

## Impact of Microfinance Facilities on Performance of Small Medium Enterprises in Malaysia

*T. Pei-Wen, M.A. Zariyawati, F. Diana-Rose and M.N. Annuar*

Faculty of Economics and Management, Universiti Putra Malaysia, Malaysia

---

**Abstract:** Small and medium enterprises (SMEs) are the primary component of economic development in Malaysia, with the major contributions from SMEs in the growth, employment and productivity sectors. The purpose of this study is to investigate the effect of microfinance facilities on SMEs in Malaysia. The data of this study was collected from primary sources and questionnaires distributed to the owners of SMEs which fall into a microenterprise category in the Klang Valley. Results of regression analysis demonstrate that microfinancing has a significant effect on SMEs' incomes. Hence, to enhance SMEs development, we suggest that more microfinance institutions (MFIs) will assist in providing more microfinance facilities to SMEs.

**Key word:** Microfinance • Small medium enterprises (SMEs) • Microfinance institutions (MFIs) • Malaysia

---

### INTRODUCTION

Small and medium enterprises (SMEs) have been accepted as the engine of economic growth and the promoter of equitable development [1]. Without exception, SMEs in Malaysia also play a vital role in developing the Malaysian economy. According to Department of Statistics in Malaysia (2012), SMEs in Malaysia consists of 77% micro-sized establishments, followed by 20% small-sized establishments and 3% medium-sized establishments. These statistics clearly indicate that micro enterprises comprise the largest portion of Malaysia's SMEs and most remain micro-sized instead of expanding their business. The main reason micro enterprises are remaining as such rather than developing their business into next category like small and medium enterprises is the shortage of debt and equity financing. They lack capital, or funding, to expand their business.

Limited access to formal credit facilities represents the primary problem faced by SMEs [2]. Further, they often lack the necessary capital to operate their business. Access to capital is critical to the development of small-scale enterprises [3]. In addition, banks are more willing to provide loans to large firms rather than small-scale firms. This is because large firms can provide acceptable collateral. For this reason, the Malaysian government has

taken the initiative of offering small loans or microfinance facilities to individuals and groups in order to help them to initiate or expand business activities. This is a represents an excellent opportunity for those who need such assistance, especially since these loans are granted to SMEs with simple loan requirements, including the stipulation that no collateral is required.

Microfinance has been considered a useful tool in efforts to eradicate poverty and as an alternative source of financing for the poor. Both progressive and dynamic, microcredit loans allow many borrowers to successfully access to larger loans, which in turn help them to rise from poverty even faster. Similarly, microfinance addresses the entire array of financial and non-financial services, including skill upgrades and entrepreneurial development, which are provided to the poor to enable them to overcome their limitations [4, 5]. Findings from a study mentions that microfinancing serves as a practical tool in reducing poverty in Bangladesh [6]. This is consistent with Zaman's study, which suggests that access to credit has a potential significantly impact on the reduction of poverty [7]. Additionally, Dunn also discovered that microfinance increases the revenue of borrowers' enterprises [8]. Therefore, governments and financial institutions across the world should increase their efforts to improve clients' financial education and understanding of the concept of microfinance [9].

Thus, microfinance plays an important role in the development of micro SMEs Malaysia. Microfinance in Malaysia began in 1987 with the establishment of Amanah Ikhtiar Malaysia (AIM). Due to the importance of SMEs in the country's economic growth, the government has encouraged the involvement of more financial institutions in providing microcredit products to the public. However, lack of financial and non-financial resources is the main factor behind government agencies' inability to accommodate microfinancing requests by SMEs' in Malaysia.

