

**ISLAMIC FINANCING SCHEMES FOR SMES IN MALAYSIA: A CASE STUDY ON
THE USAGE AND EFFECTIVENESS**



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4. Enhanced Research Title and Objectives

(if any)

Original Title as Proposed:

ISLAMIC FINANCING SCHEMES FOR SMES IN MALAYSIA: A CASE STUDY ON THE USAGE AND EFFECTIVENESS

Improved/Enhanced Title:

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Original Objectives as Proposed:

- i. To disclose to the SMEs on Islamic financing schemes.
- ii. To find out what are the adverse factors that's affecting the usage and the performance of Islamic financing schemes of SMEs.
- iii. To determine the level of effectiveness and usage of Islamic Financing schemes of SMEs in Malaysia
- iv. To identify the feasibility of applying the other Islamic financing products to the SMEs.
- v. To suggest appropriate recommendations to authority concerned.

Improved/Enhanced Objectives:

This study attempts to explore the usage and effectiveness of Islamic Banking Guarantee Scheme (IBGS) by Credit Guarantee Corporation for SMEs. Specifically the research tries:

- i. To find out what are the factors affect the usage and the performance of Islamic financing schemes of SMEs.
- ii. To determine the level of effectiveness and usage of Islamic financing schemes of SMEs in Malaysia
- iii. To study the trend of business performance and the level of profitability of logistics and transportation firms.
- iv. To discover firms' liquidity in the business operations.
- v. To determine the level of business efficiency

5. Report

5.1 Proposed Executive Summary

(Original proposal – 300 words) – 1 page only

Entrepreneurs everywhere need access to credit to start their businesses. Conventionally, the formal credit institutions usually laid down several taxing conditions to be fulfilled by the clients/entrepreneurs. Conditions such as collateral, repayment terms, interest on loan, repayment periods etc. can hardly be met by small scale businesses. As at end-2007, total financing outstanding of RM224.7 million was provided to 22,788 microfinance customer accounts, with an average financing size of RM9,800, which comprises of both the conventional and Islamic financing schemes. As Malaysia is moving towards becoming an Islamic Financial hub for Asia in particular, and for the world in general, the Bank Negara Malaysia through its agencies has introduced the Islamic financing schemes, as alternative to those entrepreneurs who keen to finance their businesses free from interest. There are two agencies that have been offering the Islamic financing scheme to the SMEs, namely the Credit Guarantee Corporation (CGC) and the Perbadanan Usahawan Nasional Berhad (PUNB). However, the level of usage of the Islamic financing schemes is still low among the SMEs. This study, therefore trying to evaluate the usage and effectiveness of the Islamic Financing scheme of SMEs in Malaysia.

5.2 Enhanced Executive Summary

(Abstract of the research) – 1 page only

Small and medium enterprises (SMES) formed part of important commercial activities in Malaysia. SMEs play important roles in job creation, in providing a resilient industrial base for adapting to turbulence, and in creation of an internationally competitive industrial structure. SMEs are often small and inexperienced as compared to many larger and well established multinational companies. Banks are reluctant to lend money to SMEs due to substantial amount of risk bank to undertake. In an event of any default payment it affects the bank's lending ability in the future. Due to this, the government established Credit Guarantee Corporation (CGC) in 1972, as one of financial institutions with the mission to help SMEs that do not have any collateral or record in securing loan from financial institutions. It is proven that the establishment of CGC had contributed to the expansion of many types of businesses from the agriculture sector to manufacturing sector. Various guarantee schemes, may it be conventional or Islamic, have been offered by the organization to assist entrepreneurs to secure loan whether as a starts up capital or for business expansion. One of the earliest Islamic guarantee scheme introduced by the corporation is the Islamic Banking Guarantee Scheme (IBGS). This scheme was introduced as alternative to conventional financing, which in nature the transaction is free from interest and highly recommended by the religion. To what extend the scheme offered by CGC has been utilized by the SMEs? Does the scheme offered is similar to the conventional one? Is the scheme offered effectively and efficiently managed by the clients? A set of questionnaires were distributed to the CGC's clients to seek their opinion on the IBGS. Correspondingly, assessment is made

on the financial statements of selected SMEs' firms (logistics and transportation) such as income statement and balance sheet. Base on the financial ratios analysis it gives advantage to entrepreneurs to be ahead from their competitors since the ratio analysis will furnish them with useful information of business performance, such as to forecast for growth and to avoid from bankruptcy. More importantly, the firm is able to survive for a longer period of time. The result shows that the overall financial performances, in term of profitability, liquidity, solvency and efficiency for transport and logistics firms, are excellent over the last five years.

5.3 Introduction

Access to finance for small and medium entrepreneurs always being a central of discussion and focus to policymakers since the small medium enterprises (SMEs) are significant contributor to the economic growth and development of the country. Through this industry, the socio economic of society has improved, the problem of poverty could be tackled, jobs are created and even most importantly it has diversify the economic landscape of the country from commodity based to industry based. This research is carried out to depict the industry of SMEs in particular the availability of Islamic financing as alternative mechanism for them to start or to expand the businesses. Apart from discussing the nature of Islamic financing, the research also analyze the performance of selected SMEs that devised the Islamic financing scheme.

Problem Statement

SMEs represent more than 90 percent of commercial establishments and contribute to 46 percent of the national output. (9th Malaysian Plan). With proper financial and non-financial support, SMEs will be able to contribute significantly to the nation's economic growth. Inevitably, the greatest challenge to Islamic financial institutions is to compete with the well-developed and mature conventional banking industry which has been evolved over the past many centuries (Hassan & Lewis, 2007). Malaysia, being one of the pioneer in Islamic banking, would also have to face similar confrontation, particularly, when they are operating in a dual-banking system where the conventional banks run parallel with the Islamic banks. Thus, people are expecting that the Islamic banks could deliver better services to them and the financing tools which are not only interest free but at the same time able to sustain them in the market. If the conventional financing is seeing of creating debt slave to the borrowers in the long run, many are expecting that with Islamic financing such problem could be reduced, hence creating a generation of SMEs' entrepreneurs which are debt free.

As Malaysia is moving towards becoming an Islamic Financial hub, for Asia in particular and for the world in general, Bank Negara Malaysia, through its agencies, has introduced the Islamic financing schemes, as alternative to those entrepreneurs who keen to finance their businesses that free from interest. The amount of micro financing for macro enterprises ranges from RM500 to RM50 000. The amount is meant for