



RESEARCH ARTICLE

SUPPLY-SIDE OF FINANCING TO BUMIPUTERA SME: ACTION RESEARCH IN A MALAYSIAN ISLAMIC BANK

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ABSTRACT

Malaysia has a unique phenomenon vis-à-vis other developing countries where the focus of economic empowerment since its independence is on one ethnic group, i.e. the Bumiputera. There are vast literatures covering the demand-side of financing provided to the full spectrum of the Bumiputera Economy. However, there is a research gap due to scarce of literature available on supply-side of financing from commercial banks to Small and Medium Enterprise (SME) in general and specifically to Bumiputera SME (BSME) by an Islamic bank in Malaysia, which is most likely due to sensitivity and confidentiality of information. The objectives of this research in closing supply-side gap of financing to BSME in Business Banking Division (BBi) of AA Bank are to observe, analyse and intervene in the decision making process on the strategies pertaining to three major infrastructure pillars i.e. personnel, products and branches network adopted by BBi in achieving their internal Key Performance Indicators (KPI) set on increasing their BSME customer franchise. Qualitative methodology using action research framework is applied where we explore situations in which the intervention being evaluated has no clear, single set of outcomes. The preliminary findings using base data from 2008 to 2013 revealed that the BSME financing customer base for AA Bank has grown by more than 10 times in the last five years with most significant year-on-year growth was recorded in 2013 due to the surge of unsecured financing product customers. However, BSME's growth-rate is still slower relative to non-BSME's growth-rate in 2013, which means, in order for BSME financing customer base to grow, the total SME customer base needs to be enlarged first. At the time of reporting also, there is no BSME Sales personnel left in BBi from the original 19 BSME sales personnel in 2008 which indicates that BSME customers could still be acquired without BSME sales personnel as long as the marketing effort by the Bumiputera Development Unit (BDU), a unit under BBi, could be performed in systematic manner. Since granting financing to BSME in AA Bank is gaining considerable momentum over the past five years, it would be of interest from academic and commercial perspectives to investigate and document the observations for sustainable growth. These observations would also help influence further major investment decisions such as future branches network expansion, and shall be tested as per the classic action research framework for consistency.

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INTRODUCTION

Background

Malaysia has a unique phenomenon vis-à-vis other developing countries where the focus of economic empowerment since its independence is on one ethnic group, i.e. the Bumiputera (Kadir, 2013; and Lee et al, 2013). There are even comparisons made between the treatments accorded to the Bumiputera in Malaysia and the Black Economic Empowerment in South Africa (Lee, 2010). The attention given by the government to the Bumiputera economy is manifested by 15 Key Ministries managing various aspects of scaffolding the activities undertaken by Bumiputera and the Prime Minister himself chairs the National SME Development Council (SME Annual Report, 2010/2011).

Despite the magnitude of the focus, the Bumiputera's economic agenda under the The New Economic Policy covering 1970 to 1990 fell short of the 30% objective of managing economic equity shareholding (Bashar et al, 2013). The question then arises, what has gone wrong -- is it the policy or the implementation?

Research Gap and Problem Statement

Discussion on the nation's economic agenda would not be comprehensive without due deliberation on access to financing to SME due to its significant contribution to Gross Domestic Product and employment in almost all countries globally. The demand-side of SME financing is also well documented in various literatures globally such as in Beck et al, (2008); and Ardic et al (2012); regionally such as in Low,

(2006); and Rosengard et al (2011); locally for example in Manan et al, (2011); and Siraj et al (2011); and discussions on Islamic banking such as in Abedniya et al (2011); Abdullah et al, (2012); and Demirgüç-Kunt et al, (2013). However, there is a research gap due to scarce literature available on supply-side of financing from commercial banks to SME in general, a view shared by Beck et al, (2008); and specifically to BSME by an Islamic Bank in Malaysia. Therefore, it is still relevant to investigate the effectiveness of the strategies and activities undertaken by BBi under the current leadership since September 2008 in closing the supply-side gap in granting financing to BSME in AA Bank.

Research Questions

Since the commercial perspectives in growing the BSME business in AA Bank is too wide to be covered within the context of this research alone, three major questions that form the core pillars of the research are narrowed down as follows:

- i. Do we need Bumiputera Sales Staff to sell financing products to BSME?
- ii. Does the BSME require a specific financing product?
- iii. Do we need more branches, and if yes, where should the location of these branches be?

