

SMALL SCALE ENTREPRENEURS: PERCEPTIONS OF MALAYSIAN COMMERCIAL BANKERS

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ABSTRACT

Lack or shortage of capital is one of the main findings of many empirical research as the cause of small business failure. For many Malaysian small scale entrepreneurs, the lack of capital is highly correlated with their difficulty in obtaining bank loans. These entrepreneurs may even feel that commercial banks are not sympathetic to their needs. In most cases, it would seem that commercial banks are only interested in financing big businesses. This exploratory research attempts to highlight some of the common problems faced by commercial banks in dealing with small businesses that prejudice them against, or make them wary of small scale enterprises (SSEs). These findings may be useful to small scale entrepreneurs seeking financial assistance from commercial banks in Malaysia.

INTRODUCTION

The unwillingness of commercial banks to finance SSEs has always been a prominent issue in seminars, conferences or workshops involving small scale entrepreneurs. Many small scale businessmen have expressed their dissatisfaction over the attitude of commercial bankers towards SSEs. They claim that it is very difficult to get loans from commercial banks. On many occasions they had to wait patiently, and sometimes for more than three months before finally knowing the fate of their application. They also had to comply with the many terms and conditions imposed by the bank before the funds were released. These entrepreneurs believe that all the hassle could be eliminated had the bankers been more sympathetic towards their problems.

The continuous allegations against commercial banks for not helping SSEs prompted this study. The objective of the survey was to collect information on the perceptions of commercial bankers towards lending to SSEs. Aspects such as common problems

when dealing with SSEs, the preferable methods of initial contact with SSEs, the future of existing SSE customers obtaining loans, factors used in credit appraisal, and chances of financing new businesses were examined.

BACKGROUND OF LENDING TO SMALL BUSINESSES

Commercial banks in Malaysia, especially locally incorporated banks, have been involved in financing small businesses since the early days of their establishment. During that time, because of their expertise and experience, foreign banks were more interested in fulfilling the capital requirements of corporate customers, including large foreign-owned plantations, mines and agency houses. Therefore, domestic banks were set up to fill the gap in the credit market by catering mainly to small companies which were neglected by the foreign banks.

Over the years, domestic commercial banks accumulated experience and expertise in the various aspects of banking, until finally they were able to provide services similar to that of the foreign banks. Like many other business entities, profit has always been in the minds of the commercial banks. Thus, it was inevitable that domestic commercial banks soon expanded their horizon and began courting big corporations and neglecting the small business sector. Once again, small businesses were left without any source to finance their needs.

The changing trend in domestic commercial banks did not necessarily mean that they were turning their backs on small businesses. However, they were now free to choose the customers to whom they would loan their money. And, it was their prerogative to establish their lending priority sector.

For nearly 95 years (1875–1970), commercial banks were free to formulate their lending policies without interference from the regulatory body, that is, the Central Bank, which is better known as Bank Negara Malaysia (BNM). In 1970, the Malaysian government realised that there was insufficient commitment by the commercial banks to help small businesses; and in conjunction with the New Economic Policy, the government through BNM started formulating policies for the commercial banks pertaining to lending to the small business sector.

One of the most significant steps taken by the government to help small businesses was the incorporation of the 'Credit Guarantee Corporation Malaysia Berhad (CGC)', on July 5, 1972. The main objective of the corporation was to assist small borrowers in obtaining credit from commercial banks at a reasonable cost.

Policies on Small Business Established by Bank Negara Malaysia.

In order to facilitate the implementation of the New Economic Policy as spelt out in the Second Malaysia Plan (1971–1975), BNM took the initial step by reviewing the role to be played by commercial banks in managing their resources. Prior to the introduction of the policies and their implementation, BNM had conducted a series of seminars with the top

management of commercial banks.

