

repayment and rehabilitation per year, the more the cash that will be available for further loan issuance.

By implementing the BIS, the information on the account provided/obtained from the branches is verified before submission and therefore, efficiency and sufficiency is increased. With the BIS, the NPL can be transferred fast and efficiently processed to avoid backlog and critical accounts. By hiring Accounts Executive, the shortage of manpower is resolved. Aside from that, the executive will also reduce the processing time for the rehabilitation process. As a result of lack of communication between branches and the Rehabilitation Department, incomplete information is received. This is solved by the accounts executive and the BIS.

8.0 Collateral Management Unit

8.1 Introduction

Our second proposal relates to the following issues faced by the department:

- **The Bank's current process flow is limited to rescheduling and restructuring (debt restructuring) the NPL only. This defeats the purpose of its existence.**

- **The Bank does not have the expertise in marketing, management and financial restructuring to advise NPLs recovery accordingly. Therefore, various problems occurred when hiring third party such as professional bodies to advise and consult the NPLs account**

We propose the establishment of a new unit to manage the collateral before foreclosure. We will name this unit as **Collateral Management Unit**. Before we proceed to explain the functions, we need observe the position of the unit in the grand scheme of the Rehabilitation Department. Figure 11 shows the position of the unit:

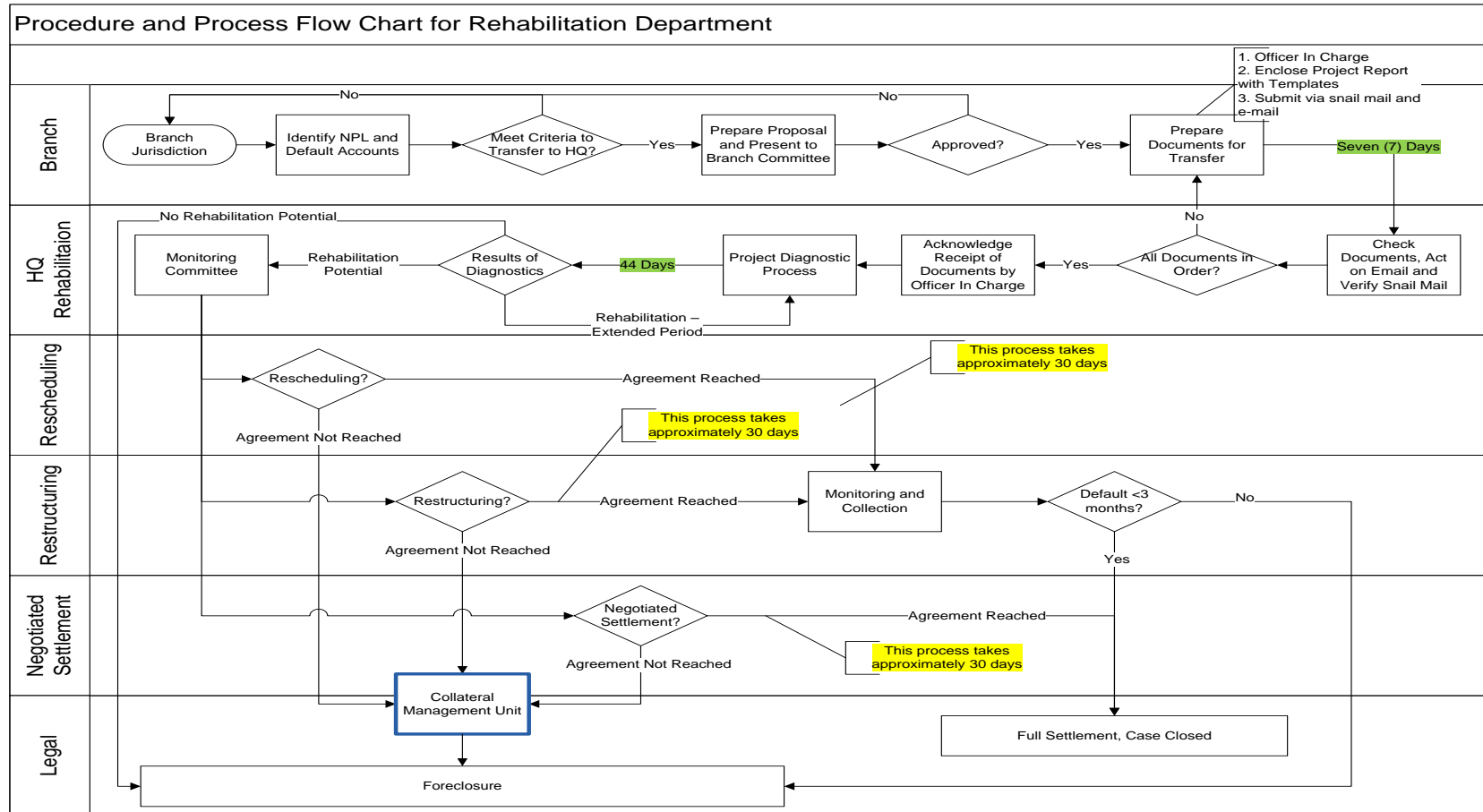


Figure 13: Collateral Management Unit (marked in blue process block)

As mentioned earlier, unsuccessful negotiations in restructuring, rescheduling or negotiated settlement will lead the account to be foreclosed. In other words, if the Rehabilitation Department is unable to reach an agreement with the borrower in any of the three options, then the assets of the borrower will be foreclosed. Therefore, before the assets are foreclosed and equitable right for redemption is terminated, the Collateral Management Unit would be able to negotiate a different type of settlement.

Collateral Management is a process of agreeing, confirming and advising collateral transactions. Collateral are properties or assets that are offered to secure a loan or other credit. Collateral becomes subject to seizure on default. Despite the unit being called a collateral management unit, it does not only function in managing collateral but also functions to manage the other assets that are not considered collateral. Furthermore, the unit is placed before foreclosure for a variety of reasons.

Referring to the paragraph under Objective Research; “An improvised process flow comes with a comprehensive system and newly proposed **Collateral Management Unit** would encompass the operations management in the existing process.”and also to support the implementation of guidelines under Rehabilitation Department;

- **Disposal of any valuable assets (productive assets) to fully or part paid the outstanding loans (debts).**
- **To appoint external consultants to evaluate and analysis projects or accounts which are still viable and have the recovery potential**
