local content: Defined as cost of Malaysian raw materials and/or parts and components manufactured in Malaysia, excluding wages, salaries, water, electricity and other domestic inputs, as a percentage of total cost of raw materials and/or parts and components

## Agricultural Projects

Criteria	Details	Minimum %ITA
1 (a) Primary Activities and (b) (i) Export, or (ii) Import Substitution	Activities/products which are promoted under the National Agricultural Policy and which are gazetted under the Promotion of Investments Act, 1986 Export 50% or more by value of its promoted agricultural products Products currently imported in large quantities	50% 50% 50%
2 Integration	Integrated agricultural projects, involving both cultivation and manufacturing	100%

## Tourism Sector

Criteria	Hotel Area % ITA				Tourism Projects Area % ITA			
	A	B	C	D	A	B	C	D
(a) Location	25	35	55	65	35	45	65	75
(b) Fixed assets of at least \$50 million (excluding land)	10	10	10	10	10	10	10	10
(c) Employment of at least 300 full time Malaysian workers	10	10	10	10	10	10	10	10
(d) Projects having international linkages	5	5	5	5	5	5	5	5
Area A	50	60	80	90	60	70	90	100

Area A: Covering the following areas except Area D: Federal Territory of Kuala Lumpur and the State of Penang

Area B: Covering the following areas except Area D: The States of Selangor, Perak, Negeri Sembilan, Melaka and Johor

Area C: Covering the following areas except Area D: The States of Pahang, Terengganu, Kedah, Kelantan, Perlis, Sabah, Sarawak and the Federal Territory of Labuan

Area D: Covering islands, hill resorts and such other areas as may be determined from time to time

## APPENDIX III

## List of Promoted Products and Activities

### Agricultural Production

- ( 1 ) Cultivation of cocoa, coffee or tea
- ( 2 ) Cultivation of fruits
- ( 3 ) Cultivation of vegetables, tubers or roots
- ( 4 ) Cultivation of cereals
- ( 5 ) Cultivation of herbs or spices
- ( 6 ) Cultivation of essential oil crops
- ( 7 ) Production of planting materials
- ( 8 ) Cultivation of medicinal plants
- ( 9 ) Cultivation of fodder crops or animal feed ingredients
- (10) Cultivation of tobacco
- (11) Floriculture
- (12) Sericulture
- (13) Apiculture
- (14) Livestock farming
- (15) Spawning, breeding or culturing of aquatic products
- (16) Off-shore fishing
- (17) Any other agricultural activity, except planting of rubber, oil palm and coconut

### Integrated Agriculture

- ( 1 ) Cultivation and processing of cocoa, coffee or tea
- ( 2 ) Cultivation and processing of fruits
- ( 3 ) Cultivation and processing of vegetables, tubers or roots
- ( 4 ) Cultivation and processing of cereals
- ( 5 ) Cultivation and processing of herbs or spices
- ( 6 ) Cultivation and processing of essential oil crops
- ( 7 ) Cultivation and processing of medicinal plants
- ( 8 ) Cultivation and processing of fodder crops or animal feed ingredients
- ( 9 ) Cultivation of tobacco and curing of tobacco

The list of promoted activities and promoted products is gazetted under Gazette Multikultural No. P.U. (A) 31, dated 11 November, 1986.

- (10) Floriculture and packaging or processing of its produce
- (11) Sericulture and processing of its produce
- (12) Apiculture and processing of its produce
- (13) Breeding and rearing of livestock and processing of live stock and livestock products
- (14) Spawning, breeding or culturing and processing of aquatic products
- (15) Off-shore fishing and processing of its produce

