

ALTERNATIVE MODEL FOR FINANCING MICRO ENTERPRISES IN MALAYSIA

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ABSTRACT

The contributions of micro enterprises (MEs) in Malaysia can be measured in terms of some inter-related issues: economic, social and political. Despite these recognized importance and the largest contributor to SMEs - the micro enterprises have hardly considerable financing assistance. MEs are considered as risky business and strict loan conditions have been imposed on them such as strict collateral requirement, high cost of financing, strict documentation requirement and good business track record. Unfortunately, most of them cannot fulfil these conditions and continue to face the problem of accessing finance. Thus, the present study has used content analysis to critically survey the literature on the subject. This study aims to propose an Integrated Cash Waqf Micro Enterprise Investment (ICWME-I) Model as a solution to overcome MEs' financial constraints and enhance their activities that contribute to the national income. The study concludes with some suggestions for future research.

Keywords: Micro Enterprises, Financing, Integrated Cash Waqf Micro Enterprise Investment (ICWME-I) Model

1.0) INTRODUCTION

The role of micro enterprises (MEs) has been identified in both developed and developing economies that play significant role. According to Hailey (1991), the role of MEs can be measured in terms of some inter-related issues: economic (income generation), social (poverty reduction) and political (wealth redistribution). For the economic contribution by MEs, it includes employment creation, wealth creation, increase of output, mobilization of local resources and adaptation of indigenous technologies. Meanwhile, the social benefits include a reduction of poverty, balanced development, provision of goods and services appropriate to local needs, a seed bed for new initiatives, and redistribution of both income and opportunity in the community. The role of MEs in political can be realised from the redistribution of wealth, opportunity and therefore power within the community. Furthermore, it is noted that MEs contributions also cover a wide range of areas and sectors with disproportionate number of total establishments in many countries. Some statistics indicate that MEs represent about more than 70 percent of the total SMEs establishments in the most world economies and these enterprises contribute around 60 percent of total employment.

In Malaysia, MEs form a largest composition of the enterprises along with small and medium enterprises with 77 percent, 20 percent and 3 percent, respectively (Economic Census: Profile of SMEs, 2011). MEs in Malaysia is defined as the establishment with less than 5 employees or less than RM 250,000 of the sales turnover for all sectors namely agriculture, mining & quarrying, construction, services and manufacturing. In terms of the contribution to the national gross output and value added, Malaysian MEs contributed RM93.6 billion and RM54.53 billion, respectively (Economic Census: Profile of SMEs, 2011). Meanwhile, for the total employment of MEs in Malaysia, MEs employed 1.3 million workers or 36.5 per cent, with an average of 3 workers per establishment.

Despite these recognized importance and its contribution towards the economy, MEs in Malaysia face hurdle in accessing external finance. The studies by (Hashim, 1999; Ting, 2004; Saleh & Ndubisi, 2006; Abdullah & Mannan, 2010; SME Annual Report, 2011/2012; SME Masterplan, 2012-2020; Aris, 2006) pointed out that lack of accessing finance from financial institutions and government development agencies were cited as major hindrances to MEs development. Among the factors that hindered their access to external finance are (i) inadequate collateral, (ii) insufficient legal status, (iii) high transaction costs, (iv) insufficient information and documentation, (v) no financial track record, (vi) nature and quality of business, (vii) rigidity of the financing procedure and (viii) lack of awareness on financial facility. Furthermore, most of the financial institutions do not serve MEs because MEs are perceived as high risks of default, high costs involved in small transactions and perceived low relative profitability. Although the Malaysian government has provided various financial schemes, yet the impacts of such schemes are yet to be felt whereby MEs continuously affected with this problem.

