Micro-banking System for Developing Small Medium Enterprises (SME): Comparative Lessons for Indonesia and Malaysia

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Abstract:
SMEs in Indonesia and Malaysia account for a large portion of total establishment in various sectors. The government of both Indonesia and Malaysia has also recognized the importance of having SMEs as an important element in creating a sophisticated economy, especially through their role in developing inter-industry linkages, or as supporting industries producing component for Large Enterprises (LEs) or subcontracting system or other form of production linkages. Despite the fact that SMEs are very potential for building a stable economic growth, developing SMEs is difficult issue. The most common problem for SMEs is lack of access to capital. This paper attempt to examine the access to capital is not only constraint for SMEs to grow, but it is also considered an important problem in developing SMEs. It then draws comparative lessons of micro-banking system to potential and future development of SMEs in Indonesia and Malaysia.

Keywords: micro-banking system, micro-credit, micro-finance, SMEs.

1. Introduction

The government of Indonesia and Malaysia have recognized the importance of having modern Small and Medium Enterprises (SMEs) as an important element in creating a sophisticated economy, especially through their role in developing inter-industry linkages, or as supporting industries producing components and parts for Large Enterprises (LEs) either, via market mechanism or subcontracting system or other form of production linkages. The further importance of SMEs in the economy is indicated by predominantly large share of SMEs in terms of number of establishments, total number of employees, total whole sales, total retail sales and total added value in the manufacturing sector.

The significant role of SMEs in Malaysian economy is demonstrated by their output which was worth about RM 4.3 billion or about 20 percent of Malaysian Growth Domestic Product (GDP) since 1990 and was projected to be around 50 percent or RM 120 billion by the year 2020 (Abdullah, 2003). Meanwhile, SMEs in Indonesia contribute significantly to the economic development as 54.74 percent of Gross Domestic Product (Ministry of Cooperatives & SMEs, 2001). Of Indonesia’s 2.8 million industrial establishments, 2.5 million are micro enterprises and 245,000 are SMEs, together accounting for 60 percent of manufacturing employment.

The role of developing entrepreneurship is very much related to SMEs. Here, large enterprises also have a complementary role to play. Many entrepreneurs received their initiation in a large enterprise. In this regard, large enterprises normally provide then with the skills, knowledge and opportunities to acquire the necessary capital to start their own venture. Through SMEs, entrepreneurs are able to acquire further experience and to improve abilities gradually with the growth of business enterprises. Moreover, SMEs represent the platform through which indigenous entrepreneur can progressively upgrade their investment and management skills.
Despite the fact that SMEs are very potential for building a stable economic growth, developing SMEs is difficult issue. Currently, SMEs in Indonesia and Malaysia have similar limited access to finance and capital, and the infancy of venture funds in initial or mezzanine financing. SMEs traditionally finance their operations through own savings, loans from family members and friends, as well as supplier credits. Especially for new start-ups, face difficulties in securing credit, as they have built little collateral or track record. The solution lies in improving access to institutional credit for SMEs. The venture capital industry is not sufficiently developed to spur the emergence or creation of new enterprises generating wealth from knowledge-based activities.

2. Problem Statement

Access to capital is not only constraint for SMEs to grow, but it is considered an important problem in developing SMEs. There is a common misunderstanding that banks are reluctant to lend money to SMEs as the banks never believe that lending to SMEs are commercially viable for them. SMEs that are essential to develop and sustainable growth will never get enough of the capital they need to build and expand the business.

3. Objective of Study

This study attempts to examine aspects of the strategic contribution of micro-banking system to financing of SMEs of two countries, Indonesia and Malaysia. It then draws comparative lessons with respect to potential and future development of SMEs in both countries.