### Agricultural Processing

- ( 1 ) Cocoa and cocoa products
- ( 2 ) Coffee
- ( 3 ) Tea
- ( 4 ) High fructose syrup
- ( 5 ) Coconut products except copra and crude coconut oil
- ( 6 ) Fruits
- ( 7 ) Vegetables
- ( 8 ) Cereal products
- ( 9 ) Starch and proteins
- (10) Herbs or spices
- (11) Essential oils
- (12) Fodder or other animal feed ingredients
- (13) Tobacco
- (14) Flowers or ornamental foliage
- (15) Honey
- (16) Meal
- (17) Livestock products
- (18) Aquatic products, including seaweed
- (19) Agricultural waste and by-products
- (20) Sugar
- (21) Aquaculture feed

### Forestry and Forestry Products

- ( 1 ) Reforestation
- ( 2 ) Forestry products
- ( 3 ) Rattan processing
- ( 4 ) Basketware and other rattan products
- ( 5 ) Bamboo products

(Source: Malaysia, 1991 pp 60-75)

### Manufacture of Rubber Products

- ( 1 ) Tyres, all types
- ( 2 ) Retreading of aircraft tyres
- ( 3 ) Tubes
- ( 4 ) Pre-cured retreads
- ( 5 ) Moulded rubber products
- ( 6 ) Latex dipped products
- ( 7 ) Extruded rubber products
- ( 8 ) General rubber goods
- ( 9 ) Foam rubber products
- ( 10 ) Rubberised fabrics
- ( 11 ) Inflatable rubber products
- ( 12 ) Conveyor belts, transmission belts, V-type belts and other rubber belting
- ( 13 ) Engineering components of rubber (e.g. building mounts, anti-vibrations mounts)
- ( 14 ) Reclaimed rubber
- ( 15 ) Rubber based (elastomeric) speciality coating
- ( 16 ) Epoxidized natural rubber

### Manufacture of Palm and Palm Kernel Oil Products and their Derivatives

- ( 1 ) Fatty acids and their derivatives, fatty esters and their derivatives inclusive of metallic esters, fatty alcohols and their derivatives, fatty amines and their derivatives and glycerine (crude and refined)
- ( 2 ) Cocoa butter replacers (such as cocoa butter substitutes, cocoa butter alternatives, cocoa butter modifiers, cocoa butter equivalents); palm oil mid fraction, special olein II and special olein III
- ( 3 ) Margarina, vanaspati, shortening and other manufactured fat products
- ( 4 ) Crude palm kernel olein and stearin, neutralised or refined and bleached palm kernel olein and stearin and neutralised or refined, bleached and deodorised palm kernel olein and stearin
- ( 5 ) Hydrogenated and/or interesterified oils and oils blends, all types.
- ( 6 ) Neutralised palm kernel oil
- ( 7 ) Refined, bleached and deodorised palm kernel oil

### Manufacture of Chemicals and Pharmaceuticals

- ( 1 ) Chemical derivatives obtained from methyl and ethyl alcohol
- ( 2 ) Plant and vegetable extracts for pharmaceutical, perfume, cosmetics and food flavouring industries
- ( 3 ) Antibiotics
- ( 4 ) Basic manufacture of pharmaceuticals
- ( 5 ) Basic manufacture of fertilisers
- ( 6 ) Basic manufacture of pesticides
- ( 7 ) Chemical derivatives from petroleum, natural gas or coal
- ( 8 ) Fine chemicals
- ( 9 ) Animal vaccines and clinical diagnostic reagents
- ( 10 ) Synthesised raw materials for advanced ceramic
- ( 11 ) Common salt
- ( 12 ) Chemical derivatives from inorganic sources
- ( 13 ) Recycling of chemicals and plastic wastes
- ( 14 ) Gelatine
- ( 15 ) Carbon black master batch
- ( 16 ) Chemicals for fire extinguishers
- ( 17 ) Sodium carboxy methyl cellulose
- ( 18 ) Specialised paints and coatings
- ( 19 ) Plastic colour compound excluding PVC compound
- ( 20 ) Plastic colour masterbatch and dry colour
- ( 21 ) Dental cement
- ( 22 ) Epoxy encapsulation moulding compounds
- ( 23 ) Synthetic naphtha
- ( 24 ) Synthetic gas oil
- ( 25 ) Synthetic kerosene
- ( 26 ) Synthetic waxy raffinate
- ( 27 ) Synthetic paraffin wax
- ( 28 ) Synthetic detergent feedstock
- ( 29 ) Synthetic solvents
- ( 30 ) Multicellular polyurethane tyres
- ( 31 ) Plaster of Paris bandages
- ( 32 ) Copper clad laminates