Thus, given this scenario, the present study attempts to address the following questions: (i) Does the existing policies provided by the government are ineffective in addressing the need of micro enterprises and to create a long-term sustainable growth of micro enterprises in particular? (ii) Supposedly, if there is a new viable and attractive model that can mitigate the micro enterprises risk factor [financing], can it enhance and harness the

potential of micro enterprises towards increasing output and GDP? Therefore, the present study aims to propose a viable and attractive model which is known as Integrated Cash Waqf¹ Micro Enterprise Investment (ICWME-I) Model and demonstrate that it is possible to effectively address the issue of financing faced by MEs in Malaysia. By offering such a viable and attractive model, it could enhance their potential to contribute to the national income and increase their productivity.

2.0) LITERATURE REVIEW

The recent survey which was held in Second Quarter of 2012 indicates that 33 percent of enterprises in Malaysia are facing the problem of accessing external finance. Thus, various studies have been carried out by the researchers as part of the efforts to trace the root of the problems of accessing external finance faced by micro enterprises in Malaysia.

Based on the findings by Hashim (1999), Saleh & Ndubisi, (2006), Abdullah & Mannan (2010), Hassan et.al (2010), Selamat et.al (2011), Aris (2006), Hamdan et.al (2012) and Economic Census: Profile of SMEs (2011), the problems of accessing external finance can be classified into (i) lack of collateral, (ii) insufficient documents to support loan application, (iii) no financial track record, (iv) nature of businesses (v) high cost of borrowing (vi) rigidity of the financing procedures, (vii) characteristics of micro entrepreneurs, (viii) lack of awareness on financial assistance facilities.

2.1) Lack Of Collateral

In the case of external debt financing particularly from the financial institutions, the financial institutions typically request collateral in order to mitigate the risks associated with the moral hazard. However, the lack of collateral is probably the most widely cited obstacle encountered by micro enterprises in accessing finance including in Malaysia. For financial institutions, the majority of the MEs do not have acceptable collateral that can make them qualify for a loan.

In Malaysia, the study conducted by Aris (2006) and Meza (2012), they found that an absence of adequate collateral and strict collateral requirement prevented micro enterprises in from getting loan from the financial institutions. In 2005 only, almost 56 percent of micro enterprises in Malaysia found the difficulties to access external financing due to the lack of collateral (Aris, 2006).

2.2) Insufficient Information & Documents

Lack of accessing external finance by micro enterprises also occurs due to the insufficient information and documents to support loan application (Census of Establishment and Enterprise, 2005; SME Annual Report, 2006). Information related to the business such as size, age and type of ownership are needed by the financial institutions before approving the application of financing. As micro enterprises are often on the stage of start-up and opening new plant, most of them probably do not have enough information and documents to support their application for financing. Hence, as there is absence of insufficient information and documents of their businesses, the financial institutions are reluctant to provide financing to them.

¹ Waqf is one of the charitable trust or endowments that can be categorized into liquid assets (cash) and illiquid asset (land, other immovable assets). The Waqf has three main characteristics which are: (i) perpetuity, (ii) inalienability and (iii) irrevocability (Kahf, 2007).

The statistics provided by Census of Establishment and Enterprise (2005), indicated that more than 13 percent of the micro enterprises in Malaysia were constrained from accessing external finance due to insufficient information and documents to support loan application.

2.3) No Financial Track Record

Traditionally, one of the key requirements in credit evaluation by financial institutions is the financial track record behaviour of micro enterprises. However, micro enterprises in Malaysia are having difficulty in getting finance from commercial financial institutions because they are not able to provide financial track record (Aris, 2006; Hassan et.al, 2010; SME Annual Report 2009/2010).

As most of micro enterprises are involved at the early stage of businesses and start-up businesses, they are not able to provide any financial track record history. In the absence of such record, micro enterprises are considered as risky business and the financial institutions are reluctant to extend financing for them. According to the statistics released by Census of Establishment and Enterprise in 2005, almost 11 percent of micro enterprises in Malaysia were unable to access external finance due to the failure of them to provide financial track record.

2.4) Nature And Quality Of Business

The nature and quality of business of micro enterprises are also the obstacles for them to get financing from financial institutions in Malaysia (Census of Establishment and Enterprise, 2005; SME Annual Report, 2007). As micro enterprises are considered as a risky business, the financial institution in Malaysia assumed that the nature of their businesses do not meet the basic standards for receiving any serious consideration for financing. It is also complicated with the quality of business plan that are submitted for financing, which is often fall below minimum standards.

