Session 2: Regulating Alternative Finance – Addressing Challenges and Identifying Opportunities

by:

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SMEs are important economic agent

Financial landscape for SMEs in Malaysia; Is alternative financing viable?

HIP3: SME Investment Programme (SIP) another form of alternative financing

Other Modes and Key policy recommendations for alternative financing

Source: Economic Census 2011: Profile of SMEs, Department of Statistics Malaysia (DOSM)
SMEs are important economic agent

- 97.3% (645,136) of total establishments
- Mainly (77%) microenterprises
- Concentrated in services sector (90%)

Distribution of Business Establishments by Size

Services
- Distributive Trade & Repair of Motor Vehicles and Motorcycles (50%)
- Restaurants (25%)

Manufacturing
- Textiles & Wearing Apparel (26.5%)
- F&B Products (16%)

Construction
- Non residential buildings (21.5%)
- Civil Engineering (21.0%)

Agriculture
- Crops (70.4%)
- Livestock (13.4%)

Mining & Quarrying
- Stone Quarrying (83.6%)
- Mineral Mining (16.4%)

Source: Economic Census 2011: Profile of SMEs, Department of Statistics Malaysia (DOSM)
Significant progress in SME development since establishment of NSDC in 2004... high level body

SME Definition
Statistics

SME Development Framework
SME Masterplan

Centralisation of training programmes, Advisory

Information - Annual Report, SMEIPA, SMEinfo portal

New financial products - microfinance, guarantee

Financial infrastructure - SME Credit Bureau, SDRS, transformation of DFIs

NSDC: National SME Development Council

NSDC: National SME Development Council
Including establishment of **SME Corp.**, a dedicated Agency for SME development

- Formulate policy & undertake economic assessment
- Coordinate programmes & policies
- One Referral Centre

**NSDC**

- Secretariat to NSDC

**Ministries & Agencies**

**SMEs**

**Chambers & Industry Associations**
Resulting in impressive SME growth performance... but still a long way to achieve a high income nation

33% of GDP
57% of employment
17% of exports

SME vs Overall GDP Growth

Contribution of SMEs to GDP

Source: Department of Statistics, Malaysia
Malaysian economy continues on a **steady growth path** with **domestic demand** as the key pillar.

**Robust expansion in private investment and improvement in external demand**

**Consolidation of Public sector**

**Private consumption is expected to be underpinned by healthy labour market**

**Malaysian Economy is expanding at 6.0% (2014)**

**Official GDP Growth Forecasted (BNM) at 4.5-5.5% (2015)**

- **SME Development**: Domestic demand gains momentum, as countries focus on inclusive growth for long-term prosperity and social being of the nation.

**Doing Business Report 2014 by the World Bank**

- Malaysia has been ranked number one for six consecutive years for ‘getting credit’ since 2007 which mirrors a strong financing ecosystem in Malaysia.
- Financial Institutions play an important source of external funding for SMEs contribute about 95% (BIs: 90%, DFI: 5%)
Access to financing is one of the key factors to promote SMEs growth.

Financing Lifecycle for SMEs

As innovative SMEs mature, their financing needs become more similar to other SMEs and debt financing becomes a more important source of external finance.
Malaysia offers various financing channels to SMEs

FINANCIAL LANDSCAPE FOR SMEs

BANKING INSTITUTIONS
- Venture Capital Companies
- Leasing and Factoring
- Ar-Rahnu and Pawn Broking

DEVELOPMENT FINANCIAL INSTITUTIONS
- Microfinance Institution

Government Funds and Schemes
- Government Crisis Funds

Credit Guarantee Schemes
- Credit Bureau Malaysia

BNM Special Funds and Guarantee Schemes

Credit Guarantee Schemes
Create more avenues particularly for start-ups and innovative SMEs

Reduce the cost of financing & stimulate innovative power of SMEs

Effectively using multiple innovative forms

Improve financing support & promote sustainable SME devlp

...with alternative financing growing rapidly
Nevertheless, financing SMEs is still a challenge let alone to use alternative financing.
Currently, mainstream financing plays important role in access to financing for SMEs in Malaysia.