4. Literature Review

SMEs in Malaysia account for a large proportion of the total establishments in the various sectors. In the manufacturing sector, for instance, SMEs comprise 93.8 percent of all establishments. Moreover, of the total number of SMEs, small enterprises comprise 76.0 percent, while medium companies account for 17.8 percent of all manufacturing establishments (SMI Development Plan 2001 – 2005). Meanwhile, the Eight Malaysia Plan (2001 – 2005) estimated that 90 percent of all manufacturing establishments were SMEs, employing 868,000 workers or 38.9 percent of the total. Small enterprises account for 3.9 percent and 11.4 percent and overall, 85 percent of the small establishments generate less than RM 5 million in output annually and employed less than 25 workers.

In Indonesia, SMEs have historically been main player in domestic economic activities, especially as a large provider of employment opportunities. In the last few years, the Indonesian government has recognized the importance of having modern SMEs as an important element in creating a sophisticated economy, especially through their role in developing inter-industry linkages, or as supporting industries producing components and parts for large enterprises (LEs) either, via market mechanism or subcontracting system or other forms of production linkages (Tambunan, 2006). SMEs could also play a powerful role in energizing agriculture through the development of high competitive agricultural-based industry, because Indonesia is a large agrarian economy owning a huge variety of agricultural commodities.

SMEs play a major role in every sector of the Indonesian and Malaysian economy. Indeed, no one can give a picture of the economic development in both countries without stressing the role of SMEs. Their number had been continually increasing since 1990s. According to the history of SMEs of Asian countries has shown that SMEs including micro enterprises form the backbone of the economy. Many researches finding reinforced the need for aggressive efforts to be undertaken in a strategies and coordinated manner to support the expansion of SMEs and strengthen their capacity and competitiveness, given their significant potential to contribute to the nation’s economy. Hence, it is recognized that a strong, dynamic and efficient SME sector will determine a sustainable economic development.
In recognition of SMEs’ substantial contribution to the economy, the strategies and initiatives to promote SME development feature prominently in all of the government’s economic development plans of both countries. Broadly, strategies to promote the development of SMEs have been formulated against the backdrop of a changing and challenging economic environment. Emphasis was placed on enhancing capacities and capabilities of SMEs, and enhancing their access to financing. One of the strategic priorities of Indonesian and Malaysian government is to develop and strengthen infrastructure that is required to create an enabling environment to support the growth of SMEs and entrepreneurs. A well-developed financial infrastructure that is able to meet the diverse financing needs of SMEs is essential to support the competitiveness and continuous growth of SMEs.

5. Analytical Framework

The government of Indonesia and Malaysia, through various Ministries and Agencies, has undertaken a lot of initiatives and programmes to support the development of SMEs. The aim is to promote the development and resilient SMEs towards increasing their contributions to the economy. Towards this end, a holistic and comprehensive approach is being undertaken, encompassing three broad strategic thrust, namely, strengthening enabling infrastructure; building the capacity and capability of SMEs; and enhancing access do financing. The analytical framework of this study has shown on figure 1.

A strong and dynamic SME sector would stimulate the economy and contribute to achievement of a wide range of economic development objectives. In short, SMEs employ more workers per unit capital as compared to large enterprises (LE); they contribute towards achieving a more equal income distribution in society. They also serve as a “training platform” for upgrading and developing skills of industrial workers and entrepreneurs. Moreover, they contribute to significantly establish forward and backward linkages, and they play a vital-complementary role to large and giant firms in the economy.
6. Methodology

The study is based on a qualitative approach that serves the following purposes (Peshkin, 1993; Leedly, 2005):

(a) **Description**: data can reveal the nature of certain situation, settings, processes, relationship, systems, or people that related to the objectives of these study.

(b) **Interpretation**: data enable to gain new insights about a particular phenomenon on micro-banking system and discover the problems that exist within that phenomenon.

(c) **Evaluation**: data provide a means through which a researcher can judge the effectiveness of particular policies, practices, or innovations regarding the micro-banking system on developing SMEs.

Data collected by observations to micro-banking system that currently operated in Indonesia and Malaysia to facilitate SME development. The study also use electronic documents (e.g., e-mail messages, articles, and Web sites), and anything else that can help them answer the objectives of the study.