### Manufacture of Leather and Leather Products

- ( 1 ) Tannery
- ( 2 ) Leather products

### Manufacture of Wood and Wood Products

- (1) Plywood, fancy plywood, pre-finished and printed plywood
- (2) Building and insulating boards, such as blockboard, laminated board, batten board, medium density board, soft board, hard board, water board, lamin board, particle board and chipboard
- (3) Timber mouldings, all types
- (4) Prefabricated housing units and components
- (5) Wooden cabinets for electrical or electronic products
- (6) Builders' carpentry and joinery, assembled parquet flooring panels.
- (7) Wooden staircases
- (8) Wooden doors and windows
- (9) Products derived from utilisation of wood waste (e.g. activated charcoal, wooden briquettes, wood wool)
- (10) Wood pellets
- (11) Articles of turned wood
- (12) Rubberwood veneer
- (13) Wooden pencil slats
- (14) Wooden household articles
- (15) Wooden snow shovels
- (16) Wooden furniture parts and components
- (17) Wooden caskets
- (18) Wooden lasts, footwear parts and components
- (19) Complete wooden picture frames and picture frames in complete knock down (C K D) form

### Manufacture of Pulp, Paper and Paperboard

- (1) Pulp
- (2) Newsprint
- (3) Printing and writing paper
- (4) Security paper
- (5) Household and sanitary paper
- (6) Wrapping and packaging paper and board
- (7) Linerboard
- (8) Kraft liner
- (9) Fluting medium
- (10) Sack kraft
- (11) Folding boxboard
- (12) Other paper and paper board

### (13) Specialised commercial printing

#### Manufacture of Textiles and Textiles Products

- (1) Man-made fibre, all types excluding polyester and staple fibre
- (2) Silk, silk yarn and fabrics of silk
- (3) Continuous yarn or filament yarn of man-made fibres
- (4) Woven fabrics
- (5) Special fabrics for upholstery and furnishing fabrics
- (6) Commission dyeing, bleaching, printing and finishing facilities of high standard for yarn and fibre
- (7) Cord fabrics including tyre-cord fabrics
- (8) Made-up textile articles
- (9) Natural fibre
- (10) Batik printing
- (11) Knitted fabrics
- (12) Accessories for the textile industry
- (13) Knitted articles
- (14) Yarn of wool
- (15) Combed yarn of higher count
- (16) High quality finished fabrics
- (17) Flock
- (18) Dyed yarn
- (19) Woven fabrics of continuous filament yarn
- (20) Knitwear
- (21) Discontinuous yarn of natural and man-made fibres

#### Manufacture of Clay and Sand-Based Products and other Non-metallic Mineral Products

- (1) High grade processed kaolin
- (2) High grade processed ball clay
- (3) High alumina and basic refractories
- (4) Kiln furniture refractories
- (5) Laboratory, chemical or industrial wares
- (6) Ceramic artware, ornaments and articles for adornment
- (7) Medium and high tension porcelain insulators
- (8) High grade silica sand and powder
- (9) Glass liners for vacuum flasks or for other vacuum vessels
- (10) Decorative glass and glassware

