

## **Zeti Akhtar Aziz: Enhancing SMEs' awareness on access to financing**

Keynote address by Dr Zeti Akhtar Aziz, Governor of the Central Bank of Malaysia, at the Banking Industry Seminar "Enhancing SMEs' Awareness on Access to Financing", Kuala Lumpur, 9 July 2008.

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### **Introduction**

It is my pleasure to be here this morning to speak at this seminar, to enhance greater SME awareness on access to financing organised by the Association of Banks in Malaysia. The development of a strong and dynamic SME sector is a priority on the national agenda. It is part of the efforts towards creating sustainable and balanced economic growth. The reasons for this are clear. SMEs account for 99% of the total business establishments in Malaysia and for 56% of total employment and contribute about 32% to gross domestic product and 19% of total exports of the nation.

Over the recent five years, SMEs have also increased their contribution to growth. In several developed countries, SMEs contribute at least half of the gross domestic product. Taking SMEs in these economies as a benchmark, there is clearly significant potential for SMEs in Malaysia to increase their contribution to the economy.

My remarks today will focus on three areas. Firstly, the implications of global economic and financial developments on the Malaysian economy, and in particular on businesses and SMEs. Secondly, on the strategy adopted by the Government and Bank Negara Malaysia to develop the potential of the SME sector as a source of economic growth. And finally, the further measures that need to be implemented by the banking institutions and the SMEs in a more challenging environment of rising costs.

### **Economic and financial developments**

Going forward, the international economic and financial environment is expected to remain challenging with slower global growth and continued uncertainties in the international financial markets. The moderation in global growth is also occurring in an environment of increasing inflation arising from the higher energy and commodity prices.

The Malaysian economy has been on a steady growth path averaging about 6% in the recent three years. In 2007, the economy expanded by 6.3% and has continued to register a strong growth in the first half of 2008. This stronger growth has been achieved despite the more challenging external environment and increased uncertainties in the international financial markets.

One of the important contributing factors has been the successful transformation of the Malaysian economy in this recent decade which has resulted in a more balanced and diversified growth, in which the services and agriculture sectors have become increasingly more important drivers of growth. In addition, domestic demand has a more significant role in driving the growth. The stronger domestic demand and growth in the services and agriculture sectors have benefited the SME sector since the majority of the SMEs are operating in these sectors.

However, the rising international prices of energy and commodities have confronted economies globally with rising costs and intensifying inflationary pressures. This has prompted several emerging economies to restructure their fuel subsidies in an effort to create more efficient economies and to achieve more sustainable fiscal positions. This has been followed by the consequent adjustments in consumer prices as the gap between international market prices and domestic prices narrow. In Malaysia, petrol prices were adjusted by

40.6% while diesel prices by 63.3%. This adjustment would be reflected in the consumer price inflation in June, which is expected to exceed 6%. Beginning 1 July, electricity tariffs have also been raised by up to 18% for households and an average of 26% for some commercial and industry users. While domestic inflation is expected to remain elevated for the remaining part of this year and early next year, it is expected to moderate in the second half of 2009.

In the current international environment, the policy response needs to be contextualised to the conditions prevailing in each individual economy. In those economies that are experiencing overheating and strong demand conditions, there is greater clarity in terms of the need for policy to rein in demand. However, for economies that are experiencing moderating growth, the risks to growth and inflation need to be carefully evaluated. In addition, consideration needs to be given to the deflationary impact of the fuel price increases on consumption. Trends in consumption and the conditions in the labour market will provide signs of potential second round effects following rising costs and the extent to which a generalised price increases are occurring.

In such an environment, SMEs need to consider repositioning of business strategies and to find new markets and avenues of growth. Reengineering of processes would also be required to better manage the higher cost conditions. The key is for the SMEs to use their inherent flexibility and agility to create new products and reorient the business. Given that the current inflationary pressures is a global phenomenon, with many of our trading partners and neighbors having similar or higher inflation rates, the inflation is unlikely to erode Malaysia's comparative advantage.

In this more challenging economic environment, sustaining growth will also require concerted efforts by the public and private sectors to reduce costs and become more efficient and more productive. To assist SME businesses in this environment, the Government has recently established a Special Committee to recommend potential measures to reduce the impact of rising costs on SMEs. The measures to be announced later this month are aimed at enhancing efficiency and productivity of SMEs, reducing the cost of doing business and ensuring that SMEs have sustainable access to financing.

