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The purpose of this paper is to examine common perceptions of financing difficulties faced by SMEs, based on evidence from industry and independent sources. The findings offer useful insights to support the Bank's ongoing public information and engagement programmes to address the perceptions.

Access to Financing for SMEs: Perception and Reality

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Access to Financing for SMEs: Perception and Reality

Executive Summary

Access to financing is crucial for the growth of small and medium enterprises (SMEs). Despite evidence from supply side data and independent surveys that point to increased financing for Malaysian SMEs, common perceptions of financing difficulties faced by SMEs continue to persist.

Evidence presented in this paper suggest that the perceptions are largely unfounded, and likely to be the result of information gaps rather than a reflection of reality. Of note, a significant majority (97%) of SMEs affirm that they are able to obtain financing based on the quarterly survey of SMEs conducted by SME Corporation Malaysia. The same survey revealed that the top 5 concerns of SMEs related to business rather than financing challenges.

SMEs also represent the fastest growing financing segment among financial institutions. Growth and approval rates for SME financing continue to outstrip other customer segments of financial institutions. The share of SME financing over total business financing has also steadily trended upwards to 49% from 38% in 2010, reflecting an increased focus on SMEs as a strategic growth driver for FIs.

Simplified application processes have significantly reduced the time and effort involved for SMEs to apply for financing. The average processing time for unsecured financing applications has been reduced to between 7 and 16 days, from up to 70 days previously.

Financing for SMEs cuts across a spectrum of companies, including newly established businesses. 2 in 10 SME financing approvals are to newly established SMEs that have been in operation for less than 3 years. The rejection rate for newly established SMEs was also observed to be only marginally higher than the average rejection rate for all SMEs. This could suggest an increased appetite among financial institutions for financing to younger SMEs in line with improvements in the ability of financial institutions to assess viability and manage associated risks.

FIs also remain active in providing pre-emptive debt restructuring and rescheduling (R&R) assistance to financially distressed SMEs. Between 2008 to 2016, 73% of total R&R were undertaken on performing accounts to help SMEs tide over temporary business and financial setbacks, especially during economic downturn coinciding with the global financial crisis.

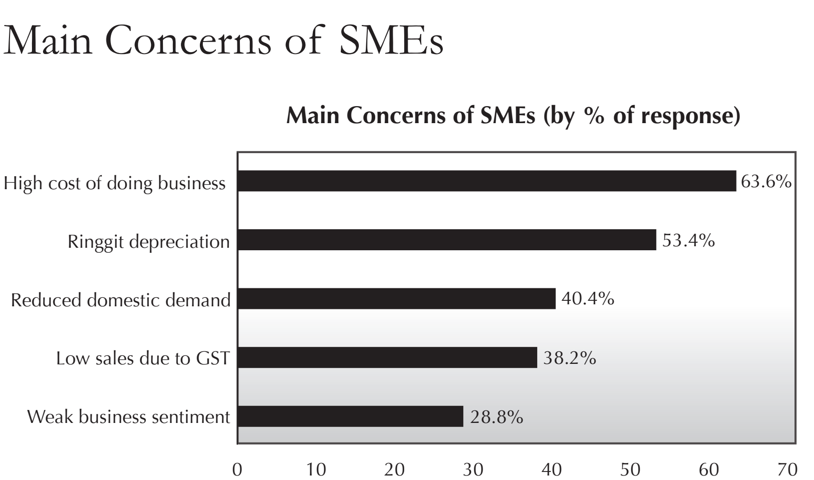
Introduction

Despite increased financing to SMEs, there are still perceptions that access to financing is an issue

Access to financing is crucial for the growth of small and medium enterprises (SMEs). Given sufficient funding, businesses can prosper, expand and further contribute to the country's economic growth. The recent publication by OECD in April 2017[1] cited Malaysia as having a sustainable SME financing growth among 39 countries surveyed, as reflected by the significant increase in SME loans against overall total loans, low impaired financing and the availability of market-based financing to meet SMEs' changing needs. While the findings of OECD and domestic surveys conducted revealed increased access to financing by SMEs, there are perceptions that access to financing is still an issue facing the SMEs.

This paper examines four most common perceptions on SME financing, drawing on available demand and supply side data, as well as feedback from both financial institutions[2] (FIs) and associations/ chambers representing the SMEs. These perceptions appear to be largely unfounded based on evidence presented in this article, underscoring a need for continued sustained education and engagement to improve perception.