- (11) Glass ornaments and articles of adornment
- (12) High tension electrical glass insulators
- (13) Bricks, tiles, slabs, paving blocks, squares and other articles of pressed or moulded glass used in building
- (14) Mirrors
- (15) Glass envelopes (including bulbs and tubes) for electrical lamps, electric valves or the like
- (16) Glass fittings for lighting purposes
- (17) Glass pellets
- (18) Glass fibres (staples and continuous) for reinforcement and textiles, produced from basic raw materials
- (19) Polished slabs of locally sourced marbles and granite
- (20) Panels, boards, tiles, blocks and similar articles of vegetable fibre, wood fibre, straw, wood shavings or wood wastes, agglomerated with cement plaster or with other mineral binding substance
- (21) Cellular concrete blocks and panels
- (22) Rice husk ash cement
- (23) High quality calcium carbonate powder
- (24) Advanced ceramics and its derivatives
- (25) Ceramic floor tiles
- (26) Abrasive products for grinding, polishing and sharpening
- (27) Ceramic wall tiles
- (28) Vitriified clay pipes
- (29) Laminated safety glass
- (30) High purity alumino-silicate ceramic fibre
- (31) Speciality clay
- (32) Float glass
- (33) Formulated clay
- (34) Ceramic components and parts for electrical and industrial use
- (35) Fritz and glazes, glaze stains

#### Manufacture of Iron and Steel and their Products

- (1) Pig iron, sponge iron and hot briquetted iron
- (2) Ingot, billet, bloom and slabs of all grades of steel
- (3) Bars and wire rods (except those of mild steel), angles, shapes and sections of all grades of steel either hot-rolled, cold-rolled or cold-finished
- (4) Plates, sheets, coils, hoops and strips of all grades of steel either hot-rolled, cold-rolled, cold-finished, coated or plated

- (5) Seamless pipe and pipe fittings of iron and steel including hydro-electric conduits
- (6) Wire and wire products of iron and steel
- (7) Cans of iron and steel
- (8) Steel fabricated products
- (9) Steel structures
- (10) Gas cookers and parts thereof
- (11) Ferromanganese, silico manganese, ferro-silicon
- (12) Manufacture of lock cylinder mechanism and parts thereof
- (13) Steel concrete composite pipes

#### Manufacture of Non-Ferrous Metals and their Products

- (1) Dressing and smelting of non-ferrous metals
- (2) Ingots, billet and slab of non-ferrous metals
- (3) Bars, rods, shapes and sections of non-ferrous metals
- (4) Plates, sheets, coils, hoops and strips of non-ferrous metals
- (5) Pipes and tubes of non-ferrous metals
- (6) Wire and wire products of non-ferrous metals
- (7) Cans and drums of non-ferrous metals
- (8) Fabricated products of non-ferrous metals
- (9) Powder of non-ferrous metals
- (10) Offset printing plates
- (11) Synthetic rutile
- (12) Titanium dioxide pigment
- (13) Barium sulphate pigment
- (14) Iron dioxide pigment

#### Manufacture of Machinery and Machinery Components

- (1) Industrial processing machinery
- (2) Agricultural machinery and equipment
- (3) Mining and mineral processing machinery including equipment for oil and gas exploration and extraction
- (4) Power generation machinery
- (5) Material handling equipment
- (6) Industrial machinery and equipment including engines, motors, generators, compressors, welding equipment, fans and blowers
- (7) Machine tools

**Manufacture of Handtools**

Handtools, all types (such as axes, pliers, spanners, screwdrivers, wrenches, hammers, pincers, riveting tools and other handtools)

**Manufacture of Motor Vehicles, Components and Accessories**

- ( 1 ) Manufacture of motorised vehicles
- ( 2 ) Engines of all types and their parts
- ( 3 ) Transmissions, final drives and wheels of all types, including their parts
- ( 4 ) Chassis bodies including fuel tanks and their parts
- ( 5 ) Suspension systems, stabilising system and their parts
- ( 6 ) Electrical or electronics systems, instrumentation and their parts
- ( 7 ) Fuel systems, braking systems, ignition systems, steering systems, cooling systems, air-inlet systems, exhaust systems and engine starting systems and their parts
- ( 8 ) Any other automotive component and accessories

**Manufacture of Other Transport Equipment**

- ( 1 ) Non-motorised vehicles such as bicycles, tricycles and gliders
- ( 2 ) Locomotives, coaches, wagons and their parts
- ( 3 ) Pleasure crafts, hydrofoils, hovercrafts and their parts
- ( 4 ) Aeroplanes, helicopters and their parts
- ( 5 ) Any other type of transport equipment