- **To repurchase the assets and leased to the company. It is to restructures its debts and also to ensure the problematic company as well as new company to operates.**

8.2 Why Collateral Management Unit?

Below are some of the recommendations which contribute to the establishment of **Collateral Management Unit** in Rehabilitation Process Flow.

- Collateral is the bankers second line of defense. (Behrens, 1990). It is due to if SME Bank unable to collect and receive repayment from its lending. If this repayment fails to materialize, the Bank has full rights to take possession on all collaterals which had been pledged to the Bank.
- The establishment of CMU also acts to guard the Bank from experiencing “fully collateralized”. This is when the Bank only relies on the borrower’s

estimation of the value as a result; the actual liquidation of the valued collateral is far less than the balance of the loans. (Behrens, 1990).

- It essential for the Bank to develop a procedure within the CMU on evaluation of collaterals. It is to ensure the Bank recognize its exposures against the loans.
- To develop a proper procedure to evaluate collaterals, the Bank is required to obtain credible third party opinion and evaluations. It is vital to have expertise and qualified professional to evaluate as the Bank is venturing into Asset Based Lending.
- Failure to repay the Bank usually caused by the mismanagement of financial only those secured lenders (Banks) have its second line of defense to repossess the collaterals (assets), converting into cash and using it to repay the loans.

8.3 Categories in Handling Collaterals

According to (Berhens, 1990) there are 5 basic categories in handling collaterals which can be used in the Procedures of CMU. There are as follows:-

i) Identifications

To identify only valuable and productive assets are allow to be pledge to the Bank. CMU has to obtain sufficient information on types of assets, market value, depreciation value and etc. CMU will have to register all information on the collaterals for records and should be retrieved for the purpose of valuation and also comparison.

ii) Description

CMU has to have a proper description on all the collaterals to ensure problems of policies or condition precedent pertaining to collaterals which are pledge to the Bank. This proper description has to be highlighted in proper documentation to avoid unnecessary legal action taken by customer against the Bank.

iii) Valuation

This valuation process of the collaterals requires proper handlings. CMU has to provide list of expertise (external) to be the panel for asset valuer to the Bank. CMU will cooperate with this list of panel to ensure the proceeds of disposable collaterals are sufficient to pay the loan in full.

iv) Security Documentation

To protect the security interest for both parties, CMU will act as the unit which possess these documents and provides advice accordingly.

v) Repossession and Sale

This final procedure is for CMU to ensure both interest are protected. When CMU is conducting the repossession, the unit has to able to locate and repossess all collaterals according to stated laws. CMU also need to allow borrowers / companies to execute the selling of assets / collaterals on their own. The selling of collaterals has to meet all procedures and guidelines and to ensure that it is sufficient to cover the debts.