- Standard format for financing and loan forms across all financial institutions (BIs and DFIs).
- Working together with financial institutions’ associations and maintain good relationship with banking fraternity.
- Using SME Competitive Rating for Enhancement to enhance information on SMEs.
- Role of Credit Guarantee as a financial tool.
FIs being the main source of external financing

Source of Financing of SMEs (% share)

- External Financing (Banks, DFI, etc.)
  - FIs
  - DFIs; 6%
  - *Govt. Funds / Schemes; 2%
  - **VC; 1%
  - Factoring & Leasing; 1%
  - Bls; RM225.9 bil; 90%

- Borrowings from Friends / Relatives
  - 14.3%

- Internal Financing (Retained Earnings, Internally Generated Funds, etc.)
  - 55.9%

Financing Outstanding as at end 2014

* As at end-2013. Excluding government funds that are channeled through FIs.
** As at end-2014

Source: Economic Census 2011: Profile of SMEs, Department of Statistics Malaysia (DOSM)

Source: BNM, SME Corp. Malaysia and Securities Commission Malaysia
In bridging the financing gap, SME Corp worked closely with selected key agencies to promote alternative financing.

- **Investment Account Platform (IAP), Factoring & Leasing**
- **MyULM & Equity Crowdfunding**
- **Special Guarantee Schemes**
- **Crowd Funding**
- **IP Financing Scheme (IPFS)**

**SME Corp collaborative partners**

- **IAP: New Shariah Investment platform encourages on equity participation to invest in SMEs.**
- **Innovative electronic web based platform that offers capital market access without exchange standardisation.**
- **SME Assistance GS (RM 2 Bil.) Working Capital GS (RM 7 Bil.)**
- **Under Digital Malaysia initiative to provide more opportunities at lower cost and better value.**
- **IP rights as additional source of collateral with initiative of RM200 mil. financing.**
SME Masterplan also focuses on alternative financing for innovation-led and productivity-driven growth.

**Vision**
Globally competitive SMEs across all sectors that enhance wealth creation and contribute to the social well-being.

**SME Development Framework**
- Increase business formation
- Expand number of high growth and innovative firms
- Raise productivity
- Intensify formalisation

**Goals**
- Innovation & Technology Adoption
- Market Access
- Human Capital Development
- Legal & Regulatory Environment
- Access to Financing
- Infrastructure

**Focus Areas**

**Action Plan**
- Reliable database
- Monitoring & Evaluation
- Effective Coordination
- Effective Business Services
The Plan adopts a **new approach** to SME development.

**Public-private partnership**

**Innovation and productivity-led**

**Outcome-based**

**NEW Approach**

‘Live’ plan
Financing is one of the 6 focus areas that is being addressed to unleash the growth potential of SMEs

Constraints to Growth

**Innovation & Technology**
- Access to national innovation system
- Low commercialisation & R&D
- Poor technology uptake

**Human Capital Development**
- Workforce lacks job readiness
- Low utilisation of existing training
- Non-competitive rewards & benefits

**Market Access**
- Procurement by Govt/LSIs
- Information barrier to exports
- Limited focus on marketing & branding
- Low bargaining power

**Legal & Regulatory Environment**
- Licensing / permits
- Complying to regulations
- Legislations disincentivising formation & growth

**Access to Financing**
- Limited non-banking avenues
- Poor creditworthiness
- Lack of know-how and resources

**Infrastructure**
- Trade clearance and facilitation system
- Low and infrequent trade volume
6 High Impact Programmes are being implemented together with other supporting initiatives

1. **6 High Impact Programmes (HIPs)**
   - Inclusive Innovation
   - Catalyst Programme
   - Going Export (GoEx) Programme
   - Technology Commercialisation Platform (TCP)
   - SME Investment Partner (SIP)

2. **4 Thematic Measures**
   - Resource pooling & shared services
   - Create demand for SME products & service
   - Reduce information asymmetry
   - Building capacity & knowledge

3. **East Malaysia**
   - Improve connectivity & basic amenities
   - Review restrictive laws & policies
   - Ease market access

4. **Other Measures**
   - Completion of Integrated trade system (single window)
   - Bankruptcy Law to give entrepreneurs 2nd chance
   - Review SME taxation policy
   - Synchronise measures on productivity enhancement
HIP 3: SME Investment Programme (SIP) is an example of alternative financing for early stage SMEs.