Chart 1



Perception 1: Financing is a key constraint for Malaysian SMEs

A significant majority of SMEs affirm that they are able to obtain financing

From the latest bi-annual survey[3] by SME Corporation Malaysia (SME Corp), 97% of SMEs which applied financing from FIs were able to obtain financing (3Q2016: 90.1%). Of this,

- 27% were first-time borrowers; and
- 22.6% were without collateral and credit.

Less than 10% of SMEs which obtained financing cited difficulties with current financing facilities, mainly related to:

- delays in loan approval/disbursement;
- requests for additional guarantors or collateral; and
- higher interest/profit charged.

The same survey revealed that the top 5 concerns of SMEs were not financing-related, but rather business challenges.

[1] Financing SMEs and Entrepreneurs 2017: An OECD Scoreboard, April 2017
[2] 8 FIs, which collectively account for 70% of total SME financing.
[3] 1st Quarter 2017 SME Survey, SME Corporation Malaysia (2,236 respondents nationwide; covering micro, small and medium enterprises across all economic sectors) [Note: Survey is conducted every 1st and 3rd quarters of the year

Despite the challenges faced, SMEs continue to be optimistic on the business outlook, with 36% expecting business conditions to further improve in the second half of 2017. This in turn will augur well for continued supportive financing conditions for SMEs. Average lending rates for SMEs have remained broadly stable, ranging between 5% and 6% over the last five years.

SMEs represent the fastest growing financing segment among FIs

Supply side data reported by financial institutions support the findings of the SME Corp survey:
- Growth in financing to SMEs by FIs continues to be sustained above 7%, outstripping financing growth to households (5.1%) and large corporates (6.3%);
- The approval rate for financing applications by SMEs of 76.4%, has also been consistently higher than that for all customers (62.3%); and
- The share of SME financing over total business financing has steadily trended upwards to 49% (2010:38%). This reflects an increased focus on SMEs as a strategic growth driver for FIs.

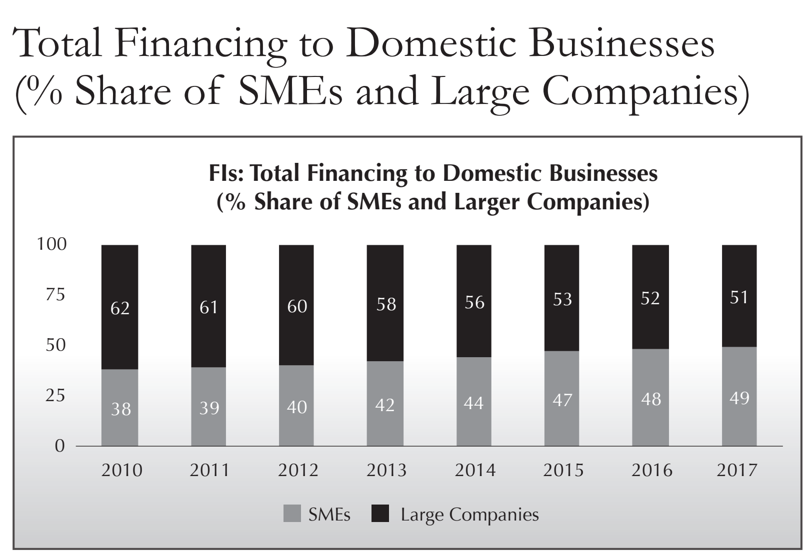
Perception 2: Applying for financing is an opaque and complicated process

The simplified application process has significantly reduced time and effort involved in applying for financing

SMEs commonly perceive the process of applying for financing to be difficult and time consuming. This can arise from a poor understanding of how FIs evaluate financing applications, and uncertainty of the documentation required to demonstrate financial capacity and business viability.

In Malaysia, banks have streamlined and simplified the application process for SME financing under the PARTNER initiative that was introduced in 2010. SME applicants are provided with standardised loan application forms and a checklist clearly setting out the information and documentation requirements to support their applications. Banks reported that the processing time for unsecured financing applications under the PARTNER programme have been reduced to between 7 days (for financing up to RM500,000) and 16 days

Chart 2



(for financing above RM500,000), from up to 70 days previously. For secured financing, the turnaround time depends on the time taken by third parties (e.g. lawyers) to complete the security documentation process, and may therefore be longer.