8.4 Recommended Alternatives in Collateral Management Unit

It is also recommended to have alternatives in the CMU pertaining opportunities given to the borrowers (NPLs account) to cure the default. CMU is required to have these alternatives when dealing with accounts which are waiting for foreclosure. Recommended alternatives are as follows:-

i) Voluntary Liquidation

CMU task is to convince the borrowers / company to voluntarily liquidate and sell their valuable assets or business assets. It is the most easy and beneficial approach to both parties. However, a close monitoring on sales of the assets to ensure all the proceeds are used to repay the debts and not to company's pocket.

ii) Compromise Settlement

This method is to negotiate with the company; it is normally exercised by the Bank. But with the CMU, this method will ease the burden of Rehabilitation officers when only the dedicated officer under the Management of Customer will negotiate with the customers.

iii) **Repossession and Sales of Collaterals**

This is to address; **Disposal of any valuable assets (productive assets) to fully or part paid the outstanding loans (debts)**. CMU is responsible to conduct the relevant action to dispose all valuable assets or collaterals. This has to be managed by expertise in the unit to avoid mishandling which may result substantial loss on the collaterals. All repossessed collaterals have to undergo selling options according to market price and in commercially reasonable manners. No black market or illegal activities are permitted. The disposal of collaterals only should benefit both parties as the main reason of this action is to enable the borrowers pay their debts to the Bank. Hence, it is prohibited to conduct sales or disposables to insiders such as employees, stakeholders or any parties which are directly related to the Bank.

8.5 Functions of Collateral Management Unit

The Collateral Management Unit not only functions as an asset/collateral management unit but also as a borrower management unit. It has to be reminded Foreclosure involves the sale of property or share collateral pledged as security to a loan. SME Bank may foreclose on the collateral if a borrower fails to repay its loan. However, SME Bank does not own these foreclosed assets and the ownership remain with the borrowers until the assets are sold.

Therefore, the primary purpose of the **Collateral Management Unit** will be able to circumvent the long and arduous process of law by negotiating with the defaulted borrower to sell or dispose of the assets at an agreeable price. The assets will be surveyed and valued by the Collateral Management Unit and proposed to the Defaulted Borrower a buyer and a possible price. The asset will be sold and the proceeds will be divided as per the agreed percentages.

In other words, the CMU acts as a market place for the borrower to sell assets to redeem part or the entire loan before foreclosure. Through this manner, SME Bank avoids the additional expense of managing foreclosed assets and at the same time is able to recover a small percentage of the defaulted loan. It is a win-

win situation since the borrower still can obtain a certain percentage of the money from the sales. Furthermore, the cost of foreclosure and litigation is reduced and therefore, profitability can be increased.

As mentioned earlier, apart from recovering assets and part of the loan, the unit is also responsible for managing the existing foreclosed assets. The unit will ensure that the assets are properly maintained and repaired to ensure a good resale value. The unit will keep abreast of the latest prices and costs from the market for the borrower to consider. Apart from that, the unit will also enlist the help of professional bodies to value assets such as land, building and other intangible assets.

8.5.1 Management of Borrower

Another function of the Collateral Management Unit is the management of borrowers. A borrower management philosophy can be borrowed from the Danaharta Borrower Management Scheme. The following are the Borrower Management Principles that has been catered for SME Bank's Collateral Management Unit:

1. **Haircut to the Shareholders of the Borrower:** Under the scheme, the shareholders must take a proportionately bigger haircut i.e. where the scheme requires debt reduction; the share capital reduction ratio must be greater than the debt reduction ratio. In addition, subordination of shareholders' loans (if any) would be made a pre-requisite to the scheme
2. **Fair treatment to Secured and Unsecured Creditors:** Schemes must reflect a genuine effort by the borrower to settle with the creditors in a fair manner. Settlements to secured creditors must be more favorable to those offered to unsecured creditors.

