Mohd Razif bin Abd Kadir: SME Credit Bureau in the financial landscape of Malaysia

Keynote address by Mr Mohd Razif bin Abd Kadir, Deputy Governor of the Central Bank of Malaysia, at the SME Credit Bureau Seminar, Kuala Lumpur, 27 May 2008.

*   *   *

It gives me great pleasure to be here with you this morning. I would like to express my appreciation to the Credit Guarantee Corporation or CGC, for inviting me to deliver the keynote address. It is encouraging to see many financial institutions and small and medium enterprises (SMEs) in the audience. The Bureau is also Malaysia's first, under a joint initiative of CGC and Dun and Bradstreet Malaysia Sdn. Bhd., a subsidiary of Dun and Bradstreet Corporation in the US, which has vast experience in establishing and operating credit bureaus globally.

The development of a strong and dynamic SME sector is a priority on the national economic agenda. The reasons for this are clear when one considers that 99.2% of the total business establishments in Malaysia are SMEs. The SME sector currently employs about 5.6 million people, and contributes about 32% of gross domestic product.

Given its economic potential, the Government has accorded significant emphasis to developing and strengthening the SME sector, to enhance its contribution to the economy. The Government took a major stride forward in June 2004 with the establishment of the National SME Development Council. It may surprise some of you to know that there are fifteen Government Ministries and 38 Agencies involved in supporting the development of SMEs. The formation of the Council was therefore a mammoth undertaking that clearly signals the commitment of the Government to the SME agenda. The Council, chaired by the Prime Minister and supported by Bank Negara Malaysia as the Secretariat, provides the policy direction of the programmes to support the SMEs, and ensures the effective implementation and coordination of these programmes.

The national SME strategy is focused on the development of high performance and resilient SMEs under three broad strategic thrusts, namely, strengthening the enabling infrastructure; enhancing the capacity and capability of SMEs; and enhancing access to financing. Bank Negara Malaysia has been at the forefront of initiatives to ensure that SMEs, at different stages of the business life cycle, have adequate access to financing. These included among others, initiatives to develop a vibrant and sustainable microfinance industry, the establishment of two venture capital funds of RM150 million each for the agriculture sector and the establishment of the Small Debt Resolution Scheme.

The various measures have already yielded positive results. SMEs today have greater access to financing, with financial institutions being the main SME financing provider. In 2007, banking institutions approved RM55.1 billion in new financing to more than 109,000 SME accounts. SME financing continues to remain robust. For the first three months of 2008 alone, a total of RM12.4 billion in new financing was approved to more than 34,000 SME accounts. As at end-March 2008, SME financing outstanding by banking institutions amounted to RM118.8 billion. Indeed, an increasing number of banking institutions have announced strategic plans focusing specifically on the SME sector. This has seen the share of SME financing increase significantly from 30% of total business financing of banking institutions in 1999 to 44% at end-March 2008.

Within the overall SME financing landscape in Malaysia, the CGC has been positioned to play a key role. Established at the initiative of Bank Negara in 1972, CGC set out to address one of the main constraints of SMEs in accessing financing, which is the lack of collateral. Since then, CGC with Bank Negara as its main shareholder and with shareholders funds amounting to RM2.7 billion and guaranteed financing outstanding of RM10.2 billion at end-

March 2008, has evolved itself as an integral part of the financial landscape, with the financial capacity to deliver its mandate.

In 2005, Bank Negara embarked on a strategy to transform CGC beyond that as a provider of credit guarantees to enhance the contribution of the fast-growing SME sector to the national economy. CGC is being now positioned to provide a wider range of credit enhancement products. More importantly, it is also being positioned to provide advisory services on financial and business development to SMEs. This represents a significant shift in CGC's strategic orientation and is validated by studies of the experiences in other countries that have found such advisory support to be critical in enhancing the viability of SMEs.

A number of recent initiatives under CGC's transformation plan deserve mention. These include widening the scope of guarantees to also cover financing by Islamic banks and development financial institutions, introducing a new guarantee scheme for start-up SMEs, participating in Malaysia's first synthetic securitisation of SME loans, introducing an equity financing arm, and introducing risk-based models for determining guarantee fees.