**Manufacture of Electrical and Electronic Products and Components and Parts Thereof**

- ( 1 ) Colour television receivers and parts thereof
- ( 2 ) Audio or video cassette recorders or players and parts thereof
- ( 3 ) Tuners
- ( 4 ) Computers, computer peripherals and parts thereof
- ( 5 ) CAD, CAM or CAE equipment and parts thereof
- ( 6 ) Controllers and parts thereof
- ( 7 ) Modems

- ( 8 ) Machinery components including ball bearings, valves, pumps, gears and gear boxes, couplings and mechanical seals braided packaging
- ( 9 ) Duplicating machines
- ( 10 ) Typewriters and parts thereof
- ( 11 ) Construction machinery and parts thereof
- ( 12 ) Automatic gate systems, burglar alarm system and parts thereof
- ( 13 ) Printing rolls and embossing rolls
- ( 14 ) Hand labellers and parts thereof
- ( 15 ) Refrigeration equipment, accessories and parts thereof
- ( 16 ) Automatic parking systems
- ( 17 ) Dicing blades and accessories for silicon wafers and ceramic substrates
- ( 18 ) Adjustable hinges
- ( 19 ) Sewing machines and parts thereof

**Supporting Products / Services**

- ( 1 ) Iron and steel castings
- ( 2 ) Iron and steel forgings
- ( 3 ) Precision machining
- ( 4 ) Precision stamping
- ( 5 ) Precision electroplating
- ( 6 ) Moulds, tools and dies
- ( 7 ) Non-ferrous metal castings
- ( 8 ) Non-ferrous metal forgings
- ( 9 ) Galvanising and other related engineering services
- ( 10 ) Irradiation services
- ( 11 ) Overhaul, repair, reconditioning, modification, servicing and testing of industrial gas turbine engines, components and subassemblies
- ( 12 ) Maintenance and servicing of air-crafts, avionics testing and repairs
- ( 13 ) Storage, treatment or disposal of scheduled wastes as defined in the Environmental Quality (Scheduled Wastes) Regulations, 1989, undertaken in an integrated facility for storage, treatment and disposal
- ( 14 ) Powder metallurgical parts

- ( 8) Telephones including cellular radios, walkie-talkies and accessories, components and parts thereof
- ( 9) Telecommunications equipment and parts thereof
- (10) Intercomms
- (11) Optical fibre products and parts thereof
- (12) Counters
- (13) Piezoelectric frequency units
- (14) Voice and data synthesis equipment
- (15) Earphones
- (16) Hearing aids
- (17) Microphones
- (18) Smoke detectors, fire alarms, electronic counters
- (19) Automatic fare collection machines
- (20) Automatic traffic control equipment
- (21) Automatic vending machines
- (22) Automatic parting machines
- (23) Automatic teller machines
- (24) Computing scales
- (25) Cash registers
- (26) Telemetering equipment
- (27) Teller machines
- (28) Photocopying machines and parts thereof
- (29) Robots and robotics
- (30) Electrical lawn mowers
- (31) Ovens
- (32) Washing machines and parts thereof
- (33) Vacuum cleaners and parts thereof
- (34) Floor polishers
- (35) Shavers
- (36) Hair dryers
- (37) Decorative lights
- (38) Industrial lamps and parts thereof
- (39) Button cells
- (40) Rechargeable cells or batteries
- (41) Dischargeable tubes
- (42) Antennae
- (43) Speakers
- (44) Microswitches
- (45) Power supplies
- (46) Quartz crystals
- (47) Sensors and transducers
- (48) Solar cells
- (49) Motors, all types
- (50) Relays
- (51) Resistors
- (52) Capacitors and parts thereof
- (53) Printed circuit boards
- (54) Pried circuit board connectors and parts thereof
- (55) Charge-coupled devices
- (56) Displays-electroluminescent plasma, liquid crystal
- (57) Ceramic substrates or packages
- (58) High density memory storage media
- (59) Gold and aluminum bonding wires
- (60) Headers and cans
- (61) Lead-frames
- (62) Magnets or ferrite cores
- (63) Semiconductor wafer fabrication integrated circuit design
- (64) Semiconductor, all types
- (65) Semiconductor testings, all types
- (66) Electronic modules
- (67) Magnetic heads
- (68) Magnetic webs and pancakes
- (69) Static converters
- (70) Compressors for refrigerators
- (71) Wire harnesses
- (72) Timer switches
- (73) Thermostats
- (74) Power tools
- (75) Electric door bells
- (76) Protective switches and parts thereof
- (77) Electric cookers
- (78) Video cassette tapes and cassette casings
- (79) Quartz blenbs
- (80) Silicon wafers
- (81) Computer diskettes
- (82) Air conditioners, components, parts and accessories
- (83) Transistor radios
- (84) Compressors for air conditioners
- (85) Wireless coded door bell
- (86) Solar powered outdoor lights
- (87) Digital encoder
- (88) Digital decoder
- (89) Audio cassette tapes
- (90) Jigs and fixtures