Objectives

The objectives of this research in closing the supply-gap of financing to BSME are as follows:

- i. To ascertain the effectiveness of BDU strategies in reaching out to BSME in the absence of Bumiputera Sales personnel;
- ii. To ascertain the marketability of product offerings in acquiring BSME financing customers; and
- iii. To ascertain the receptiveness of AA Banks new branches locations in acquiring new BSME financing customers.

Significance of the Study

The eventual outcome of this action research is therefore envisaged to be able to guide AA Bank and other Islamic banks in their quest of acquiring BSME especially on the three major infrastructure investments i.e. personnel, product and branch networks. The areas of future research could be expanded to cover the following areas: (1) supply-gap of Islamic Deposit acquisition activities from BSME; and (2) the attributes of high quality BSME.

Methodology

This research is conducted using qualitative methodologies by adopting action research framework where we will explore situations in which the intervention being evaluated has no clear, single set of outcomes. The action research methodology is applied in conducting this research where we concur with Yin, (2013) that validity and generalisation continue to be challenging aspects in designing and conducting research evaluations as we will explore situations in which the intervention being evaluated has no clear, single set of outcomes. The action research focuses on BBi's

Management aspirations in increasing its BSME customer financing base whilst at the same time contribute to knowledge sharing. Creswell, (2013) opined that in qualitative research, they may often serve as a lens for the inquiry or they may be generated during the study. Additionally, Lewin (1946) who coined the term "action research" describes it as using "a spiral of steps, each of which is composed of a circle of planning, action and fact-finding about the result of the action". Thus, to understand the strategies and activities undertaken by BDU in reaching out to high quality BSME financing customers, we will carry out the following steps:

- i. Analyse the outcome of initiatives undertaken;
- ii. Conduct in-depth interviews with various stakeholders such as the BBi and BDU management, the sales personnel, the product development work-groups and also customer groups including the associations;
- iii. Verify the effectiveness of the interventions suggested in the course of the action research;
- iv. Compare findings observed against other findings identified in previous literatures; and
- v. Introduce new variables that would be tested further for consistency.

The above steps would be repeated until the desired outcome is observed.

Research Structure

To provide impactful and meaningful research which is relevant from both academic and commercial perspectives, this research needs to be designed in such a way that it runs parallel with the dynamics and ultimate aims for AA Bank in growing their Bumiputera customer franchise. There are specific KPI given to the BBi Management for this purpose as follows: (1) to grow the number of Bumiputera customers; and (2) to achieve financing approval target accorded to BSME which forms part of the Bank Negara Malaysia (BNM) bi-annual priority sector lending approval target. Despite being given these KPI to grow BSME franchise, BBi was not given any specific concessions other than marketing activities undertaken by the BDU to reach out to the BSME customers. There is clear segregation of duties where BDU is only allowed to perform marketing role, and only the sales personnel are authorised to do the acquisition of customers. This is primarily done to ensure that the credit quality of all AA customers is not compromised, and post sales activities could still be performed by the sales personnel. The BDU was set up in 2000 following a directive by BNM, which acts primarily as the coordinator for Government/government agencies financing schemes including from BNM, Corporate Guarantee Corporation (CGC) and also Ministry of Finance. Over the years, since the BDU activities are not revenue generating in nature, the focus dwindled downwards, and was performed on "part-time" basis on top of their primary functions. The dynamics of BDU has changed significantly when the management of BBi, being the most senior personnel in AA Bank managing the Business Banking Division which includes the SME, was also tasked to manage the BDU functions commencing November 2011 and were given specific KPI to grow the Bumiputera franchise. At the time of reporting, the BDU team has since been rejuvenated to

have five dedicated headcounts and were assigned specific tasks with pre-approved budget allocations to carry out their marketing activities effectively. The agenda to grow BSME financing customers in itself could not be discussed in isolation as there are various other factors that the AA Bank's management team needs to consider such as the sustainability of their business strategy; adequate capital; liquidity management; concentration risk between the financing granted to business banking to retail banking; pre-agreed target market risk acceptance criteria with the credit-risk team; right infrastructure from expanding their branch network at strategic locations; adequate and highly trained manpower from direct hire and/or leverage model from their parent bank; launch of profitable products which adheres strictly to the Syariah and other internal and external regulators guidelines; and having the appropriate system for proper and accurate accounting and management reporting.

