REPAYMENT BEHAVIOUR OF DEVELOPMENT FINANCIAL INSTITUTION BORROWERS

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ABSTRACT

This study investigates the repayment pattern of Development Financial Institutions borrowers in Sabah and Sarawak. Additionally, factors such as demographic profile, loan characteristics and borrower-lender distance are examined to determine their relationships with repayment performance. A total of two hundred and forty-two queationnaires were collected during the study period and used for the analysis. Findings showed that 43% of the respondents default their credit obligations while the remaining take between one to six months to settle their monthly arrears. When the cross-tabulation analysis was used to identify the common demographic characteristics of the defaulters, it was found that most of the defaults are male, attain a lower level of education, have a higher total number of dependents and self-employed. An empirical analysis on the impact of the factors affecting repayment performance of Development Financial Institutions using logistic regression analysis suggested that Development Financial Institutions should manage the borrower-lender distance actively and impose a collateral requirement in order to mitigate default peoblems.

CHAPTER 1: INTRODUCTION

1.0 INTRODUCTION

The importance of small and medium enterprises (SME) in Malaysia has received attention from the academics and the government. Small and medium enterprises facing more difficulties in obtaining credit from the traditional banks compared to the larger and more established businesses. This is partly due to the fact that small and medium businesses are more easily affected by economic condition and business cycles if compared to their more established counterpart – the big enterprise. In order to provide financial services to this group of entrepreneurs, the government has set up Development Finance Institutions (DFIs). Nowadays, other than providing financing for targeted industries, DFIs also provide financing to individuals and organizations to develop and create wealth in under-served markets.

To provide adequate financing no doubt is important for the very survival of the small and medium enterprises. Without financing, good projects cannot be materialized and job creation will be stagnant. Similarly, since the household financing sector represents the biggest loan demand sector in Malaysia, the financing needs of this sector should be catered for so that the vibrant of the economy will not be jeopardized. However, the objective of the credits provided cannot be met if default rate is high. This is because poor loan performance is damaging to the long-term survival of both the industries and the DFIs concern. A high loan default is a waste of valuable funds and the services for the community as a whole. Therefore,

CHAPTER 2: BACKGROUND AND LITERATURE REVIEW

2.0 BANKGROUND OF THE STUDY

Loan repayment performance of borrowers is one of the most important elements that determine the resilience of a financial institution. Poor loan repayment performance could lead to the occurrence of credit crunch. The credit crunch started at the end of 2008 in the United States has triggered a worldwide recession. Credit crunch is a phenomenon whereby financial institutions tighten their lending suddenly independent of the interest rates. The main reasons which could lead to this phenomenon are realization of bad debt as well as an increase perception of risk regarding the solvency of other banks.

In Malaysia, bad debt of the financial institutions is also known as non-performing loans. It is defined as loans which are in default for six months or more. According to Bank Negara Malaysia (BNM) Report, the non-performing loan of the whole financial system stands at 4.1 % as at December 2008. However, RAM Rating Services Bhd expects this figure to increase to about 9% in 2009. If that is the scenario, it is expected that Development Financial Institutions (DFI) would envisage a worse NPL compared to that of the overall financial system in Malaysia. According to BNM, the Gross NPL ratios of DFI were 10% and 8.8% respectively in 2006 and 2007.