

◆ INTERNATIONAL NOTE

LENDING TO SMALL BUSINESS IN MALAYSIA

Empirical research has found lack of capital to be one of the main causes of small business failure (Fredland 1976, DiPietro and Sawhney 1977, Peterson and Shulman 1987). For many Malaysian small business owners, this lack of capital results from their difficulty in obtaining bank loans (Chee Peng Lim 1986). They claim that it is very difficult to get loans, especially from the commercial banks. These small business owners feel that commercial banks are not sympathetic to their needs. Commercial bank officers tend to emphasize the importance of establishing and maintaining relationships with their major corporate customers. This is because corporate customers generally bring more income to the bank and carry less risk (Turnbull and Gibbs 1987). On the other hand, Buerger and Ulrich (1986) argue that small businesses provide a potentially profitable market for commercial banks. They claim that small businesses are dependent on commercial banks for both short- and long-term financing and that meeting the financing needs of small businesses helps to build the local economy, which in turn benefits the banks as loans and deposits grow.

The accessibility of small business to the loan facilities of commercial banks varies from country to country. Peterson and Shulman (1987) provide international evidence on bank financing of

small business in four stages of development: start-up, survival, growth, and establishment. They reported that, at the start-up stage of business development, 91 percent of the small firms in West Germany had bank loans, as did 56 percent in Canada, 21 percent in Japan, and 32 percent in the Netherlands. At the survival stage, 87 percent of small enterprises in West Germany had bank loans, whereas in Canada 73 percent had such loans, Japan 61 percent, and the Netherlands 60 percent. At the growth stage, in both West Germany and Japan 84 percent of small firms reported having loans, followed by Canada (77 percent) and the Netherlands (71 percent). During the establishment stage, 86 percent of small enterprises in West Germany had bank loans compared to Japan, Canada, and the Netherlands with percentages of 81, 67, and 67, respectively.

In some countries, special government institutions or agencies are established to assist small businesses with their financing needs. In Malaysia, for example, many institutions were established by the government with the objective of providing capital to small businesses. The most popular agency among small businesses is called "MARA." At the end of 1992, "MARA" had granted loans to 102,968 small businesses with a total value of RM 586 million (RM or Ringgit Malaysia, 1 US dollar = 2.50 Ringgit Ma-

aysia). Another Credit Guarantee which was established by the Malaysian small enterprise commercial bank. As of December 47,152 small enterprises with a total value of RM 1,170.2 million. This corporation has many similar agencies. In these businesses, they are solving small business problems. Limited services are overly complex procedures are potential businesses prefer special banks rather than established by. Unfortunately many banks are not responsive to business needs.

The Malaysian government's attention in helping small businesses obtain loans from the commercial banks is manifest in its regulations. The Central Bank has issued many guidelines over time regarding

1. In 1972, small business enterprises were deemed to be a priority by the Central Bank. These sectors were given special consideration in the Special Grant Scheme. The Bank's annual report.
2. A guideline is required that at least 10 percent of outstanding loans should be to small businesses.
3. Effective January 1992, a guideline requires that at least 10 percent of outstanding loans should be to small businesses. The "Loan Scheme" was implemented on December 31, 1992.

aysia). Another such agency is the Credit Guarantee Corporation (CGC), which was established on July 5, 1972 by the Malaysian government to assist small enterprises obtain credit from commercial banks at a reasonable cost. As of December 31, 1991, a total of 47,152 small enterprise loans valued at RM 1,170.2 million were guaranteed by this corporation. Although there are many similar agencies available to small businesses, they have not succeeded in solving small businesses' financial problems. Limited services, lack of funds, or overly complex loan application procedures are potential reasons why small businesses prefer to deal with commercial banks rather than the agencies established by the government. Unfortunately many of the commercial banks are not responsive to small business needs.