The conclusions of the seminars with the financial institutions regarding small businesses were published in the BNM's 1971 Annual Report which may be summarised as follows:-

- The financing of small scale enterprises, particularly indigenous enterprises, and the development of rural areas is a matter of national priority, so that the commercial banks and other financial institutions will have to determine the manner and the extent of their participation in such financing.
- Under certain conditions, loans to small scale enterprises and the agricultural sector can be profitable and are not as risky as has been assumed. This has been the experience not only of other developing countries but also of some Malaysian financial institutions. The most important requirement is that banks should reorientate their whole attitude and approach towards the extension of loans to small scale enterprises and the agricultural sector. For example, the emphasis on security for a loan should be replaced by the viability of the project to be financed, such an approach requiring changes in lending techniques. Knowledge of the character and background of borrowers and the nature of the enterprises to be financed is essential, and guidance by way of technical and other advisory services is also an important factor.

Since 1972, small businesses and the agricultural sector were known as the priority sectors in the eyes of BNM. And, in their 1974 Annual Report, lending to these sectors was reported under the special column, *Bank Lending to Special Groups*. Since then, many new guidelines have been introduced to the commercial banks. Some of the relevant guidelines are:-

1. The guideline which was introduced in 1979 required that at least 20% of the outstanding loans of commercial banks should be in the form of loans to small borrowers.
2. With effect from January 1, 1981, a new guideline was introduced whereby each commercial bank was required to extend at least 12% of its loans

outstanding as at December 31, 1980 to SSEs of which 5% should be granted under the 'Special Loan Scheme (SLS)', of CGC by December 31, 1981.

3. In 1983, the guideline on the financing of SSEs was no longer applicable, but commercial banks were required to maintain throughout the year their respective levels of lending to this group as at the end of 1982. However, the guideline for loans under CGC introduced in 1981 continued to apply.
4. In 1987, besides the 1981 guideline, another guideline was introduced whereby commercial banks were required to extend new loans amounting to at least 150 million to SSEs under SLS-CGC and the compliance date was set on December 31, 1987.
5. In 1988, the commercial banks were required to extend at least \$300 million to SSEs. Of the \$300 million, at least \$150 million was to be extended under SLS-CGC. The compliance date was set on December 31, 1989.
6. In 1989, the commercial banks were required to extend at least \$600 million to SSEs. Of the \$600 million, at least \$200 million was to be extended under the 'Principal Guarantee Scheme (PGS)'-CGC. The compliance date was set on March 31, 1990.
7. In 1990, SSEs and housing are no more considered priority sectors. But the guideline for PGS-CGC still holds.

Performance of Commercial Banks in Lending to SSEs

It has been nearly two decades since BNM monitored the performance of the commercial banks in the priority sectors. Total commercial bank loans to SSEs has increased from \$343 million at the end of 1970 to \$3,712.4 million at the end of 1989, an increase of 982%. The yearly figures of the new loans extended to SSEs from 1980 to 1989 are shown in Table 1.

Table 1: Loans granted by the commercial banks¹ (in million)

Year	Total Loans Granted ²	Loans to SSEs
1980	4889.4	547.1
1981 ³	3911.9	83.3
1982	3456.3	326.2
1983	6456.1	252.5
1984	5750.7	204.8
1985	4300.6	(200.2)
1986	2614.0	(241.3)
1987	(368)	(248.4)
1988	3816	835.9
1989	9857	107.1

1 Net additional loan (Amount granted less repayment)

2 Exclude individual housing loans

3 Difference in figures due to the changing SSE definition

Source: Bank Negara Malaysia, Annual Reports, various issues.

Within the period of 1980 to 1984, loans to SSEs continued to increase, though at a fluctuating rate every year. However, in line with the economic slowdown, there was negative growth for years 1985, 1986, and 1987. The economic turnaround in 1988 gave impetus to the commercial banks to give more loans to SSEs.

From Table 1, we can conclude that commercial banks are helping small businesses. In other words, the guidelines introduced by BNM were successful and played an important role in promoting loans to SSEs through the commercial banks. To many commercial banks, these figures disprove the allegations that they are unsympathetic to the needs of small businesses. Commercial banks could further claim that the discontinuation of SSEs as a priority sector in 1990 is an indication that BNM has more faith in them.

