

Zeti Akhtar Aziz: Strengthening the financial infrastructure for SMEs in Malaysia

Keynote address by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the Launch of Strategic Partnership between Credit Guarantee Corporation Berhad and the Islamic Financial Institutions, Kuala Lumpur, 6 February 2007.

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It is my great pleasure to be here this morning to witness the launch of the strategic partnership between the Credit Guarantee Corporation (CGC) and Islamic financial institutions. This strategic partnership will provide an important platform to the Islamic financial institutions to expand lending activities to the small and medium scale enterprises (SMEs). It therefore, marks an important initiative in the efforts to provide an increased range of financing products to SMEs in addition to enhancing the access to financing.

A key national agenda of the Government is to promote a strong and dynamic SME sector which would contribute to ensuring sustainable and balanced economic development. The development of diverse and competitive SMEs will also promote greater resilience of the economy. The SMEs also represent important "incubators" of entrepreneurial talents that will provide for the potential for the development of larger Malaysian corporations. The SMEs can expect to represent an increasingly important source of endogenous growth and employment. The importance of the SME sector to the national economy is evidenced by the fact that it constitutes 99.2% of the total business establishments, employs about 5.6 million people, and contributes about 32% of gross domestic product.

In view of the potential of SMEs in the economy, significant emphasis has been accorded by the Government in developing and strengthening the capacity of the SMEs to contribute to the economy. Twelve Government Ministries and 38 Agencies are involved in supporting the development of SMEs. To ensure the effectiveness of the strategies to support SMEs, the Government established the National SME Development Council in June 2004. The Council, chaired by the Prime Minister, provides the policy direction of the programmes to support the SMEs, and to ensure that these programmes are implemented effectively. Bank Negara Malaysia is the Secretariat to the Council.

The Government's commitment to promoting the role of the SME sector in the economy has been to provide an enabling environment for their development. A comprehensive approach has therefore been adopted. In 2007, a total of 190 key programmes, involving a financial commitment of RM3.7 billion, is being implemented by the Government, to strengthen the enabling infrastructure, to build the capacity and capability of the SMEs, and to enhance SME access to financing. Indeed, for access to financing, several key strategies and measures have already been implemented to ensure that SMEs, at different stages of the business life cycle, have adequate access to financing.

The banking system continues to be the most significant source of financing in the economy. An important strategy to ensure access to financing by the SMEs has therefore been to increase access to financing from the banking institutions. Attention therefore was given for banking institutions to accord a special focus on providing financial services to SMEs, in particular in strengthening their facilities, outreach and services to SMEs. Today, all commercial banks have dedicated SME divisions and Bumiputera Development Units that are responsible for providing lending as well as ancillary support and advisory services to the SMEs. The commercial banks also have a specific client charter for SMEs, providing the necessary information to facilitate SMEs in applying for financing.

The strategy to provide increased access to financing is also reinforced by the provision of information and financial advisory services to SMEs. In 2005, Bank Negara Malaysia established Laman Informasi, Nasihat dan Khidmat (or the LINK), as a one-stop centre for SMEs to obtain information and raise matters on access to financing directly with Bank Negara Malaysia. The LINK has dedicated staff that provides financial advisory services including for dealing with problems of obtaining financing and for restructuring of existing loans. To date, about 11,000 SMEs have sought assistance from the LINK. Another important initiative in disseminating information to the SMEs is the establishment of the SMEinfo Portal, an information gateway for SMEs. The Portal provides comprehensive information required by SMEs, including details on the Government's financial and non-financial assistance, financing products for SMEs by the financial sector, training programmes as well as advise on how to start and manage a business. The Portal also provides a platform for SMEs to advertise their products

and services. To date, more than 14,000 SMEs have registered in the SME Business Directory of the Portal.

In strengthening the financial infrastructure for SMEs, Bank Negara Malaysia has also established the Small Debt Resolution Scheme where viable SMEs that are constrained by non-performing loans are assisted through loan restructuring and the provision of additional funding. In addition, through EXIM Bank, two new trade financing products for SMEs have been introduced in 2006.