- ( 91) Compact disc players and parts thereof
- ( 92) Silicon elastomer switches (key pads) for electrical and electronic instruments/appliances
- ( 93) Steam iron
- ( 94) Flat type PVC elevator cables
- ( 95) Fire resistant cables
- ( 96) Components and parts for consumer electronics
- ( 97) Industrial lightings and fittings
- ( 98) Bar code/optical character recognition printers and parts thereof
- ( 99) Software development and production
- (100) Computerised alarm systems and components
- (101) Coffee makers
- (102) Switches for electrical and electronic appliances and apparatus
- (103) Lampholder
- (104) Decorative light bulbs
- (105) Electronic calculators and parts thereof
- (106) Cable assemblies
- (107) Compact disk
- (108) Aquarium water heater
- (109) Cables and wires for electronic devices
- (110) Flexible heaters and parts thereof
- (111) Laser scanners
- (112) Pulse transformers (chip type)
- (113) Electric toaster/Electric mixer

**Manufacture of Professional, Medical, Scientific, Measuring Equipment and Components and Parts thereof**

- ( 1) Medical, surgical, dental, veterinary instruments and equipment and parts thereof, all types
- ( 2) Scientific gauges and measuring apparatus, all types
- ( 3) Surveying, hydrographic, navigational, meteorological, hydrological, geophysical instruments and parts thereof, all types
- ( 4) Testing equipment and parts thereof, all types
- ( 5) Meters gas, liquid or electric measuring
- ( 6) Infra-ocular lens

**Manufacture of Photographic, Cinematographic, Video and Optical Goods and Components**

- ( 1) Cameras, accessories and parts thereof
- ( 2) Projectors, all types
- ( 3) Sound recorders and reproducers
- ( 4) Lenses
- ( 5) Films-unexposed
- ( 6) Binoculars
- ( 7) Telescopes, magnifying glasses and microscopes
- ( 8) Cinematographic and video equipment
- ( 9) Any other photographic apparatus and accessories
- (10) Semiconductor photolithographic equipment

**Film Industry**

- ( 1) Film and video production
- ( 2) Expansion/modernisation of film and video production
- ( 3) Post production for film and video
- ( 4) Expansion/modernisation of post-production for film and video