7. Finding and Discussion

7.1. Financing SMEs in Indonesia

Recently, there were 74 private commercial banks in Indonesia and 4 large state-owned banks such as Bank Mandiri, Bank Negara Indonesia (BNI), Bank Rakyat Indonesia (BRI) and Bank Tabungan Negara (BTN). Prior to the financial turbulence, the state-owned banks dominated the banking industry, which represented nearly 50% of market share [http://www.indonesiamatters.com/950/50-banks-unsound/].

For some banks, financing SMEs may be very difficult. This is not surprising as some problems arise beyond the capability of the banks to handles such as business environment which is not conducive or a systematic ill in the financial sector. There is also legal issue in enforcing contract or business issue to obtain and enforce loan collateral. Furthermore, banks usually regard lending to SMEs is a high risk and unprofitable business due to (Mulyaningrum, 1995; Rudjito, 2007):

- Unavailability of accurate, reliable information on enterprises’ financial condition and performance
- Unconvinced and weak business plan
- Weakness in SMEs management, market links, governance, and information technology
- Weakness in banks staff including loan officers are not sufficiently trained in lending to SMEs
- Banks’ weakness in identifying the characteristic of SMEs
- Weaknesses of the bank adopting appropriate lending technologies and operation system that will enable them to realize this market potential and to lend profitably to small business
- The availability of other investing tolls which give opportunity to the banks to have lower risk investment such as holding government paper
- Higher overhead cost due to a high number of customers with smaller loan size

Aiming at promoting and strengthen the SMEs, the Indonesian government encourages the banks to have at least 20% of its portfolio in SMEs. This policy requires a lot of commitment from banks as lending to this sector requires specific treatment. There are several ways to provide financial assistance for SMEs, including:

- Developing lending programs appropriate for the enterprises
- Simplifying administrative procedures and collateral system
- Providing technical assistance
- Providing loan guarantee and micro credit insurance

With so many constraints to grow, SMEs will have to face greater challenges in free trade era in the next couple years. Strengthening SMEs must be a priority in order to prepare the facing challenges. The clients’ limitation and the banks’ interest must be formulated such that the loans delivery mechanism can provide access for SMEs without eliminating principles and prudential banking.
7.2. The role of Bank Rakyat Indonesia (BRI) in strengthen SMEs

BRI has been known as the largest commercial micro banking system in the world. BRI is the only bank in the world that provided financial services to large numbers of poor people on a long-term sustainable basis by operating as a profitable business (Robinson, 2005). The success story of *Bank Rakyat Indonesia’s Unit Desa* (BRI Unit Desa), which provides banking services to millions of low-income rural families in Indonesia, demonstrates that Rural Financial Institutions can achieve financial self-sustainability and a high degree of outreach (Yaron & Benyamin, 2007).

BRI’s micro banking system, which has been profitable every year since 1986, is now an integral part of Indonesia’s financial system. Currently, BRI has the widest network in Indonesia with 13 Regional Offices, 324 Branches, 64 Sub-branches, 4,000 BRI-Units and 238 Village Service Post. This wide network enables BRI to serve rural areas, the location of micro and small enterprises.

BRI also has overseas networks that are branch in the Cayman Island, Singapore and New York. At BRI’s branches, the bank provides full banking system such as loans to small and medium business, loans against salaries and pensions, trade finance, and food security program loans, as well as credits to cooperatives. Meanwhile, medium and corporate lending is managed by the Regional Office and Head Office. The branches also provide saving (BRITAMA), saving for pilgrimage (*Tabungan Haji*), current deposit and time deposit accounts. While at the BRI-Units, the services are limited to single loan product (*Kredit Usaha Pedesaan = KUPEDES*), rural saving (*Simpanan Pedesaan = SIMPEDES*), urban saving (*Simpanan Masyarakat Kota = SIMASKOT*), time deposit and current deposit. Recently, BRI has established an Islamic Banking Unit, which provides banking products under Islamic Law such as saving and deposit, working capital, letter of credit, bank guarantee, etc.