Therefore, the government encourages commercial banks to become involved in providing microfinance to SMEs. Further, in 2006 the National SME Development Council (NSDC) approved a complete microfinance institutional framework proposed by Bank Negara Malaysia, comprising banking institutions, development financial institutions (DFIs) and credit cooperatives to generate a sustainable microfinance industry. The purpose of this framework is to encourage more banks and financial institutions to become involved in providing microfinance facilities to SMEs. However, the results were not as strong as the government expected. The involvement of banks that willing to provide microfinance facilities and related products was minimal. Poor of loan repayment performance and low requirements for microfinance approval among the reasons why commercial banks are less actively involved in microfinance products.

Limited access to external financing is part of the reason why SMEs use their own funds or borrow from friends or family as the prime source of financing their business operations [10]. For example, 13.7% of SMEs choose to use their own funds rather than secure bank funding because of the absence of collateral and the inadequacy of microfinance institutions (MFIs) that can facilitate SMEs' financing demands. An even larger problem occurs when some SMEs do not have sufficient documents to support their loan application due to the lack of a financial track record and an absence of the proven viability of the business. Additionally, some SMEs have indicated that processing times for loan applications are an added constraint. These difficulties reveal that SMEs lack awareness of the concept of microfinance and how it actually can help them to easily obtain external funds to expand their business without any collateral. This suggests that the level of awareness about the impact of microfinancing is still low, although the government of Malaysia has placed great emphasis on this effort.

Therefore, it is important for SMEs to gain knowledge regarding microfinance facilities and explore opportunities provided by MFIs in order to sustain their business over the long term. Hence, the purpose of this study is to investigate the impacts of microfinance facilities on SME incomes in Malaysia. Specifically, the objective of this research is to investigate the effects of microfinance facilities available through government and non-government agencies on the business income of SMEs in Malaysia.

## **MATERIALS AND METHODS**

The study used primary data collection methods, with data obtained from a survey questionnaire. In this research, 125 sets of questionnaires were distributed to the owners of SMEs which fall into a microenterprise category in the Klang Valley, having borrowed loans of less than RM50000 from MFIs. Business income was represented as dependent variables in model as shown below:

$$\text{BINC} = \beta_0 + \beta_1(\text{TL}) + \beta_2(\text{LT}) + \beta_3(\text{EDU}) + \beta_4(\text{BC}) + \mu$$

**BINC** - Business Income

**TL** - Total loan

**LT** - Loan tenure

**EDU** - Educational level

**BC** - Business course

Business income is measured by the percentage amount of average changes in monthly business profit earned by microenterprises. The independent variables representing those factors that influence the dependent variables. The most influential independent variables in this study refer to the total amount of a loan, because this is the primary variable employed in this study to examine its impact on microenterprises' business income. The total of a loan is defined as the amount of a loan or microfinancing facilities received by the microenterprises from any microfinance institution, such as AIM, TEKUN, MARA, SME Bank, Bank Rakyat and other institutions. This is measured by how much respondents received in term of Ringgit Malaysia. We categorized AIM, TEKUN and MARA as government agencies (government MFIs) that provide microfinance facilities. Meanwhile, in addition to these, three others fall under the category of non-government agencies. Since this is an exploratory study, we use other independent variables that may have

an impact on SMEs' business income. Loan tenure represents the number of months that microenterprises must make repayments to the MFIs. The education variable was measured in terms of formal education acquired by the respondents. In this study, the researcher assigned respondents into two categories: tertiary and non-tertiary. For example, if the respondent's educational level was above that of certificate, diploma or bachelor's degree, they fell into the tertiary group. On the other hand, if the respondent's educational was below that of certificate, diploma or bachelor's degree, they fell into the non-tertiary group. In this study, the non-tertiary group is coded as 1, while the tertiary group is coded as a dummy value. Business course was measured according to the respondents' attendance or nonattendance at a business course provided by MFIs.