**Manufacture of Clocks, Watches and Components**

- ( 1) Clocks and watches, all types
- ( 2) Parts for clocks and watches

**Manufacture of Musical Instruments and Components**

Musical instruments and parts, all types

**Manufacture of Kitchenware**

- ( 1) Kitchenware, all types
- ( 2) Cutlery
- ( 3) Tableware

**Manufacture of Furniture**

Furniture, all types

**Manufacture of Souvenirs and Handicrafts**

Souvenirs, handicrafts and giftware, all types

**Manufacture of Educational Objects**

Educational objects, all types

**Manufacture of Toys**

Toys, all types

**Manufacture of Footwear**

Footwear, all types

**Manufacture of Sports Goods and Equipment**

Sports goods and equipment, all types

**Manufacture of Jewellery and Related Products**

( 1) Jewellery

( 2) Processed gems

**Hotel Buildings and Tourist Industry**

( 1) Establishment of hotel

( 2) Expansion/modernisation/renovation of hotel

( 3) Establishment of tourist project

( 4) Expansion/modernisation of tourist project

**Miscellaneous**

( 1) Arms and ammunition and parts thereof

( 2) War products

( 3) Barbecue set, all types and accessories

( 4) Name plate and sign plate, all types

( 5) Art and design apparatus, all types

( 6) Wall covering

( 7) Water treatment

( 8) Chopsticks, all types

( 9) Luggage cases

(10) Office equipment, supplies and parts thereof

(11) Patented rodent traps

(12) Three-dimension reflectives

(13) Castor wheels

(14) Iron soldering tips

(15) Soldering equipment

(16) Umbrella frames and umbrellas

(17) Fireworks

(18) Firecrackers

(19) Rigid (non-elastic) narrow fabrics

(20) Non-woven surgical and related products

(21) Gas room heater

(22) Mannequins

(23) Lock sets

(24) Spectacles of metal and plastic frames

**Manufacture of Fire Fighting and Detection Systems and Parts thereof**

Fire fighting and detection systems and parts thereof.

**Manufacture of Plastic Products**

( 1) Plastic products for buildings and construction

( 2) Plastic products for electrical, electronics and telecommunications industry

( 3) Plastic products for medical and veterinary use

( 4) Plastic products for engineering use

( 5) Magnetic and non-magnetic cards

( 6) Plastic packing products

( 7) Inflatable plastic products

FINANCING INSTITUTION'S QUESTIONNAIRE

1. What are the main objectives of your organisation?

a. \_\_\_\_\_

b. \_\_\_\_\_

c. \_\_\_\_\_

d. \_\_\_\_\_

e. \_\_\_\_\_

2. Which of the above objectives is of TOP PRIORITY to your organisation? (Please specify only one)

\_\_\_\_\_

3. Is there any stated objective of helping small and medium enterprises (SMEs)? Please tick (/).

yes \_\_\_ no \_\_\_

a. If yes, please state them.

The objective/s of this bank in helping SMES  
is/are:

i). \_\_\_\_\_

ii) \_\_\_\_\_

iii) \_\_\_\_\_

iv) \_\_\_\_\_

b. In serving the SME sector, is there any sector, group, race preference?

If yes, please tick and specify the sector, group, race preference?

i) sector        yes\_\_ No\_\_ \_\_\_\_\_

ii) group        yes\_\_ No\_\_ \_\_\_\_\_

iii) race        yes\_\_ No\_\_ \_\_\_\_\_

4. How do SMEs get to know about the loans which are available?

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

5. How do they know the scheme exists?

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

6. Is there an SME division in your organisation? Please tick (/) the appropriate.

yes\_\_ No\_\_

a. If yes, what are the functions of the SME division?

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

7. Does the SME division have its own key and auxiliary staff? Please tick (/) the appropriate.

yes\_\_ No\_\_

a. If yes, are they specially trained?

yes\_\_ No\_\_

b. If your answer is yes in 7a., how are they trained?

i) Formal course of training    yes\_\_ no\_\_

ii) On the job training            yes\_\_ no\_\_

iii) Through experience            yes\_\_ no\_\_

8. Are the more senior staff in the division allowed to take decisions about loan?

yes\_\_ no\_\_

a. If yes, what is the maximum limit of loan which the staff of the section can decide on?

\_\_\_\_\_

\_\_\_\_\_

9. How many branches do you have throughout the country? \_\_\_\_

10. Do you have a special section for SMEs:

a. in all the branches?    yes\_\_ no\_\_

b. in each region?            yes\_\_ no\_\_

c. in all the states?        yes\_\_ no\_\_

11. Are the staff specially trained to handle SMEs at branches/region/state?

yes\_\_ no\_\_

a. If yes, how are they trained?