Preliminary Findings

General Observations

Financing granted by all of the 16 Islamic Banks to SME in Malaysia has been on steady growth since 2008 where there was RM13.9 billion financing outstanding and the upward trend continues to RM24.4 billion financing outstanding in September 2013 recording Compounded Annual Growth Rate (CAGR) of 12.7% (source: respective Islamic Banks annual reports). AA Bank in particular, has outperformed the industry's performance by recording CAGR of more than 40% for growth of SME financing during 2008 to 2013. BSME financing customer base for AA Bank has grown by more than 10 times in the last five years; with most significant year-on-year growth was recorded in 2013. However, a closer scrutiny of the numbers revealed that the BSME's growth-rate, despite having a smaller base, is still slower relative to non-BSME's growth-rate in 2013. The incremental growth for total BSME financing customers was 2.2 times but incremental growth for total SME financing customers in AA Bank was at 2.6 times in 2013. It is noteworthy that the BSME financing customer numbers has been hovering around 11% to 15% of the total SME financing customers in AA Bank from 2009 until 2013. Interviews with various levels of sales personnel has also resulted in identical observation i.e. there is no specific technique adopted in identifying race group in sourcing leads for potential customers. The sales personnel, who receive commissions based on their successful closure of deals, is primarily concerned with the credit-worthiness of their potential customers whom can meet the strict financing parameters as set-up under the financing programme. With these observations, and as reiterated by the AA Bank's management that there is no special treatment to be accorded in acquiring the BSME as far as credit quality is concerned, it could be deduced that for BSME to grow in AA Bank, the pre-requisite is that the total SME business must also grow at least at the same growth rate.

Bumiputera Personnel

In 2008, the BBi Management decided that the Bumiputera sales personnel are required to acquire the Bumiputera Business especially from an Islamic Bank. In following through that decision, 19 Bumiputera sales personnel were

recruited for that purpose. Five years later in 2013, none of the original 19 personnel remains in SME sales, and no new Bumiputera sales personnel were recruited to replace the attrition due to various reasons, especially on performance, from 2011 onwards. Does that decision not to replace the sales personnel attrition have any negative impact on the acquisition of BSME business? Not at all, in fact, on the contrary the number of Bumiputera financing customers grew by more than 10 times from 2008 to 2013. Realising that it is not sustainable to have BSME sales personnel, BBi Management has decided to put in greater emphasis on marketing activities by BDU, while also by churning out more financing products in growing their SME customer franchise. The growth of BSME customers especially since 2011 onwards could be attributed primarily to these two activities. In the context of AA Bank, the initiatives undertaken by Product Development and the Bumiputera Development for SME are now synonymous as both initiatives are currently under the purview of the same unit. The BDU team was absorbed under the management of Product Development in December 2013 to eliminate overlapping functions of both units. For example, the Product Unit is responsible for the end-to-end product development and management processes which would include government schemes which is supposedly under the purview of BDU; and the Product Unit would also be required to do product presentations including to potential BSME customers in Entrepreneurial Clinic held in collaboration with various Malay Chamber of Commerce and other Bumiputera based Business Associations which is managed by BDU. The enlarged unit is now called Product & Compliance, Business Banking & Bumiputera Development. With five dedicated headcounts, the KPI for the enlarged unit on expanding BSME franchise are as follows: (1) to source minimum of 4,000 new SME financing names with minimum of 10% success rate; (2) to source minimum of 100 new SME deposit names with minimum of 50% success rate; (3) to organize minimum of three events such as providing Entrepreneurial Clinic, and managing exhibition booths; and (4) to host a minimum of five interns in a year. These KPI were developed after series of observations and internal findings that obtaining BSME names alone of which the unit has successfully sourced 3,328 BSME names in 2012 and 2,608 BSME names in 2013 from various Bumiputera business associations databases would not be able to guarantee success in increasing the Bumiputera customer base. Without adequate follow through, these "cold leads" to the sales team would not materialise. Hence, by incorporating the minimum success rate targets in their KPI, BDU staff would need to ensure that not only that the details in their leads they provide are accurate, but these leads must also have certain level of interest captured to start of relationship with AA Bank. Internally such leads which have been filtered through are referred to as "warm leads", which would ideally provide higher chances of success. The 10% success rate for "warm leads" – which forms part of the BDU's KPI, is a generally accepted benchmark within AA Bank that would require further verification for consistency. Since most work in sourcing the leads are done by interns while doing their attachments with AA Bank, the management has approved allowances for up to 10 interns in 2014. The tradition of hosting the interns, who on average stays around three months, has been a practice in BBi where a total of 33 interns were hosted from 2009 to 2013. Besides the leads, BDU has

also contributed 16 articles pertaining to general banking guidance for SME on fortnight basis to a Malay based newspaper in 2013 as part of their marketing effort. Considerable promotion expenditures have also been incurred in promoting SME financing in various SME publications.