BRI is the only bank that has a numerous experience in strengthening micro enterprises and SMEs in Indonesia. BRI was established in Purwokerto, Central Java, by *Raden Bei Aria Wiratmadja* on December 16, 1895 (Rudjito, 2007). As a commercial bank, BRI provides a wide range of banking products and services such as commercial loans particularly to micro, small and medium scale enterprises, saving products and other financial services. Uniquely, BRI has a microfinance window, the BRI-Unit System which provides financial services to low income people (economically active poor) and micro enterprises particularly in rural areas.
Since its establishment, the bank consistently prioritizes its business focus to micro and small enterprises development, which is stated in the mission of the bank that is to give the best banking services focusing on micro enterprises, and small and retail business to enhance activity of society (Rudjito, et al., 2003). There are two main approaches in serving the micro and small enterprises. For the micro entrepreneurs who are still below poverty line, BRI provides subsidized loans since their conditions and levels of capabilities are not sufficient enough to accommodate the commercial approach. Meanwhile, for micro enterprises above poverty line, BRI provides fully commercial basis loans since they have capabilities to do so.

In general the approach of BRI in strengthening SME can be classified into 4 layers:

- Poverty alleviation program, targeted to clients below the poverty line. At this level, BRI provides loan schemes to the bottom layer of the poor communities, e.g. rural income generating project for farmer and landless.
- Program loans, targeted to customers above the poverty line. The services encompass loans for supporting agricultural and cooperatives development, which the interest rates set up by the government.
- Microfinance, targeted to active working poor and micro entrepreneurs living above the poverty line, which the interest rates based on market.
- SME loans up to RP 5 billion. The loan scheme at this level is designed for SME that need additional capital greater than the levels 1 & 2, that generally have advanced business practice and management capability.

One of the programmes from BRI is commercial loans called **KUPEDES (Kredit Usaha Pedesaan, General Rural Credit)** which is distributed to almost all areas in Indonesia. KUPEDES loans were introduced in February 1984. The instrument was designed to meet borrower’s need as shown in field studies and through Kredit Mini and Kredit Midi. These studies and experiences consistently showed that prompt availability and convenience of the location are the most important criteria to the borrower. The level of interest rate charged is also important, but ranks below availability and convenience.

The source of funds KUPEDES comes from market. Loans are not available to start new ventures, because of the much higher credit risk in supplying venture capital. The loan size is up RP 50 million (US$ 5,600). The aim of KUPEDES is to extend small loans to individuals or enterprises considered eligible, and also members of a group or community with fixed incomes such as civil servants or state employees with certain rank, employees of well-established regional companies, pensioners on fixed incomes and others. The minimum amount of loan by KUPEDES is RP 25,000 (US$ 3.00) and the maximum amount is RP 50,000,000 (US$ 5,000).

The minimum loan term period is one month and the maximum is 24 months for working capital loans, and 36 months for fixed asset loans. BRI keeps the procedure as simple as possible and avoiding much paper work. Creditworthiness’ of the prospective borrowers is based on prospective clients’ character as there is no reliable information about the business performance. Even, on very small loans (below RP 2 millions) BRI waives the collateral requirements.

Loans products for SMEs are Investment Loans, Working Capital Loans, and Exports Loans, with maximum loan up to RP 5 billion. Even though the loan procedures are not as simple as the KUPEDES, but they are not as complicated as the loans procedures for medium entrepreneurs or corporations. As the loan size is quite significant, BRI use conventional banking approach in evaluating the prospective borrowers.

Realizing that many SMEs still require facilitator for business growth, BRI collaborate with some relevant institutions to develop SMEs business. BRI has collaboration with some universities in providing technical assistance or research in developing SMEs. Some problems may arise from SMEs ignorance of marketing product overseas. BRI tried to encounter the problems by having collaboration with Export Development Agency. This collaboration provides SMEs the opportunity to expose their product abroad through trade show.
BRI actively involves in developing SME-Center, together with TELKOM (a state owned telecommunication company). SME-Center is a virtual center, a node of network and point of transit of local business to connect with the internet in order to access the global market. BRI has established 9 SME-Center located in 9 BRI Branches Offices. The establishment of SME of these centers received positive responses from entrepreneurs as they can utilize the facilities in SME-Center to explore the business opportunities. In the next coming year, BRI will establish another 40 SME-Center (Rudjito, 2007).