Based on the statistics provided by the Census of Establishment and Enterprise (2005), more than five percent of Malaysian micro enterprises claimed that they were unable to obtain financing because of the nature and quality of their businesses.

2.5) High Cost Of External Financing

Numerous studies have pointed out that high cost of external financing particularly interest rate is a reason why micro enterprises in Malaysia reluctant to not access external finance from financial institutions (Saleh et.al, 2008 SME Annual Report, 2009/2010; SME Annual Report, 2011/2012). Usually, the financial institutions charge higher interest rates to micro enterprises in order to compensate for the higher costs of information collection, the smaller volume of external financing and the greater risk of failure. Furthermore, due to the absence of collateral by micro enterprises, many of the financial institutions therefore respond to this situation by imposing high interest rate in the credit market.

The financial institution and micro finance institutions in Malaysia offer loans to micro enterprises at high interest rates. For example, several commercial banks such as Agro Bank Malaysia, Maybank Malaysia, Public Bank Malaysia and SME Bank of Malaysia offer micro financing scheme at the rate range from 5 % to 15 %, while micro finance institutions such as Amanah Ikhtiar Malaysia (AIM) offered financing at 10 %. The recent survey which was held in second quarter of 2012, indicated that about 33 percent of the enterprises in

Malaysia were facing the problem of accessing finance due to the high cost of external financing (SME Annual Report, 2011/2012).

2.6) Rigidity Of The Financing Procedures

According to the studies by Hassan et.al (2010) and SME Annual Report (2009/2010), they found that micro enterprises in Malaysia were unable to access external financing due to the excessive rigid procedures that imposed by the financial institutions and government agencies. For example, the financial institutions tend to scrutinise different aspects of micro enterprises when making the lending decision, with the first step in the loan approval often involving the banks attempting to seek more details from borrowers. Later, it is followed with several documentation processes which involving lending terms and conditions, and long-time processing of loan (Braveman & Guasch, 1986).

On the other hand, the government agencies that provides financial assistance for micro enterprises also practising bureaucracies, red-tapes and favouritism. As such application processes that are complicated and time-consuming causing micro enterprises to seek loans from internal sources.

2.7) Characteristics Of Micro Enterprises

According to Lean & Tucker (2001), to some extent the problem of accessing finance from financial institutions by micro firm are also happened due to the characteristics of the firm itself the characteristics of the owner-manager of the firm. For the characteristics of the firm, Storey (1994) stated that firm age and size become the factors for accessing external financing. As the size of micro enterprises are very small and most of the micro enterprises involve in start-up stage compared to small and medium enterprises, the lenders are not preferable to provide financing for this group (Sahlman, 1990). For the lenders, it is known that the likelihood of failure among micro enterprises is clearly higher than among their larger counterparts (Agarwal & Audretsch, 1999; Sutton, 1997).

Meanwhile, in terms of the owner-manager's characteristics, Storey (1994) identified that the characteristic of owner-manager such as gender, age, educational attainment and experience become the factors to access external finance. For the gender, although the women represent the largest share in micro enterprises including in Malaysia (Economic Census; Profile of Small and Medium Enterprises, 2011), they are also facing difficulty in accessing external finance. It happens due to the reluctance of the lenders to lend to them. For the lenders, women's businesses are perceived to be riskier, higher cost, and generate lower return (International Finance Corporation, 2011). It is also compounded with the perception by the lenders that women are having lower education, lower skill level, and less working experience (International Finance Corporation, 2011). Thus, the financial institutions are averse to lend to women-owned enterprises as the financial institutions do not consider them as attractive and profitable undertakings (Bhattacharya et.al, 2000).

2.8) Awareness Of Financing Facility

Entrepreneurs' awareness level on loan facilities provided by the government agencies and the commercial banks also lead these loan services rendered by the bank and government agencies are not fully accessed by the micro enterprises including in Malaysia. Several studies pointed out that lack of awareness on financing facilities among enterprises prevented them from accessing external finance (Idris et.al, 2001; Hashim et.al, 2007).