However, the scenario might have been different had there been no guidelines introduced and implemented by BNM. Indeed, I strongly believe that had there been no guidelines given, not many

banks would welcome SSEs. But, this does not necessarily mean that they will not lend to SSEs. It is probable that only a few customers will succeed in getting facilities from the commercial banks. Following this, loans to small businesses would then be at a rate lower than that shown in Table 1.

The failure of commercial banks to comply with the guidelines could be indicative of their not being serious and committed towards financing SSEs. These banks are even willing to pay the penalty imposed by BNM for not complying with the guidelines.

As shown in Table 2, in 1983, 23 banks failed to comply with the guidelines. The figure increased to 32 in 1984. Later however, the figures decreased, until 1989 when only 12 banks failed to adhere to the guidelines given.

Table 2: Number of commercial banks which failed to comply with the guidelines set by BNM

Year	Number of Banks
1983	23
1984	32
1985	32
1986	14
1987	12
1988	8
1989	12

Source: Bank Negara Malaysia, Annual Reports, various issues.

METHODOLOGY

Branch managers of commercial banks were chosen on the assumption that they were the final authority on the branch's loan decisions. And, under normal circumstances all loan applications were channelled through branches to head offices for further consideration.

Both foreign and domestic commercial banks were used as samples in the survey. Five banks from each group were selected and within each of these strata, the even numbers in the list were used as target

samples. Both urban and rural banks were evenly represented in the sampling. Branches situated in Kuala Lumpur and state capitals were classified as 'Urban branches', while branches situated outside these areas were classified as 'Rural branches'. Out of the 200 questionnaires distributed, 41 or 20.5% were returned. Only three foreign bank managers responded. Most of the questions were constructed based on the Likert scale.

For the purpose of this survey, the definition of small business is based on the definition introduced by BNM in 1988. This definition is also used by all commercial banks to classify their small business customers.

According to BNM, a loan to small business is defined as a loan of \$500,000.00 or less, granted to a registered business (including petty traders) with net assets of up to \$500,000.00, or in the case of corporations, shareholders' funds of up to \$500,000.00. In this survey, loans to petty traders is not included.

FINDINGS

Generally, bankers believe that there is a greater tendency for loans to SSEs to turn sour as compared to loans to other business customers. Based on my experience as a credit officer and a branch manager, majority of the delinquent loan files are SSE customers. Bankers' prejudice towards SSEs is supported by the various research done, both locally and abroad, on small business failures. Bankers are constantly hearing statements such as '*Nine out of ten new small businesses will fold in their first year of operation*', or '*The failure rate of small businesses is at an all time high*'. However, one must remember that not many studies have been done in the area of successful small businesses, which would result in inducing bankers to loan more money to SSEs.

In West Malaysia, for the year 1982 and 1983, the total number of new businesses registered with the Registrar of Businesses was 60,611 and 63,171 respectively. But within the same period, 32,113 (or 53%) businesses cancelled their registration in 1982; and 29,954 (or 47%) in 1983.

In general, many managers tend to use their past

experience when dealing with SSEs. Bad experience usually makes the manager pessimistic and wary of SSEs. On the other hand, branches with a limited number of non-performing loan files would be more receptive to SSEs.

Common Problems Faced by Commercial Bankers

Like all commercial bankers in the world, Malaysian bankers will definitely give loans to the profitable or potentially profitable businesses, since their main source of income, after all, is the interest received from outstanding loans. Bankers perceive that profitability is correlated with repayment capacity, and that if the business is sound today, with proper supervision, it would continue to be sound in the future.

To ensure that loans are given to the right people, bankers must find a method to determine that the loan granted is the appropriate facility, disbursed at the correct time, and for the adequate amount. In general, bankers will adhere to the age-old formula in credit appraisal: 'character', 'capacity', 'capital',

'condition', and 'collateral'. The order of importance will depend on the status and policy of each bank. Financial tools such as ratio and analysis, fund movement, and cash flow analysis are often used before loan decisions are made.

