Microfinance for Enhancing the Growth of Small and Medium Industries (SMIs): Case study of Malacca State, Malaysia

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Abstract

Small and medium industries (SMIs) in Malaysia play an important role in the economic development. SMIs accounted for 89.3 percent of all establishments in the manufacturing sector since 2000. In addition, value added production from SMIs is expected to be worth 50 percent of total production in the manufacturing sector by 2020. The government of Malaysia has also recognized the importance of having SMIs as an important element in creating a sophisticated economy, especially through their role in developing inter-industry linkages, or as supporting industries producing component for Large Enterprises (LEs) or subcontracting system or other form of production linkages. Despite the fact that SMIs are very potential for building a stable economic growth, developing those is difficult issue. The most common problem for SMIs is lack of access to capital. This paper attempt to examine the access to capital is not only constraint for SMIs to grow, but it is also considered an important problem in developing SMIs. It then draws the role of microfinance to potential and future development of SMIs in Melacca State, Malaysia.

Keywords: *microfinance, microcredit, small and medium industry.*

INTRODUCTION

Small and medium industries (SMIs) in Malaysia play an important role in the country's economic development. According to statistics provided by Small and Medium Industries Development Centre (SMIDEC, 2006), SMIs accounted for 89.3 percent of all establishments in the manufacturing sector since 2000. They contributed 29.1 percent of total manufacturing output, 26.1 percent to value-added, and 32.5 percent of employment in 2003. In addition, value added production from SMIs is expected to be worth RM120 billion or 50 percent of total production in the manufacturing sector by 2020.

Furthermore, through Ministry of International Trade and Industry (MITI, 2007), the Malaysian government's commitment to the development of SMIs can also be seen in the second Industrial Master Plan (IMP2), which will end in 2005, followed by the Third Industrial Master Plan (IMP3), from 2006-2020, coinciding with the country's vision for 2020. For example, the government has implemented numerous policies and strategies under this plan which was formulated to enhance the growth of the manufacturing sector through the entire value chain and to encourage cluster-based industrial development. Hence, this plan provides an integrated approach to the development of industrial areas and opportunities for the growth of SMIs (MITI, 2007).

The awareness of the role of SMIs as one of the "backbones" of national economy has increased. It is because of the fact that SMIs conduct income generation activities for creating self-employment. On the other side, more than 73 percent of SMIs faced financial problem. They need credit but not apply because they do not have sufficient collateral or feel their enterprise does not qualify (Asian Development Bank, 2005). Because of these difficulties, when small industries borrow, they often visit their relatives or the ubiquitous local moneylender. Moneylenders often charge over 10 percent a month, or even a few percentage points "a day" for their money. While they often demonized and accused of usury, their services are convenient and fast, and they can be very flexible when borrower run into problems. Hopes of quickly putting them out of business have proven unrealistic, even in places where microfinance institutions are very active.

Microfinance is a type of banking service that is provided to unemployed or low-income individuals or group who would means of gaining financial services. Ultimately, the goal of microfinance is to give low-income people a self-sufficient by providing a means of saving money, borrowing money and insurance. Microfinance has gained recognition as an effective way to bring very poor families low-cost financial services. Microfinance produces microcredit as a financial innovation which originated in developing countries where it has successfully enables extremely impoverished rural people to engage in self-employment projects that allow them to generate an income, and begin to develop small scale industries. In many cases, microfinance begins to build wealth and exit poverty among rural people and small scale industries.

PROBLEM STATEMENT

Traditionally banks have usually not served poor clients. Banks must substantial costs to managing a client account, regardless of how small the sums of money involved. For example, the total revenue from delivering one hundred loans with US$1,000 each will not differ greatly from the revenue that results from delivering one loan of US$100,000. But it takes nearly a hundred times as much work and cost to manage a hundred loans as it does to manage one.

A similar equation resists effort to deliver other financial services to poor client. There is a breakeven point in loan and deposit sizes below which banks lose money on each transaction they make. Poor client like small medium industries usually fall below it. In addition, most small and micro industries have few assets that can be secured by a bank as collateral. Linking the case studies will be central on problem: how small and micro industries and others living in poverty those are not bankable can meet the most minimum qualifications to gain access to microfinance. These studies attempt to examine the access to capital for SMIs to grow and considered as an important problem in developing SMIs, and to explore the contribution of microfinance to enhance the growth of SMIs.