### **The SME development agenda**

In view of the important role of SMEs in the economy, the Government has accorded significant emphasis on the development and strengthening the SME sector. Culminating from the recommendations of the National SME Steering Committee, the Government took a landmark decision in June 2004 to establish the National SME Development Council. The Council, chaired by the Prime Minister and supported by Bank Negara Malaysia as the Secretariat, provides policy direction for the programmes to support the development of SMEs, and to ensure the effective coordination and implementation of these programmes. Currently, members of the Council comprise of the Prime Minister, 15 Ministers and four Heads of Agencies, that are involved in SME development.

Since the establishment of the Council in 2004, the national SME strategy has focused on the development of high performing and resilient SMEs by capacity building and providing an enabling environment for the SMEs. The measures undertaken have been clustered under three broad strategic thrusts, namely, strengthening the enabling infrastructure; enhancing the capacity and capability of SMEs; and enhancing access to financing. The basic principle adopted has been to help SMEs to help themselves.

An annual SME Blueprint Management Framework has been implemented to ensure more focused, holistic and effective SME development programmes with greater collaboration between the Ministries and Agencies involved. In 2007, more than 286,000 SMEs received assistance through the implementation of 189 key development programmes, involving

expenditure of RM4.9 billion. For 2008, 198 key programmes are being implemented, involving an expenditure of RM3.2 billion.

With the foundations now in place, on 2 June 2008 the Council announced the formation of the SME Central Coordinating Agency to further build on the successes that have been achieved and to take the SME sector to the next stage of development. This dedicated SME Agency represents a major structural enhancement in the SME development agenda and marks another milestone for SME development in Malaysia. The Small and Medium Industries Development Corporation or SMIDEC, will be transformed and repositioned to undertake this role. This new entity, that will be known as the SME Corporation Malaysia or SME Corp, will be a one-stop agency that undertakes the overall coordination of SME policy formulation and assessment of the SME development programmes. The SME Corp will serve as the central point of information, reference and advisory services for SMEs for all sectors and will assume the role of Secretariat to the Council, a role which has until now been undertaken by Bank Negara Malaysia.

### **Increasing SME access to financing**

Bank Negara Malaysia's own efforts have been focused on ensuring that SMEs, at different stages of the business life cycle, have adequate access to financing. The initiatives have been directed at four broad areas. Firstly, the strengthening of financial service providers. This has involved strengthening the role of the banking institutions in providing financing to SMEs. This recent five years have seen the financial institutions accord greater focus to the SME sector. We have also seen a paradigm shift in the approach by financial institutions in the business of SME financing. Increasingly, banks have introduced strategies for interfacing with SME customers, evolving new business cultures for the SME segment and enhancing the financial products and services offered to the SME industry. The share of SME financing has increased from 30% of the total business financing of banking institutions in 1999 to 44% at end-May 2008.

In addition, a sustainable and comprehensive Microfinance Institutional Framework was implemented in 2006. Since its implementation, there has been considerable progress in the participation of financial institutions in providing microfinance. Currently, nine financial institutions have launched microfinance products, which has helped to increase access to financing to micro-enterprises. The outstanding micro-financing now amount to RM325 million with more than 31,000 customers.

In addition, the financial service providers such as the Credit Guarantee Corporation and Bank Pertanian Malaysia, now known as Agro Bank, have been transformed into institutions that are more effective, efficient and financially sustainable. In relation to this, the SME Credit Bureau, a key initiative under the transformation plan of the CGC has officially commenced operations on 1 July 2008. The Bureau serves as a source of reliable credit information for both the SMEs and their potential financiers. The Bureau will assist SMEs to build a track record and thereby enhance access to financing on more favourable terms, leading to faster decisions on loan applications, and providing a balanced profile of the credit standing of the SMEs. This will also promote a better understanding by SMEs of their financial conditions, drawn from the analysis provided through the Bureau reports.