The most common documents required by FIs to conduct credit and viability assessments are audited accounts, income tax statements and cash flow projections. However, all the FIs surveyed confirmed that alternative documents are accepted, including unaudited management accounts and bank statements, in place of standard documents (e.g. for start-ups and micro businesses). These FIs also maintain dedicated SME desks to provide assistance to applicants, which include advice on the organisation and preparation of financing documents.

As a further step to support SMEs in the financing process, 20,363 bank officers nationwide have been provided with specialised training under a Train-the-Trainers Programme to equip them in advising SMEs. These officers in turn provide practical interventions to increase the capabilities, awareness and knowledge of the SMEs on financing matters, including advice on:

- financial management and business planning;
- understanding the credit application requirements and processes; and
- avenues to seek help and redress (e.g. AKPK, SDRS).

Reasons must be given by FIs for all rejected applications. This provides important information for SMEs to take concrete actions that will improve the prospect of obtaining financing.

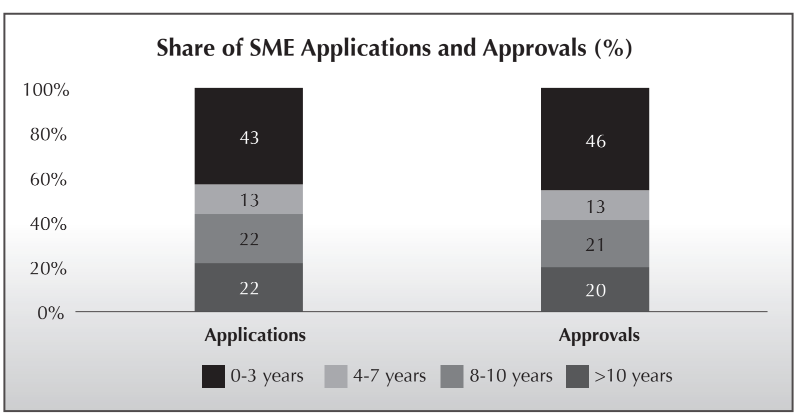
Reasons for rejection of SME financing applications are explained

The key reasons cited by FIs for rejection of financing are:

1. Unsatisfactory financial track records and poor credit history (CCRIS) e.g. record of persistent losses, low capital commitment, excessive leverage and history of delinquency or defaults;
2. Inability to provide basic information to demonstrate repayment capacity e.g. bank statements, income tax statements or management accounts; and
3. Integrity concerns e.g. evidence of misappropriation of company's funds for personal use and misrepresentations of credit exposures and financial information.

Chart 3

Share of SME Applications and Approvals (%)



Perception 3: Banks do not extend financing to start-ups

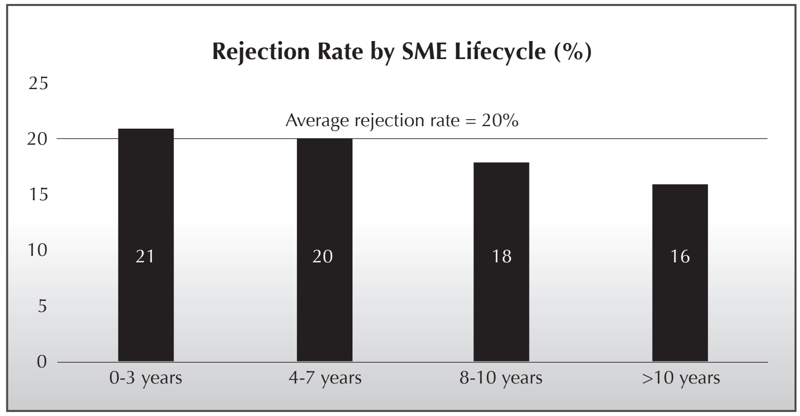
2 in 10 financing approvals are to newly established SMEs

An analysis of CCRIS data (2016) for SME businesses revealed that FIs continue to provide financing across the spectrum of companies, including start-ups (in operation for 3 years or less). The distribution of financing approvals closely reflects applications received, of which 20% are associated with start-ups.

The rejection rate for SMEs with less than 3 years in operation was observed to be only marginally higher than the average rejection rate for all SMEs. Engagements with FIs indicate that this has been a more recent development, reflecting an increased appetite among FIs for financing to younger SMEs as FIs improve the ability to assess viability and manage the associated risks. This development also follows the increased focus on SMEs as a strategic growth segment for many FIs. As expected, rejection rates decline for SMEs that have been longer in operation in line with more stable operational and financial management typically associated with mature businesses.