STUDY EXPECTED

a) Exploring research excellence within the relationship between significant assistance of access to credit and SMIs development.
b) Understanding the working of microfinance institution as an agent to solve financial problem for SMIs.
c) Advancing the knowledge and experience and provide trained researchers to meet the beneficiaries of the relationship microfinance institution and SMIs that can be seen as mutually and simultaneously shaping one another.

LITERATURE REVIEW

According to the free encyclopedia, Wikipedia (2008), microfinance services are financial service that poor people desire and are willing to pay for. The term also refers to the practice of sustainable delivering those services. More broadly, it refers to a movement that envisions a world in which as many poor and near-poor households as possible have permanent access to an appropriate range of high quality financial services, including not just credit but also insurance, and fund transfers.

Theoretically microfinance encompasses any financial service used by poor people, including those they access in the informal economy, such as loan from a village moneylender. In practice however, the term is usually only used to refer to institutions and enterprises whose goals include both profitability and reducing the poverty of their clients. Microfinance services are needed everywhere, including the developed world. However, in developed economies intense competition within the financial sector, combined with a diverse mix of different types of financial institutions with different mission such as solidarity lending from developing countries to developed ones have met with little success. Microfinance can also be distinguished from charity. It is better to provide grants to families who are destitute, or so poor they are unlikely to be able to generate the cash flow required to repay a loan.

Microfinance institution is an organization that provides microfinance services ranging from small non-profit organizations to large commercial banks. Historical context can help explain how specialized microfinance institution developed over the last few decades. Between the 1950s and 1970s, governments and donors focused on providing subsidized agricultural credit to small and marginal farmers, in hopes of raising productivity and incomes. A microfinance institution can be broadly defined as any organization—credit union, down-scaled commercial bank, financial non-government organization (NGO), or credit cooperative—that provides financial services for the poor. The World Bank (2007) estimates that there are now over 7000 microfinance institutions, serving some 16 million poor people in developing countries. The total cash turnover of microfinance institution world-wide is estimated at US$2.5 billion and the potential for new growth is outstanding.

Quite simply, a microfinance institution is an organization that offers financial services to low income populations including SMIs. Almost all of these offer microcredit and only take back small amounts of savings from their own borrowers, not from the general public. Within the microfinance industry, the term microfinance institution has come to refer to a wide range of organizations dedicated to providing these services: credit unions, cooperatives, private commercial banks and non-bank financial institutions (some that have transformed from NGOs into regulated institutions) and parts of state-owned banks, for example.

There were some fact related to demand and supply of microfinance. There is a vast unmet gap in the provisions of financial services to the poor. A very little segment of the poor people is being served by the formal financial system for microcredit. Majority of the poor population depends on informal financial system for their credit needs. According to the World Development Report (2008), there were 1.8 billion people live in extreme poverty, subsisting on less than US $ 1 a day and almost half of the world population (2.8 billion) lives on less than US $ 2 a day. South Asia is the home to half of the world's poor families.

In African countries, women account for more than 60 percent of the agriculture labor force and contribute up to the 80 percent of the total food production, yet receive less than 10 percent of the credit provided to small farmers. In India, various estimates put the requirements of micro credit at Rs. 150 billion to Rs. 500 billion per year. As against these estimates, bank advances to weaker section aggregated about Rs. 100 billion per year and self-help groups (SHGs) are estimated to provide about 1 billion per year. About 36 percent of the rural households are outside the fold of institutional credit.

Singh (2008) stated that the *Grameen* Bank, Bangladesh, was started as an experiment in 1976 and accorded a special banking charter in 1983. In 1984 BRI (Bank Rakyat Indonesia) started microfinance in Indonesia. In 1984, K-REP (Kenya Rural Enterprise Programme) was set up by USAID (United States Agency for International Development) to develop credit programmes for micro-enterprises through NGOs intermediation. In 1983 ADEMI (Association for Development of Micro Enterprises) was established in Dominican Republic, Santo Domingo with support from ACCION, an International

Agency. In 1981 National Development Foundation, Jamaica was started with support of Pan American Development Foundation.

In 1986 ACEP (Agence de Credit Pour 'L Enterprise Privee) was established in Senegal with the support of USAID. In 1986 PRODEM (Foundation for the Promotion and Development of Micro-Enterprises), that was established by USAID & ACCION International in Bolivia, started micro finance. Later on it was converted into a bank called Bancosol (Banco Solidario) in 1992. In 1987 IDH (Instituto de Desarrollo Hondurando) was started in Honduras with the support of Opportunity International.