Under normal circumstances, every customer who comes to the bank for a business loan will need to go through the following stages:

- a) Preliminary interview
- b) Second interview
- c) Pre-sanction visit
- d) Loan decision
- e) Loan documentations and
- f) Disbursement

Small scale entrepreneurs must be aware that bankers deem the first three stages most important in the lending process. In many cases, bankers will make lending decisions during the first contact with the potential borrower. During the first interview, many questions will be asked pertaining to the borrower's business background and the viability of

Table 3: Common problems with SSEs (mean^a)

	Domestic	Foreign	Urban	Rural
1. Insufficient information	4.27	4.33	4.25	4.29
2. Lack of knowledge in accounting and working capital management	4.12	3.00	3.87	4.12
3. Lack of knowledge about banking facilities	4.08	3.33	3.93	4.08
4. Own capital contribution relatively small against loan required	4.08	4.00	4.00	4.12
5. Asking loan today and expecting to be approved tomorrow	4.08	2.66	3.87	4.04
6. No business plan	4.03	2.66	3.87	4.04
7. Business is a one-man show	3.97	3.00	3.94	3.87
8. Fail to impress banker during the first interview	3.86	3.33	3.81	3.83
9. Enter into competitive business	3.81	3.66	3.69	3.87
10. Unable to determine actual finance required	3.67	3.33	3.62	3.67
11. Inexperience in the purpose venture	3.54	2.66	3.44	3.50
12. No bank account	3.32	3.00	3.25	3.33

- a: 1 = never happen 2 = not often
 3 = sometimes 4 = often
 5 = happens all the times

the proposed project. Therefore, it is up to the borrower to convince the banker that he is a capable and knowledgeable businessman and that the loan granted will generate more profit to the business.

During my tenure as a branch manager, I encountered many problems when dealing with small scale entrepreneurs, and these problems were shared by other managers. Some common problems are listed in Table 3 (see p. 35).

Table 3 shows the perceptions of commercial bankers from different backgrounds. Some common problems faced by domestic commercial banks are insufficient information, lack of knowledge in accounting and working capital management, lack of information or knowledge about banking facilities, small capital contribution, expecting fast loan decisions, and the absence of a business plan. Insufficient information and small capital contribution are the only two prevailing problems faced by foreign commercial banks. The information also shows that customers of foreign bank are more knowledgeable than customers of the local banks.

Rural branches face more problems with SSEs than their urban counterparts. This is probably due to the availability of various facilities such as training opportunities, better communication networks, and more business opportunities open to the urban entrepreneurs.

How Bankers Perceive Small Scale Customers

The importance of SSEs to commercial banks may best be exemplified by the ratio of the total outstanding SSEs loans to the total business loans. The higher the percentage of outstanding loans, the more committed are the commercial banks towards SSEs. In 1970, the total credit to SSEs was 14.5% as compared to 6.3% in 1989. The yearly percentages from 1980 to 1989 are listed in Table 4.

From these figures, it may be deduced that commercial banks are not committed to helping small businesses. The percentage of outstanding loans to SSEs was 17.7% in 1980 and has been decreasing every year since then. At the end of 1989, the rate was only 6.6%.

Table 4: Outstanding loans to SSEs against total outstanding loans (in million)

	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: Bank Negara Malaysia, Annual Report, various issues.

Lack of confidence is the main factor which discourages commercial banks from lending money to SSEs. Only 47.5% of the respondents to the survey believed that their existing SSE customers would someday become commercial or corporate customers, whereas 52.5% were not confident of their SSE customers. Statistics of bankers' marketing visits to SSEs is further evidence of this lack of confidence in SSEs. Only 42.5% always visited SSE customers when making marketing visits, the other 57.5% seldom or never included SSEs in their itinerary.

Loan Application and Credit Appraisal

In any loan application, bankers will consider five basic factors—*character, capacity, capital, condition, and collateral*—prior to making any decision. Which factor gets the top priority depends very much on the individual bank loan policy and the perceptions of the managers. For SSEs, the emphasis on lending factors is shown in Table 5 (see p. 37).