The Malaysian government's intervention in helping small enterprises obtain loans from the commercial banks is also manifest in its regulatory policies. Using the Central Bank as its regulatory body, many guidelines have been introduced over time regarding commercial banks:

1. In 1972, small businesses and agriculture were deemed a "priority sector" by the Central Bank, and loans to these sectors were reported under a special column, i.e., "Bank Lending to Special Groups" in the Central Bank's annual report.
2. A guideline introduced in 1979 required that at least 20 percent of the outstanding loans of commercial banks should be in the form of loans to small borrowers.
3. Effective January 1, 1981, a new guideline required commercial banks to extend at least 12 percent of loans outstanding as of December 31, 1980 to small businesses of which 5 percent should be granted under the "Special Loan Scheme" (SLS) of CGC by December 31, 1981.
4. In 1983, the guideline on the financing of small businesses was rescinded but commercial banks were required to maintain their respective levels of lending to this group to the end of 1982. However, the guideline for loans under CGC introduced in 1981 continued to apply.
5. Besides the 1981 guideline, another guideline was introduced in 1987 whereby commercial banks were required to extend new loans amounting to at least RM 150 million to small businesses under SLS-CGC and the compliance date of December 31, 1987 was set.
6. In 1988, the commercial banks were required to extend at least RM 300 million to small businesses. Of the RM 300 million, at least RM 150 million was to be extended under SLS-CGC. The compliance date of December 31, 1989 was specified.
7. In 1989, the commercial banks were required to extend at least RM 600 million to small businesses. Of the RM 600 million, at least RM 200 million was to be extended under the "Principal Guarantee Scheme" of the CGC (PGS-CGC). The compliance date was set for March 31, 1990.
8. In 1990, the small business sector was no longer considered a priority sector, but the guideline for PGS-CGC still holds.

These many guidelines do not seem to have changed the attitude of most commercial banks. They still tend to focus their efforts in fulfilling the needs of larger corporate customers. The importance of the small business sector to commercial banks in Malaysia may be measured by the ratio of the total outstanding small business loans to the total loans granted by the commercial banks. The higher the percentage of the outstanding loans, the more committed are the commercial banks towards small business. While the percentage of small

business loans in the United States was increasing (Struck and Glassman 1983), the ratio was decreasing for small business loans in Malaysia. In 1980, the total loans to small business was RM 3,330.7 million or 17.7 percent of the total outstanding loans, and the percentage has been decreasing every year since then. At the end of 1989, the ratio was only 6.6 percent (Haron 1990).

The purpose of this study was to collect information on the perceptions of Malaysian commercial bank loan officers towards lending to small businesses. It was designed to determine the problems faced by bankers in dealing with small businesses and to determine the extent to which these problems influenced the banker's decision making processes. For many commercial banks in Malaysia, the basic function of loan officers is to process the loan application and provide recommendations on the application. Common problems when dealing with the small business sector, preferable methods of initial contact, and factors used in credit appraisal by loan officers were examined. This study also explored the significance of each problem in influencing the loan officer's decision making during the loan appraisal process.

Because of the difficulties in obtaining financing from other sources and consequently greater dependence on commercial banks for both working and fixed capital financing, it is essential for small business owners to be aware of the common problems faced by the bankers when dealing with small business loans. Such an understanding will assist both bankers and small business owners in appreciating the difficulties faced by each other.

Methodology

Currently there are 37 commercial banks (21 domestic and 16 foreign banks) with 1,125 branches operating in

Malaysia. Of the 37 commercial banks, 4 are considered leading (big) banks and 33 are medium-sized banks. Although there is no clear demarcation for classification, all leading banks have total assets of more than RM 4 billion, whereas other banks have assets between RM 1 billion to RM 4 billion. For this pilot project, one leading bank and four other commercial banks were selected. The total branches for these selected banks were about 40 percent of the total of all commercial bank branches. One hundred and fifty questionnaires were mailed to the loan officers of selected branches, with the selection of branches based on systematic random sampling. Of the 150 questionnaires distributed to the loan officers, 49 loan officers returned the questionnaire giving a response rate of 33 percent. Since this is only a pilot study, no attempt was made to increase the number of responses. The existing data were considered sufficient to draw general conclusions.

The questionnaire contained three sections. The first section gathered information about the respondents' personal backgrounds. The characteristics of the respondents are presented in table 1. With respect to age, 65.3 percent of the loan officers are younger than 35 years old, while 63.2 percent of the loan officers have been with the bank for less than 10 years. In terms of qualifications, 38.8 percent of them possess either a degree or professional qualification, and 58.1 percent of those degrees held are in business, accounting, or economics. In terms of involvement in credit work, 65.3 percent of the loan officers have less than five years' experience.