State \_\_\_\_\_

Branches \_\_\_\_\_

12. Please state the problems faced by SMEs in Malaysia as perceived by your bank?

- a. \_\_\_\_\_
- b. \_\_\_\_\_
- c. \_\_\_\_\_
- d. \_\_\_\_\_
- e. \_\_\_\_\_

13. How do you rate/rank the severity of these problems faced by SMEs? (Please rate 1 to 5, 5 for most severe)

- a. Financial problem \_\_\_\_
- b. Management problem \_\_\_\_
- c. Marketing problem \_\_\_\_
- d. Production problem \_\_\_\_
- e. Staff problem \_\_\_\_
- f. Other problems \_\_\_\_  
(Please specify the type of problem \_\_\_\_\_)

14. If finance is one of the main problem, how do you feel this problem can be overcome?

- a. \_\_\_\_\_
- b. \_\_\_\_\_
- c. \_\_\_\_\_
- d. \_\_\_\_\_

15. Are there any differences regarding problems faced by SMEs across ethnic groups?

yes\_\_ no\_\_

a. If yes, please state the differences.

- i) \_\_\_\_\_
- ii) \_\_\_\_\_
- iii) \_\_\_\_\_
- iv) \_\_\_\_\_

16. Is there a section in the credit department that handles SME loans?

yes\_\_ no\_\_

a. If no, please state the reason why?

---

17. Are there any special/specific people to handle SME loans?

yes\_\_ no\_\_

18. Do they perceive problems faced by SMEs are different from those of large businesses (LB)?

yes\_\_ no\_\_

a. If yes, what are they?

---

19. What are the criteria in assessing the viability of SME loans?

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20. Are there any differences in the process of assessing the viability of SME loans from LB loans?

yes\_\_ no\_\_

a. If yes, please state the differences.

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21. How are SME loan applicants being helped with the procedure of application?

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22. Does any person in the bank help the SME loan applicants in filling up the application forms?

yes\_\_ no\_\_

23. Does any person in the bank help the applicant to prepare cash flow projection for them?

yes\_\_ no\_\_

24. What proportion of the number of loans are for:

a) working capital \_\_\_\_\_%

b) start-up capital \_\_\_\_\_%

c) expansion \_\_\_\_\_%

25. What is the average amount of loan applied for?

a. working capital M\$ \_\_\_\_\_

b. start-up M\$ \_\_\_\_\_

c. expansion M\$ \_\_\_\_\_

26. What is the proportion of your total fund that is lent to Bumiputeras?

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27. Roughly how many loans are extended to Bumiputeras?

---

28. What is the repayment period and interest rate charged for the different types of SME loans?

	Type	Repayment period	Interest Rate %
a.	Working capital	_____	_____
		_____	_____
b.	Start-up capital	_____	_____
		_____	_____
c.	Expansion		
	i.	_____	_____
	ii.	_____	_____
	iii.	_____	_____
d.	Other purposes	_____	_____
	(Please specify: _____)		

29. Are SMEs sensitive to the effect of interest rates?

yes\_\_ no\_\_

30. Are there any loan follow-up services?

yes\_\_ no\_\_

a. If yes, when, how often and how long is the follow-up services carried out?

When? \_\_\_\_\_

How often? \_\_\_\_\_

How long? \_\_\_\_\_

b. If yes, are these services being perceived as useful by SMEs?

yes\_\_ no\_\_

31. What is the proportion of borrowers that have difficulties in servicing their loan?

a. Working capital: \_\_\_\_\_%

b. Start-up capital: \_\_\_\_\_%

c. Expansion: \_\_\_\_\_%

32. What is the proportion of the value of loans that is never repaid?

a. Working capital: \_\_\_\_\_%

b. Start-up capital: \_\_\_\_\_%

c. Expansion: \_\_\_\_\_%

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THANK YOU VERY MUCH