The establishment of the SME Credit Bureau is indeed a watershed event in CGC's evolution. As a source of credible and reliable credit information that serves the needs of both the SMEs and the potential financiers, it is a natural progression of CGC's continuous effort to enhance access to financing by SMEs. The establishment of a SME Credit Bureau by CGC and D&B would no doubt complement the other initiatives of the Government and the financial sector.

The significance of the SME Credit Bureau lies in dispelling the general misconception that SMEs pose higher financial risk to financiers, lack financial management disciplines and would be unable to provide relevant financial information to their financiers to facilitate assessment and monitoring of loans extended to them. Yet, SMEs are often skeptical of the benefits of credit bureaus, believing them to hurt rather than assist SMEs in obtaining access to financing. The reality is very different.

Our own experience in Malaysia with the Centralised Credit Reference Information System or CCRIS that is managed by Bank Negara, and the experience in other developed and developing countries where SMEs form the backbone of the economy have shown that greater access to credit information has in fact contributed to greater access to financing and reduced loan processing times. By enriching the information available to financiers to support credit risk assessments, the asset quality of financial institutions are also improved, thereby reducing the cost of financing to borrowers and enhancing the capacity of financial institutions to continue extending credit to deserving SMEs. Allow me to elaborate the benefits to SMEs, with particular reference to the SME Credit Bureau:

Firstly, the Bureau assists the SMEs to build track records. One of the key factors in credit evaluation is the historical conduct of accounts. SMEs that have no previous banking history would not have the "reputational collateral" that would otherwise give them easier access to financing. The SME Credit Bureau will be able to address this information gap by collecting and disseminating information from a wider base, including trade credit data that captures the dealings between SMEs and their suppliers. In this manner, SMEs which have no financial relationships with banks, but which have strong credit standing among their trade creditors and suppliers, will be rewarded through favourable ratings that can be used to support financing applications when the need arises.

Secondly, SMEs with good track records will not only enjoy a wider acceptance from banks, they will also be able to access financing on more favourable terms, and obtain faster decisions on their financing applications. This is because the Bureau acts as a one-stop center for banks to obtain consolidated information on SMEs, which is currently scattered, and will take longer for banks to obtain and verify individually. We have already seen how this can work in the case of consumer financing, where real-time and comprehensive information on consumers' credit exposures and history that is available from CCRIS has significantly shortened loan-processing times. With greater availability of information on SMEs, the processing time for SME loans can be similarly shortened.

Thirdly, the Bureau includes and takes into account both positive and negative information on SMEs. Certain third party information that financial institutions use in the evaluation of credit applications only provides negative information on the business conducts. Examples are information on bankruptcy and legal suits, which are sometimes not updated and may result in a biased assessment of creditworthiness. By collecting and disseminating both positive and negative information, the SME Credit Bureau will benefit SME loan applicants by providing a more balanced view of SMEs' credit standings. In an objective rating process, credit bureaus typically accord greater weight to the more recent credit information or behavior. Negative records in the past can thus be mitigated by more current and consistent good track records.

Lastly and perhaps of most value to SMEs, is the insights that SMEs would gain from a better understanding of their financial deficiencies which lead to rejections of financing applications by financial institutions. This can be deduced from the analysis provided through the Bureau ratings and reports. The credit reports would also serve as a convenient tool for SMEs to carry out a self-evaluation to identify areas that need improvement and initiate adequate remedial actions to increase their competitiveness. SMEs are thereby *empowered* to improve their own profile, with correspondingly enhanced prospects for the SME sector as a whole.

As I mentioned earlier, it is also encouraging to see a considerable turnout by financial institutions at this seminar. This underscores the sustained and growing attention by financial institutions in the SME sector that is critical to provide the enabling environment for the SME sector to thrive. Bank Negara has seen a paradigm change in the way in which financial institutions approach the business of SME financing. Banks have, and continue to invest significantly, in supporting SME financing niches, and the organisational changes that we have seen have been pervasive in many banks. These banks have acquired tremendous insights on effective strategies for successful interfaces with SME customers. In some banks, completely new business cultures for their SME segments have evolved as a result which bodes well for the SME industry.