**RESULTS AND DISCUSSION**

Table 1 lists statistics for 125 microenterprises that received loans from government and non-government agencies with a range of RM3000 to RM50000. The average amount of loan approved for SMEs in this study is RM23520.33, while the standard deviation of a total loan is RM16354.85. Respondents can make loan repayment as minimum as 12 months while maximum loan tenure approved to SMEs is 72 months which is about 6 years. Business income generated by respondents is in the range of RM3500 to RM200000. The values of the Variance Inflation Factor (VIF) for all of the constructs were below 5.0 and the range of Tolerance Value was between 0.281 and 0.888. Therefore, the findings indicate that the problem of multicollinearity was not significant in this study.

Table 2 shows results of the impact of microfinancing on the business income of SMEs. Results of all of the samples reveal that a total loan (0.778) is positively related and significant at the 1% level with business income. This proves that the business incomes of SMEs borrowers will increase when they are receiving microfinancing from MFIs. SMEs use these microfinance facilities as capital to establish their businesses. Loan tenure (0.016) is also positively related and significant at the 1% level. SMEs that are securing microfinance facilities with a longer loan tenure will increase their business income. The longer repayment period allows borrowers to realize a lower repayment amount, while lower repayments amount will help borrowers to achieve better cash flow, which will generate more business

Table 1: Descriptive Statistics.

	N	Minimum	Maximum	Mean	Std. Deviation
Amount of loan	125	3000	50000	23520.33	16354.85
Business Income	125	3500	200000	20450.80	27136.75
Loan Tenure	125	12	72	52.68	13.711

income. Additionally, educational level (-0.529) is also highly correlated with business income. Educational level is negatively related and significant at 1% with business income. This demonstrates that educational level has an impact on the business incomes of SMEs. In addition, the relationship is negative, meaning that a lower level of education may reduce SMEs' business income. This result also reveals that when borrowers have a higher educational level, higher business income is generated.

Table 2 also reveals the results of microfinance's impact on the business incomes of SMEs that borrow from government and non-government MFIs. Consistent with all samples, business income is positively correlated with the total loan received from government and non-government MFIs at a 1% significance level. Findings reveal that SMEs, regardless of whether they are financed by government or non-government MFIs, will both realize increases in their business income. Hence, SMEs do need support from MFIs to fund their businesses since they have limited access to raise capital from other channels due to lack of collateral. Consistent with all sample results, educational level is also an important factor that will affect the business incomes of SMEs that are receiving microfinance facilities from government and non-government MFIs. Further, we found no relationship between loan tenure and income of SMEs that are receiving loans from non-government MFIs. However, we found that loan tenure is positive and significantly associated with income of SMEs that are being funded by government MFIs. This demonstrates that government will provide loan tenures for loan repayment to ensure lower monthly payments for borrowers. Government MFIs believe that low monthly repayments can help SMEs to have more working capital to generate or increase future income. In addition, we also found that business courses have a positive (0.505) relationship with business income at a 5% significance level for non-government agencies. This demonstrates that non-government agencies require their borrowers to attend a business course before receiving a loan from them. They believe that SMEs who attend a business course may use the knowledge to increase their business income.

As shown in Table 3, the change of business income for all sample, government and non-government agencies is as follows: 70.6%, 72.7% and 57.4%, respectively, as

Table 2: Regression Analysis for All Sample, Government Agencies and Non-Government Institution

Model	All Sample		Government Agencies		Non-Government Institution	
	Coefficient	P value	Coefficient	P value	Coefficient	P value
(Constant)	0.939	0.434	-0.808	0.678	-1.829	0.428
Total Loan	0.778	0.000***	1.003	0.000***	1.174	0.000***
Loan Tenure	0.016	0.004***	0.846	0.005***	-0.012	0.218
Education	-0.529	0.001***	-0.506	0.041**	-0.482	0.047**
Business Course	0.170	0.366	-0.177	0.600	0.505	0.050**

Note: \* significant at 10% level, \*\* significant at 5% level, \*\*\* significant at 1% level

Table 3: Result of Relationship Strength

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.840	0.706	0.689	0.7035
2	0.853	0.727	0.689	0.7243
3	0.758	0.574	0.522	0.7007