The second section of the questionnaire was designed to collect information about the bank branch: location, size of deposits, and size of loans. The final part of the questionnaire was designed to generate data concerning the problems faced by the bank officers

Age:

Younger than 25
30 — 34
35 — 39
40 years and older

Highest academic qualification:

High school or diploma
Degree or professional

Discipline:

Business, accounting, economics
Arts, engineering, science

Length of service with bank:

Less than 5 years
5 — 9
10 — 14
15 — 19
20 years or more

Involvement in credit work:

Less than 5 years
5 — 9
10 — 14

*Varying in total duration

when dealing with small businesses. The frequency of occurrence of each problem was measured on a five-point scale, ranging from "never occurred" to "always occurred." The response was used to indicate the degree of various problems in the loan application process, consisting of a standard deviation analysis.

For the purpose of this study, "business" was defined as the Central Bank of Malaysia's

commercial banks, 4 (big) banks and banks. Although ation for classifi- ks have total as- billion, whereas s between RM 1 For this pilot pro- and four other selected. The to- selected banks of the total of all ches. One hun- tionnaires were icers of selected ction of branches andom sampling. res distributed to loan officers re- ire giving a re- ent. Since this is ttempt was made er of responses. e considered suf- conclusions.

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Table 1
CHARACTERISTICS OF RESPONDENTS

	Number*	Percent
Age:		
Younger than 29 years	17	34.7
30 - 34	15	30.6
35 - 39	14	28.6
40 years and older	3	6.1
	49	100.0
Highest academic qualification:		
High school or diploma	30	61.2
Degree or professional	19	38.8
	49	100.0
Discipline:		
Business, accounting, or economics	25	58.1
Arts, engineering, or science	18	41.9
	43	100.0
Length of service with the bank:		
Less than 5 years	11	22.5
5 - 9	20	40.8
10 - 14	8	16.3
15 - 19	8	16.3
20 years or more	2	4.1
	49	100.0
Involvement in credit work:		
Less than 5 years	32	65.3
5 - 9	14	28.6
10 - 14	3	6.1
	49	100.0

*Varying in total due to the missing responses.

when dealing with loan applications made by the small business owners. The respondents were asked to indicate the frequency of occurrence of the problems on a five-point scale ranging from "never occurred" to "occurred all the time." The respondents were also asked to indicate the degree of importance of various problems in influencing their recommendation for approval of the loan application. Univariate statistics consisting of arithmetic means and standard deviations were used in data analysis.

For the purpose of this study, "small business" was defined according to the Central Bank of Malaysia. This defini-

tion, which is also used by Malaysian commercial banks to classify their small business customers, states that a loan to small business is a loan of RM 500,000 or less granted to a business with net assets of up to RM 500,000 (or in the case of corporations, shareholder's funds of up to RM 500,000).

Findings

Under normal circumstances, banks will give a loan to a profitable or potentially viable business. After all, banking is largely a lending business, and its main source of income is the interest received from the loan granted. To ensure that loans are given to assist business owners in their venture, bank officers

must give their customers the right amount of credit, disbursed at the right time. Generally factors such as "character," "capacity," "capital," "collateral," and "condition" (the "Five Cs of Credit") are taken into consideration while appraising the loan application. A loan application goes through the following stages:

1. Preliminary interview
2. Second interview
3. Pre-decision visit
4. Loan decision
5. Loan documentation
6. Disbursement

The first three stages are the most important stages in the lending process. However, to some extent, the mode of introduction between the bank officer and the potential customer (which precedes the preliminary interview) will impact the decision-making process. Loan officers were not happy when potential borrowers seek assistance from politicians in the introduction process; the most preferred method of introduction is the establishment of a relationship as a result of the officer's marketing efforts. The second most preferred method perceived by loan officers was for existing customers to introduce the prospective customer.

During the preliminary interview, apart from the purpose of the loan and the source of repayment, many questions are asked by the officers, especially in the area of management, finance, and marketing. The borrower must be able to convince the bank officer that he/she is a capable and knowledgeable business owner and that the loan will be used for the intended purpose and to generate more profit. However, many officers encountered problems when dealing with the loan applications of small business owners. The list of problems and the frequency of occurrence is presented in table 2.

As shown, the five most common prob-

lems faced by the loan officers when dealing with small business owners were the applicant's lack of knowledge in accounting, incomplete information on the loan application, limited sources of income for the loan's repayment, insufficient personal financial contribution as compared to the loan requested, and running their business by themselves. The five least common problems were improper reasons for entering business, entering into unprofitable business, having no idea about the direction the business was going, and lack of confidence in applying for the loan.

