

ENTREPRENEURS' AWARENESS OF BANK BORROWING OFFERED BY GOVERNMENT AGENCIES AND COMMERCIAL BANK IN MALAYSIA

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Abstract

In Malaysia, it has shown that the commercial bank and government agencies are helping SMI's to obtain loans. However, entrepreneurs' awareness level on loan facilities provided by the government agencies and the commercial banks resulted these loan services rendered by the bank and government agencies are not fully utilized by the SMI entrepreneurs. The purpose of this study is to investigate the awareness level by SMIs entrepreneurs on lending offered by commercial bank in northern region in Malaysia. The result of the study shows that the majority of the entrepreneurs surveyed, did not realize the existence of loan facilities and loan related-information for SMIs. The gap on information of loan facilities was found to be the main factors that contributed towards unsatisfactory loan applications by the SMI entrepreneurs. The entrepreneurs were preferred to apply for loan facilities provided by commercial banks instead of government agencies for their future financing choices. The study suggests that the government and commercial banks should bridge the loan information gap which is found to be mainly due to the lack of promotional activities on loan availability to SMIs entrepreneurs and also due to their socio-economic background and locality.

1. INTRODUCTION

The small and medium industries (SMIs)¹ play an important role in providing linkages to export-oriented industries in Malaysian economy development (Bank Negara Malaysia, 31 March 2000). The SMIs are expected to contribute significantly in terms of value added and labour absorption in economic growth, particularly in the manufacturing sector, as driver of growth.

Perlis and Kedah have contributed a total of 4 per cent of small scale industries and 6.5 per cent for medium scale industries (see Table 1). For small-scale industries, the major contributing states (more than ten per cent) are Penang (ten percent), Perak (thirteen percent), Kuala Lumpur (ten percent), Selangor (seventeen percent), and Johore (eighteen percent). The lowest is Perlis, that to be 1 per cent (excluding Labuan, less than half per cent). Meanwhile, Kedah recorded three per cent Negeri Sembilan and Melaka, which contributed two per cent respectively. For medium scale industries, Kedah contributes 6 per cent while Penang (eleven percent), Perak (nine percent, Kuala Lumpur (eight percent), Selangor (twenty three percent), and Johore (twenty two percent. Perlis only contributes less than half per cent.

¹ According to MITI (Ministry of International Trade and Industry), the definition of SMI is a firm which employed full-time workers that lower than 150 people, and annual sales turnover to be not more than RM 25 million paid up capital and less than RM 5 million (<http://www.miti.gov.my/>).

Table 1. Profile of SMIs - by Size within State

State:	Small Scale Industries	Medium Scale Industries
=> <i>Perlis</i>	<i>1%</i>	<i>less than 0.5%</i>
=> <i>Kedah</i>	<i>3%</i>	<i>6%</i>
=> <i>Penang</i>	<i>10%</i>	<i>11%</i>
Perak	13%	9%
Kuala Lumpur	10%	8%
Selangor	17%	23%
N.Sembilan	2%	3%
Melaka	2%	3%
Johor	18%	22%
Pahang	3%	2%
Kelantan	9%	3%
Terengganu	6%	3%
Sabah	3%	3%
Sarawak	4%	3%
Labuan	less than 0.5%	- %

(Source: adapted from <http://www.smidec.gov.my> , 22 June, 2000)

Table 2 shows that Bumiputra SMIs have not achieved their loan target. For instance loans of RM500,000 and below achieved RM 511.4 million compared to target of RM 571.0 million.

Table 2. Commercial Banks: Lending Guidelines to SMIs

	1998/99 (performance as at end-1999)	
Loans of RM500,000 and below:	Target	Achieved
▪ Total loans approved (RM million)	1,064.7	1,984.3
▪ Non-compliance (no. of institutions)		(6)
Of which: for Bumiputera		
▪ Total loans approved (RM million)	571.0	511.4
▪ Non-compliance (no. of institutions)		(18)
Loans of RM5 million and below:	Target	Achieved
▪ Total loans approved (RM million)	1,043.0	2,052.3
▪ Non-compliance (no. of institutions)		(11)
Of which: for Buniputera		
▪ Total loans approved (RM million)	521.5	527.9
▪ Non-compliance (no. of institutions)		(27)