In 1992, BANPECO (Banco Nacional del Pequeno Comercio) that is, National Bank for Small Traders was renamed as BNCI (Banco Nacional de Comercio Interior), that is National Bank for Domestic Commerce and started micro financing in urban areas of Mexico. Micro-Credit Summit (2-4 February, 1997) held at Washington D.C. was organized to launch a global movement to reach 100 million of the world's poorest families, especially the women of those families, with credit for self-employment, by the year 2005.

Despite their important contribution to exports, employment and economic growth, there is a wide recognition in the literature about the challenges and barriers facing SMIs in Malaysia, preventing them from growing further and putting them in a critical position to face the new challenges that are arising from globalization, liberalization and extensive organizational, institutional and technological change. It has been documented that the barriers facing SMIs in Malaysia undermine their performance. Some of the existing literature, including Wan (2003); Sukor (2005); Musa (1999); MacGuare (2000); and SMIDEC (2004), highlight many challenges facing SMIs in a globalized environment, for example from a lack of financing, low productivity, lack of managerial capabilities, access to management and technology, heavy regulatory burden among many others.

METHODOLOGY

The study is based on a qualitative approach that serves of the following purposes (Leedly, 2005):

a) *Description*; data can reveal the nature of certain situation, settings, processes, relationship, systems, or people that related to the objectives of these study.
b) *Interpretation*; data enable to gain new insights about a particular phenomenon on microfinance and discover the problems that exist within that phenomenon.
c) *Evaluation*; data provide a means through which a researcher can judge the effectiveness of particular policies, practices, or innovations regarding the microfinance on developing SMIs.

Data collected by observations to microfinance institution that currently operated in Malacca State Malaysia to facilitate SMI enhancement to grow. The study also use electronic documents (e.g., e-mail messages, articles, and Web sites), and anything else that can help them answer the objectives of the study.

FINDING AND DISCUSSION

1. *The barrier for SMIs development*

The difficulty in accessing formal credit is one of the most important constraints facing SMIs in Malacca State, Malaysia. More than half of the SMIs observed mentioned it as a problem with almost a quarter saying that it was the most important problem that they faced. The reasons given by small industries and household business that claim to need credit, appear to qualify, but who do not apply for loans from banks or other formal sector institutions include: collateral requirements; the perceived complexity and cost of application procedures; and the issues of the legal standing of the enterprise in question, particularly the high costs of formal registration of a business required by formal lending institutions.

On the other side, banks are constrained from making loans to SMIs by the difficulty and cost of accessing information that allows them to identify micro and small industries that could potentially become successful borrowers. The potentials benefits of alleviating constraints in access to formal credit on commercial terms would appear to be large. Based on opinion of small industries that have observed, the research estimated that their incomes could grow by 40 – 50 percent if these financial constraints could be removed. Of course this is only an estimate from the firm themselves, but comparisons of the desired loan amounts with current levels of working capital suggest that it is not an implausible estimate.

Possible means of reducing the credit restraint faced by small and micro industries will involve supporting pro-competition policies and reinforcing competitive behavior at the micro level by:

- Improving information sharing requirements between financial institutions
- Developing common on-line savings initiatives
- Exploring mechanism of expanding the reach of commercial financial services to currently underserved

International evidence suggests that access to credit is important to enterprise performance and growth. The microfinance program of the bank is aimed at delivering credit to the target community through financial institution. The target community is small and micro industries especially in the rural areas.

2. *Microfinance institutions for enhancing the growth of SMIs*

SMIs enhancement needed approach of microfinance which is based on the premise that people should earn money by investing in viable small and micro industries. They should earn profit from their enterprises. Major share of the profit should be reinvested in industries for their growth. By earning profit from the viable small and micro industries, people will increase their paying ability for services delivered to them under different entrepreneurship development projects run by microfinance institutions.

Malaysia is classified as an upper middle income country by the World Bank. This is an important factor in the approach taken to poverty alleviation through microfinance in Malaysia, an approach deriving from the New Economic Policy (NEP) which operated from 1971 to 1990. The NEP was directed to reducing poverty and income disparities between ethnic groups, and particularly to improving the position of the *Bumiputera*. These are the indigenous peoples of Malaysia, who were seen as economically disadvantaged by comparison with other ethnic groups, particularly the Chinese.