The information provided by the SME Credit Bureau can further support efforts by banks to strengthen risk management for their SME portfolios, regardless of the level of sophistication and size of the institutions. Banks with an SME credit model already in place can benefit from the Bureau information in various ways. For example, as the Bureau rating is determined based on diverse information obtained from various sources including CCRIS, trade credit data and the Companies Commission of Malaysia, banks can use such information to bridge any information gaps and address the limited pool of internal data available for their internal models. Such gaps currently exist, as banks in general are highly dependent on borrower information alone. In addition, given the diversity of information available within the SME Credit Bureau, banks would now have access to information on various economic sectors that may not be available within existing credit portfolios. At the same time, Bureau ratings could be used by the banks to validate the robustness of their own internal models by comparing the ratings produced between their internal ratings and that by the SME Credit Bureau.

For smaller and less sophisticated banks, the Bureau information will supplement the current SME credit assessment methodology that is traditionally qualitative in nature. Such banks will be able to obtain quantitative information from the Bureau database to enhance the overall credit evaluation process, thereby supporting more informed and objective credit decisions. The benefit is not limited only to enhancing credit evaluation, but also provides the foundation for more effective portfolio analysis and management on an ongoing basis that are the hallmarks of any effective risk management system. For example, the overall quality of the SME portfolio can be monitored based on information available from the Bureau to support analyses on the distribution of financing by rating, migration analysis and stress tests. The findings from portfolio analysis supported by the bureau information would assist SME financiers to better price their SME financing and facilitate more effective allocations of capital.

Moving forward, one of the roles that the SME Credit Bureau can effectively play is to provide market research and reports on the SME industry. This will expand its user base beyond SME financiers and creditors to include policy makers, economic and investment analysts, and even academic scholars.

The credit information infrastructure in Malaysia is advance, relative to other countries in a similar stage of economic development. Our main credit information database currently is the CCRIS that captures information on all credit facilities extended by licensed banking institutions in Malaysia , as well as other institutions regulated by Bank Negara. While access to CCRIS is limited for the time being mostly to regulated financial institutions, we are encouraged by the progress made by private bureaus, such as the SME Credit Bureau, in providing access to credit information to a wider user base, as well as developing new value added products and services.

With the expanded role of private credit bureaus comes the responsibility to protect privacy and ensure the accuracy and timeliness of credit information. The Government is in the final process of developing the regulatory framework for the protection of credit information and other personal data. In addition to according greater protection to consumers, the Government is formulating the new credit reporting law and regulatory framework to achieve an appropriate balance between consumers' right to privacy and financiers' right to access credit information. To preserve this balance, SMEs will need to provide consent to financial institutions, for them to obtain the ratings from the SME Credit Bureau. As described earlier, the sharing of credit information will benefit the majority of SMEs, primarily through expanded access to credit, shorter processing times and lower borrowing costs. Therefore, while participation is optional, it would be in the best interests of businesses to participate in this effort and be more forthcoming in providing the information that in the final analysis will be beneficial not just to individual SMEs, but for the development of the SME sector as a whole.

From Bank Negara's perspective, the information compiled by private credit bureaus would provide us with more information on the financial, household and corporate sectors for financial surveillance and policy calibration purposes. The more comprehensive and granular information will enable Bank Negara to detect emerging risks or vulnerabilities within the respective sectors at an earlier stage, and enable us to implement pre-emptive policy measures with greater speed and precision.

Indeed, the SME Credit Bureau initiative represents a convergence of different objectives by various stakeholders, namely the Government, SME financiers and creditors, CGC and D&B. It is a big step in bridging the current gaps in the availability of credit information on SMEs. Nevertheless, the real and largest beneficiaries of the initiative would be the SMEs themselves.

On this note, I would like to congratulate CGC and Dun & Bradstreet Malaysia Sdn. Bhd. in their new venture. I am also confident that this will open up a new chapter in the history of credit bureaus and enable these entities to play an even greater role in the future development of the financial industry in Malaysia, and consequently, enhance access to financing by SMEs.