(Adopted partly of Table A.52: Commercial Banks: Lending Guidelines to the Priority Sectors, Bank Negara Malaysia, Annual Report 1999)

2. PAST STUDIES

Small firms usually depend on financial intermediaries, particularly the commercial banks in order to obtain credit for their operations (Berger and Udell 1995). For Malaysia case, Sudin and Shanmugam (1994) found 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. The main reasons are the lack of knowledge in accounting, the *insufficient information on loan application given to the bank*, the business being a one-man show, the lack of knowledge in working capital management, no proper business plan, great urgency for loan, and the applicant's inability to explain financial problems professionally. The banks' willingness to provide needed financing was the primary selection criterion given by these small businesses for choosing their lending banks. An IBM Consulting Group (1995) survey of small-business perspectives toward commercial bank revealed significant dissatisfaction with bank financing and services. Another survey on small-business owners in Canada revealed that obtaining financing is no longer the most serious concern due to of the industry's effort to gather detailed information about the availability of credit to small business (Canadian Banker, 1997).

Graeme (1993) states that a small business using bank finance should ask for services, including:-

1. flexibility in the type of facilities provides,
2. end of financial year tax planning including payment of interest in advance,
3. consistency in the interpretation and implementation of the bank's policies and decisions at all levels of the bank,
4. direct dealing with the bank's officers responsible for the loan facilities and the ability to deal with these people on a continuing basis.

Larry (1992) found that the typical interaction between banker and borrower over prospective business loans often proves unsatisfactory for the small business owner.

Local banking institutions continue to represent the most readily-accessible sources of outside capital for small businesses, both for start-ups and expansion of already-established business. A point stated out is that bankers do not spend enough time explaining underlying principles behind commercial lending time-tested principles that generally serve as the framework for all commercial loan decisions. As reported by Clarke (1999) the full story on Small and Medium-sized enterprises (SMIs) financing market, policy makers need more information from other suppliers of credit and about other types of financing. While the Canadian Bankers Association publishes the seven major banks' business credit statistics on a quarterly basis, there's no comparable information available about the other sources of SMI financing.

Nakamura (1993) mentioned that information externalities constitute the reason for credit markets unreliability. An information externality in credit markets exists when each lender relies on information generated by the lending activities of other institutions. Banks tend to raise their lending requirements more during an economic down-turn, creating a *credit crunch* that borrowers have difficulty obtaining credit at any price. This dynamic interaction between information and economic behavior involves an externality - that is the failure of one borrower to conclude a loan and to make loans more costly and harder to obtain for later borrowers.

The reduction in economic activity leads to less information and thus a further reduction in economic activity. As such, there may be a useful role for the Government to play in encouraging credit activity. Cowling and Westhead's study (1996) suggests that small

firms should provide their bankers with more detailed financial information. The 'finance gap' is a function of limited debt funding opportunities for small firms because the cost of debt to small firms is significantly greater than for large firms (Holmes, Dunstan and Dwyer, 1994, p. 27). They (Holmes, Dunstan and Dwyer, 1994) found that for micro-small and small firms, application cost including costs associated with completion of the information requirements of the lending institution, represented a significantly greater proportion of total funds borrowed than for medium and large firms. Small firms can experience a loan gap because they have insufficient business collateral.

According to Lund and Wright (1999), economists have often argued that market imperfections in the financing of small firms arise mainly because of information asymmetries - the owner of a small business generally has much better information than the bank on his firm's performance, and has more control of the outcome. Such problems can lead to credit-rationing for small and medium-sized enterprises that is, finance is not made available to all firms with viable projects whose net present value is positive.

3. THE PURPOSE OF THE STUDY

The motivation of the study is based on observation that most SMIs failed to obtain required financing due to low level of awareness or poorly advised about appropriate sources of finance. Hence, the information gap has provided the rationale for the activities of many enterprises, which have sought to provide SMIs with comprehensive information on funding sources (Aston Business School, 1991). In this regards, many small firms are prevented from getting loans due to lack of information

and awareness level. A lack of knowledge or imperfect information found to be the main reason why SMIs failed to approach appropriate funding bodies (Bannock and Partners, 1991; Harvey, 1992). However, Bates and Hally (1982) and CBI (1982) pointed out that the root of the problem often lies with the owner managers themselves. This is because, they tend to react late to information and they do not approach the appropriate persons for advice until a funding crisis occurred.