3. **No dilution of inadequate security:** Schemes should not result in a dilution of the security to the lenders, unless the collateral is in excess of the outstanding loans. All forms of cash collateral must only be utilised to retire or settle the outstanding loan amount.
4. **Only one opportunity given:** SME Bank will only be give the borrower only one opportunity in implementing a scheme. This is to prevent borrowers from making unnecessary revisions once the scheme is implemented.
5. **Make borrowers work for lenders:** Any scheme must allow for the lenders to also benefit from efforts put in by borrowers. Whilst viable borrowers are given the time and opportunity to make good their obligations, they will be closely monitored as to performance and efforts to repay lenders.

The Collateral Management Unit should also provide professional services for default borrowers who are able to reach an agreement through the three rehabilitation methods. The following figure should delineate clearly the functions:

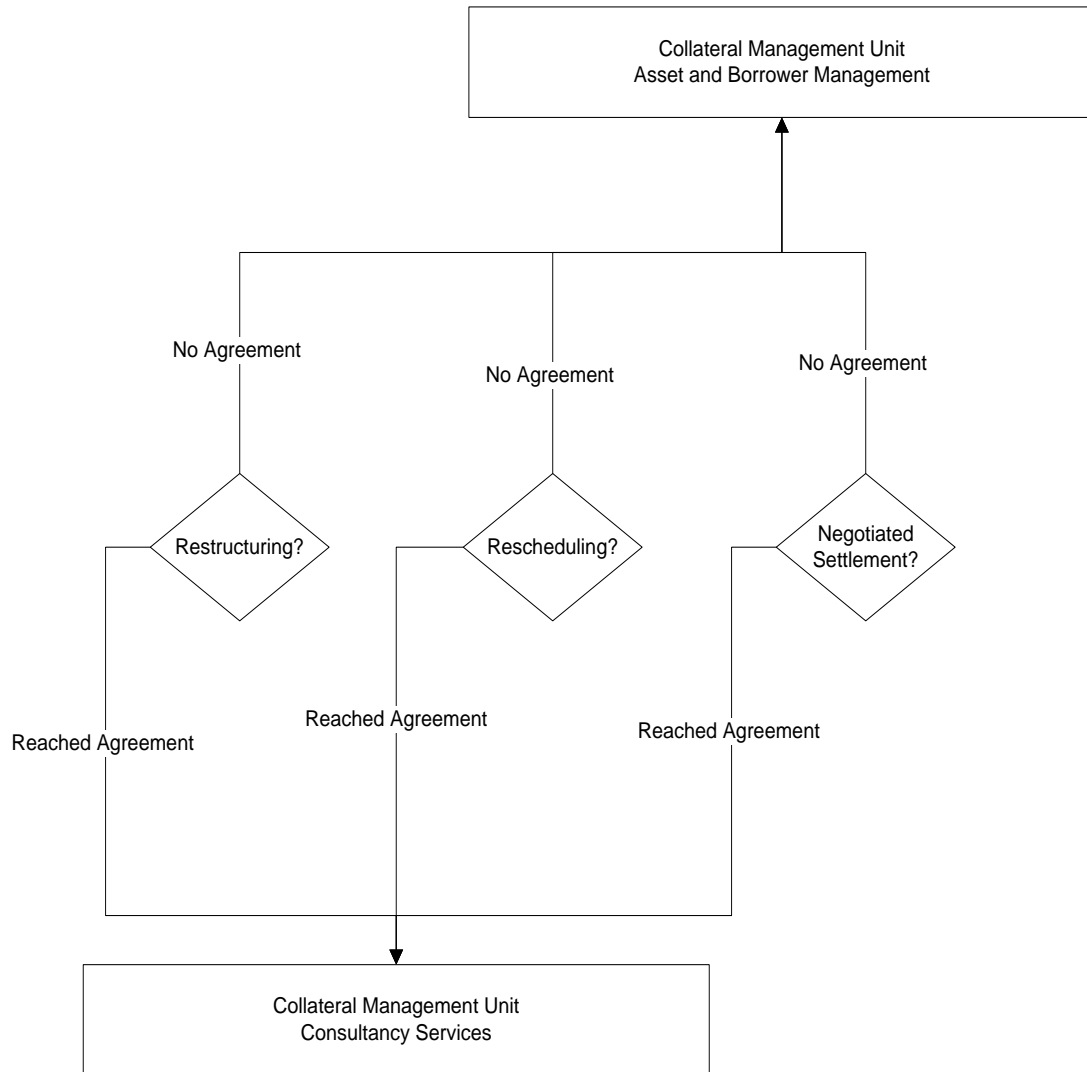


Figure 14: Collateral Management Unit Functions

8.5.2 Consultancy and Advisory Services

The secondary function of Collateral Management Unit includes providing consultancy and advisory services to the borrowers who successfully negotiated a rehabilitation program. This is imperative to ensure that the entrepreneur do not repeat the same mistake and return to the default status. Therefore, a unit that advises and provides guidance to the entrepreneur should be formed.

