

Malaysia's Microfinance Framework

Micro enterprises are critical for balanced and sustainable economic growth

Micro enterprises constitute 78.7% of all businesses in Malaysia and employ over 1.2 million employees¹. More than four-fifths, 87.7%, of micro enterprises are in the services sector, with significant involvement in the retail, food and transportation sub-sectors. Even though these micro enterprises are small, they are agile and able to take advantage of niches that larger firms are not able to undertake effectively.

Financial empowerment through microfinance

In accessing financing from the formal financial system, the credit history of micro enterprises will be recorded by a recognised credit information system. This enables micro enterprises to build credit histories and credit ratings that opens new opportunities for these enterprises. With good credit ratings, micro enterprises can access further financing for business expansions at better financing rates. Micro entrepreneurs are better served by the formal financial system through the provision of 24-hour electronic banking and payment services which can enhance productivity and efficiency², and provision of advisory services such as financial management. Such advisory services are commonly provided by micro financing institutions (MFIs) as part of the complement of financing solutions. Significant resources are allocated by MFIs to help micro enterprises develop business capabilities through training workshops, networking events and business advisory services. This broad range of developmental services have contributed towards enhancing the viability and growth potential of micro entrepreneurs.

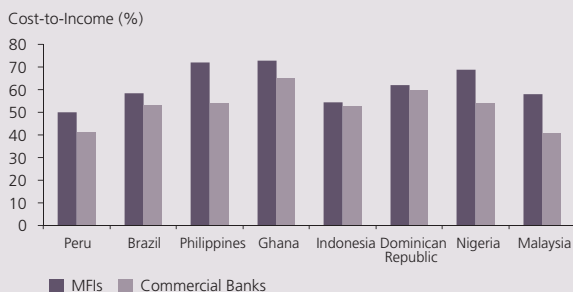
Inclusion in the formal financial system also helps to enhance the financial literacy of borrowers. This allows micro entrepreneurs to make more informed financial decisions, thus promoting the more effective utilisation of a broad range of financial products in a safe and responsible manner. Micro businesses will also have access to new services such as micro insurance schemes which provide businesses with additional tools to better manage various risks inherent in the business.

Microfinance is a challenging endeavour

Global experiences show that the cost-to-income ratio of MFIs is higher than those of commercial banks. This is due to the inherent nature of micro financing where the financing amounts are small

and customers are geographically dispersed, with many located in rural and underserved areas. Hence, MFIs are required to dedicate more resources to expand outreach to these customers. In order to serve customers well, MFIs need to put in place the procedures and processes that are necessary to accommodate the large volume of small applications and to monitor and facilitate release and repayments of micro financing accounts.

Chart 1
Cost-to-Income Ratio of MFIs and Commercial Banks of Selected Countries



Source: MIX Market Data, The Banker (July 2009), Annual Reports of Central Banks

Sustainable micro financing in Malaysia

Malaysia is recognised for its efforts to enhance access to financing. Among 183 countries, the World Bank has ranked Malaysia as number one in terms of "Getting Credit"³. As at end

¹ Department of Statistics Malaysia, (2007) "Census of Establishments and Enterprises 2005"

² World Bank, (2005) "Rural Finance Innovations"

³ World Bank, (2009) "Doing Business 2010"

2009, there were 449,703 micro finance borrowers in Malaysia with outstanding financing extended amounting to RM2.4 billion given through the formal financial system and government agencies.

Prior to 2006, the micro finance industry players comprised largely of government agencies serving the hardcore poor and the informal financing system. To enhance support for the growth of micro enterprises through improved access to the formal financial system, the National SME Development Council approved a sustainable micro finance framework named *Pembiayaan Mikro* in 2006. The framework identified three strategic initiatives: to define the parameters of an appropriate micro financing product, to raise awareness on micro financing, and to attract the participation of financial institutions in providing micro financing solutions.

With *Pembiayaan Mikro*, micro entrepreneurs now have access to financing which requires no collateral, and applies simple application procedures, minimal documentation and a quick approval and disbursement turnaround to meet the unique financing needs of micro enterprises. Under the *Pembiayaan Mikro* framework, the median approval time is four days and the median disbursement time is three days, significantly quicker than other business financing. To promote broader awareness of the availability and benefits of *Pembiayaan Mikro*, numerous initiatives were implemented including the creation and display of the *Pembiayaan Mikro* logos at premises that offer *Pembiayaan Mikro*, the direct distribution of flyers to more than 397,000 micro enterprises, feature articles in the newspapers and advertisements on television and radio.

Since its launch, the number of participating financial institutions in the *Pembiayaan Mikro* initiative has increased to nine, comprising six banking institutions and three development financial institutions. The active participation of these institutions have expanded access to micro financing through over 1,800 contact points nation wide. Recognising the diverse financial needs of micro enterprises, these financial institutions have adopted different business models and strategies that leverage on the institutional strengths and niches. A number of financial institutions have adopted a mass market model whereby the financial institution provides microfinance products through its existing branch network. Others, like Bank Rakyat, have adopted a cooperative model which provides microfinance to its members. Some have employed the distributor network model, which leverages on the distributive capabilities of strategic business partners. Another is the monoline model with a dedicated microfinance operation, formed with its own distinct branding and processes designed to uniquely appeal to micro enterprises.

Under *Pembiayaan Mikro*, outstanding micro financing of the nine participating financial institutions stood at RM616.5 million involving 57,403 customers as at end 2009. This represented an annual growth of 29.1% and 27.1% respectively. A survey conducted to gauge the performance of micro enterprises after receiving micro financing, showed an increased capacity of micro enterprises to serve new markets and customers. More specifically, the survey found that micro enterprises that received micro financing were able to invest and expand their business capabilities, thereby contributing to an average increase in revenue and employment of about 18.5% p.a. and 10% p.a.⁴ respectively.

Moving forward, the microfinance industry is expected to develop further with increased investments in technology and improvements to existing processes which will support an expanded outreach and further efficiency gains. As the micro financing industry grows, both financial institutions and non-bank financial institutions will continue to broaden the range of financial services being offered to include micro-insurance, remittances, Ar-Rahnu pawn-brokering and micro-investment schemes. This, in turn, will contribute towards greater financial inclusion.

⁴ Based on a random survey conducted by participating financial institutions, measuring the increase in revenue and employment 3 years after the micro enterprise receive micro financing