The problems faced of Malaysian SMIs, despite the calls for financial institutions to be more liberal in providing financing for small and medium industries continue to gripe about the difficulties faced in securing loans (Sunday Star, 8, October 2000, p. 20). In 1999, the Malaysian Finance Minister threatened to withdraw the unutilized funds from the banks, and a year later, the issue remains unresolved (Sunday Star, 8 October, 2000 p. 20). According to Looi (Sunday Star, 8 October 2000, p.20), SMI Association of Malaysia president, one major hitch in SMIs securing a loan pertains to collateral. Banks have to shift from this primitive, collateral-based lending because they cannot expect too much collateral from SMIs. Looi added that sometimes SMIs have no choice but to turn down an approved loan because the amount granted is less than what they asked for, and this leads the banks to believe that the SMIs are not genuine in wanting the loan.

Thus, the purpose of this study is to survey the SMI's awareness towards the information on funds provided by the lending institutions.

4. METHODOLOGY

For the purpose of the study 136 samples of SMIs in Penang , Kedah and Perlis were systematically drawn from a sampling frame of Small and Medium Industries Development Corporation (SMIDEC) directory. Structured questionnaires were administered by mail and followed by telephone call. Forty respondents responded which account twenty nine percent of the samples. The questionnaires were designed with two sections. The first section is about the SMI's background and lending information and second section are the questions about lending awareness. The data were analyzed using the descriptive analysis, t-test, and analysis of variances to develop respondents' profile and test of significant differences.

FINDINGS

Table 3 reports the profile of the respondents . The profile shows that fifty seven and a haft percent of respondents are from Penang and the remaining are from Kedah and Perlis. Firms ownership are fifty seven and half percent bumiputra and the other forty two and half percent owned by non-bumiputra. From the industry categories, most of the respondents do not involved major industry (forty percent) as categorized by Small & Medium Industries Development Corporation (SMIDEC). The operation mainly involved small scale labor that is less than ten employer, however twenty seven and half percent of firms are in the category of employment more than forty employer. It is surprisingly that, more than half of the respondents (sixty two and half percent) do not realized and understood about SMI financing facilities. In order to see the behavior of bank's preferred, the study found that Maybank is the most preferable, followed by Perwira

Affin Bank and Public Bank. The main objective of loan requested by entrepreneurs is for their business operation and product expansion. The need for working capital and financing and starting capital is also motivate SMIs to borrow from commercial banking institutions. This indicates that the lending are directed into long-term productive uses instead of short-term cash flow problems. This study reveals that the SMIs still prefer to deal with commercial banking institutions as compared to government agencies for their future financing choices.

Table 3. Characteristic of Respondents

State of Industry Operated:	Percent
Penang	57.5
Kedah & Perlis	42.5
Ownership:	
Bumiputra	57.5
Non-Bumi	42.5
Type of Industry:	
Food beverage & tobacco	7.5
Fabricated metal products, machinery & equipment	20.0
Wood & wood product	7.5
Texite, wearing apparel & leather	7.5
Chemical& of chemical pertroleum, coal and ect.	17.5
Others	40.0
Category of Employment:	
less than 10	40.0
11 to 20	20.0
21 to 30	7.5
31 to 40	5.0
more than 40	27.5
Understanding SMI Facilities:	
Yes	37.5
No	62.5
Major Banks Used in Recent:	
Bank Islam	7.7
Mayban	35.9
Mayban Finance	5.1
Public Bank	10.3
Perwira Affin Bank	12.8
Bumiputra-Commerce	10.3
Ban Hin Lee	2.6

MBF	5.1
Hong Leong Finance	2.6
RHB	7.7
Objective of Loans Financing:	
Operational & Product Expansion	40.0
Working Capital Need	27.5
Starting Capita	15.0
Refinancing	10.0
Others	5.0
Cash flow problem	2.5
Financial Institution Preferred for Future Financing:	
Commercial banks	65.0
SME Agency	20.0
Finance companies	12.5
Others	2.5

The second section of the questionnaire was designed to collect information about the bank lending awareness. The questions were designed to generate data concerning the problems faced during loan financing in commercial banks using fix-point scale ranging from “unimportant” to “vital”. For the purpose to occur the information about the attitude of commercial banks toward loans financing.