Malaysia has a modern financial system with a diverse range of institutions, both private and public, including Islamic banks. Public institutions include development financing institutions a development bank and an agriculture bank (*Bank Pertanian*), as well as the Credit Guarantee Corporation (CGC) which provides guarantees on lending by other financial institutions to small and medium industries (SMIs). At the lower end CGC has a credit guarantee scheme for 'hawkers and petty traders', but loan sizes for this scheme suggest it is operating at a level somewhat above conventional microfinance. The smaller loans guaranteed by CGC would, however, qualify in terms of the definition of microfinance used in the ADB Microfinance Development Strategy for the Asia-Pacific region (ADB, 2005).

Microfinance is the provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low-income households and their micro industries. There are also urban credit cooperatives, but these serve a salaried clientele, while rural credit cooperatives have minuscule outreach and the cooperative movement as a whole is in a weak condition with Government now attempting to revitalize it. Essentially, the only institutions engaging in microfinance are drawn from the NGO community, where there is one dominant microfinance institution and a handful of minor operators.

Among other factors, interest rate controls may have played some part in keeping commercial banks out of microfinance. Conroy (2008) noted that *Bank Negara Malaysia*, the central bank, restricted the spread between base and maximum lending rates in the commercial banking system to 4 percent, less than would be required to cover the extra costs associated with microfinance lending. In the case of some loans guaranteed by CGC the permissible spread was only 2 percent, reinforcing this effect. There has been some engagement by regulated financial institutions with microfinance in other ways, however, and this is described below.

a) Amanah Ikhtiar Malaysia (AIM): the dominant microfinance institution

Malaysia's dominant microfinance institution, *Amanah Ikhtiar Malaysia* (AIM), was established in September 1987 to institutionalize an action research project carried out by the Centre for Policy Research of University Science Malaysia (USM), sponsored by the Asia Pacific Development Centre (APDC), Islamic Economic Development Foundation of Malaysia (*Yayasan Pembangunan Ekonomi Islam Malaysia* = YPEIM) and the Selangor State Government. With some modification from the *Grameen* Bank model, the *Ikhtiar Project* was adopted as a programmed to eradicate poverty of the rural poor in Malaysia.

AIM is governed by its Board of Trustee who will meet at least a year. A management Committee will be responsible for its daily operation. The Management Committee chaired by Managing Director shall meet at least once every quarter. The important objective of AIM is to reduce the poverty rate in Malaysia by providing financing to poor household to enable them to undertake viable economic activity to upgrade their household income. It is complementary to the government objective in eradicating poverty among the poor households in Malaysia.

AIM operational costs are borne through its administrative charges to its borrowers, state government, federal government, banks and financial institutions and the private sectors. Up to 1998 it made some 103,000 loans and disbursed a total of RM 328 million ($86 million at the current exchange rate, considerably more if contemporary exchange rates are applied). Some 80 per cent or more of all funds loaned were for economic purposes, the remainder for 'social' purposes.

Table 1: Sources of operational costs & revolving loan capital of AIM

ON-LENDING FUND	AMOUNT
Government-free interest loan	RM300.0 million (USD78.9 M)
Government-grant	RM18.2 million (USD4.9 M)
Financial institutions – soft loan	RM28.05 million (USD7.4 M)
Government Agencies	
LKIM – free interest loan	RM4.0 million (USD1.05 M)
Rural Development Ministry - grant	RM12.8 million (USD3.4 M)
Grants for Operational Costs	
Federal and States Government	RM30.0 million (USD7.9 M)

Source: http://banktani.tripod.com/microfinance.htm

AIM's activities have been directed almost entirely to the alleviation of poverty among poor Malays.1 It was set up with a charter 'to disburse small loans on reasonable terms exclusively to the very poor households to finance additional income generating activities' (Gibbons and Sukor Kasim, 1990) but for all practical purposes has confined its attention to the *Bumiputera*, the indigenous (principally Malay) people. This is evident from its outreach data rather than from its charter.

<u>Concept of *Amanah Ikhtiar Malaysia*</u>

The concept of AIM is to create out of the hardcore poor households, highly motivated individuals who are committed to earn an honest living and eventually move out of the poverty level. Maximum tenure is 25 weeks to 6 months with maximum financing is RM20, 000.00. The strategies are by giving out to borrowers' interest free loans to undertake income generating projects. The loans are to be repaid on a weekly basis.