Product Development

The development of financing to SME by Islamic Banks in Malaysia could also be observed by the investment made by these banks in introducing new products. AA Bank in particular, has launched 10 new financing products to their customers adding to their existing six financing products in 2008. The new Islamic financing products launched in AA adopting various Syariah concepts such as Musyarakah, Commodity Murabahah, Ijarah and also a revamped version of Bai-Al-Inah to cater for the financial needs of SME from working capital and acquisition of fixed assets. However, with BNM's new guideline on Bai-Al-Inah and various other concept papers currently being drafted by BNM, it is envisaged that the wide ranging Islamic Banking product suites that are available in Islamic Banks today, may need to be relooked in the near future. With various products introduced by the industry, it is quite perplexing to note that only a handful of Islamic Banks in Malaysia, besides AA Bank, that offers unsecured (collateral free) term financing to SME in Malaysia as at 31 Dec 2013 (source: various Islamic Banks' websites). The common unsecured financing available are Islamic Cashline (Overdraft Facility) and the CGC Guarantee schemes. In our opinion, the other Islamic Banks are not addressing the obstacles to access of financing to SME as cited by the Department of Statistics (cited in SME Annual Report, 2005) as follows: 55.2% was due to lack of collateral; 13.1% from insufficient documents to support financing application; 10.7% was due from no financial track record; 9.8% was due from long financing processing time; 5.3% was due to Financial Institutions deem SMEs business plan as not viable; and remaining 5.9% were from various other reasons. Since the prevailing supply of financing does not meet the SME demand, it is of no surprise that total SME financing for the industry is only 10% of total domestic business enterprises and individuals financing by all Islamic Banks as at September 2013. AA Bank on the other hand, recorded more than 35% SME financing from total of all financing granted bank-wide for the same period. This observation is parallel to the one made by Beck et al (2008) that banks in developing economies tend to be less exposed to SME, and tend to charge higher fees and interest rate. It is noteworthy also that the unsecured term financing offered by AA Bank has seven days disbursement target from date of application and also does not require complex documents to support financing application – effectively removing two other major obstacles to access of financing as cited by the above survey by the Department of Statistics, which makes the acceptance to the product to be very healthy. Due to market forces and the need to maintain market share, it is envisaged that there will be more Islamic Banks in Malaysia that would start offering unsecured financing in the near future.

Branches Network

Since it is established that we need to expand the business in

order for us to acquire bigger BSME business, so the next question we need to ask ourselves would be, where should we locate our future branches, subject to the approval of BNM? Should we consider cities within market center such as Shah Alam where the Bumiputera forms the majority population there, or should we go to towns like Sibuluan and Sandakan where the Bank does not have presence yet? The issue with the potential locations is that while we know the Bumiputera population in any cities from publicly available statistics, but we do not know details of ethnicity of business owners by location and industry due to sensitivity of the information as informed by the government agencies. So how would we know whether we are making the right guess?

Suggestions

Since granting financing to BSME in AA Bank is gaining considerable momentum over the past five years, especially in 2013, it would be of interest from academic and commercial perspectives to investigate, record and where relevant, to intervene on the activities undertaken for sustainable growth. It is established that for AA Bank, the BSME business would grow in tandem with the growth of the overall SME business and the observation is still true even when there was a huge jump in the business in 2013 from their launch of their hugely popular unsecured financing product in late 2012. While the unsecured financing may cease to be offered in the near future due to various factors including regulations and concentration risk, BDU should consider adopting more systematic and scientific approach in reaching out to their new-to-bank BSME financing customers' leads, and equally important to be able to track their leads referred to the sales personnel so that they could monitor success rate more comprehensively. The source of leads for example, needs to come only from selected industries where AA Bank has credit appetite. The traditional way of just providing BSME names to the sales personnel and also to have email and text blast to mass recipients might not be the most optimum way moving forward. Despite providing the "feel-good-factor" for considerable large number of leads, this practice must cease due to its ineffectiveness and also on the opportunity cost forgone. Whilst it is unfortunate that statistics on the National BSME population and location are not made available for public consumption by the relevant government agencies, BDU could still focus on major towns in Malaysia with high Bumiputera population that are within the vicinity of their existing branches. The fact that there is no Bumiputera Sales personnel left at the time of reporting adds on to the dynamics of this research which would appear as a potential hindrance in the acquisition of BSME for AA Bank. All of the above would test the effectiveness of BDU's prevailing strategies and it is paramount that these strategies are closely observed and analysed for sustainable growth.

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