Collateral Management Unit should be assigned this responsibility since the entrepreneurs that have been through rehabilitation process are more likely to default compared to those who never had to undergo the rehabilitation process. Therefore, this unit must be equipped with consultants or executives that are able to provide advice in terms of **market restructuring, management restructuring, technical restructuring and financial restructuring.**

In **Market Restructuring**, the CMU will advise possible avenues for the entrepreneur to find new market. Through its vast network, CMU will be in prime position to advise the possible ventures that could be undertaken to expand into new markets. This would require the unit to help the entrepreneur to identify the key external factors that affect the business. Some external factors include economic forces, social, cultural and demographic forces, technological forces, and competitive forces. The CMU will need to explain and guide the entrepreneur on how these forces affect his/her business. Changes in external forces translate into changes in consumer demand and therefore, this affects the business. Aside from external forces, internal forces must also be recognized and dealt with. For example, the entrepreneur will need to identify his distinctive competencies as well as identifying his weaknesses and turning them into strength.

Since marketing is defined as the process of defining, anticipating, creating, and fulfilling customer's needs and wants for products and services, the unit must also strive to enable the entrepreneur to independently conduct Customer Analysis, Selling Products and Services, Product and Service Planning, Pricing, Distribution, Marketing Research and Opportunity Analysis.

In short, the **Market Restructuring** consultancy should include, but not limited to the following:

- 1. Provide assistance to entrepreneurs to enter into new markets**
- 2. Provide assistance to entrepreneurs to increase product diversity**
- 3. Appoint Consultants to strengthen the enterprise's market presence**
- 4. Provide assistance to entrepreneurs in planning and executing promotional activities**
- 5. Provide ideas to improve the pricing strategy of the enterprise**
- 6. Provide assistance to entrepreneurs to improve their supply and distribution chain.**
- 7. Provide assistance to entrepreneurs to revamp and reengineer their marketing strategy that are more objective and better.**

In terms of **management restructuring**, the unit will advise the best possible operations management set up. The consultancy covers the following:

1. **Providing assistance to improve management system such as financial assistance for the implementation of ISO standards**
2. **Providing advice and assistance to entrepreneurs to restructure management staff to reflect current trends and to increase efficiency**
3. **To propose a synergy or joint venture with other companies to increase presence and strengthen the company.**
4. **To appoint SME Bank staff to oversee the operations of the enterprise.**

In terms of **technical restructuring**, the unit can advise the following:

1. **Provide assistance to entrepreneurs to obtain the latest technology available**
2. **Provide advice in terms of technology management such as attending technology seminars and courses.**
3. **Providing assistance in equipment and machinery innovation to increase productivity**

Financial Restructuring is another branch of consultancy that the unit has to look into. The Collateral Management Unit provides advice on the following:

- 1. Debt Restructuring in terms of managing liabilities to ensure continues payment as business expands.**
- 2. Sales of unproductive assets to boost current assets and provide necessary capital for expansion**
- 3. Implementing cost cutting exercises to reduce overhead and product cost.**
- 4. Issuing additional shares to dilute the current shares and increase the investment into the current business**
- 5. Provide assistance to entrepreneurs to lay off workers as necessary and to implement financial control measures**
- 6. To review the supply and distribution agreements to obtain better terms and conditions.**

With these consultancy services, we expect the entrepreneurs to be successful and the entire SME Bank loan will be repaid. The asset and borrower management function alleviates the loss on both sides of the coin – the SME Bank and the defaulter. This unit will be an integral and an important unit in

reviving failed businesses. Therefore, the SME Bank will benefit not only in terms of profitability, but also in terms of reaching its objective of increasing the number of successful SME's in Malaysia.

By forming the CMU, the Bank's current process flow is not limited to rescheduling and restructuring (debt restructuring) the NPL only. This strengthens the purpose of its existence by instituting an actual recovery program which is consistent with the Bank's overall objective. Through the formation of CMU, the Bank will have internal expertise in marketing, management and financial restructuring to advise NPLs recovery accordingly. Therefore, various problems that occur when hiring third party such as professional bodies to advise and consult the NPLs account will avoided and more SME's will benefit from this.