The Census that was completed in 2005 had however, indicated that about 80% of SMEs are micro enterprises which had limited access to financing from the formal financial system to maintain and expand their businesses. To meet the financing needs of this key segment of the SMEs, microfinancing has now been established in our financial system. A number of financial institutions are participating in providing fast, flexible and convenient access to financing to individuals and micro enterprises for their business activities.

The various measures that have been undertaken have now already yielded positive results. SMEs today have had greater access to financing, with the banking institutions being the main source of financing. In 2006, RM40 billion in new loans was approved to more than 84,000 SME accounts. Of this, the Islamic banking institutions provided RM5 billion in new financing, compared with RM3 billion in 2005. The share of SME loans of the banking institutions has increased from 30% of total business loans at end-1999 to 45% at end-2006. Total SME outstanding loans of the banking institutions have now breached the RM100 billion level in 2006.

The Credit Guarantee Corporation is a key institutional arrangement in facilitating greater access to financing by the SMEs. By providing guarantee to loans obtained by SMEs, CGC addresses one of the main constraints of SMEs that is the lack of collateral. Bank Negara Malaysia, as the largest shareholder of CGC, is committed to ensure that CGC is in a position to have an effective role. Towards achieving this, RM1 billion was injected into CGC in 2000 to enhance its financial capacity to provide guarantees. In 2005, a process to transform CGC was initiated to enhance its role and to expand its range of products and services offered.

The aim is to position CGC as not only a provider of credit guarantees, but as an important institution that enhances the ability of SMEs to obtain financing from the financial institutions, in particular, through the provision of wider credit enhancement products, advisory services on financial and business development and credit information services. In 2006, CGC has shown commendable progress in this transformation process. Indeed, the strategic partnership that is being entered today between CGC and Islamic financial institutions is part of the initiative for CGC to expand the outreach of its products.

This strategic partnership between CGC and Islamic financial institutions is an important milestone as it brings together the two important objectives of the Government, namely enhancing SMEs' access to financing and promoting the growth of Islamic finance. Islamic finance has now not only experienced significant growth but is becoming more internationally integrated. This is underpinned by its great potential as a competitive form of financial intermediation. In Malaysia, the Islamic banking system has evolved into a dynamic, competitive and internationally integrated industry. In this recent five years, the Islamic banking industry has continued to record double-digit growth rate of about 20 percent. It is also an important contributor to the strong levels of profitability recorded by the banking groups. In terms of assets, the Islamic banking sector now accounts for 12 percent of the total banking system. It is envisaged that by year 2010, the Islamic banking industry will constitute 20 percent of the overall banking industry market share.

Financing extended by the Islamic financial institutions to SMEs has shown an encouraging upward trend, growing at an average annual rate of 34.2% for the period 2001-2006. As at end-2006, Islamic financing to SMEs reached RM10 billion, accounting for 9.6% of total SME loans outstanding of the banking system. This is a significant increase compared with the amount of Islamic financing extended to SMEs at end-2000, which was only RM1.7 billion or 2.4% of total SME loans outstanding of the banking system.

Indeed, there is great potential for Islamic financial institutions to play a more significant role in providing greater choice to SMEs to meet their financing needs. Increasingly now, SMEs from the different sectors require more customised and differentiated financial products and services that accommodate their unique requirements. This reflects the more highly diversified nature of the Malaysian economy. Islamic financial institutions therefore need to understand these requirements and be able to provide not only new innovative products but also attractive financing packages. In

addition, Islamic financial institutions need to intensify efforts to create greater awareness amongst the SMEs on the unique features associated with Islamic products and services. Enhanced financial literacy on Islamic financial products will facilitate the process for SMEs to make informed and effective decisions on their financial transactions.

Today's event that marks the establishment of strategic partnership between CGC and the Islamic financial institutions augurs well for SMEs. It provides a platform for the Islamic financial institutions to extend greater financing to SMEs. For CGC, this is an opportunity to expand the scope of its guarantee beneficiaries to include Islamic financial institutions. The real beneficiaries would be the SMEs.

On this note, it is my pleasure to once again congratulate CGC and the Islamic financial institutions for this initiative to forge this strategic alliance and collaboration to maximize the potential opportunities in SME financing. I wish every success in this strategic collaboration.