Note: Model 1- All Samples, Model 2-Government Agencies, Model 3- Non Government Institution

Table 4: ANOVA

Model	Sum of Squares	df	Mean Square	F	P value
1 Regression	136.940	7	19.563	39.531	0.000
Residual	56.911	115	0.495		
Total	193.850	122			
2 Regression	69.838	7	9.977	19.019	0.000
Residual	26.229	50	0.525		
Total	96.067	57			
3 Regression	37.754	7	5.393	10.985	0.000
Residual	27.985	57	0.491		
Total	65.740	64			

Note: Model 1- All Samples, Model 2-Government Agencies, Model 3- Non Government Institution

explained by a combination of various independent variables, including total loan, loan tenure, educational level and attendance at a business course.

Table 4 reveals the results of ANOVA. All models illustrate  $p < 0.0005$ , which is less than 0.05, indicating that overall, the regression model statistically significantly predicts the outcome variable. This means that the entire sample should affect the business income of the SMEs. Therefore, we can conclude that the regression model fits the data at a 0.05 level of significance and both models will affect the business income of SMEs.

### CONCLUSION

The purpose of this study was to examine the impacts of microfinance on SMEs in Malaysia. Findings in this study revealed that microfinance facilities run by both government agencies and non-government agencies have a positive impact on SMEs' business income. This means that SMEs can improve their income when get funded by microfinance. Finally, it would be a useful exercise to conduct future research devoted to an evaluation of the funding arrangements of SMEs in Malaysia.

### ACKNOWLEDGEMENT

The author is grateful to the Ministry of Science, Technology & Innovation for the financial supported granted to this research project.

### REFERENCES

1. Christopher, I.F., 2007. Impact of Microfinance on Small and Medium-Sized Enterprises in Nigeria.
2. Schoombee, A., 2000. Getting South African Bank to Serve Micro-entrepreneurs: An Analysis of Policy Options. *Development Southern Africa*. 17(5): 751-767. <http://dx.doi.org/10.1080/713661429>.
3. Leaman, S.H., T.J. Cook and L.S. Stewart, 1992. Rural Economic Development: Learning From Success. *Economic Development Review*, 104(4): 27-33.
4. Sarkar, A.N. and Singh Jagjit, 2006. Savings-led Microfinance to Bank the Unbankables: Sharing of Global Experience, *Global Business Review*, 7(2): 271-295.
5. Sengupta, R. and C.P. Aubuchon, 2008. The Microfinance Revolution: An Overview, Review, Federal Reserve Bank of St. Louis, issue Jan, pp: 9-30.

6. Khandker, S., 2001. Does Micro-finance Really Benefit the Poor? Evidence from Bangladesh. Paper delivered at Asia and Pacific Forum on Poverty: Reforming Policies and Institutions for Poverty Reduction held by the Asian Development Bank. Manila.
7. Zaman, H., 2000. Assessing the Poverty and Vulnerability Impact of Micro-Credit in Bangladesh: A case study of BRAC. World Bank. [www.worldbank.org/html/dec/Publications/Workpapers/wps2000series/wps2145/wps2145.pdf](http://www.worldbank.org/html/dec/Publications/Workpapers/wps2000series/wps2145/wps2145.pdf)
8. Dunn, E., 1999. Microfinance Clients in Lima, Peru: Baseline Report for AIMS Core Impact Assessment. University of Missouri-Columbia. Retrieved from <http://www.mip.org>
9. Bichanga, W.O. and L. Aseyo, XXXX Causes of Loan Default within Micro Finance Institutions in Kenya. Retrieved from <http://journal.archives31.webs.com/316-335.pdf>
10. Aris, M., 2006. SMEs: Building Blocks for Economic Growth. Retrieved from [http://www.statistics.gov.my/portal/download\\_journals/files/2007/Volume1/Contents\\_smes.pdf](http://www.statistics.gov.my/portal/download_journals/files/2007/Volume1/Contents_smes.pdf).