Table 3 illustrates the level of importance associated with the problems that tend to influence the final decision of loan approval. The variable which loan officers perceived to be the most important in adversely affecting the decision-making process was the applicant's lack of knowledge in working capital management. The second most important variable perceived by loan officers was total dependence on business income as a source of loan repayment and the third most important factor was insufficient information on the loan application given to the bank.

Conclusions

This article sought to highlight the problems associated with lending to small businesses in Malaysia, as perceived by loan officers by using data from these loan officers to determine the various factors that relate to the approval or rejection of small business loan applications. The results of this study, though confined to five banks and involving only 49 loan officers, give insight to small businesses and to agencies established by the government, agencies whose central objective is to help small businesses.

In any loan application, bank officers will consider five basic factors — character, capacity, capital, condition, and col-

FREQUENCY OF OCCURRENCE OF PROBLEMS

1. Lack of knowledge
2. Total dependence on business income
3. Insufficient information on the loan application
4. Great urgency for the loan
5. Own contribution insufficient
6. Unable to explain reasons for entering business
7. Lack of knowledge in accounting
8. Lack of knowledge in working capital management
9. Business is a new venture
10. Entering into competition
11. Unable to provide collateral
12. Unable to determine the fate of their application
13. No proper business plan
14. Lack of knowledge in working capital management
15. Constantly disturbed by family matters
16. Lack of knowledge in accounting
17. Fail to impress the loan officer
18. Unable to decide on the loan
19. Total dependence on business income
20. Newcomer to the business
21. Having an attitude of dependence on the bank
22. Lack of confidence in the bank
23. Maintaining no relationship with the bank
24. Unclear about the loan
25. Entering into business without a plan
26. Entering into business without a plan

*1: Never occurred

lateral — prior decision. "Character" is the level of knowledge and the way the borrower runs his business, and the way he repays the loan. "Capacity" is the ability to pay back the loan. "Capital" is the assets that the borrower has. "Condition" is the state of the bank as a security. When lending to small businesses, loan officers are said to consider five basic factors — character, capacity, capital, condition, and collateral (Haron

Table 2
FREQUENCY OF OCCURRENCE OF MAJOR PROBLEMS FACED BY OFFICERS
WHEN DEALING WITH SMALL BUSINESS LOAN APPLICATIONS

	Mean*	S.D.
1. Lack of knowledge in accounting.	3.95	0.77
2. Total dependence on business income as source of loan repayment.		
No other source of income to support the application.	3.75	0.81
3. Insufficient information in the loan proposal given to the bank.	3.73	0.76
4. Great urgency for loan.	3.63	1.20
5. Own contribution relatively small compared to loan requested.	3.56	0.82
6. Unable to explain financial problem professionally.	3.50	0.68
7. Lack of knowledge about banking facilities available to them.	3.48	0.68
8. Lack of knowledge in working capital management.	3.41	0.86
9. Business is a one-man show.	3.40	0.94
10. Entering into competitive business.	3.39	0.73
11. Unable to provide collateral as requested to support the loan application.	3.38	0.96
12. Unable to determine actual amount of financing or loan required for the business.	3.33	0.90
13. No proper business plan.	3.31	0.99
14. Lack of knowledge in marketing.	3.23	0.66
15. Constantly disturbing officer by phone or other means to know the fate of their application.	3.16	0.87
16. Lack of knowledge in overall business management.	3.15	0.85
17. Fail to impress officer with appearance or personality during the first interview.	3.12	0.73
18. Unable to decide the appropriate banking facilities for their business.	3.10	0.94
19. Total dependence on officer to determine the amount required and other terms.	3.06	0.88
20. Newcomer to the venture.	2.94	0.72
21. Having an attitude that he/she is the only one who knows all the aspects of his/her business.	2.94	0.72
22. Lack of confidence and always relying on others to help them in the loan application.	2.90	0.99
23. Maintaining no account with the branch (bank).	2.88	0.86
24. Unclear about where their business is going.	2.85	0.86
25. Entering into unprofitable business.	2.71	0.84
26. Entering into business because of political reason or reason other than own interest.	1.99	0.81
*1: Never occurred 2: Not often 3: Sometimes 4: Often 5: Occurred all the time		

lateral — prior to making any loan decision. "Character" involves attitude, level of knowledge in all aspects of business, and the way of thinking of the borrower. "Capacity" relates to the ability to pay back the loan. "Condition" deals with the environment in which the business operates, and "collateral" refers to the assets that the borrower offers the bank as a security in case of default. When lending to small business, bank officers are said to perceive character as the most important factor in making any loan decision, followed by capacity and collateral (Haron 1990).