Table 5 indicates that domestic commercial bankers regard character as the most important factor in their credit analysis followed by collateral, capacity, capital, and condition. Surprisingly, foreign commercial bankers perceive capital as the most

Table 5: Ranking of credit factors in order of importance (mean^a)

	Domestic	Foreign	Urban	Rural
Character	2.15	2.52	2.12	2.20
Capacity	2.97	4.00	2.94	3.10
Capital	3.08	1.50	2.62	3.30
Condition	3.85	3.00	3.87	3.75
Collateral	2.94	4.00	3.44	2.65

a : 1 = very important 5 = least important

important factor in their credit analysis and ranked character as the second most important factor.

Both urban and rural bankers tend to agree that character is the most important in comparison with other factors. However, rural bankers regard collateral as the second most important factor, which urban bankers regard as the second least important. The scarcity of collateral in the urban area would probably explain this finding.

How an SSE customer is introduced to the branch may create certain perceptions and to some extent influence a loan decision. As explained in Table 3, one of the common problems faced by managers is an applicant with no account with the branch. Without any account, it is difficult for them to assess the integrity of the applicant and the operation of the his business. Customers without an account with the branch will normally seek assistance from other

parties to introduce them to the bank. The 'introducer', to some extent, plays an important role in convincing the managers. Table 6 shows the various modes of introduction and how commercial bankers perceive them.

This table may serve as a guide to small businessmen intending to seek commercial bank facilities. Many bankers are not impressed when customers come to the branch with a politician. Most prefer customers who come as a result of their marketing call. The second most preferable method is customers who are introduced to the branch by existing customers.

For those who have just started a business, commercial banks is not the place to get financial assistance. Fifty-seven and a-half percent of managers either moderately agree, agree, or fully agree that those starting out in a new business should

Table 6: Frequency of response on the mode of introduction

	Like very much %	Like %	Neutral %	Dislike %	Dislike very much %
1. Political figure	2.5	5.0	35.0	35.0	22.5
2. Head office or other branch officer	5.0	35.0	50.0	5.0	5.0
3. Superior	7.7	35.9	43.6	10.3	2.6
4. Own marketing	43.6	41.0	10.3	5.1	0.0
5. Existing customer	5.1	46.2	46.2	2.6	0.0
6. Customer's own initiative	0.0	17.9	76.9	2.6	2.6

first try other institutions, such as MARA or other government agencies. Most commercial banks finance business expansion, but not the setting up of a new business.

CONCLUSION

The results of the survey provide information about the perceptions of commercial bank managers towards SSEs. Many reasons are linked to managers being non-committal towards financing small businesses. Statistics indicate that commercial banks are not reliant on SSEs. Bad experience with SSE customers is probably the main stumbling-block for managers not favouring SSE loans.

Nevertheless, a common consensus among managers is that they will give loans to SSE customers if these customers meet the lending factors listed in this paper. After all, giving loans is their main business, and no loans will be granted if they doubt the customer's repayment capacity or if the customer is unknown to them. Therefore, first timers applying for loans should not become too dejected upon

receiving loan rejection letters from banks. Instead, they should talk to and learn from those who are currently enjoying bank facilities and try to obtain clues on how to handle bank managers.

Although SSEs is no longer a priority sector, many commercial banks have begun to recognise that giving loans to SSEs may become a very profitable business. SSE customers will normally accept whatever terms and conditions of loans imposed by the banks. Big corporations on the other hand, always demand terms and conditions which will benefit them most. These corporations are also very particular about every step of the banking transaction and will often lodge complaints over any trivial matter.

Today, many banks have their own small business departments which introduce special promotional activities and assistance programmes such as courses and free consultations. Commercial banks which fail to recognise the significance and contribution of SSEs to their growth are missing the opportunities created by this sector, and more so in the future as the entrepreneurial spirit spreads.

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