Realizing the need of the clients, BRI also provide technical assistance for them. While credit officers are visiting the client for monitoring they also give direct assistance regarding administration, market information, financial management, etc. In order to anticipate the development of information technology for business expansion, BRI is developing a site for SMEs called SME Online at the BRI website.

As a leading micro banking institution, BRI has a commitment to share its wealth of experience with other countries interested in microfinance. In 1996, BRI established the International Visitor Program (BRI-IVP). BRI-IVP provides Study Visit Programs and training programs, which have been attended by 1,700 visitors from 37 countries. On 5th – 9th March 2007, Bank Kerjasama Rakyat Malaysia visit BRI-IVP. They want to be as successful launching similar product in Malaysia (www.bwtp.org/links/News_2007).

### 7.3. SMEs access to financing in Malaysia

Malaysian SMEs can obtain financing from various types of financial institutions, including banking institutions, development financial institutions, leasing and factoring companies, as well as venture capital companies. To complement the financial institutions, the Government has also established special funds for SMEs.

The main provider of funds for SMEs is the banking institutions. The total outstanding SME loans expanded at an annual rate of 6.5 percent since 2001, to reach RM96 billion or 42.6 percent of outstanding business loans at end-2005. On 2002 – 2005, banking institutions approved an averaged of RM31.2 billion of financing annually to SMEs, whilst disbursements averaged at RM86.9 billion annually. In 2005, the banking system approved RM35.8 billion of financing to more than 85,000 SME accounts, whilst RM110.7 billion was disbursed to SMEs. In 2006 the total outstanding SME loans grew by 12.4 percent to RM101.7 billion (Bank Negara Malaysia, 2006).

The Development Financing Institutions (DFI) that provides financing to SMEs include the SME Bank, EXIM Bank, Malaysian Industrial Developmental Finance Berhad (MIDF), Bank Pertanian, and Bank Pembangunan for high-technology and ICT companies. In 2005, the DFIs approved RM2.3 billion of financing to more than 5,000 SME accounts. In 2006, the DFIs approved RM2.3 billion of financing to about 2,300 SME accounts.

Major initiatives to enhance SMEs’ access to financing including:
- Establishment of the SME Bank in October 2005
- Transformation of Credit Guarantee Corporation
- Strengthening of Bank Pertanian
- Establishment of the Small Debt Resolution Scheme
- Introduction of two new trade finance products, namely the multi currency trade finance and indirect exporter financing scheme
- Establishment of two venture capital funds for agriculture sector

Initiatives to further develop the manufacturing and manufacturing related services sectors include the setting up of a services sector development fund for SMEs to assist potential entrepreneur to upgrade their technical and professional skills. Given that more than 85 percent of SMEs in Malaysia are involved in wholesale and retail trade, concerted efforts will also be made to provide a comprehensive supporting infrastructure for SMEs in distributive trade. These include provision of business premises and related services, as well as strengthening managerial and technical skill.
7.4. SME Bank services

The Malaysian Government, in its effort to accelerate the development of SMEs in terms of output growth and providing employment, has given the much needed support with the recent establishment of the SME Bank. The SME Bank, a wholly owned subsidiary of Bank Pembangunan Malaysia Berhad, commenced business on 3rd October 2005 with initial loan book of about RM2 billion. The bank operates through its head office in Kuala Lumpur and 16 branches nationwide.

The vision of SME Bank is to become the SME Hub by 2010 with the unique capability to evaluate, promote and grow Malaysian SMEs with a focus on the development of the Bumiputera Commercial and Industrial Community (BCIC) in line with Government’s aspirations. SME Bank’s mission is in achieving recognition as the SME Hub, the management and employees of Bank will collaborate with its network of strategic partners or providers to focus on becoming the centre of knowledge and expertise on the financing and growth needs of Malaysian SMEs.