The importance of this study to small business owners lies in two areas. First, this study finds that problems related to the character factor indeed appear to be the major difficulty faced by the bank officers when dealing with small business customers. Some of the common problems are lack of knowledge in accounting, insufficient information on the loan application given to the bank, the business being a one-man show, lack of knowledge in working capital management, no proper business plan, great urgency for loan, and the applicant's inability to explain financial problems pro-

Table 3
IMPORTANCE OF PROBLEMS IN INFLUENCING FINAL DECISION ON LOAN

	Mean*	S.D.
1. Lack of knowledge in working capital management.	4.21	0.77
2. Total dependence on business income as a source of loan repayment. No other source of income to support the application.	4.18	0.77
3. Insufficient information in the loan application given to the bank.	4.17	0.90
4. No proper business plan.	4.13	0.77
5. Lack of knowledge in overall business management.	4.04	0.71
6. Entering into unprofitable business.	4.00	1.15
7. Unable to provide collateral as requested to support the loan application.	3.98	0.99
8. Newcomer to the venture.	3.93	1.03
9. Lack of knowledge in marketing.	3.91	0.70
10. Lack of knowledge in accounting.	3.89	0.88
11. Unclear about where their business is going.	3.87	0.87
12. Own contribution relatively small against loan required.	3.75	0.89
13. Unable to determine actual amount of financing loan required for the business.	3.69	0.90
14. Unable to decide the appropriate banking facilities for their business.	3.61	1.05
15. Unable to explain financial problem professionally.	3.60	0.84
16. Maintaining no account with the branch (bank).	3.58	1.22
17. Lack of confidence and always rely on others to help them in the loan application.	3.53	0.99
18. Entering into competitive business.	3.36	1.02
19. Lack of knowledge about banking facilities available to them.	3.37	1.02
20. Business is a one-man show.	3.25	1.01
21. Total dependence on officer to determine the amount required and other terms.	3.18	0.91
22. Entering into business because of political reason or reasons other than own interest.	3.09	1.29
23. Having attitude that he/she is the only one who knows all the aspects of his business.	3.09	0.98
24. Fail to impress officer with appearance or personality during the first interview.	3.08	0.98
25. Great urgency for loan.	2.86	1.13
26. Constantly disturbing officer by phone or other means to know the fate of their application.	2.80	1.06

*1: Not important at all 2: Not important 3: Slightly important 4: Important 5: Very important

professionally. Factors related to "capacity" are secondary and include total dependence on business income as a source of loan repayment, and no other source of income to support the application.

Second, if small business owners know the importance of each factor in influencing a loan officer's decision-making process, remedial action can be taken prior to approaching bank officers for financing. Clearly, bank officers perceived factors that relate to character as the most important factor when making the loan decision. (Interestingly, lack of knowledge in accounting was the most

common problem faced by the officers when dealing with small business customers, but this factor was not considered as the most important when making the loan decision). Officers perceived lack of knowledge in working capital management, an evidence of character, as the most important criterion when evaluating small business loans. Working capital management here means that small business owners must be able to handle cash, receivables, and inventories properly. Other character factors which officers perceived as of importance include insufficient information in the loan application

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4.17	0.90
4.13	0.77
4.04	0.71
4.00	1.15
3.98	0.99
3.93	1.03
3.91	0.70
3.89	0.88
3.87	0.87
3.75	0.89
3.69	0.90
3.61	1.05
3.60	0.84
3.58	1.22
3.53	0.99
3.36	1.02
3.37	1.02
3.25	1.01
3.18	0.91
3.09	1.29
3.09	0.98
3.08	0.98
2.86	1.13
2.80	1.06

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SMALL BUSINESS HOTLINE

The Export-Import Bank has instituted a toll-free Small Business hotline: 800/424-5201. This is a specialized service for smaller exporters needing both general information and problem-solving assistance in conducting business overseas. It provides information on export credit, available assistance from other government agencies and certain private sector sources.

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