Problems Faced for Loan Application Process.

Table 4. Problems Faced of Loans Application

	Mean	S.D	Rank
Cost of Borrowing	4.15	1.81	1
Prospect of Future	3.60	1.69	2
Past Performance	3.45	1.72	3
Collateral	3.40	1.61	4
Economic downturn	3.33	1.48	5
Lack of SMI information from Bank	2.83	2.12	6

The finding of the study shows that cost of borrowing to be the major problem for SMI financing application, (table 4). The future prospect and past performance of the firms are also important issue to be considered while financing requested. Of the information gap

justification, lack of SMI information from banking institutions found not to be the major problem of loan applications.

Table 5. Problems Faced During Loan Application Process Associated with Ownership

	Mean:		t-value
	Bumiputra	Non-Bumi	
Lack of SMI information from Bank	3.1739	2.3529	1.216
Past Performance	3.8261	2.9412	1.639***
Collateral	3.5217	3.2353	0.550
Prospect of Future	3.0870	4.2941	-2.358**
Economic downturn	3.5217	3.1176	0.852
Cost of Borrowing	3.4348	5.1176	-3.508*

* $\rho < 0.01$, ** $\rho < 0.05$, and *** $\rho < 0.10$

Table 5 reveals the significant differences between Bumiputra and Non-Bumi perception that cost of borrowing and prospect of future as major problems faced during loan application process. Other elements found no significant different between the ethnic group.

Table 6. Problems faced during loan application process with Status of SMI Financing

	Mean		t-value
	SMI financing	No SMI financing	
Lack of SMI information from Bank	2.50	2.93	-0.554
Past Performance	3.80	3.33	0.737
Collateral	3.60	3.33	0.448
Prospect of Future	3.20	3.73	-0.861
Economic downturn	2.40	3.67	-2.502**
Cost of Borrowing	4.50	4.03	0.703

** $\rho < 0.05$

The results of Table 6 show that there are differences between SMI financing firms and non-SMI financing firms perceived the economic downturn as problems faced during loan application process. Other factors found no differences between SMI financing status firms.

Table 7. ANOVA - Problems faced during loan application process with type of Industry

	F-statistic
Lack of SMI information from Bank [a]	2.103***
Past Performance [b]	3.515**
Collateral	1.125
Prospect of Future	1.113
Economic downturn	1.905
Cost of Borrowing	1.423

** $\rho < 0.05$ and *** $\rho < 0.10$

Note:	Mean
[a]	
Food Beverage & Tobacco	1.667
Fabricated metal ect.	3.375
Wood& wood product	2.000
Texite, wearing apparel ect.	1.000
Chemical & chemical ect.	4.571
Others	2.500
[b]	
Food Beverage & Tobacco	3.667
Fabricated metal ect.	4.375
Wood& wood product	2.000
Textile, wearing apparel ect.	6.000
Chemical & chemical ect.	3.286
Others	2.813

The analysis of variance revealed that there is a significant different between type of industry facing the problem of lack of SMI information from bank and past performance. Chemical industry is the major industry facing the problem of lack of SMI information from bank. Past performance is the major problem for textile, wearing apparel industries in order to apply loans financing. These findings can be explained by the statement made by vice-president of the Malay chamber of commerce, who says that "Banks use criteria like payback period, return of investment and viability as the determining factors. Some

use the excuse that they follow the guidelines stipulated by Bank Negara, and as a result they can't give out loans to certain sectors or that they have reached the quota of a particular fund".

Willingness To Provide Financing Facility:

Table 8. Willingness of Bank to Provide SMI Facilities

	Mean	SD	Rank
Bank provide sufficient Financing Information	3.025	1.4049	1
Information from SMI fair of bank counter	2.825	1.5172	2
Informed timely by banker personal visit	2.800	1.2649	3
Banker update upcoming financing facilities	2.725	1.3202	4

As results shown in Table 8, from perception of respondents, bank fail to provide sufficient information, but unwilling to update loans information. The SMI fair found to be a channel for financing information. This finding is consistent with the current issue address by the president SMI Association of Malaysia who says that "Bankers have been giving out loans but only on a very selective basis and loans are only given out to viable businesses but the issue of viability is according to the banks' interpretation". He added that banks prefer to award loans to bigger companies and multinationals. In addition, the fact remains that many SMIs do not satisfy the requirements stipulated by financial institutions (Sunday Star, 8, October 2000, p. 20).