Initiatives have been taken to continuously develop new financing products that meet the evolving needs of SMEs in various segments and stages of growth. This includes the introduction of the new CGC guarantee scheme to assist start-up SMEs that have insufficient collateral and insufficient financial track record to obtain bank financing.

Finally, to complement the financial infrastructure, initiatives have been taken to develop comprehensive financial advisory services. Bank Negara Malaysia's Laman Informasi Nasihat dan Khidmat or BNMLINK, and BNMTELELINK, which is a dedicated Contact Centre, provide financial advisory services to the SMEs. In addition, Bank Negara 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.

Today, SME financing has become robust with financial institutions being the main provider of SME financing. In 2007, banking institutions approved RM55 billion in new financing to more than 109,000 SME accounts. For the first five months of 2008 alone, a total of RM22.7 billion in new financing was approved to more than 55,800 SME accounts. As at end-May 2008, outstanding SME financing by banking institutions amounted to RM120.3 billion. In 2008, banking institutions are projected to approve RM61 billion of financing to more than 115,000 SME accounts, increasing at an annual growth rate of 10%.

Over the years, SME customers have gained a more prominent standing in the books of banking institutions in Malaysia. Consequently, it is in the banking institutions' best interest to meet the requirements of viable SME customers, which may face difficulties in the current challenging environment. Banking institutions need to engage and regularly interface with the various associations that represent SMEs to ascertain and formulate solutions to address issues confronting the SMEs while also communicating the requirements expected of the SMEs. Banks also need to provide greater flexibility in structuring the financing facility including customisation of the repayment periods within acceptable risk management levels. Banks may also expand the provision of advisory services to SMEs and proactively seek out SME customers that may be facing stress in this difficult business environment well before their conditions deteriorate. Adequate advice on financial management could pre-empt and avoid problems with respect to the financing facility.

Bank Negara Malaysia has also advocated for the migration to electronic payments as a measure to improve efficiency levels. This cannot be overemphasised in the current environment. The adoption of electronic means of payments would result in greater business efficiency in addition to reducing the cost of doing business. It is important for the businesses including the SMEs to place high priority on the adoption of more expedient and efficient means of payments. In facilitating this transition, Bank Negara Malaysia is reducing transaction fees for the RENTAS system (the real time gross settlement system operated by Bank Negara Malaysia) for payments made by financial institutions on behalf of their customers. With effect from 15 July 2008, the RENTAS transaction fee imposed on the member banks will be reduced by RM1.00, from RM2.50 to RM1.50. This reduction in fees will result in a corresponding reduction in bank charges imposed by member banks on their customers for RENTAS payments with effect from the same date. In addition, the banking industry will be reviewing the fee structure for fund transfers to apply a fixed fee instead of the existing Inland Exchange Commission of 0.03%.

In this environment, the SMEs also need to initiate their own measures to complement those undertaken by the Government and the banks. Achieving cost efficiency and productivity improvements needs to be a priority for SMEs. SMEs should look at every facet of their business operations to identify ways to streamline processes, eliminate waste, consolidate activities and adopt new technology and energy-efficient processes. SMEs that operate in common geographical locations and that have similar production inputs, should also consider pooling their purchase requirements to benefit from bulk discounts by suppliers, in addition to sharing common costs such as transportation. In this regard, the Chambers of Commercences and industry associations can have a key role. They can facilitate the bulk purchase of raw materials for their members. Experience-sharing sessions can also be organized for successful members to share their experiences in achieving cost efficiency and productivity improvements.

As important as achieving cost efficiency is the need to raise the level of value creation and to find new areas of growth. This will require shifting resources to new areas of competitive advantage. In striving towards long-term competitiveness, SMEs should adopt best practices in their governance and risk management processes. An aptitude for hard work and prudent

practices, the agility to adapt to changing conditions, perseverance and entrepreneurial skills and the ability for reinvention – these are the qualities that will enable SMEs to ride through the near term challenges and allow them to grow and enhance their contribution to our economy.

Ladies and gentlemen,

Today's seminar provides a platform for SMEs to widen their knowledge on the numerous financing arrangements offered by the banking institutions. Take advantage and benefit from this opportunity. On this note, I would like to congratulate the Association of Banks in Malaysia for organising this important seminar on "Enhancing SME Awareness on Access to Financing". I wish you a productive and successful seminar.