Eligibility criteria for AIMs borrower are as bellows:

(1) Household income below the following Current Government Poverty line:
- Malacca State : RM661 per month (RM152 per capita)
- Sarawak state : RM765 per month (RM167 per capita)
- Sabah state : RM888 per month (RM173 per capita)

(2) The participant to set up a group consisting of 5 members of the same gender, responsible and committed to the programmed and members are not close relatives

(3) The participant must attend compulsory short course. Upon passing the special test, the member is required to attend the weekly Central Meeting that comprised of 2 to 8 groups of AIM members

(4) Purpose of financing for Working capital. Eligible sector or types of financing are all economic activities. Application procedure is that applicant to liaise with AIM.

If once fully paid, bigger loans are being offered. This process goes on as the need arises. The first loan is normally restricted to RM1,000 (USD263) up to a maximum of RM4,000 (USD1,289) for successive loan. Successful borrowers could apply for a much bigger loans of RM5,000 (USD1,315) or even up to RM10,000 (USD2,2631). Following the model of the *Grameen* Bank, poor borrowers formed themselves into groups of five who in turn guaranteed each other's loans. These households will undergo a one week compulsory training of one hour per day to understand their rights and obligations in order to ensure good repayment.

Believing that while the NEP had successfully reduced the number of households in poverty, the persistence of hardcore poverty required a new approach, AIM adopted the *Grameen* Bank model, with some modifications to suit the Malaysian context. An official survey in 1989 indicated that some 94,600 households, or 2.2 percent of the total population, were classified as 'hard core poor', with incomes below half the level of the official poverty line. The indigenous Malay community was disproportionately represented among these poor households. AIM, intent on targeting the poorest among the poor, used the official periodic.

Amanah Ikhtiar Malaysia loans programmes

Household Income Survey as a guide and developed its own means test to identify the hardcore category. By August 1994, AIM had some 6,100 *Grameen* groups in operation with a total membership approaching 30,000 borrowers. Assuming that its procedures to identify the poor were both effective and consistently applied, this is quite impressive coverage of the target population, achieved in seven years. As discussed below, outreach might have been higher, but for political interference. Total loans disbursed to that time amounted to RM37.9 million ($14.8 million) and, reflecting the relative priorities accorded savings and credit, total savings were $1.8 million. Some 28 per cent of lending was for agriculture, 46 per cent for trade, 15 per cent for animal husbandry and 10 per cent for other activities (Conroy, 2008).

Currently, AIM offers the following loan products to its members:

(a) *Ikhtiar* Loan Scheme 1 (*Skim Pembiayaan Iktiar 1* – SPI 1): provides loans to poor households with average monthly of not more than RM340 (USD89) or two third of poverty line income. Initial loans are up for a maximum of RM1,000 (USD263), increasing to RM2,000 (USD526), RM3,000 (USD789), RM4,000 (USD1,052) and RM4,900 (USD1,289). The loan repayment period is between 50 weeks to 100 weeks.

(b) *Ikhtiar* Loan Scheme 2 (*Skim pembiayaan Ikhtiar 2* – SPI 2): loan scheme provides loans between RM5,000 (USD1,315) to RM9,900 (USD2,605) to borrowers who have made good repayment from the previous two loans and having a monthly income exceeding RM600 (USD158). The repayment period of the loan is between 50 to 150 weeks

(c) *Ikhtiar* Loan Scheme 3 (*Skim Pembiayaan Ikhtiar 3* – SPI 3): provides loans up to RM10,000 (USD2,631) to borrowers with good track record with perfect repayment for at least 2 times SPI 1 or SPI 2 and having a monthly income exceeding RM1,000 (USD263). The loans could be repaid up to a maximum period of 150 weeks.

(d) Single Mother Loan Scheme (*Skim Ibu Tunggal* – SKIT): provides loans to single mothers living in town areas. The aims of the scheme are to increase the living standard of single mothers and motivate them to undertake stable economic activities to support the family. Eligibility for the loans depends on the household earnings and varies within states. Household earnings for those living in Kuala Lumpur and Johor must not exceed RM1,200 (USD315); Selangor, Malacca and Negeri Sembilan RM800 (USD210) per month; Kelantan, Terengganu and Kedah RM425 (USD111) per month; and Perak RM600 (USD157) per month.