Chart 4

Rejection Rate by SME Lifecycle (%)



Perception 4: In a downturn, SMEs are the first to experience withdrawal of financing lines and/or reduced credit limits

Pre-emptive assistance is actively provided to financially distressed SMEs

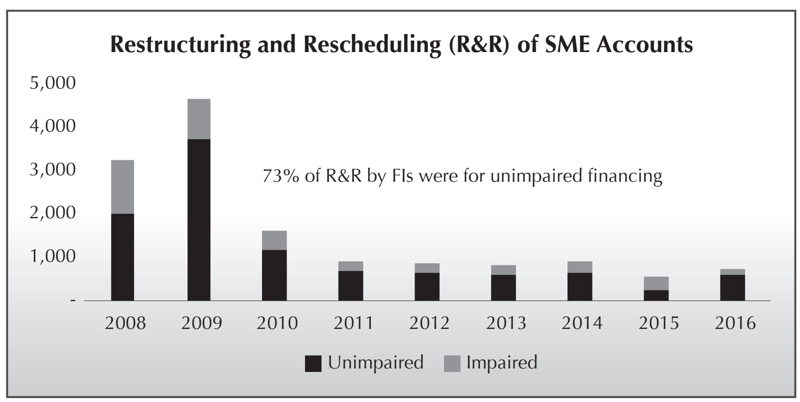
From the SME Corp survey, less than 2% of SMEs with existing financing from FIs cited difficulties faced as a result of reduced credit limits or a withdrawal of credit facilities by FIs.

Since the Asian Financial Crisis, FIs have been demonstrably more forthcoming in providing debt restructuring and rescheduling (R&R) assistance to viable but financially distressed SMEs, particularly during a downturn. Between 2008 to 2016, more than 14,000 distressed SME accounts were assisted through R&R. Of this,

- 73% of total R&R by FIs were for performing accounts, underscoring early and pre-emptive actions to assist SMEs;
- 97% were assisted directly by FIs, while 3% were assisted under the Small Debt Resolution Scheme (SDRS); and
- 55% of the R&R occurred in 2008-2009, during the economic downturn coinciding with the global financial crisis.

Chart 5

Restructuring and Rescheduling (R&R) of SME Accounts by FIs



Additional insights from complaints data and engagements with SMEs

Financing issues raised generally not followed up with specific information for actions to be taken

In the past 12 months, the Bank has had no less than 25 engagements with SME groups and associations. Various issues were raised by SMEs which were encouraged to refer specific cases with details to the Bank for further investigation. The follow-up rate (SMEs reverting with further information), however, has been consistently low with only 2 follow up cases referred to the Bank following the engagements. Over the same period the Bank received a total of 6,423 complaints, of which, only 6.9% were from SMEs and 8 cases were on loan rejections.

However, we observe an increasing trend in complaints on difficulties associated with restructuring and rescheduling applications by SMEs. The vast majority of these cases were complaints by companies that have either ceased business operations or were at an advanced legal stage, thus disqualifying them for R&R assistance from FIs or under the SDRS.

Initiatives being pursued by SME Corp to support insolvent SMEs under statutory voluntary arrangements and provide a fresh start to such SMEs will help to address this.

Ongoing Initiatives

Online SME Financing Application Platform to further enhance ease of access to financing for SMEs

Given the varied risk appetites of FIs, the Online SME Financing Application Platform being developed by CGC in collaboration with the Bank, would further enhance the ease of accessing financing for SMEs. The platform, expected to be launched early next year, will enable SMEs to source suitable financing solutions for their needs from multiple FIs and SME funds efficiently and seamlessly.

Unmatched and rejected applications will be referred via the platform to a Financial Accelerator Lab, which will deliver structured assistance to immediately help SMEs take concrete steps to improve their eligibility for financing in the future. The Lab will leverage on existing programs that currently support SMEs.

Alternative financing avenues required to complement banking system financing for SMEs

Going forward, the development of alternative financing avenues, to complement the banking system remains an important priority to better support certain SME segments, particularly in new growth areas. This includes equity crowdfunding, P2P, private equity and venture capital. Bank financing will remain ill-suited to some businesses in such areas, given the fiduciary responsibility of banks to ensure the safety of the public's deposits and avoid excessive risk-taking.

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