According to the study by Idris et.al (2001), they found that the majority (62%) of the entrepreneurs surveyed in Northern States of Malaysia such as Kedah, Perlis, and Penang did not realize the existence of loan facilities and loan related-information offered by the government agencies and the commercial banks. The gap on information of loan facilities (insufficient information on loan) was found to be the main factors that contributed towards unsatisfactory loan applications by entrepreneurs.

3.0) THE NEED OF ALTERNATIVE MODEL

Micro Enterprises (MEs) importance comprise of economic (income generation), social (poverty reduction) and political (wealth redistribution). Despite its importance and the continuous support from the government, MEs in Malaysia are facing the problem of accessing finance. Such problem is continuously affected the potential of MEs and lead them to contribute low to the economy. Given this drawback that is faced by MEs, there is a need to come out with a new model that could address the problem of accessing finance.

Hence, the present study aims to propose a viable and attractive model which is known as Integrated Cash Waqf Micro Enterprise Investment (ICWME-I) Model and demonstrate that it is possible to effectively address this problem. Waqf (Islamic Endowment) as concerned is a unique Islamic economic institution that has played a remarkable socio-economic role in the history of Islam and Muslims (Cizaka, 2009). Kahf (2007) also stresses the sustainable economic and financial benefits of the Waqf to promote the development of Muslim entrepreneurs and fulfilling other economic agenda. Thus, this new model should be able to tackle the issues facing MEs in Malaysia. By providing such facilities, it could enhance their potential to contribute to the national income and increase their productivity.

4.0) THE PROPOSED MODEL FOR FINANCING MES

As the existing schemes of financing are filled with several problems of accessing finance, hence there is a need to look for a more effective and efficient funding schemes to help improve the access to funds by MEs. An Integrated Cash Waqf Micro Enterprises Investment Model (ICWME-I) is proposed with the aim to be an alternative option for the existing micro enterprises schemes of financing in Malaysia as shown in Figure 1. This new model should be able to provide financial services and sustainable access to credit at a low cost, taking into consideration the risky nature of the micro enterprises.

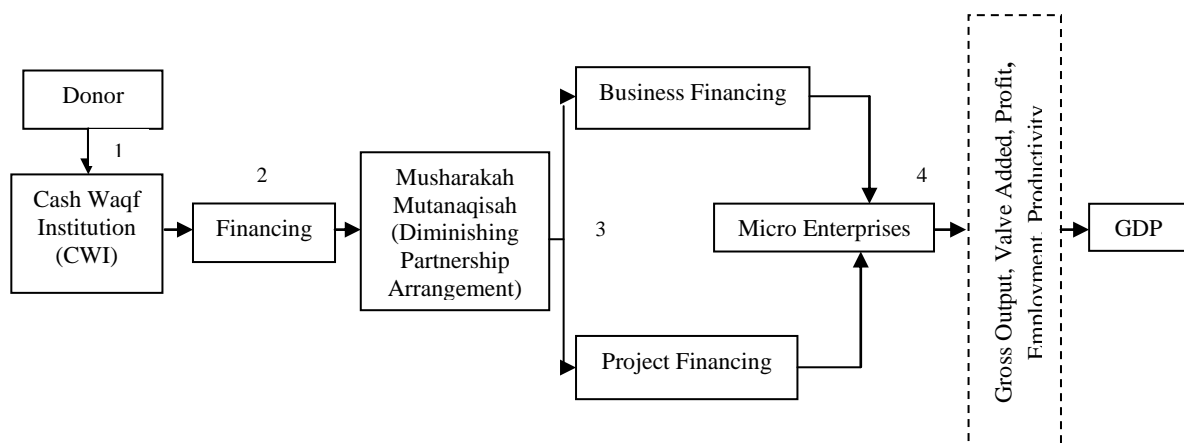


Fig. 1: Conceptual Framework of ICWME-I Model

4.1) Modus Operandi Of ICWME-I Model

The proposed ICWME-I model has some stages which involve:

- Arrow 1 indicates the flow of fund from the donors (both public and corporate sector) that will contribute Cash Waqf to Cash Waqf Institution (CWI) with the intention of creating perpetual Waqf. The public will contribute Cash Waqf by donating or purchasing Waqf share offered by CWI voluntarily. The corporate sector can contribute Cash Waqf as a part of their corporate social responsibility (CSR). The CWI becomes a Mutawali (Manager) of the fund. The manager would be responsible for making the necessary investment decisions of the fund.
- Arrow 2 and 3 show that the financing provided by CWI for micro enterprises by using Cash Waqf fund. CWI will provide financing facility by involving Musharakah Mutanaqisah (diminishing partnership) arrangement with micro enterprises. Musharakah Mutanaqisah (diminishing partnership) arrangement is where both CWI and micro enterprises jointly engage with business activity or purchase property/commercial enterprises. Later, the ownership of financier (in terms of share) divided into parts with the understanding that the customer will gradually purchase that share via periodic payments. The objective is for the customer to become the sole owner of the property or enterprise eventually. This arrangement is suitable for business financing and project financing. For the business financing, it includes the financing of machinery, land, electric installation, equipments, and other fixed assets. Meanwhile, the project financing involves financing of construction of shop lots and business premises.
- Arrow 4 shows that after the micro enterprises received the financing facility provided by CWI, micro enterprises can increase their gross output, value added, profit, employment and productivity, which later contribute to the national income or GDP.

5.0) THE SIGNIFICANCE OF ICWME-I MODEL

From the ICWME-I Model developed, it can be seen that the Cash Waqf and micro enterprises can complement each other. Micro enterprises are means to boost the economy and Cash Waqf can provide financial support for micro enterprises. Thus, from the broader perspective, ICWME-I Model could bring a significant impact to micro enterprises as well as society and economy as a whole.

5.1) Impact On The Micro Enterprises

As this model incorporates the use of Cash Waqf for micro enterprises, it brings benefit to micro enterprises. For instance, this integration of Cash Waqf with the micro enterprises will be useful in achieving a higher profile for the business involved and enhance the image of the micro enterprises. In addition, the focus of Waqf on business and project financing eliminate risky speculation. Furthermore, this model can increase the success of micro enterprises by providing assistance for their development. ICWME-I Model can also assist in the growth of micro enterprises from micro to small, to medium and large scales enterprises.

5.2) Impact On The Society And Economy

The model is also anticipated to bring benefits to the society and economy. As this model emphasize on financing, it creates an environment of innovation and diversification of economic activity. It also helps to stimulate private ownership among MEs. ICWME-I Model enables the poor to reach to affordable consumer goods and services through establishing more sustainable micro enterprises. This model provides seed capital to develop micro enterprises sector and give them access to finance. In addition, as this model incorporates Cash Waqf, it can play an intermediary role of assisting corporate sector in doing their corporate social responsibility by donating to Cash Waqf. On the other hand, this model creates employment opportunity and helps the poor micro entrepreneurs to generate income and thus alleviate poverty

6.0) CONCLUSION

This study has shown that MEs represent the largest component of SMEs in Malaysia. However, MEs face the problem of accessing external finance from both private and government sources. They are considered risky segment in the market and therefore strict loan conditions have been imposed on them such as collateral, proper support documents and good business track record. Unfortunately, most of them cannot fulfil these conditions and they are continued to face the problem of financing. Thus, the present study proposes an idea of Integrated Cash Waqf Micro Enterprise Investment (ICWME-I) model as a solution for microenterprises to overcome their financial constraint and enhance their development and contribution to the national income. Future research needs to refine ICWME-I model through focus group studies. The model should be validated through surveys to gauge the intentions of the stakeholder. Theories such as TRA (Fishbein & Ajzen (1975) and TPB (Ajzen, 1991) can be very useful in this regard.

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