In addition, special education loan scheme up to RM1,000 (USD263) with maximum loan period up to 50 weeks, and special housing loan scheme up to RM5,000 (USD1,315) with maximum repayment period up to 100 weeks are available to borrowers with good repayment record. At August 2003, AIM has an outstanding loans balance of about RM130 million (USD 34.2 million). From its inception in 1987, the loan programmes have benefited more than 120,000 members. The existing members now stand at about 89,000. Based on the figures of 150,000 (two-third) of poor households targeted by AIM, it has successfully made an outreach of about 80 percent in term of the number of poor households it has targeted in Malaysia.

In Malaysia, because of the sensitivities of its Muslim clients and sponsors, AIM levied 'service charges' on loans rather than interest expressed in percentage terms. If calculated as interest on the principal involved, however, these charges were well below rates in the Malaysian commercial banking sector. For example, the average loan size for borrowers taking a third loan in 1994 was RM1,044 ($427) for which the service charge equated to around 4.7 percent flat over the usual one year loan term. Service charges on larger loans were somewhat higher in percentage terms, but these were only a small proportion of total advances; for all classes of loans service charges covered only a portion of AIM's lending costs (Conroy, 2008).

Basis for an effective and efficient programmed

Some 60 percent of AIM's operational costs between 1989 and 1995 were covered by a Malaysian Government grant, while the state governments granted additional support of up to 40 percent annually. In consequence AIM had limited stimulus to strive for self-sufficiency in its early years (McGuire, Conroy and Thapa, 1998). Loan capital was provided by central government grants, supplemented by soft loans from CGC and some commercial banks, especially those with majority government shareholding.

However, from 1992 a constraint on expansion of outreach operated, due to a government decision to channel a grant of $7.3 million intended for loan capital over the period 1991 to 1995 through an Islamic foundation, Islamic Economic Development Foundation of Malaysia (*Yayasan Pembangunan Ekonomi Islam Malaysia* = YPEIM). YPEIM, however, decided to program the disbursement over a much longer period, a decision which according to a recent evaluation of AIM's program caused a serious cash flow problem and undermined AIM's plans for expansion and the achievement of viability (Sukor Kasim, 2000).

(a) Exclusive Focus on the Very Poor: AIM uses special means test to identify eligibility of its potential clients. It is based on conditions of the house and monthly households income of not more than USD66 (1986-1994), USD75 (1995-2000) and USD90 (2001). Priority of AIM loans will be given to the poorest among the poor.

(b) Specialised Delivery System: AIM has set up requirements to ensure that the poor has access to the credit programmes. These requirements are:
   - Suitable loan condition (no collateral, no guarantor and no legal action)

- Credit is taken to the very poor, to their village
- Simple procedures, compulsory group training and oral test on understanding of rules and regulations
- Formation of groups by potential members (five members in a group, equal socio-economic status, create right peer pressure and peer support)
- Collective responsibility, group and centre accept collective responsibility
- Small loan and weekly repayment, loan for income generation
- Close supervision by field staff in centre meeting and loan monitoring
- Availability of subsequent loan
- Open conduct of all business at centre meeting.

Efficient and effective operational staffs are required to deliver a well done job. Rigorous and practical training are conducted with a basic training for six months and a probation period of 12 months. The training period is divided into three phases and trainees must pass each phase before being offered as AIM probation staff. All staff must have good understanding of AIM rules and procedures. AIM has the support from the federal government and also from the state government. Grants and soft loans are given to support its operational and administrative costs. AIM also has close linkages with government agencies and they have been supporting its branches and regional offices by organising together programmes and workshops for its members and their families.

b) Agriculture Bank of Malaysia (Bank Pertanian Malaysia = BPM)

Microfinance is nothing new in Malaysia. It has been operated by credit unions, cooperative banks and specialized credit windows of banks. Microfinance services of financial credit range for about RM 10,000 (USD 2, 631) and mostly to finance small business, agricultural loans for poverty reduction. *Majlis Amanah Rakyat* (MARA), council of trust to the *Bumiputera* and Credit Guarantee Corporation (CGC) are some of the pioneers to introduce microfinance loans to its borrowers.

The rural credit institutions comprising of Agriculture Bank of Malaysia (BPM), Farmers Organisation Authority (LPP), Federal Land Development Authority (FELDA), and agro-based Co-operative Societies provide micro credit for the agriculture sectors. There are a number of non-government organisations (NGOs) that engaged in microfinance. These include *Yayasan Usaha Maju* operating in Sabah, *Koperasi Kredit Rakyat* in Selangor.