Table 9. Willingness of Bank to Provide SMI Facility associated with Ownership

	Mean:		t-value
	Bumiputra	Non-Bumi	
Bank provide sufficient financing Information	2.6957	3.4706	-1.853***
Informed timely by banker personal visit	2.3913	3.3529	-2.537**
Banker update loans upcoming financing facilities	2.4348	3.1176	-1.653***
Information from SMI fair of bank counter	2.8261	2.8235	0.005

** $\rho < 0.05$ and *** $\rho < 0.10$

The study found that non-bumi SMIs are more sufficient, timely, and aware in getting lending information (table 9).

Plan to Obtain SMI Financing

Table 10. Plan to obtain SMI Financing

	Mean	SD	Rank
Update business plan	3.95	1.0365	1
Need more working capita in future	3.78	1.2707	2
Need information about SMI	3.18	1.3939	3
Plan to apply SMI	3.08	1.4031	4
Follow-up SMI announcement	2.65	1.3117	5

Table 10 indicates the behavior of respondents to obtain SMI financing. Updating business plan is the major activities of planning to obtain loans. This is true that according one banker said that "... We can't just give it (loan) out to anybody, especially when many of the loan applicants come to us with very shabbily presented proposals" (Sunday Star, 8 October 2000, p.20). However, they unwilling to apply SMI (rank 4) and follow-up SMI news. This show that the firms are more rely the information that supplied by banking institutions.

Table 11. Plan to obtain SMI Financing associated with Ownership

	Mean		t-value
	Bumiputra	Non-bumi	
Update business plan	3.696	4.294	-1.972***
Need information about SMI	3.217	3.118	0.221
Need more working capita in future	3.696	3.882	-0.455
Follow-up SMI announcement	2.609	2.706	-0.229
Plan to apply SMI	3.000	3.177	-0.389

*** $\rho < 0.10$

From Table 11, Non-Bumi found to be more aggressive to obtain financing facility compared to Bumiputra particularly by their commitment to updating their business plan.

Table 12. Plan to obtain SMI Financing associated with SMI Financing

	Mean		
	SMI financing	No SMI financing	t-value
Update business plan	3.700	4.033	-0.732
Need information about SMI	3.600	3.033	1.117
Need more working capita in future	4.300	3.600	1.535
Follow-up SMI announcement	3.100	2.500	1.262
Plan to apply SMI	3.700	2.867	1.663

Table 12 shows that there are no differences between the firms under SME financing or no in order of their willingness to apply SMI financing in future.

6. IMPLICATIONS AND DISCUSSION

The results appear to answer the objectives of the study to discover the information gap SMIs on the lending facilities available and provided by the government agencies and the participating commercial banks in Northern region of Malaysia. It is surprisingly that more than half of the respondents (62.%) significantly, do not understand or the existing of information towards SMIs financing facilities.

While past research had found that the typical interaction between banker and borrower over prospective business loans often proves unsatisfactory for the small business owner (Larry 1992). This study indicate that the information of loan facilities are the main factors that contributed towards unsatisfactory for SMIs on loan decisions.

Secondly, this study found that the SMI still prefer to deal loan facilities or financing available with commercial banking institutions instead of Government agencies even for

future financing choices. In addition, only 25% responded are categorized under financing of SMI facilities and a larger portion of remaining respondents about 62.5% related to the extend of SMI financing information found do not understand about SMI financing packages.

The availability of lending in the government and the commercial banks is to support the growth of SMI that contribute to the stimulation of the economy. Various initiatives, supports and incentives have been introduces by the government agencies as well as the private sectors. The above objectives cannot be achieved as long as SME do not understand about SMI financing packages that is currently available. To overcome this situation, the government and commercial banks should find out the reason for such lacking and perhaps this due to internal and external factors such as promotion and advertisement. Another possibility of lacking in the information could be the socio-economic background and the location of the businesses.

However, the study has some limitations and suggestions. First, the scope of sample only focus on Northern State, there are Kedah, Perlis, and Penang. The sample on overall SMI in Malaysia is suggested for future study. Second, the information of the study on focus on descriptive information. A study on the determinants of success of getting SME financing from commercial banks can be done as further study.

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