**Context**
- Limited avenues for **early stage financing**
- VC industry lacks **vibrancy**; highly dependent on public funds (51%)

**Private Investors**
- RM1

**Government Loan through SIP**
- RM 2x matching debt capital

**Investment Companies**
- Debt
- Debt & equity

**SMEs**

**Characteristics**
- Debt in addition to equity
- Has monitoring & evaluation
- Managers are mainly from industry

**Govt.** provide long term capital into licensed investment companies

**Investment companies** to provide debt, equity or hybrid investments in promising SMEs.
Other **Modes** of alternative financing for SMEs across the world

**Access to Early Stage Financing**

- Issuing bonds to family and friends (Japan)
  - Privately-placed bond
  - Simplified procedure
  - Raise funds from family members and friends

- Encourage commercial banks to provide loans to microentreprises (Chile)
  - Start-up Chile
  - Uses a market-based subsidy to induce banks to provide microfinance
  - Two auctions are held in each year
  - Commercial banks are asked to bid on a per loan subsidy

**Innovation oriented Equity Programmes**

- SMEs with a high technology orientation and high growth
- Alternative way to raise capital
  - MyULM Trading platform for unlisted companies

- Most investments in the range of USD 0.25 M to USD 4 M
- Cover firms not served by venture capital companies

**Other Modes of alternative financing for SMEs across the world**

- Equity Financing with VC Funds (AUSTRIA)
- MyULM Equity Crowdfunding (MAS)
- Small Business Investment Companies (SBIC) (USA)

**Other Modes**

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Other Modes of alternative financing for SMEs across the world

New form of VC (OECD)

VC minimise the info asymmetry using following mechanism:
- Thorough evaluation of Business Plan
- Apply PS and numerous restrictive covenants
- VC provides important link between innovation and finance
- Proportion of VC in the financing lifecycle vary across countries
- Proper exit mechanism (IPO, second-tier market, bank oriented capital market)
- Availability of pension fund
- Integrate into global industrial economy, well developed human capital and government capabilities

Improved form of access to loans

Government assistance to curb finance risk (HK)

- Using government assistance such as loan guarantees to mitigate the risk of FIs financing the SMEs
- Reduce transaction cost by using internet to get the information on SMEs
- Create Credit Bureau: Credit Scoring System
- Remove obstacles to business creation
Key elements taken into consideration for enhancement in access to financing

- Reduce financing gap by using public sector fund to leverage private sector financing
- Recognise the need of proximity between demand and supply of funds
- Increase the managerial and technical expertise of intermediaries whose role to M&E the companies
- Facilitate international transfer of institutional infra and expertise
- Review the risk finance restriction for institutional investors
- Collaborate SMEs with accounting bodies to recognise, measure and report intangible asset
Other **key recommendations** in the Masterplan relating to access to financing

- Expedite growth of VCs, Angels, Risk Capital to create a more vibrant funding environment through tax incentives and capacity building
- Enhance current credit information system to address information asymmetry, esp. on Govt. funding
- Provide effective outreach to enhance financial inclusion through awareness campaigns, publications and advisory services
- Establish Independent Panel of Experts (IPE) comprising industry experts to assist financial institutions to evaluate businesses in new area
Focus will be towards:

**Implementation of HIPs**
- Quantum leap growth with private sector assuming a greater role

**M&E**
- Programmes and impacts of SME Masterplan’s initiatives
  - Mid-term review in 2017 with reference to progress of SME Masterplan implementation

**Economic Contribution in 2020:**
- Contribution to Employment: 57.5% → 62%
- Contribution to GDP: 33.1% → 41%
- Contribution to Export: 16.9% → 25%

Moving forward into **2020**….
One Referral Centre
Business Advisory Services (BAS)

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