Most recently, under the economic package announced by the Government on May 21, 2003 to generate economic activities by mobilising domestic sources of growth while reducing the country dependence on the external sector, Agriculture Bank of Malaysia (BPM) is given the allocation of RM500 million (USD 132 million), and National Savings Bank (BSN), the allocation of RM300 million (USD79 million) to carry out their respective micro credit programmes. The loan programmes aim of giving loans to individuals and small enterprises who do not qualify for existing bank products due to the lack of good collateral/guarantors. The loans are given based on the projects cash flow.

BPM has launched its Micro Credit Scheme (*Pembiayaan Kredit Mikro*) on the 3rd June 2003 after the announcement of the economic package by the Prime Minister on 21 May 2003. The scheme starts with an initial capital injection of RM200 million from the government and will be increased to RM500 million when the fund for the scheme has been finally raised. The scheme is offered to small entrepreneurs in agriculture related projects in production, processing and marketing. Loan size is up to a maximum of RM20,000 (USD5,263) with an interest rate of 4% per annum and loan period of not more than 4 years. The applications from the public are very encouraging. Up to October 2003, RM188.6 million (USD49.6 million) has been disbursed to the borrowers with a loan balance of RM174.1 million (USD45.8 million). It is still early to measure the performance of the scheme, although the collection rate that has been achieved to date is about 92%.

The Agriculture Bank of Malaysia reports that there are also a number of NGOs that engage in microfinance, including *Yayasan Usaha Maju* in Sabah, *Koperasi Kredit Rakyat* in Selangor, and AIM, the most widely known MFI in Malaysia. The poorest of the poor are given priority for AIM loans. As a result, AIM has established an eligibility test for its potential clients based on factors such as the condition of their homes and monthly household income. In order to qualify for AIM loans, an individual's monthly household income must be no more than $90.

Che Zakiah Che Din (2008) reports that microcredit scheme was launched in May 2003 by the Malaysian government to enhance micro industries' access to financial supports. Two development financial institutions, *Bank Pertanian Malaysia* (the Malaysian Agriculture Bank) and *Bank Simpanan National* (the National Savings Bank), are mandated to implement this microcredit scheme. The scheme is collateral-free and borrowers are eligible for loans of up to US$5,263 with interest rates at 4 percent per annum for a period of no more than 4 years. At the end of 2003, total loans disbursed amounted to US $164 million.

Small and micro industries traditionally finance their operations through own savings, loans from family members and friends, as well as supplier credits. New start-up businesses face difficulties in securing credit, as they have built little collateral or track record. The solution lies in improving access to institutional credit for small and medium industries. The venture capital industry is not sufficiently developed to spur the emergence or creation of new enterprises generating wealth from knowledge-based activities. There were limited access to finance and capital, and the infancy of venture funds in initial or mezzanine financing in developing small business especially for rural community.

There were major initiatives to enhance small entrepreneur access to financing included:

- Establishment of the SME Bank in October 2005;
- Transformation of Credit Guarantee Corporation;
- Strengthening of *Bank Pertanian*;
- Establishment of the Small Debt Resolution Scheme;
- Introduction of two new trade finance products, namely the multi currency trade finance and indirect exporter financing scheme; and
- Establishment of two venture capital funds for agriculture sector.

Figure 10. Rural business location

As can be gleaned from this study so far, the Malaysian government has been, and continues to be, supportive of entrepreneurship. It has taken various steps to promote the development of entrepreneurs in general (including providing conducive economic environment, various financing and funding schemes, tax incentives, as well as business advisory centers). The government has regarded nurturing entrepreneurs as a way to facilitate and upgrade the infrastructure so as to create small entrepreneur, especially in rural areas for the next generation. For this reason, the government has paid special attention to the development of small and medium enterprises.

CONCLUSION

The need for the government to get involved in the financial “market,” by providing small and medium industries with alternative sources of funding and credits at favorable rates also added to the complexity of the funding situation in the country. In the early days, small and micro industries faced difficulties in obtaining credit in the open market as they lacked collateral or did not meet the criteria of banks and financial institutions for whatever reason. Currently, there are numerous sources of funding available to small and medium industries (SMIs) and micro industries that are basically provided by the government. Nevertheless, as these are government-led funding sources, the inevitable problem of bureaucratic delays or red tape is also ubiquitous

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