The SME Bank’s primary role is to contribute towards the growth of more robust entrepreneurial community in Malaysia. The SME Bank will provide financing and business advisory services to SMEs residing within predefined categories which have been framed with National SME Development Council. They will serve SMEs in the manufacturing and services sectors include hi-tech, agro-based and ICT businesses. Depending on the type of assets financed, the bank offers attractive margin of financing from 50 to 90 percent, and their interest rates range from 3.75 to 7.50 percent both of which are dependable on the sources of funds.

The Bank will supplement private commercial banks that are already rendering products and services to SMEs. Financial products for the micro business are offered in both conventional and Islamic products and services that include working capital, term loans, hire purchase and leasing, and advisory services. Special micro-programmes have been indentified to meet specific industry and cluster need and these are:

(a) *Tabung Usahawan Siswazah (TUS)*: or the Graduate Entrepreneurs Scheme was created by the Ministry of Entrepreneur and Co-operative Development (MECD) to encourage university graduates to become entrepreneur in specific sectors. The scheme includes an Incubator Graduate Entrepreneurs Programme to support the business planning and knowledge needs of the young entrepreneurs.
(b) *Skim pembiayaan Ekonomi Desa (SPED)*: or the Special Scheme for Rural Economic Development offers funding for entrepreneurs in small business in the rural areas. The funding is supported by the Ministry of Rural development.
(c) *Skim Modal Asas (SMA)*: or the Batik and Craft Entrepreneurs Programme is a programme to develop entrepreneurship in the national batik and the handicraft industry.
(d) *Vendor Entrepreneurial Programme*: develops Bumiputera entrepreneurs to become vendors in certain industries. The vendors, in turn, will develop and support smaller SMEs under the umbrella programme. The funding and advisory services are supported by the Bank and MECD.
(e) *Film Maker and Drama Financing Scheme*: will provide financing collaboration with the Ministry of Culture, Arts, and Heritage.
(f) *Kompleks Kilang SME Ban*: provide financing facilities, factory space rental, and entrepreneurship training.

The financial products and services catering to small business in any sector include working capital, revolving working capital, and term loans/leasing/industries/hire purchase for asset acquisition, bank guarantees and share financing/loan stock financing. As one of the key vehicles established, the SME Bank, with its integrated products and services, aims to meet the Government’s objective to accelerate the development and growth of Malaysian SMEs with the domestic and global business environments.
8. Conclusion

Several lessons can be drawn from BRI’s experience as a good model of micro banking system for strengthening SME:

- Simplicity, the system designed to be very simple, to keep the system efficient and effective
- Accessibility, easily accessible by to clients, who mostly live in remote areas
- Demand driven that fit to the customers’ needs and preferences
- Transparency, accounting system and procedures are set up transparently and easy to understand for both officers and clients
- Sustainability, all costs are recovered by income with a sufficient margin for growth
- Independence, BRI work with out intervention from outside parties
- Incentives, these are given to employees who perform well, and to customers who pay the loan on time
- Local based (community) development approach through using local resources
- Continuous training to enhance the capacity of staff in delivering the services to the clients
- Effective supervision to ensure managers and officers comply with sound banking practices.

Through the availability of the integrated financial and business development services, the SME Bank and its services network will collectively be able to enhance entrepreneurship across the six products groups by offering the right evaluation expertise and resources to all Malaysian SMEs. To ensure that the business growth path which SMEs take is viable, the SME Bank will route SMEs to the appropriate expert or service provider in financial services or business development support such as:

- Business advisory
- Entrepreneurial development
- Knowledge sharing

The development of SMEs in Malaysia and Indonesia is aimed to reach a level where they can compete for access to the global supply and production chains. Through the comprehensive approach towards SMEs development, the both Government will include initiatives that will increase their access to capital and business services, and improve their business environment.

References


